Notice of Meeting and Agenda

Audit Committee

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

Date: **Tuesday, 25 September 2018**

Time: **14:00**

John Blair
Director, Resources

Contact:
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Further Information:

This is a meeting which is open to members of the public.

Audio Recording Notice: Please note that this meeting will be recorded. The recording will be publicly available following the meeting. The Council will comply with its statutory obligations under the Data Protection Act 1998 and the Freedom of Information (Scotland) Act 2002.

1 Welcome, Introductions and Apologies

2 Order of Business

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

3 Declaration of Interest

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

4 Minutes of Previous Meeting

5 Public Reports

6 Private Reports

No items for discussion

7 Date of Next Meeting

The next meeting will be held on Tuesday 11 December 2018 at 2 pm

Minute of Meeting

Audit Committee
Tuesday 25 September 2018
Item No: 4.2

Midlothian

Audit Committee

Date	Time	Venue
Tuesday 19 June 2018	9.00 am	Council Chambers, Midlothian House, Dalkeith, EH22 1DN

Present:

Mike Ramsay (Chair)
Councillor Hardie
Councillor Milligan
Councillor Muirhead
Councillor Smaill
Peter de Vink (Independent Member)

In attendance:

Kenneth Lawrie	Chief Executive
John Blair	Director, Resources
Kevin Anderson	Head of Customer and Housing Services
Gary Fairley	Head of Finance and Integrated Service Support
Alan Turpie	Legal Manager
Chris Lawson	Risk Manager
Stephen Reid	Ernst and Young, External Auditors
Jill Stacey	Chief Internal Auditor
Elaine Greaves	Principal Auditor
James Polanski	Internal Auditor
Mike Broadway	Democratic Services Officer

1. Welcome and Apologies

Apologies were received from Councillors Baird and Parry.

2. Order of Business

At the suggestion of the Chair the Committee agreed that the order of business was adjusted as follows:- all the Annual Assurance related items – agenda items 5.3, 5.6 and 5.8 – be taken together before 5.9 (Audit Committee – Special Meeting) at the end of the agenda ; and that the additional report 5.10 Local Government Workers Pay and Grading be taken before the report on the Transformation Programme (agenda item no 5.7) as they refer to each other.

3. Declarations of interest

No declarations of interest were received.

4. Minutes of Previous Meetings

The Minutes of (i) Meeting of 1 May 2018 and (ii) Special Meeting of 15 May 2018 were submitted and approved as correct records.

With regards to the Minutes of the Special Meeting of 15 May 2017, the Committee considered a suggestion from Independent Member, Peter de Vink regarding the addition of a further bullet point to the list on page 4 (page 10 of the agenda) concerning whether the Council had incurred any loss, and agreed that if appropriate this should be included.

Action: Democratic Services

The Chair then gave a brief resume of the further Special Meeting that had been held on Monday, 18 June 2018. He confirmed that the further report sought by the Committee had been provided but that it had been met with frustration from Members on the information which it provided.

5. Public Reports

Report No.	Report Title	Submitted by:
5.1	Treasury Management	Internal Audit
Outline of report		
A report dated 30 May 2018 was presented by the Principal Internal Auditor. The objective of the audit was to test controls over policies and practices, strategies and reporting and compliance with the Treasury Management Code of Practice. There were 3 medium rating recommendations, which were detailed within the report, to reduce risk further and these recommendations had been agreed by Management. The overall audit rating was Good - the control framework was of a good standard with only minor elements of risk identified which were either accepted or being dealt with by management.		

Summary of discussion
In considering the report the Committee remarked on the recommendations arising as a result of the Internal Audit report, expressing support for a review of the governance arrangements for the three main treasury management reports to ensure that they were adequately scrutinised prior to being considered by the Council. Members also sought confirmation that the requirements of the CIPFA Treasury Management in the Public Services Code of Practice were being fully met and clarification of the contractual position in relation to the appointment of the Council's Treasury Management Advisers.
Decision
After further discussion, the Audit Committee agreed to continue consideration of the report in order to allow the above issues to be addressed.
Action
Head of Finance and Integrated Service Support/Chief Internal Auditor/Democratic Services

Report No.	Report Title	Submitted by:
5.2	Trade Waste	Internal Audit
Outline of report		
A report dated May 2018 was presented by the Internal Auditor. The objective of the audit was to review the systems and controls in place for the charging, collection, and disposal of Trade Waste and related performance reporting. There was 1 high, 11 medium and 2 low rated recommendations, which were detailed within the report, to reduce risk further and these recommendations had been agreed by Management. The overall audit rating was Average - the overall control framework was of an average standard. Some weaknesses had been identified in the controls and improvements were possible.		
Summary of discussion		
In discussing the report the Committee remarked on the disappointingly high number of recommendations and also the timescales for some of the actions which appeared to be overly long. In response Internal Audit explained the reasons for this being the case.		
Decision		
The Audit Committee noted the content of the report.		
Action		
Internal Audit		

Report No.	Report Title	Submitted by:
5.4	Risk Management Update for 1 January 2018 - 31 March 2018	Risk Manger
Outline of report and summary of discussion		
There was a report dated 23 May 2018 submitted providing the Committee with the 2017/18 quarter 4 strategic risk management update, covering the period 1 January to 31 March 2018.		
Decision		
The Audit Committee, having heard from the Risk Manager who responded to Members' questions/comments, noted the quarter 4 2017/18 Strategic Risk Profile report and considered the current responses to the issues, risks and opportunities highlighted.		
Action		
Risk Manager		

Report No.	Report Title	Submitted by:
5.10	Local Government Workers Pay and Grading	Director Resources
Outline of report and summary of discussion		
The purpose of this report was to provide the Audit Committee with details of the benefits arising from the changes in terms Local Government Workers and conditions which were implemented by the Council from 1 October 2016.		
Decision		
In view of the late circulation of the report it was agreed to continue consideration of this item to the next Audit Committee meeting.		
Action		
Director, Resources/Democratic Services		

Report No.	Report Title	Submitted by:
5.7	Midlothian Council Transformation Programme – 2017/18 Closure Report (June 2018)	Chief Executive
Outline of report		
With reference to paragraph 8.5 of the Minutes of Midlothian Council held on 13 February 2018, there was submitted report, dated 4 June 2018, by the Chief Executive, the purpose of which was to present to the Audit Committee the Transformation Programme – 2017/18 Closure Report; a copy of which was appended to the report.		

The report explained that the Transformation Programme Closure Report had been produced to ensure appropriate closure of the existing programme whilst providing clarity of the change and transformation programme approach going forward.
Summary of Discussion
The Audit Committee, having heard from the Chief Executive who responded to Members' questions/comments, discussed the report, giving particular consideration to the targeted savings and the savings actually achieved and how these had been tracked and reported, there being concerns about the consistency of the figures given in different reports/publications. The Head of Finance and Integrated Service Support sought to reassure Members on this issue and explained that the current Q1 figures would be reported as part of the finance reports going to the August Council meeting. With regards the future tracking/reporting process this was explained by the Chief Executive. The Chief Internal Auditor added included in the Internal Audit Plan was plans for a review of the governance of the new change/transformation programme.
Decision
After further discussion, the Audit Committee noted the report.

Report No.	Report Title	Submitted by:
5.5	Audit Scotland Report - Report on a Significant Fraud – Dundee City Council (Audit Scotland, March 2018)	Head of Finance and Integrated Service Support
Outline of report and summary of discussion		
The purpose of this report was to provide the Audit Committee with (i) a summary of Audit Scotland's 'Report on a Significant Fraud – Dundee City Council', including details of the wider lesson from this incident, for other councils to consider, and (ii) an update on the Council's position in relation to the report's main findings.		
Decision		
The Audit Committee, having heard from the Head of Finance and Integrated Service Support who responded to Members' questions/comments, noted the Audit Scotland report and the position of Midlothian Council in relation to the report's recommendations		

Report No.	Report Title	Submitted by:
5.3	Internal Audit Annual Assurance Report 2017/18	Chief Internal Auditor
Outline of report		
There was submitted report, dated 31 May 2018, by the Chief Internal Auditor presenting the Internal Audit Annual Assurance Report for the year to 31 March 2018, which included the Chief Internal Auditor's independent and objective		

opinion regarding the adequacy and effectiveness of internal controls within the Council, provided details of the Internal Audit activity that supported the opinion and the performance during the year to fulfil its role, and summarised the outcomes of assessments of the Internal Audit service against the Public Sector Internal Audit Standards, which had become effective for local authorities in April 2013 (updated April 2017).

The report further highlighted that the Internal Audit Annual Assurance Report 2017/18, a copy of which was appended to the report, provided assurances in relation to the Council's corporate governance framework that was a key component in underpinning delivery of the corporate priorities within the Single Midlothian Plan and had been used to inform the Annual Governance Statement 2017/18.

Summary of discussion

The Chief Internal Auditor in presenting the report advised that her opinion was that the systems of internal control and governance were generally adequate though there were indications in some areas of non-compliance and a lack of evidence of Management monitoring that they were operating satisfactorily; therefore improvements were required to the second line of defence consistently across the Council to ensure probity in systems and operations, including the prevention, detection and resolution of fraud and irregularities.

In discussing the report, the Committee noted:-

- that the Chief Internal Auditor's concerns were not restricted to one particular service or division;
- that from an external audit perspective the distinction between the current and past control environments would be of particular interest to them as things moved forward;
- that concerns remained that in the current circumstances it was difficult to take assurance over internal controls until ongoing matters were concluded.

The Committee then debated the adequacies of qualifications contained within the report to address any findings that may come out of the currently ongoing confidential Investigation of Roads Contract Management, and although the Chief Internal Auditor confirmed that in her opinion they were, concerns remained about the ability of the Committee to come to a similar judgement in the absence of the full facts.

Decision

After further discussion, the Audit Committee:

- Noted the Internal Audit Annual Assurance Report 2017/18.
- Agreed to reserve judgement on the assurances contained therein for the time being for the reasons raised during the foregoing discussions as outlined above.

Action

Chief Executive

Report No.	Report Title	Submitted by:
5.6	Annual Governance Statement	Chief Executive

Outline of report

This report provided an assessment of the Council's compliance with its Code of Corporate Governance and invited the Audit Committee to note and comment on the draft Annual Governance Statement which would be included in the Financial Statements.

The Chief Executive in presenting the report highlighted the main sections from both the report and the draft Annual Governance Statement; a copy of which was appended to the report. He acknowledged that in light of earlier discussions there was still work to be done before it was finalised.

Summary of discussion

Councillor Milligan made reference to the requirement for the Annual Governance Statement to be authorised by the Leader of the Council and the Chief Executive. He advised that he had major reservations about his being able to sign off such an assurance within the required timescale given the current position with the Investigation of Roads Contract Management. He emphasised that without movement on this matter there was every likelihood that the Statement would have to go forward without his authorisation.

The Committee, in considering the potential implications, emphasised the need to ensure that this matter was resolved in order to ensure compliance with the required regulatory requirements, and discussed the timescales for this.

Decision

After further discussion , the Audit Committee:

- Noted the draft Annual Governance Statement.
- Noted the need for the finalised Statement to be authorised by both the Leader of the Council and the Chief Executive
- Agreed to strongly support efforts to ensure that the Leader of the Council was provided with a copy of the Phase 1 report in order that he could give proper consideration to the assurance position as set out in the Annual Governance Statement.

Action

Chief Executive

Report No.	Report Title	Submitted by:
5.8	Audit Committee Annual Report 2017/18	Independent Chair

Outline of report and summary of discussion

There was submitted a report, dated 31 May 2018, by the Independent Chair of the Audit Committee presenting the Audit Committee Annual Report 2017/18 and the annual self-assessments of the Committee against best practice. In preparing

the report reference was made to the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) guidance note Audit Committees Practical Guidance for Local Authorities and Police 2013 Edition.
Decision
The Committee, having heard from the Independent Chair, who responded to Members questions, noted the Report.

Report No.	Report Title	Submitted by:
5.9	Audit Committee – Special Meeting	Head of Finance and Integrated Service Support
Outline of report and summary of discussion		
A report dated 8 June 2018 was presented by the Head of Finance and Integrated Service Support. The report invited the Audit Committee to agree to a Special Meeting of the Committee to consider the unaudited Annual Accounts, which required to be submitted to the Auditor by 30 June 2018, and which required to be reviewed by the Committee whose remit includes audit or governance by the legislative deadline of 31 August 2018 as set out in the Local Authority Accounts (Scotland) Regulations 2014.		
Decision		
After discussion, the Audit Committee agreed to hold a Special Meeting of the Committee to consider the unaudited Annual Accounts by the legislative deadline of 31 August 2018 as set out in the Local Authority Accounts (Scotland) Regulations 2014.		
Action		
Director, Resources/Democratic Services/All to Note		

6. Private Reports

No private business was discussed.

The meeting terminated at 10.40 am

Minute of Meeting

Audit Committee
Tuesday 25 September 2018
Item No: 4.3

Midlothian

Special Meeting of Audit Committee

Date	Time	Venue
Tuesday 28 August 2018	12 noon	Council Chambers, Midlothian House, Dalkeith, EH22 1DN

Present:

Mike Ramsay (Chair)
Councillor Baird
Councillor Milligan
Councillor Muirhead
Councillor Smaill
Peter de Vink (Independent Member)

In attendance:

Grace Vickers	Chief Executive
Mary Smith	Director of Education, Communities and Economy
Gary Fairley	Head of Finance and Integrated Service Support and Section 95 Officer
Alan Turpie	Legal Services Manager and Monitoring Officer
Stephen Reid	Ernst and Young, External Auditors
Sarah Croft	Ernst and Young, External Auditors
Elaine Greaves	Principal Auditor
David Gladwin	Financial Services Manager
Callum Alsmeyer	Accountant
Janet Ritchie	Democratic Services Officer

1. Welcome and Apologies

Apologies were received from Councillor Hardie and Councillor Parry

2. Order of Business

The order of business was as set out in the Agenda.

3. Declarations of interest

No declarations of interest were received.

4. Minute of Previous Meeting

No previous minutes were submitted.

5. Public Reports

Report No.	Report Title	Presented by
5.1	Unaudited Financial Statements 2017/18 – Presentation	Head of Finance and Integrated Service Support
Outline of Presentation and Summary of discussion		

The Head of Finance and Integrated Service Support presented an overview of the details contained within the unaudited Accounts 2017/18 covering:

- The 2017/18 Highlights from the Accounts.
- The regulations in the preparation and publication of the accounts.
- An overview of the Accounts timetable.
- The key statements within the Accounts.
- The year-end position – the Balance sheet and Reserves.
- The Tracking Financial Performance.

The Head of Finance and Integrated Service Support confirmed that the presentation would be provided as an appendix to the minute.

Thereafter the Head of Finance and Integrated Service Support, the External Auditors and Council Officers responded to questions on the unaudited Accounts raised by members of the Committee. Councillor Milligan further commented that he did have several other questions but these could not be addressed at this time due to time constraints. He then commented that the Elected Members and the Audit Committee were aware of the ongoing investigations and that this had still to be reported back to the Committee.

The Chair then asked if anyone had any further issues which needed addressed before the signing off the Audited Accounts and as no further points were raised the Chair drew the meeting to its conclusion.

Decision
The Audit Committee noted the presentation would be attached to the minute as an appendix.
Action by
Democratic Services Team

Report No.	Report Title	Submitted by:
5.2	Unaudited Financial Statements 2017/18 Report	Head of Finance and Integrated Service Support
Outline of presentation and summary of discussion		
The report dated 21 August 2018 was submitted by the Head of Finance and Integrated Service Support. The purpose of this report was to enable the Audit Committee to consider and comment on the unaudited accounts for 2017/18. The Local Authority Accounts (Scotland) Regulations 2014 sets out the requirements in respect of preparation, submission and scrutiny of unaudited accounts as follows, paragraphs 9 and 10 set out the requirements for Audit Committee to consider the unaudited accounts by 31 August 2018. The regulation also provided for public inspection and in this regard the public inspection ran from 2 – 23 July 2018 with no objections lodged. Accordingly as agreed by Council this special meeting was specifically to fulfil the requirements of paragraphs 9 and 10 of the regulations. It was noted that for future years the Audit Committee meeting schedule had been revised to allow for earlier consideration of the unaudited accounts.		
Decision		
In accordance with The Local Authority Accounts (Scotland) Regulations 2014, set out in section 2 of the report, the Audit Committee considered and commented on the unaudited accounts for 2017/18.		

The meeting terminated at 2.01 pm

Actions Log

Midlothian

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
1	**Internal Audit Report on Treasury Management**	19/06/18	After further discussion, the Audit Committee agreed to continue consideration of the report in order to allow the identified issues to be addressed.	Chief Internal Auditor/Head of Finance and Integrated Service Support	25/09/2018	Update will be provided at 25/09/2018 meeting by Chief Internal Auditor as part of Minutes / Action Tracker.
2	**Local Government Workers Pay and Grading**	19/06/18	In view of the late circulation of the report it was agreed to continue consideration of this item to the next Audit Committee meeting.	Head of Finance and Integrated Service Support	25/09/2018	Item included within agenda for 25/09/2018 Audit Committee meeting.
3	**Annual Governance Statement 2017/18 (2018/19 Areas for Improvement)**	19/06/18		Chief Executive	June 2019	Final AGS 2017/18 included within audited Statement of Accounts 2017/18 for 25/09/2018. Management's proposal is to report on Areas of Improvement progress to Audit Committee on a quarterly basis.

Local Government Workers Pay and Grading

Report by John Blair, Director Resources

1 Purpose of Report

The purpose of this report is to provide Audit Committee with details of the benefits arising from the changes in terms Local Government Workers and conditions which were implemented by the Council from 1 October 2016.

2 Background

2.1 Previous Reports

The previous reports considered by the Council are set out and are summarised below to provide the Audit Committee with context and background.

2.2 4 February 2014 Financial Strategy 2015/16 and 2016/17

This report set out proposals for the Council to review pay and grading for the Local government staff group. The Council pay and grading Structure was previously reviewed in June 2009.

2.3 25 March 2014 Review of Local Government Staff terms and Conditions

Objectives and Remit

The Objectives of the review was to:

- To provide research and analysis relating to the employees terms and conditions across Scotland compared to Midlothian Council
- To identify areas where potential efficiencies can be considered
- To provide details of Midlothian Council pay levels relative to other employers and comparator groups

The scope of the review included:

- All staff within the Council current pay grades 1 to 14
- Comparison of allowances and expenses with other organisations
- Options for reviewing the sickness absence provisions.

The scope as set out above required to comply with the following criteria:

a) Equal Pay compliance
b) The integrity of the Council's Job Evaluation scheme and processes must be maintained
c) Any changes require to be financially sustainable and reflect future years budgetary projections.

The review specifically focused on:

- Levels of pay
- Working week
- Sickness absence provisions
- Overtime premiums and arrangements
- Public holiday arrangements
- Pay progression options
- Pay frequencies
- An examination of other allowances

2.4 24 March 2015 Review of Local Government Working Team and Conduct

The report presented to Council on 24 March 2015

- Outlined the financial restraints which required a refocus of the review towards the lowest grades together with consideration of a range of non-financial rewards to extend across all local government employees,
- Highlighted that improving pay levels for the lowest grades would have a positive impact on the local economy and as such contribute to addressing the wider issue of inequality,
- Highlighted that by increasing the base pay there would inevitably be an increase in the overall Council pay bill.

2.5 23 June 2015 Review of Local Government Workers Pay and Grading

This report provided Council with:

- An overview of the potential implications of the link to the Real Living Wage on pay differentials,
- An update on the ongoing pay modelling work,
- The equality and legislative implications of the pay and grading review,
- The outcome of the non-financial benefits survey,
- An outline of the policy changes which formed a key strand of the review.

The report also gave approval of the key principles, a cost ceiling for the review and authority for the Council to commence formal negotiations with the recognised Trade Unions.

2.6 22 September 2015 Review of Local Government Workers Pay and Grading

This report provided the Council with an update on the Review of Local Government Workers Pay and Grading arrangements, incorporating developments nationally and locally since the previous report to Council on 23 June 2015.

2.7 15 December 2015 Review of Local Government Works Pay and Grading

This report provided the Special Council meeting with an update on the Review of Local Government Workers Pay and Grading arrangements, incorporating developments nationally and locally since the last report to Council on 22 September 2015.

2.8 8 June 2016 Review of Local Government Works Pay and Grading

This report appraised Council on the position with the Review of Local Government Workers Pay and Grading arrangements.

The report also updated Council on the outcome of the negotiations to secure a collective bargaining agreement and sought approval to make a formal proposal to the recognised Local Government Workers Trade Unions, Unison, Unite and UCATT.

The proposal encompassed the four strands of the review, namely:

- Changes to the pay and grading structure for Local Government Workers;
- Changes to the Council's HR Policy Framework;
- The adoption of an expanded employee non-financial benefits package; and
- The enhancement of Lifelong Learning.

2.9 28 June 2016 Review of Local Government Works Pay and Grading

This report appraised the Council of the outcome of Trade Union ballot process in respect of the Review of Local Government Workers pay and grading.

The outcome of the ballots were in favour of the proposals and accordingly arrangements were put in place by the Council to formalise the collective agreement and proceed to implementation effective from 1 October 2016.

3 Local Government Works Pay and Grading

3.1 The Case for Change

The overarching aims of the proposed package of changes set out by the Council was to change culture and sustain employee relations through a transformational program of service reviews, e.g. by removing the premium of a fifth that applied to weekend working. The package was designed to promote workplace flexibility and employee work life balance and enhanced the provision of lifelong learning. The other benefits of the review of pay and grading included:

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

Alterations to terms and conditions included:

- A reduction to four recognised public holidays (two at Christmas and two at New Year) with the remaining five public holidays becoming part of employees annual leave entitlement.
- Contracted Saturday and Sunday working paid at the standard hourly rate (except 10pm – 6am) rather than the current time and a fifth;

- Contractual night working between the hours of 10pm to 6am to be paid at time and a fifth;
- Raising the threshold before overtime premium applies from 36 hours to 40 hours in any week;
- Reducing the overtime premium paid for hours worked above 40 hours per week from time and a half to time and a quarter;
- Annual Leave entitlement enhanced by one additional day with the exception of Chief Officers;
- Standby arrangements remain as at present, i.e. payment for first two hours for first call out and time and a half premium for time worked under standby arrangements. The standby payment increased to a flat rate of £20 per 24 hours.

3.2 Progress since Implementation

A significant amount of work has been carried out with regards to each of the four strands as identified in section 2.8. and this section provides a brief update with further information and commentary also being provided.

3.2.1 Changes to Pay Grading structure for Local Government workers

The changes necessary to integrate the Scottish Government Living Wage were significant. The new pay scales delivered a substantial increase in pay for the lowest earners (grades 1-3) of between 7.7% -14.4% in the first year. This was made possible by successfully agreeing with the Trade Unions limited criteria for the application of and a reduction in the value of, premium rates of pay. The objective was to end a culture of dependency on premium rates to boost earnings.

The changes also had a positive impact on the gender pay gap as the majority of employees in these pay bands (76%) are female.
It should also be noted that the next section provides details of the benefits realised and will be further expanded and enhanced by the Investing in Our Workforce (IioW) Board over the coming months.

3.2.2 Benefits realised from the Introduction of Revised Terms and Conditions and Changes to the Councils HR Policy framework

Gender Pay

An independent Equality Impact assessment was carried on the revised terms and conditions in February 2017. The EQIA concluded "On the basis of the information supplied, the new pay scheme is consistent with the principles of equal pay for work of equal value. It reduced the overall gender pay gap for both basic salary and the salary package."

Specifically it was noted the new scheme reduced the pay gap at three grades, left the gap unchanged at ten grades and increased it slightly at one grade. Although each of these changes was relatively small.

The report observed that overall gender pay gap is influenced by the distribution of men and women across the grades, as well as by pay structure issues. A major contributor to the overall pay gap is that the two grades with the highest number of women are grades one and two, while the two grades with the highest number of men are grades two and five.

However, there was a reduction from 11.3% to 10.7% in the overall pay gap between men and women under the new arrangements. This was largely because the largest increases in basic salary were at grades one to three, where there were significantly more women than men.

Sickness Absence Levels

Since October 2016 the following headline statistics relate to sickness absence.

The average days lost per month for each of three financial years are as follows:

Year	Months	Days	Average Monthly Days Lost	Monthly Charge	Cumulative	Percentage reduction	Notes
2016/17	6 months	14,602	2,434	--	--	---	(a)
2017/18	12 Months	22,405	1,867	567	567	23.3%	(b)
2018/19	5 Months	9,912	1,982	(115)	452	18.5%	(C)

Notes
a) December 2016 all-time high of 2,939 days.
b) Significant improvement consistently during 2017/18.
c) The increase in the 2018/19 part year monthly average is due to an August 2018 high of 2692 days which is the second highest month since October 2016. This is being investigated with service managers through workforce management protocols in-order to facilitate a continuation of the downward trend. .

Commentary

- Committee are invited to note the downward trends regarding sickness absence levels.
- Committee are invited to note that Midlothian Council in 2016/17 ranked in the first quartile for non-teacher sickness absence (seventh) based on the Local Government Benchmarking Framework Indicators.
  Note that information on sickness absence trends is included in the Councils quarterly performance monitoring, and that going forward more detailed information will be included to explain the trends.

Agency Spend

Whilst recognising there is a place for agency workers as part of the overall workforce strategy required to deliver services, one of the outcomes of the review supported by the Council and previously considered by the Performance Review and Scrutiny Committee was a reduction in Agency spend through the adoption of a more robust Agency Workers Policy. This approach has been delivered with a review of business need. The production of detailed data from the registration and assessment process introduced to comply with the HMRC legislative changes for these workers allowed the IioW Board to focus on and prioritise the reduction in Agency spend.
.
The following table details the Council spend of agency personnel since April 2016.

Year	Months	Amount	Monthly Average	Notes
2016/17	12 months	£3,829,000	£319,000	--
2017/18	12 Months	£3,371,000	£281,000	
2018/19	4.5 Months	£727,000	£161,000	(a)

(a) Month 1 traditionally low due to year end processing Easter Holidays and actuals spend for month 2 over the last three years in the same period is as follows:

Year	Panel 5 Spend
2016/17	£1,337,000
2017/18	£1,136,000
2018/19	£727,000

Please note Period 5 ledger period generally ends mid-August.

Commentary

- Committee are invited to note the Council has a robust policy, secured through the low pay negotiations, covering the use of agency staff leading to a significant reduction in agency spend.
- Committee are invited to note the significant reduction in agency spend.
- Committee are invited to note that the Council has a process in place to monitor spend on agency staff.
- Notes that monthly payroll metrics are prepared for (and reviewed by) the Investing in Our Workforce Project Board.

Additional Hours

The following table details the change in additional hours which includes hours worked at plain time and those hours worked at premium rates time since October 2016.

Payroll	Year	Months	Hours	Monthly Hours
661 – Monthly	2016/17	6 months	139,000	23,170
	2017/18	12 months	278,000	23,170
	2018/19	5 months	121,000	24,200

Payroll	Year	Months [period]	Amount	Period Amount
662 – Four Weekly	2016/17	6 months	25,000	4,160
	2017/18	13 months	41,000	3,150
	2018/19	5 months	23,000	4,600

Commentary

- The static position regarding additional hours for monthly payroll remains disappointing and could be considered as the next possible priority for the Investing in Our Workforce board. The statistics would suggest some consistency in the service demands for hours that could either be made contractual or translated into additional posts, to allow employees to sustain a healthy work/life balance.
- The collective agreement included a commitment to increase contractual hours to reflect regular additional hours up to and including full time status to increase employees security over their earnings
- With regards to the four weekly payroll the reduction in additional hours reflects the decrease in premium hours which is set out in detail in the next section.

Premium Hours

The following table sets out the position with regards to premium hours paid, i.e. hours which attract a premium of greater than 1.0 excluding night working.

For completeness and to monitor trends the full year spend for 2014/15 and 2015/16 has been reflected in the following table. It should also be noted that year 2016/17 includes 6 months under the previous terms and conditions and 6 months of the Investing in Our Workforce terms and conditions.

Year	Months	Double Time	Time half	Time Quarter	Total
2014/15	12 Months	£213,000	£1,699,000	£0	£1,912,000
2015/16	12 Months	£144,000	£1,750,000	£0	£1,894,000
2016/17	12 Months	£183,000	£1,128,000	£145,000	£1,456,000
2017/18	12 Months	£156,000	£480,000	£422,000	£1,058,000
Four Year Change		£(57,000)	£(1,219,000)	£422,000	(£854,000)
2018/19	12 weeks	£76,000	£16,000	£117,000	£209,000

Commentary

- The reduction in premium rate payments was a key element in delivering an affordable uplift in base pay for grades 1-4.
- Over the last four years the cost of premium working has reduced significant particularly post investing in Our Workforce.
- Note that level of hours paid at premium rates continues to be monitored by the Investing in Our Workforce Board.

Case Work Levels

The following table sets out the levels of casework for Disciplinary Cases by Directorate, following the introduction of the Resolution Policy as part of the collective agreement.

Year	Months	Health Social Care	Education Communities Economy	Resources	Total
2014/15	12	3	12	2	17
2015/16	12	4	6	4	14
2016/17	12	3	4	7	14
2017/18	12	1	4	3	8

Commentary

A new Code of Conduct and a range of new progressive People Policies were introduced in April 2017. Three of the cases in Education, Communities and Economy are traditional grievances as this is still the procedure used by teachers to raise issues in this manner. The figures in 2017/18 do not reflect the number of resolutions dealt with at an informal stage as this is not recorded. The ethos of the resolution policy is to seek early resolution to issues in the workplace so this is being followed as much as possible and dealt with informally if applicable.

4 Report Implications

4.1 Resources

The financial implications were fully set out in Chief Executives report to the special meeting of Council held on 8 June 2016.

In this report the financial implications of implementing Investing in our Workforce were as follows:

Financial Overview

	2016/17 £	2017/18 £	2018/19 £m	2019/20 £m	Total £m
Impact of National Living Wage	0.000	1.000	1.700	2.300	2.300
Cost of Proposals	0.800	1.613	1.270	1.030	1.030
Additional cost of Proposals	0.800	2.613	2.970	3.330	3.330
Less Offsets	(0.330)	(0.660)	(0.660)	(0.660)	(0.660)
Net Cost of Proposals	**0.470**	**1.953**	**2.310**	**2.670**	**2.670**
Pay Protection					
Upfront	0.302	--	--	--	0.302
Cash Conservation	0.071	0.061	0.030	0.016	0.178
Pay Protection total costs	**0.373**	**0.061**	**0.030**	**0.016**	**0.480**

Committee should note that the changes have contributed to ensuring that the Council’s pay and grading structure has the capacity to meet future increases in the living wage without having a detrimental impact on grade boundaries or compromising the Councils performance framework due to a significant compression of grades. A proportion of the additional cost was offset by significant changes in the hours which attracted premium rate payments.

5 Risk Implications

The Investing in Our Workforce Board has been chaired by the Chief Executive in recognition of the need to ensure that services maximise the flexibility and other changes introduced from the collective agreement. Whilst positive efforts have already been made to reduce premium overtime and Agency workers costs, it is essential that Service Managers ensure that their workforce plans maximise the benefits and opportunities provided by the changes and increased flexibility secured in terms and conditions and people policies.

Looking forward it is necessary to monitor the implications of changes from:

- The Real Living Wage
- Future Nationally agreed Pay Awards

Which potentially could have implications for the structure of the Council’s pay and grading structure in the medium term.

5.1 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

5.2 Key Priorities within the Single Midlothian Plan

The single Midlothian Plan sets out the partnership three key priorities of:

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

The proposals set out in the Investing in Our Workforce Strategy directly support the third of these priorities and are expected to have a positive impact of the other two priorities. This is particularly relevant given the number of staff who are also Midlothian residents.

Moreover, whilst pay and grading structures and People Policies do not in isolation create organisational change, they can assist in facilitating change which allows the Council to focus on its key priorities and to utilise the staff resource in an effective manner.

5.3 Impact on Performance and Outcomes

The Council is committed to having a motivated and high-achieving workforce in order to adapt to changing service demands and reducing financial resources. By ensuring that the Council offers a range of appropriate rewards it is likely they will be more committed and motivated in the workplace.

5.3.1 Adopting a Preventative Approach

Implementing all elements of the review, including increased lifelong learning opportunities may make frontline employees feel more valued and result in a reduction in staff turnover and absence levels.

5.3.2 Involving Communities and Other Stakeholders

The proposals regarding low pay as set out in this report have been developed through negotiation with the recognised local government Trade Unions resulting in a collective agreement. This process adopted the partnership arrangement set out within the Recognition and Procedural Agreement.

This report addresses internal employment issues and therefore does not involve external stakeholders, although the proposals require to be considered alongside the contractual arrangements of the Council's contractors, suppliers and other external providers. In this respect Council is recognised as a living wage employer, having received accreditation in April 2016.

The Council has been recognised nationally for the approach adopted resulting in shortlisting for the Living Wage Award in 2018.

5.6 Ensuring Equalities

The proposals regarding low pay have been independently equality impact assessed. The assessment has confirmed that the improving pay levels for the lowest grades has a positive impact on addressing in work poverty, with a positive impact on pay for female workers. It will also contribute to the local economy and as such contribute to addressing the wider issues of inequality.

5.7 Supporting Sustainable Development

There are no issues relating to environmental sustainability arising from this repost.

5.8 IT Issues

The implication of the proposals required changes to the business applications, principally I Trent, the Councils Payroll and HR system, to facilitate the revisions to pay and grading etc. as set out in this report. These were encompassed and resourced in the associated implementation plans.

6 Summary

The changes to the pay and grading structure have had a positive impact on the gender pay gap. An independent EQIA completed on the Pay and Grading Structure revealed a reduction of 0.4% and 0.6% in basic and total pay respectively.

Additional work is required to reduce the gender pay gap further, specifically progression opportunities for female employees and issues of occupational segregation.

The framework has provided a sound foundation for the delivery of both the financial strategy and service excellence through a programme of service reviews.

Progress towards the ambitions outlined above are monitored at the Implementation Board using a set of metrics that demonstrate:

- Between October 2016 and July 2018 FTE absence days lost fell significantly.

- Additional hours worked over the period from October 16 has reduced and premium costs have also been reduced.

- The overall average hours worked by employees has reduced by 1.5% but earnings have reduced by less than 0.5%, demonstrating that employees can sustain their earnings without the need to work additional hours.

- The overall employee head count in Midlothian Council has increased by 4.6% as spend on agency workers is reduced, more employees are being recruited and the commitment to further reduce regular additional hours remains.

- Performance appraisal ratings show a 31% increase in employees recorded as having delivered an outstanding performance since April 2016, demonstrating that employees are engaging with and delivering on the Council's ambitions.

- Employee testimonials have revealed the career opportunities and impact on self-esteem that participation in lifelong learning has presented to those who have participated. Evening HNC courses in Early Years have been offered to learning assistants to allow access to the career opportunities presented by the expansion in Early Years.

- Other employees have reported the extra income has allowed them to save for the first time, or that flexible work practices now allow them to achieve a work life balance without being absent from work.

7 Recommendations

Audit Committee is recommended to:

- Consider the commentary as set out in section 3.2.2 of the report;

- Note the monitoring of the Investment in Our Workforce Project by the Board;

- Note the ongoing development and the use of payroll metrics by service management.

15 June 2018

Report Contact:

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Background Papers:

Audit Committee
Tuesday 25 September 2018
Item No: 5.2

Annual Treasury Management Report 2017/18 and revisions to TMS – Report by Head of Finance and Integrated Service Support

1 Purpose of Report

The purpose of this report is to bring to the Committee's attention to the Annual Treasury Management Report 2017/18 and revisions to TMS presented to Council on 26 June 2018 by the Head of Finance and Integrated Service Support.

2 Background

These reports have previously been considered by the Council.

3 Report Implications

These remain unchanged from those highlighted in the Head of Finance and Integrated Service Support's reports.

4 Recommendations

The Committee is invited to scrutinise for its interest the reports by the Head of Finance and Integrated Service Support.

Date 13 September 2018

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Annual Treasury Management Report 2017/18 and revisions to TMS

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

1. Purpose of Report

The purpose of the report is to inform members of the Treasury Management activity undertaken in 2017/18, the year-end position and recommendations to amend the TMS.

2. Background

The main points arising from treasury activity in 2017/18 were:

- Total new long term borrowing taken in the year amounted to £20.000 million, comprising the following:-
  - One £10 million Maturity loan sourced from PWLB in April 2017 taking advantage of historically low PWLB rates;
  - One £10 million Equal Instalment of Principal loan sourced from Deutsche Pfandbriefbank, drawn on 29 June 2017 following loan execution and hedging of interest rate in February 2016.

- Two new investments (for a period greater than 364 days) were placed with other Local Authorities as follows:-
  - One £10 million 2 year investment with Warrington Borough Council placed on 21 March 2018, maturity 23 March 2020 on a structured basis earning 1.00% for the first year and 1.70% for the second;
  - One £5 million 2 year investment with Plymouth City Council placed on 28 March 2018, maturity 30 March 2020 on a structured basis earning 1.00% for the first year and 1.70% for the second;

- The average rate of interest paid on external debt was 3.37% in 2017/18, marginally up from 3.32% in 2016/17;

- The average rate of return on investments was 0.64% in 2017/18, exceeding the benchmark of 0.40% for the fourteenth year in succession;

- The pooled internal loans fund rate for General Fund and HRA decreased from 3.24% in 2016/17 (lowest in mainland Scotland – see Appendix 1) to 3.08% in 2017/18, which is again expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland;

- Were the pooled internal loans fund rate to have equated to the Scottish weighted average of 4.20%, this would have generated loan charges in 2017/18 of £19.7 million. The Council's actual 2017/18 loan charges for General Services and HRA were £16.3 million, representing a cash saving (compared to the Scotland average) of £3.3 million in 2017/18;

- The appointment of interest between HRA and General Fund was changed in 2017/18, with the HRA charged interest at the weighted average interest rate on the Council's long-term debt, removing interest rate risk for the HRA to support the long-term rent setting strategy. The interest charge to the General Fund provides support to the Council's medium term financial strategy and capital plans;

- No debt rescheduling was undertaken during 2017/18.

A detailed report "*Annual Treasury Management Review 2017/18*" on the activity during 2017/18 is attached as Appendix 2.

3. Changes to the TMS – Statutory repayment of loans fund advances

In accordance with Scottish Government Finance Circular 7/2016, Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

A variety of options are provided to Councils so long as a prudent provision is made each year. As noted to Council in the '*Treasury Management and Investment Strategy 2018/19 & Prudential Indicators'* report on 13 February 2018, a review of the Loans Fund accounting arrangements was being undertaken which included an assessment of the period over which Loans Fund advances are projected to be repaid, noting that the final outcome would be reflected in the both the revised Capital Strategy and reported as part of the final Treasury Management outturn position for the current year. In addition, any proposed change to the policy for the repayment of loans fund advances will be reported to Council for approval.

Following this review, the following policy on the repayment of loans fund advances is proposed:-

1. Where the loans fund advance is expected to be repaid through a future dated secured funding source e.g. a Section 75 developer contribution or capital receipt, the Council will adopt the funding/income profile method for the repayment of these advances. Where the funding or income is anticipated to be less than the capital expenditure, two separate loans fund advances will be made, one being for the value of the anticipated income, profiled to reflect that income stream, with a second loans fund advance being made for the remaining balance and repaid by applying the methodology outlined below.

   Specifically, the loans fund advance equating to the value of the anticipated income, will be charged interest over the period from when the advance is made to the point where the advance, or part of the advance, is repaid. There will be no principal repayments charged during this period. This ensures that the repayment of these advances is matched to the income stream which funds the expenditure of the new asset.

Officers will keep under review loans fund advances that have been calculated by reference to an income stream to ensure the provision for repayment remains prudent. Where an authority identifies that the income stream is, or will be, insufficient to repay the loans fund advance, a prudent repayment profile will be adopted for that loans fund advance.

2. Where loans fund advances relate to new assets, principal repayments on the new asset will be deferred until the financial year following the one in which the asset is first available for use;
3. All loans fund advances from 2018/19 shall be repaid by the annuity method. Officers are currently reviewing the appropriate advance life and interest rate and will report back to Council at a later stage;
4. The advance life and interest rate used for all loans fund principal repayments prior to 1 April 2018 are also currently being reviewed by officers in line with item 3 above and a report outlining the impact of any change to this approach will be brought back at a later stage.

4. Other Issues

Revised CIPFA Codes

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code.

One recommendation was that local authorities should produce a new report to members to give a high level summary of the overall capital strategy. This is presented elsewhere on today's agenda.

Markets in Financial Instruments Directive II (MiFID II)

The EU set the date of 3 January 2018 for the introduction of regulations under MIFID II. These regulations govern the relationship that financial institutions conducting lending and borrowing transactions will have with local authorities from that date. This has had little effect on this Authority apart from having to fill in forms sent by each institution dealing with this Authority and for each type of investment instrument we use, apart from for cash deposits with banks and building societies.

5. Report Implications

5.1. Resources

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

The loan charges associated with Capital Expenditure and Treasury Management activity during 2017/18 are reported in the Financial Monitoring 2017/18 – General Fund Revenue report elsewhere on today's agenda and reflected in the draft Capital Strategy.

5.2. Risk

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

5.3. Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

5.4 Impact on Performance and Outcomes

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

5.5 Adopting a Preventative Approach

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

5.6 Involving Communities and Other Stakeholders

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

5.7 Ensuring Equalities

There are no equality issues arising from this report.

5.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

5.9 IT Issues

There are no IT issues arising from this report.

6. Summary

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

7. Recommendations

It is recommended that the Council:-

a) Note the Treasury Management Annual Report for 2017/18;
b) Approve the changes to the TMS for the statutory repayment of loans fund advances as set out in Section 3.

Date 24 May 2018

Report Contact:
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Appendices:-

Appendix 1: Loans Fund Rate Comparison with other Scottish Local Authorities
Appendix 2: Annual Treasury Management Review 2017/18
Appendix 3: Investment Benchmarking Analysis 2017/18

Appendix 1:-

Loans Fund Pooled Rate Comparison 2016/17

Council	Loans Fund Rate 2016/17
Midlothian	3.24%
Perth & Kinross	3.28%
Dumfries & Galloway	3.31%
Aberdeen City	3.49%
East Lothian	3.49%
Fife	3.69%
Inverclyde	3.72%
Aberdeenshire	3.77%
North Lanarkshire	3.82%
East Renfrewshire	3.84%
Falkirk	3.84%
Orkney	3.84%
West Dunbartonshire	3.88%
South Lanarkshire	3.92%
Dundee City	4.09%
North Ayrshire	4.17%
Highland	4.28%
West Lothian	4.31%
Scottish Borders	4.36%
East Dunbartonshire	4.38%
Glasgow City	4.39%
Stirling	4.42%
Argyll & Bute	4.43%
Renfrewshire	4.44%
Angus	4.51%
Shetland	4.52%
Moray	4.56%
South Ayrshire	4.66%
East Ayrshire	4.99%
Edinburgh City	5.06%
Clackmannanshire	5.23%
Comhairle Nan Eilean Siar	6.55%

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

Appendix 2

Annual Treasury Management Review 2017/18

Midlothian Council
June 2018

Contents

1. The Council's Capital Expenditure and Financing 2017/18

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

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

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

Table 1: Capital Expenditure + Financing

	2016/17 Actual £000	2017/18 Budget £000	2017/18 Actual £000
General Fund			
Capital Expenditure	39,423	24,263	16,984
Available Funding	19,596	14,319	13,106
Borrowing Required	**19,827**	**9,944**	**3,878**
HRA			
Capital Expenditure	23,906	41,945	10,571
Available Funding	11,681	1,289	4,989
Borrowing Required	**12,225**	**40,656**	**5,582**
General Fund and HRA			
Capital Expenditure	63,329	66,208	27,555
Available Funding	31,277	15,608	18,095
Borrowing Required	**32,052**	**50,600**	**9,460**

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2017/18 unfinanced capital expenditure (see above table), plus prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

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

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

The total CFR can also be reduced by:

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

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

Table 2: Council's Capital Financing Requirement			
	31-Mar-17	**2017/18**	**31-Mar-18**
CFR:	**Actual**	**Budget**	**Actual**
	£000	**£000**	**£000**
Opening balance	**£ 254,024**	**£ 275,974**	**£ 278,783**
Add Borrowing Required	£ 32,052	£ 50,600	£ 9,460
Less scheduled debt amortisation	£ (7,293)	£ (7,411)	£ (7,969)
Closing balance	**£ 278,783**	**£ 319,163**	**£ 280,274**

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

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2015/16) plus the estimates of any additional capital financing requirement for the current (2017/18) and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2017/18. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 3: Council's Gross Borrowing Position			
	31-Mar-17	2017/18	31-Mar-18
	Actual	Budget	Actual
	£000	£000	£000
Gross Borrowing	£ 257,303	£ 301,274	£ 241,032
CFR	£ 278,783	£ 319,163	£ 280,274

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

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

Table 4: Gross Borrowing against Authorised Limit / Operational Boundary	
	2017/18
Authorised limit - borrowing	£482,021
Operational boundary - borrowing	£318,647
Maximum gross borrowing position	£293,275
Average gross borrowing position	£255,524

3. Treasury Position as at 31 March 2018

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the Purpose section of this report, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2017/18 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 5: Treasury Position

	31 March 2017 Principal	Rate/ Return	Average Life (Yrs)	31 March 2018 Principal	Rate/ Return	Average Life (Yrs)
Debt						
Fixed Rate Debt						
PWLB	£ 197,964	3.79%	25.45	£ 197,933	3.74%	26.87
Market	£ 44,339	0.78%	6.93	£ 28,099	1.92%	20.19
Total Fixed Rate Debt	**£ 242,303**	**3.24%**	**22.06**	**£ 226,032**	**3.51%**	**26.04**
Variable Rate Debt						
PWLB	£ -	n/a	n/a	£ -	n/a	n/a
Market	£ 15,000	4.63%	33.71	£ 15,000	4.63%	32.71
Total Variable Rate Debt	**£ 15,000**	**4.63%**	**33.71**	**£ 15,000**	**4.63%**	**32.71**
Total debt/gross borrowing	**£ 257,303**	**3.32%**	**24.15**	**£ 241,032**	**3.47%**	**26.45**
CFR	**£ 276,334**			**£ 280,274**		
Over/ (under) borrowing	**£ (19,031)**			**£ (39,242)**		
Investments						
Fixed Rate Investments						
In House	£ 74,985	0.80%	0.52	£ 64,985	0.79%	0.84
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Fixed Rate Investments	**£ 74,985**	**0.80%**	**0.52**	**£ 64,985**	**0.79%**	**0.84**
Variable Rate Investments						
In House	£ 8,581	0.28%	0	£ 8,026	0.46%	0
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Variable Rate Investments	**£ 8,581**	**0.28%**	**0**	**£ 8,026**	**0.46%**	**0**
Total Investments	**£ 83,566**	**0.75%**	**0.47**	**£ 73,011**	**0.75%**	**0.75**
Net Borrowing	**£ 173,737**			**£ 168,021**		

The maturity structure of the debt portfolio was as follows:

Table 6: Maturity Structure of Debt Portfolio						
	31-Mar-17		2016/17		31-Mar-18	
	Actual		Original Limits		Actual	
	£000	%	%		£000	%
Under 12 months	£ 49,031	21%	0% to 50%		£ 23,034	10%
12 months to 2 years	£ 10,034	4%	0% to 50%		£ 8,437	4%
2 years to 5 years	£ 17,733	7%	0% to 50%		£ 9,956	4%
5 years to 10 years	£ 2,256	1%	0% to 50%		£ 1,609	1%
10 years to 20 years	£ 55,665	23%	0% to 50%		£ 55,590	23%
20 years to 30 years	£ -	0%	0% to 50%		£ 9,821	4%
30 years to 40 years	£ 80,534	34%	0% to 50%		£ 85,535	35%
40 years to 50 years	£ 37,049	16%	0% to 50%		£ 42,049	17%
50 years and above	£ 5,000	2%	0% to 50%		£ 5,000	2%
Total	**£ 257,302**	**108%**			**£ 241,031**	**100%**

The maturity structure of the investment portfolio was as follows:

Table 7: Maturity Structure of Investment Portfolio		
	31-Mar-17	31-Mar-18
	£000	£000
Investments		
Under 1 Year	£ 83,566	£ 73,011
Over 1 Year	£ -	£ -
Total	**£ 83,566**	**£ 73,011**

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

Table 8: Fixed/Variable Interest Rate Exposure of Debt Portfolio					
	31-Mar-17		2016/17	31-Mar-18	
	Actual		Original Limits	Actual	
	£000	%	%	£000	%
Fixed Interest Rate Exposure	£242,302	94%	0% to 100%	£ 226,032	94%
Variable Interest Rate Exposure	£ 15,000	6%	0% to 30%	£ 15,000	6%
Total	**£ 257,302**	**100%**		**£ 241,032**	**100%**

4. The Strategy for 2017/18

The expectation for interest rates within the treasury management strategy for 2017/18 anticipated that Bank Rate would not start rising from 0.25% until quarter 2 2019 and then only increase once more before 31.3.20. There would also be gradual rises in medium and longer term fixed borrowing rates during 2017/18 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

During 2017/18, longer term PWLB rates were volatile but with little overall direction, whereas shorter term PWLB rates were on a rising trend during the second half of the year.

With that in mind, the general strategy for any new borrowings required was to balance savings from the utilisation of short-term market money from other UK public sector bodies at rates available at less than base rate (0.5%), with borrowing from PWLB at historically low rates. This allowed longer-term borrowing to be undertaken in the early part of the financial year when rates were low, whilst continued use of shorter-term borrowing within the overall portfolio continued to add value.

5. The Economy and Interest Rates

UK. The outcome of the EU referendum in June 2016 resulted in a gloomy outlook and economic forecasts from the Bank of England based around an expectation of a major slowdown in UK GDP growth, particularly during the second half of 2016, which was expected to push back the first increase in Bank Rate for at least three years. Consequently, the Bank responded in August 2016 by cutting Bank Rate by 0.25% to 0.25% and making available over £100bn of cheap financing to the banking sector up to February 2018. Both measures were intended to stimulate growth in the economy. This gloom was overdone as the UK economy turned in a G7 leading growth rate of 1.8% in 2016, (actually joint equal with Germany), and followed it up with another 1.8% in 2017, (although this was a comparatively weak result compared to the US and EZ).

During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year; quarter 1 came in at +0.3% (+1.7% y/y) and quarter 2 was +0.3% (+1.5% y/y), which meant that growth in the first half of 2017 was the slowest for the first half of any year since 2012. The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up in quarter 3 to 0.5% before dipping slightly to 0.4% in quarter 4.

Consequently, market expectations during the autumn rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate. The MPC meeting of 14 September provided a shock to the markets with a sharp increase in tone in the minutes where the MPC considerably hardened their wording in terms of needing to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered on this warning by withdrawing the 0.25% emergency rate cut which had been implemented in August 2016. Market debate then moved on as to whether this would be a one and done move for maybe a year or more by the MPC, or the first of a series of increases in Bank Rate over the next 2-3 years. The MPC minutes from that meeting were viewed as being dovish, i.e. there was now little pressure to raise rates by much over that time period. In particular, the GDP growth forecasts were pessimistically weak while there was little evidence of building pressure on wage increases despite remarkably low unemployment. The MPC forecast that CPI would peak at about 3.1% and chose to look through that breaching of its 2% target as this was a one off result of the devaluation of sterling caused by the result of the EU referendum. The inflation forecast showed that the MPC expected inflation to come down to near the 2% target over the two to three year time horizon. So this all seemed to add up to cooling expectations of much further action to raise Bank Rate over the next two years.

However, GDP growth in the second half of 2017 came in stronger than expected, while in the new year there was evidence that wage increases had started to rise. The 8 February MPC meeting minutes therefore revealed another sharp hardening in MPC warnings focusing on a reduction in spare capacity in the economy, weak increases in productivity, higher GDP growth forecasts and a shift of their time horizon to focus on the 18 – 24 month period for seeing inflation come down to 2%. (CPI inflation ended the year at 2.7% but was forecast to still be just over 2% within two years.) This resulted in a marked increase in expectations that there would be another Bank Rate increase in May 2018 and a bringing forward of the timing of subsequent increases in Bank Rate. This shift in market expectations resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 year, rather than longer term yields.

As for equity markets, the FTSE 100 hit a new peak near to 7,800 in early January before there was a sharp selloff in a number of stages during the spring, replicating similar developments in US equity markets.

The major UK landmark event of the year was the inconclusive result of the general election on 8 June. However, this had relatively little impact on financial markets. However, sterling did suffer a sharp devaluation against most other currencies, although it has recovered about half of that fall since then. Brexit negotiations have been a focus of much attention and concern during the year but so far, there has been little significant hold up to making progress.

The manufacturing sector has been the bright spot in the economy, seeing stronger growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year. However, the manufacturing sector only accounts for around 11% of GDP so expansion in this sector has a much more muted effect on the average total GDP growth figure for the UK economy as a whole.

EU. Economic growth in the EU, (the UK's biggest trading partner), was lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of quantitative easing to stimulate growth. However, growth eventually picked up in 2016 and subsequently gathered further momentum to produce an overall GDP figure for 2017 of 2.3%. Nevertheless, despite providing this massive monetary stimulus, the ECB is still struggling to get inflation up to its 2% target and in March, inflation was still only 1.4%. It is, therefore, unlikely to start an upswing in rates until possibly towards the end of 2019.

USA. Growth in the American economy was volatile in 2015 and 2016. 2017 followed that path again with quarter 1 at 1.2%, quarter 2 3.1%, quarter 3 3.2% and quarter 4 2.9%. The annual rate of GDP growth for 2017 was 2.3%, up from 1.6% in 2016. Unemployment in the US also fell to the lowest level for 17 years, reaching 4.1% in October to February, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has been the first major western central bank to start on an upswing in rates with six increases since the first one in December 2015 to lift the central rate to 1.50 – 1.75% in March 2018. There could be a further two or three increases in 2018 as the Fed faces a challenging situation with GDP growth trending upwards at a time when the recent Trump fiscal stimulus is likely to increase growth further, consequently increasing inflationary pressures in an economy which is already operating at near full capacity. In October 2017, the Fed also became the first major western central bank to make a start on unwinding quantitative easing by phasing in a gradual reduction in reinvesting maturing debt.

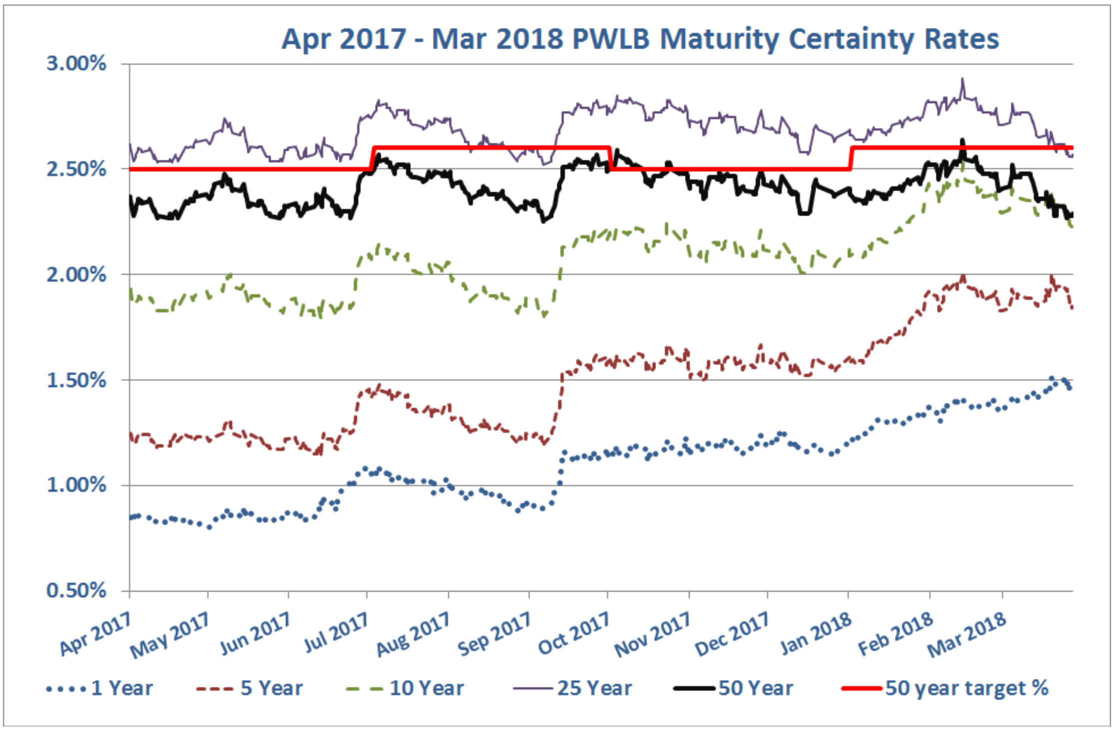
Chinese economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus and medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing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

Japan. GDP growth has been improving to reach an annual figure of 2.1% in quarter 4 of 2017. However, it is still struggling to get inflation up to its target rate of 2% despite huge monetary and fiscal stimulus, although inflation has risen in 2018 to reach 1.5% in February. It is also making little progress on fundamental reform of the economy.

6. Borrowing Rates in 2017/18

PWLB certainty maturity borrowing rates – As depicted in the graph and tables below and in appendix 3, PWLB 25 and 50 year rates have been volatile during the year with little consistent trend. However, shorter rates were on a rising trend during the second half of the year and reached peaks in February / March.

During the year, the 50 year PWLB target (certainty) rate for new long term borrowing was 2.50% in quarters 1 and 3 and 2.60% in quarters 2 and 4.
The graphs and tables for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



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

7. Borrowing Outturn for 2017/18

New Treasury Borrowing:-

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

The loans drawn were:-

Table 9: New Loans Taken in Financial Year 2017/18						
Lender	**Date Taken**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Maturity Date**	**Term (Yrs)**
PWLB	06 Apr 2017	£ 10,000	2.27%	Fixed	06 Apr 2065	48.00
Deutsche Pfandbriefbank	29 Jun 2017	£ 10,000	2.63%	Fixed	29 Jun 2045	28.00
Market	Various	£300,500	0.23%-0.60%	Variable interest rate	Various	0.08-0.17
Total		**£320,500**				

Market loans of £300.5 million reflect an average carrying value of £25.0m of Temporary Borrowing drawn on average every 1 month. This compares against a budget assumption of new short-term market borrowing of £36.5 million at an average interest rate of 0.30%.

Medium-long term borrowing of £20.0 million compares with a budget assumption of new borrowing of £39.1 million at an average interest rate of 2.79%.

Maturing Debt:-

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

Table 10: Maturing Debt in Financial Year 2017/18						
Lender	**Date Repaid**	**Principal £000's**	**Interest Rate**	**Fixed/ Variable**	**Date Originally Taken**	**Original Term (Yrs)**
PWLB	Various (Annuities)	£ 31	8.72%	Fixed	Various	59.75
PWLB	29 Jun 2017	£ 10,000	3.26%	Fixed	29 Jun 2011	24.70
Salix	Various	£ 61	0.00%	Fixed	Various	7-8 years
Deutsche Pfandbriefbank	29-Dec-17	£ 179	2.63%	Fixed	29 Jun 2017	28.00
Market	Various	£326,500	0.23%-0.60%	Variable interest rate	Various	0.08-0.17
Total		**£336,771**				

Rescheduling:-

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

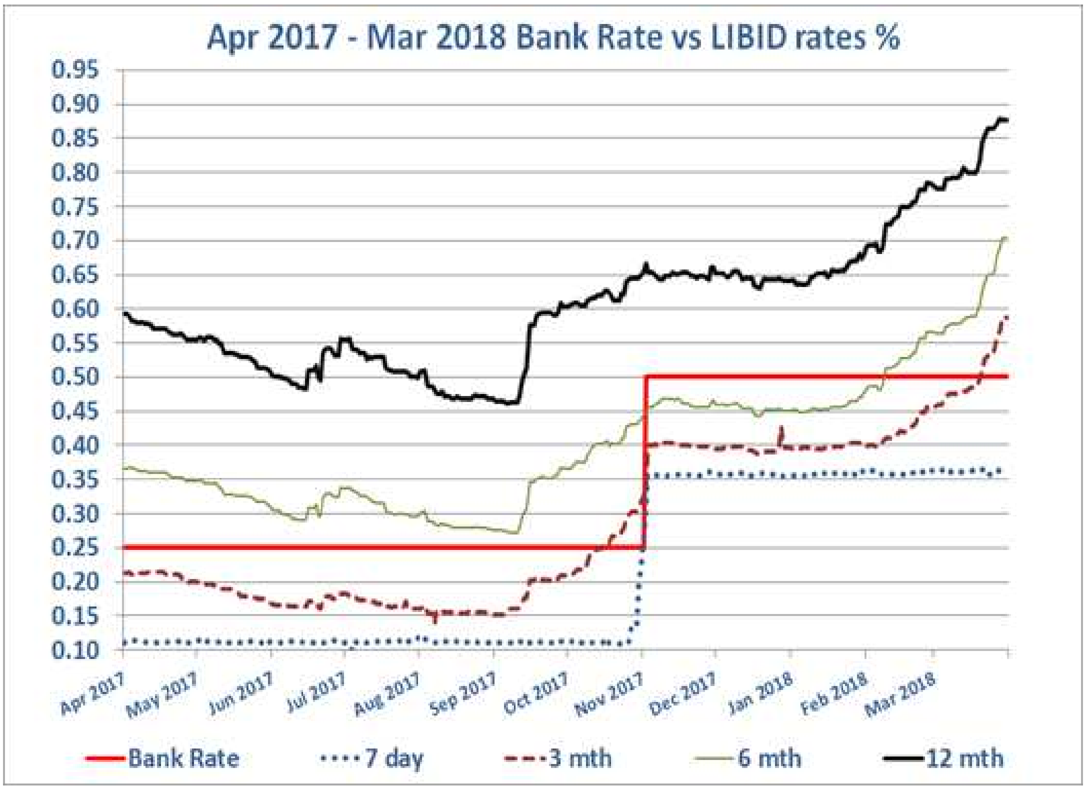
Summary of debt transactions:-

The average interest rate payable on external debt increased from 3.32% to 3.47%. The average life of debt within the loan portfolio lengthened from 24.15 years to 26.45 years.

8. Investment Rates in 2017/18

Investment rates for 3 months and longer have been on a rising trend during the second half of the year in the expectation of Bank Rate increasing from its floor of 0.25%, and reached a peak at the end of March.

Bank Rate was duly raised from 0.25% to 0.50% on 2.11.17 and remained at that level for the rest of the year. However, further increases are expected over the next few years. Deposit rates continued into the start of 2017/18 at previous depressed levels due, in part, to a large tranche of cheap financing being made available under the Term Funding Scheme to the banking sector by the Bank of England; this facility ended on 28.2.18.



Money market fund rates started the year between 0.23%-0.48%, trending at base and sub-base rate levels throughout the year.

9. Investment Outturn for 2017/18

Investment Policy:-

The Council's investment policy is governed by Scottish Government Investment Regulations, which have been implemented in the annual investment strategy approved by the Council on 7 February 2017. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

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

Investments held by the Council:-

The Council maintained an average balance of £84.7 million of internally managed funds. The internally managed funds earned an average rate of return of 0.64%. The comparable performance indicator is the average 6-month LIBID un-compounded rate, which was 0.40%.

10. Performance Measurement

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

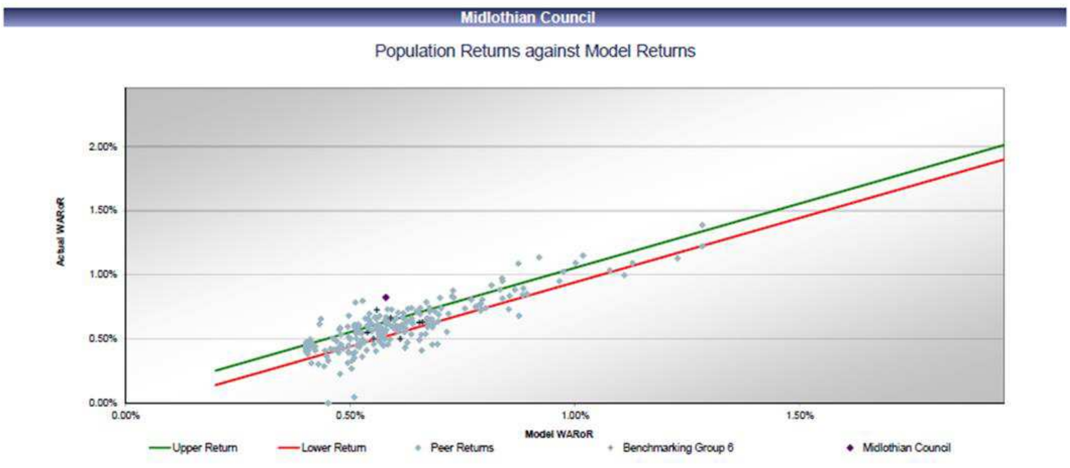
Loans Fund Rate

Combining the interest paid (earned) on external debt (investments) with charges for premiums written off and internal interest allowed into an average Loans Fund Rate, Midlothian's result of 3.24% for 2016/17 was the lowest Loans Fund Rate amongst all mainland authorities in Scotland (see Appendix 1).

The comparative Loans Fund Rate for 2017/18, of 3.08%, is once again expected to be one of the lowest when benchmarked against all mainland authorities in Scotland (note that at present, these benchmark figures are not yet available).

Investment Benchmarking

The Council participates in the Scottish Investment Benchmarking Group set up by its Treasury Management Consultants, Capita. This service provided by Capita provides benchmarking data to authorities for reporting and monitoring purposes, by measuring the security, liquidity and yield within an individual authority portfolio. Based on the Council's investments as at 31 March 2018, the Weighted Average Rate of Return (WARoR) on investments of 0.75% against other authorities is shown in the graph below:-



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	0.83%	0.58%	0.25%	0.52%	0.63%	Above

** Models for 30 June 2017, 30 September 2017 and 31 December 2017 are attached as Appendix 3.*

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

Debt Performance

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

11. Conclusion

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

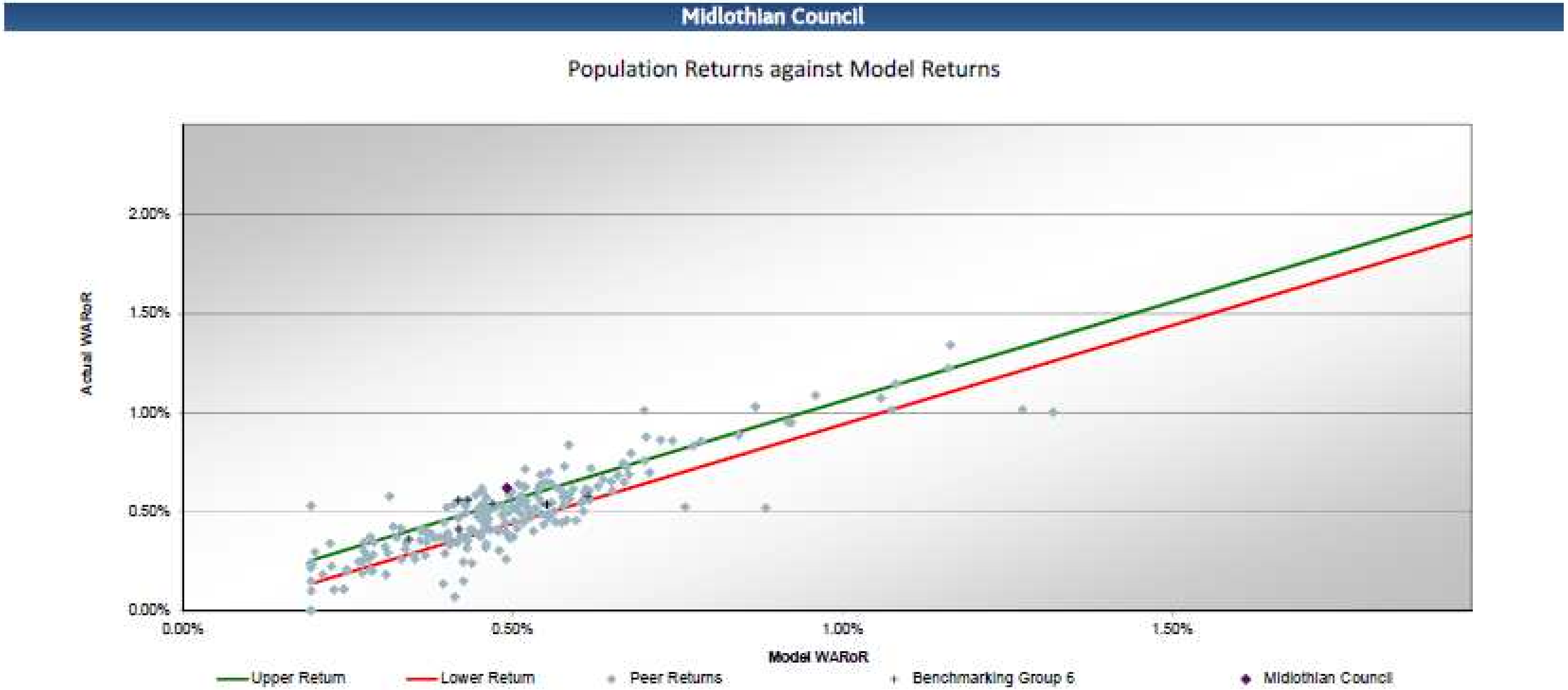
The cost of long term borrowing has been maintained by taking up opportunities to borrow from the PWLB at low interest rates whilst advantage has also been taken of the low rates available for temporary borrowing.

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

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

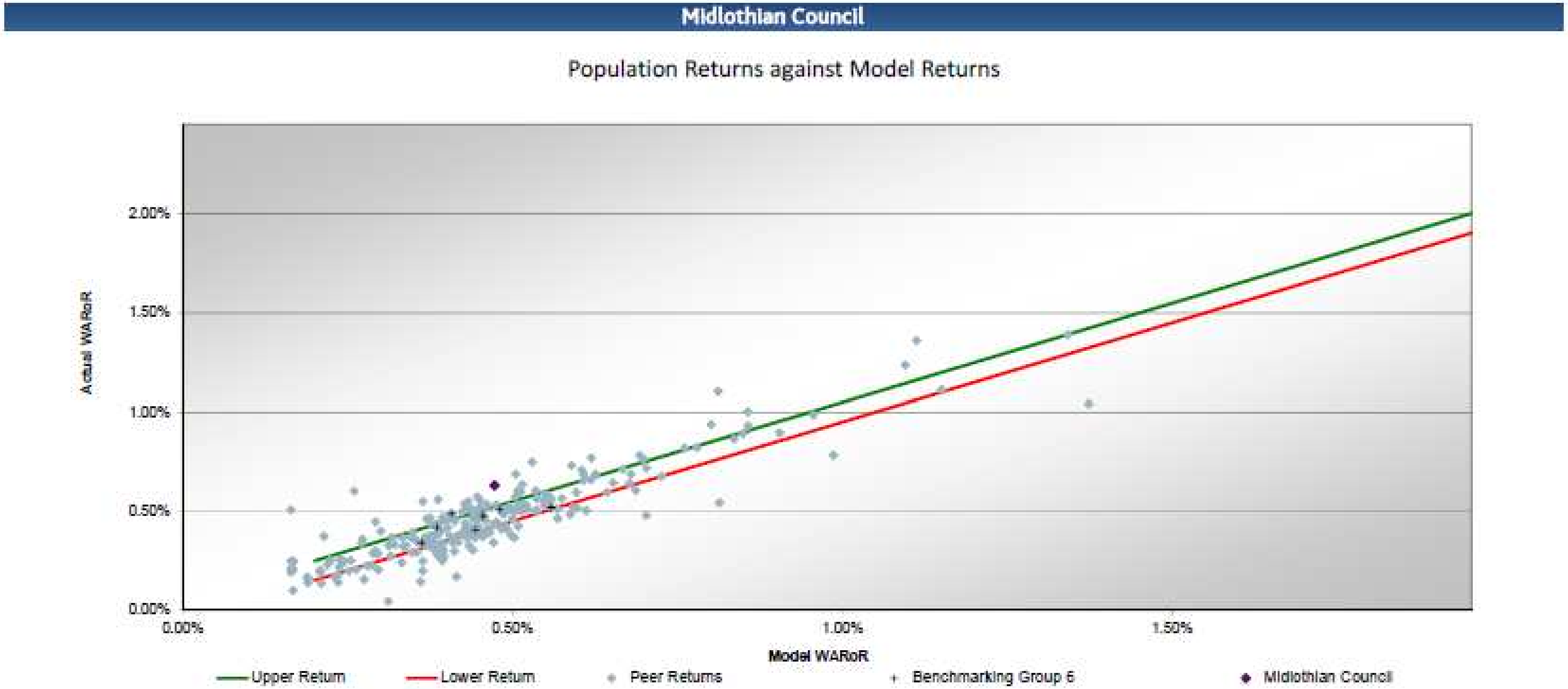
Appendix 3

Midlothian Council Investment Portfolio return as at 30 June 2017



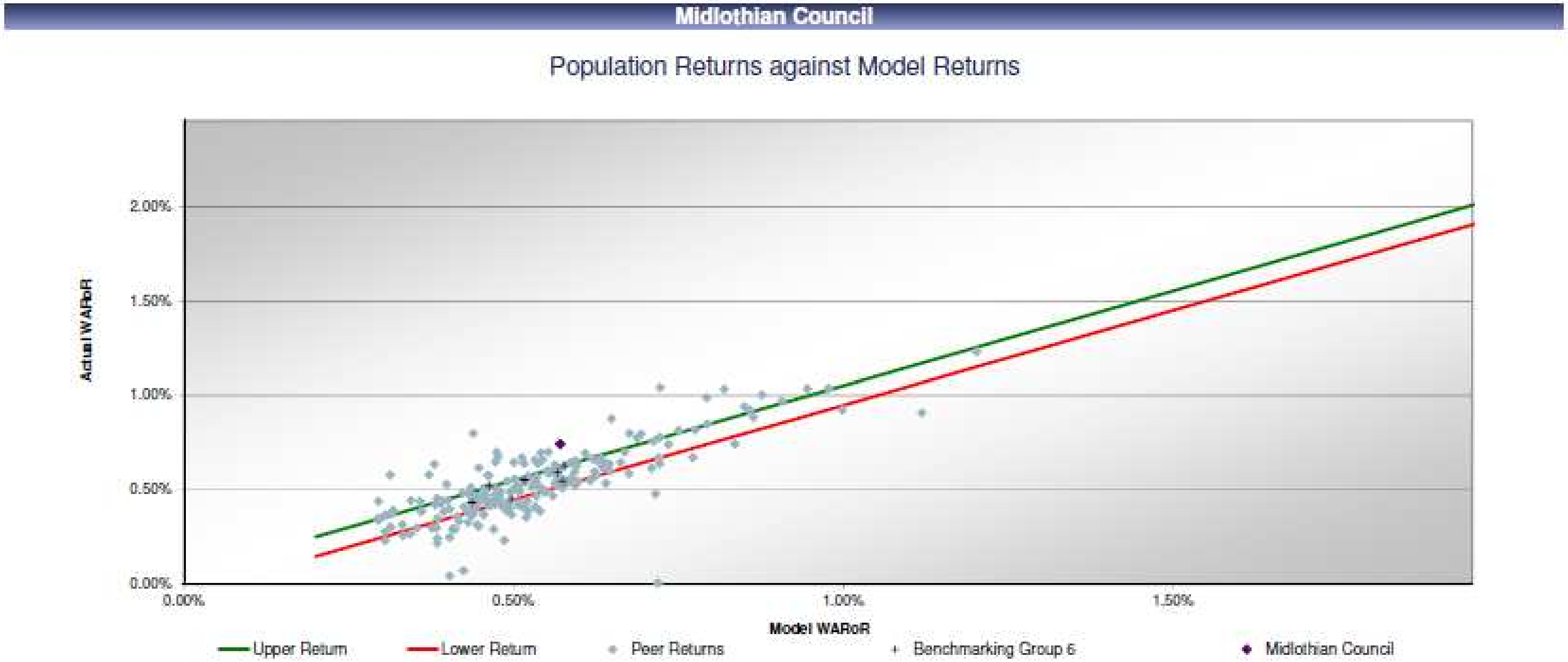
	Actual WA RoR	Model WA RoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	0.62%	0.49%	0.13%	0.43%	0.55%	Above

Midlothian Council Investment Portfolio return as at 30 September 2017



Midlothian Council	Actual WA RoR	Model WA RoR	Difference	Lower Bound	Upper Bound	Performance
	0.63%	0.47%	0.16%	0.42%	0.52%	Above

Midlothian Council Investment Portfolio return as at 31 December 2017



	Actual WARoR	Model WARoR	Difference	Lower Bound	Upper Bound	Performance
Midlothian Council	0.74%	0.57%	0.17%	0.52%	0.62%	Above

Chief Internal Auditor
Jill Stacey

Audit Committee
Tuesday 25 September 2018
Item No: 5.3

Auditor: Amber Ahmed, Ext 3280

Final Internal Audit Report

to

- **Dr Grace Vickers, Chief Executive**
- **John Blair, Director, Resources**
- **Garry Sheret, Head of Property Facilities and Management**
- **William Jackson, Building Services Manager**
- **Greg Vettraino, Capital Contracts Manager Major Works**

on

Social Housing Programme – Phase 2

12 September 2018

1 Introduction

1.1 The purpose of the audit was to review the adequacy of the capital investment control framework established by Management to allow for the successful delivery of the Social Housing Programme.

2 Audit Scope

2.1 The scope of this audit was to focus on Phase 2 of the programme and reviewed the key capital investment processes and controls designed by Management to allow the social housing project to be delivered within cost, timeframe and to the required quality standards. This included a review of the management and control of the following areas:

- project cost, timeframes and quality of build;
- contractors, suppliers and consultants; and
- change, variations and post completion sheets.

3 Management Summary

3.1 The Council commenced a Social Housing Programme with the initial developments delivered from 2006. Phase 1 of the Social Housing Programme delivered 864 houses over a period of 7 years with a total budget of £108.7m and was completed in 2012. The Council is aiming to build a further 1,000 homes by 2022. Phase 2 of the Social Housing Programme is targeted to provide 428 homes with an original budget of £63.663m, funded from the Housing Revenue Capital Account.

3.2 The Council has approved a further 2 Social Housing programmes (Phase 3 and 4) which will follow on from Phase 2. Phase 3 was approved in December 2015 and is envisaged to deliver around 240 homes, to be constructed from a budget of £36m. In June 2017, additional funding from the Scottish Government was approved making the revised budget for Phase 2, £77.121m and Phase 3, £42.208m. Phase 4 was approved in February 2018 with a budget of £94.050m for social housing and £6m for Temporary Accommodation.

3.3 Whilst Phase 1 of the programme was implemented via frameworks for contractors and external design teams, in Phase 2 the Council adopted a design and build contract procurement route. The award of contracts for each separate build in Phase 2 was procured and awarded to two contractors through the housing construction framework. In order to attract more contractors to tender for Phase 3, each site is being tendered separately.

3.4 The following examples of good practice were found:

- Progress reports are reported to Cabinet/Council every 6-12 months and the Service now have regular meetings with Councillors to report on the progress made on housing projects;
- There is a monthly tracking on cost reports against the budget allocated to each site and the Head of Property Facilities Management receives monthly cost and progress reports;
- The design and build procurement approach provides certainty over costs and transfers many of the risks, such as the design, to the contractor who is best placed to manage them; and
- Issues were identified by Management with the inspection undertaken by the Clerk of Works on the complex care home. A Clerk of Works is now employed by the Council to check standards of workmanship and specifications are in accordance with the contract.

3.5 Improvements are required for: audit trails – ensuring that documentation is complete and easily accessible for each housing project; the controls for verifying variations; contract management documentation – ensuring all required documentation is completed appropriately; and the quality checking of progress reports to ensure they are accurate and complete.

3.6 Although the delivery of the Social Housing Programme is off target, in the main due to factors outwith the control of the Council, the controls in place to monitor and report on this are satisfactory. Internal Audit considers that the level of assurance we are able to give is Substantial Assurance.

3.7 The Internal Audit function conforms with the professional standards as set out in the Public Sector Internal Audit Standards (2017), including the production of this report to communicate the results of the review.

3.8 We would like to thank those officers who assisted us during our review.

4 Findings

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref
4.1 Financial loss or reputational damage through the project not delivering affordable housing, not being delivered to original cost, to agreed timescales or to an acceptable quality	Project costs, timeframes and quality of build are adequately monitored by Management	**Timeframes** There is a risk of not achieving the target to provide a further 1,000 new builds by 2022 as the Phase 2 and 3 projects are off target. This risk was highlighted in the March 2018 progress report to Cabinet/Council. The target for Phase 2 was to complete 400-450 homes by the end of December 2017. The number of homes built at the end of December 2017 was 264 - 10 sites have been completed and 3 are still outstanding. Phase 2 is now expected to be completed by October 2019 which indicates a slippage from the original target of December 2017. In September 2016, it was reported that tendering for Phase 3 sites was to commence in October 2016 and the earliest potential construction start on site will be September 2017. However, this was delayed and the tendering for Phase 3 did not commence until March 2018 - 5 Sites have since been tendered. Management advised that there have been issues identifying sites for new builds and it will be necessary to acquire further land for development and/or develop Council owned surplus open space. In addition to this, it is proposed to purchase completed houses from external developers as an additional procurement route.	Satisfactory controls in place though programme timescales not being met due to lack of availability of sites/external factors	
		Progress Reports Six monthly progress reports are reported to Cabinet/Council detailing anticipated completion dates for each project. The progress reports do not highlight any changes from the original target or detail why sites have moved from one phase to the next (e.g. site 109 changing from phase 2 to 3 and site 23 moving from phase 3 to phase 2). Additional funding was received from the Scottish Government in June 2017, making the overall total budget for Phase 2, £77.121m. However, progress reports reported after this date did not include the revised budget. An error was identified in the March 2018 progress report. The progress report indicated that total builds from Phase 2 would be 419 but actual is 428 as one site had changed from 70 to 79 units. Management have advised that officers preparing the report altered the site numbers but forgot to change the total figures.	Satisfactory	5.1

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref
		Cost reports Cost reports for each project are generated monthly by the Project Manager however the Integra report could not be reconciled to the cost reports. There was a lack of information to verify the figures in the cost reports and, in some cases, figures were just noted in the reports with no supporting documentation or calculations.	Satisfactory	5.2
		Audit trails Documentation required for audit testing was not always readily available and there was not always a complete audit trail for each housing project.	Satisfactory with a few exceptions	5.3
4.2 Financial loss or reputational damage through mismanagement of contractors, suppliers and consultants	Management regularly monitor the controls in place over the management of contractors, suppliers and consultants	**Contract Management Documentation** 13 sites from Phase 2 were competitively tendered; however for 2 of these sites additional construction work was undertaken and specialised art work was purchased but a Non-Competitive Action (NCA) form was not completed to explain why the main contractors were not used.	Satisfactory - subject to completion of NCA where applicable	5.4
		For 1 site, there was a change made on a tender document but this was not formally documented in a revised tender report.	Satisfactory – subject to update of tender document	5.5
		A final account is issued at the end of each project after costs have been agreed by all parties. For 1 site, the project was completed in 2013 yet the final accounts have not been completed due to a dispute with the contractor regarding solar panels. It is noted that accounts will not be finalised until issues regarding defects are resolved.	Satisfactory	N/A
		Collateral warranties are provided by the Contractor as part of agreeing costs for the construction work undertaken on a site. For 1 site, a practical completion was signed in 2015 but collateral warranties have not been obtained from the Contractor despite various reminders. This is an ongoing issue and a sum of £20k has been withheld from the Contractor until the collateral warranties are provided.	Satisfactory	N/A

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref
4.3 Poor change control / variation procedures can result in financial loss and /or fraud	There are adequate controls in place over changes, variations and post completion sheets	**Variations** Pre-variations that occur during site investigations are listed in a tender reconciliation report and are presented to the Head of Property and Facilities Management before the contract sum is agreed to show the variations between the tender sum and contract sum. Testing revealed that there was a lack of change control / variations documents showing appropriate authorisation and 1 tender reconciliation report was missing. It was also noted that cost reports detailing variations were sometimes unclear.	Satisfactory	5.6
		Insurance of Buildings A new complex care home was opened in July 2017; however the insurer was not advised of its existence until December 2017 due to a miscommunication between departments. The insurance has been backdated to July 2017 after the insurer confirmed with the Council that no incidents had occurred during the uninsured period.	Satisfactory subject to checklist / prompt list being used to evidence	5.7
		Post Completions checks Practical Completion certificates are signed by the Project Manager at the time of handover who checks to ensure various professionals have complied with relevant building and health and safety requirements. However, it was noted that there is no checklist or prompt list to evidence this.	Satisfactory subject to checklist / prompt list being used to evidence	5.7

5 Action Plan

Rec. Ref No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.1	Quality Assurance checking of progress reports should be undertaken to ensure they are accurate and complete.	**Medium**	Initial indicative forecasts and budgets do change over time, especially with large and complex projects. Whilst there are risks, the Service continually work to overcome these and mitigate the risk. Budget figures will be updated in the progress reports. Quality checks are and have always been taken. Whilst some typos and a computational error were discovered, these can occur even with checking. Normally at least two senior staff members check reports and any official report or calculations/documentation should have a peer review from a construction colleague prior to issue. The reports are also issued to the Head of Property and Facilities Management and Head of Customer and Housing Services.	Capital Contracts Manager Major Works **Complete**
5.2	Costs incurred to date should reconcile with the expenditure on the Integra system and forecast figures should be supported with appropriate documentation.	**Low**	Cost reports can make allowances and may not always reflect exactly what is in Integra and in some instances Officers had not always updated cost figures from Integra. Predicted fees are updated to reflect the actual construction cost on the issue of the final certificate. Whilst there have been oversights, staff need to be more diligent and this has already been stressed. Variances from Integra that were picked up were generally included in the reports but were just not cross referencing exactly. Training has been provided to staff and guidance has been improved in report templates for future reports.	Capital Contracts Manager Major Works **Complete**

Rec. Ref No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.3	Management should ensure documents are readily available and there is a clear audit trail for each housing project.	**Low**	For the most part, documentation was readily available but the filing is extensive and takes time to search through. Each housing project has a separate file, file reference number and a separate cost code which establishes a clear audit trail. Whilst specific project management software would potentially help, the IT difficulties and costs involved would be prohibitive. We are considering adopting the Council's Document Management System (CS10) as housing projects are large and complex with multiple projects. However our test project is proving there are a lot of difficulties to be overcome. Transferring to CS10 may be trialled on some more projects first.	Capital Contracts Manager Major Works, by **September 2019**
5.4	Ensure a Non Competitive Action form is completed for occasions where competitive tenders / quotes are not obtained.	**Medium**	The quote for the additional work was provided by the contractor but the Project Manager obtained a cheaper quote from another contractor and did not have time to obtain 3 quotes due to the risk of delaying the construction work. Significant savings were made to the Council; however extra actions could have been taken to document the process. For the specialised art work, the Officer had been in discussions with Land Services and Planning colleagues and felt this was sufficient, not thinking to submit a NCA form. Staff should be aware of the need for NCAs and this requirement has been reinforced and will be reinforced again in staff training following receipt of the final Internal Audit report.	Capital Contracts Manager Major Works **Complete**
5.5	Any changes made on a tender document should be formally documented and reported with an explanation.	**Low**	Senior staff were fully briefed and aware on tender changes but it would have been better to have it formally reported.	Capital Contracts Manager Major Works **Complete**

Rec. Ref No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.6	Variations should be noted in a control change document with appropriate authorisation. Variations should be clearly demonstrated on the cost reports.	**Medium**	Monitoring variations through the monthly cost reports was seen as a more efficient process of scheduling changes which are monitored by the Capital Contracts Manager, issued to the Building Services Manager and onto the Head of Property and Facilities Management (acting as the Senior Responsible Officer) who personally monitors cost variations. Post contract variations change controls are now in place. Pre-construction change controls have also been put in place.	Capital Contracts Manager Major Works **Complete**
5.7	A checklist or prompt list should be in place to outline what needs to be checked before practical completion is signed off and this should include insurance requirements.	**Low**	Whilst a checklist has been implemented, officers should have the knowledge and wherewithal to investigate and carry out the appropriate checks according to the latest requirements. Construction are not responsible for implementing insurance once a building is handed over. This is a client/user requirement. Housing Services arrange for properties to be added to the insurance register; however the Complex Care unit was considered as social housing and that occupants were tenants. Property & Estates services are normally informed of non-domestic completions and arrange the insurance. Processes are being put in place to prevent such re-occurrence and the Property & Estates service will manage this going forward and will be informed of all completed construction projects.	Capital Contracts Manager Major Works **Complete**

Overall Audit Opinion level and definition

Comprehensive Assurance	Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas might be required.
Substantial Assurance	Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse.
Limited Assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse.
No Assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or misuse is unacceptable. Significant improvements are required.

Recommendation Ratings

Recommendations in Internal Audit Reports are suggested changes to existing procedures or processes, to improve the controls or to introduce controls where none exist. The rating of each recommendation reflects our risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact. The ratings are:

High	Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high to require immediate action within one month of formally raising the issue. The risk should be added by Management to the relevant Risk Register for control and monitoring purposes and included in the relevant Head of Service Annual Assurance Statement.
Medium	Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue.
Low	Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to the attention of Senior Management.
Other	Minor administrative weaknesses posing little risk of error, fraud, financial loss or reputational damage.

The Action Plans in Internal Audit Reports address only Recommendations rated High, Medium or Low. Outwith the Internal Audit Report, we inform Service Management about Other Minor matters to improve internal control and governance.

The recommendations will be input to Pentana performance system to assist with Management tracking of implementation. If responsible owners are unable to achieve the standard timescales for actions please notify the Chief Internal Auditor with the reason for the delay in implementation and the revised timescales to assist with the implementation and follow-up of these recommendations to improve internal control and governance.

Jill Stacey
Chief Internal Auditor

Midlothian

Internal Audit Report

Follow-up Review of Audit Recommendations

Issued: 30 August 2018

Final

Level of Assurance	N/A – Follow-up reviews are not rated.

Table of Contents

Executive Summary

1.0 Introduction

Internal Audit Reports include a section with management actions where recommendations are made to improve upon the existing internal controls and assist the Council achieve best value. These recommendations, following agreement with management, are endorsed by the Audit Committee and are then updated by Internal Audit to the Council's performance management system Pentana Performance with a target completion date set.

Management are responsible for acting on the recommendations by the agreed due date and when complete, closing the issue on Pentana. The Internal Audit plan includes a budget for two follow up reviews in relation to recommendations made. The first reviews management's reported performance in closing issues raised by Internal Audit by the agreed due date (reported in December of each year) while the second looks at a sample of recommendations flagged as closed by management and reviews for the adequacy of the actions taken against each issue. This report addresses the second area.

A sample of **59** audit recommendations were judgmentally selected from the Pentana system which were shown at the 'completed' status and evidence obtained to support the satisfactory completion of each recommendation sampled. This included **18** high priority recommendations, **40** medium priority recommendations, and **1** low priority recommendation.

A sample of recommendations from the following Internal Audits were selected for this review:

Audit Report	Number of Recommendations Included in Review	High Priority	Medium Priority	Low Priority
Arrears	15	4	11	0
Sundry Debt	10	2	8	0
Monitoring of External Care Homes	8	3	5	0
Health and Safety	13	8	5	0
Review of Utilisation of Assets Held Under PPP Contracts	10	1	9	0
Stores	3	0	2	1
Total	**59**	**18**	**40**	**1**

2.0 Objectives of the Audit

The objective of this follow-up audit was to review a sample of recommendations that have been signed off as complete in 2017/18 to determine whether they had been implemented satisfactorily and thus give assurance over the ongoing improvement of internal control.

3.0 Conclusion

We have identified that the majority of audit actions have been completed satisfactorily. However, we have identified that some actions have not been adequately completed.

From the **59** recommendations tested, **52** (88**%**) were found to have been completed satisfactorily, and 7 (12%) were identified as requiring further work (full details of these can be found in **Appendix 1**).

As is standard Internal Audit practice, we have not rated this review since it is a follow-up of previously raised audit recommendations. We have however noted **7** recommendations where we have agreed with management that further improvements can be made.

Appendix 1 - This explains the **7** recommendations identified as not being fully completed.

Appendix 2 - This outlines the recommendations arising from this review with revised completion dates.

Appendix 1 – Recommendations identified as requiring further work

No	Audit	Original Recommendation	Priority	Testing Results and Auditor's Comments
1	Arrears	Clear guidance should be agreed by senior management on how to escalate cases where an employee is refusing to come to an arrangement to repay their debt.	High	Although procedures are in place to identify debt and seek payment for new starts and staff identified through the staff debt data match exercise, there have been no memos to Heads of Service highlighting staff failing to engage in the process since September 2016 and thus no disciplinary action has been taken.
2	Sundry Debt	Invoices should refer to directorates as per the current Council structure and consideration should be given to providing a contact email address on invoices.	Medium	During the follow-up audit work it was identified that invoices were still being issued that referred to 'Corporate Resources' and 'Communities and Wellbeing', Directorates from Midlothian Council's previous corporate structure. As part of the 'Sales to Cash' project work, the layout of fields within the invoice will be reviewed.
3	Sundry Debt	A policy needs to be established, with appropriate guidance from Legal Services, to either refund credit balances or to write these off if the debtor in credit is not traceable.	Medium	The Sundry Debt audit report issued in May 2017 reported that the total balance for Sundry Debt accounts in credit in Integra was £118,378 for 1,518 invoices. £52,283 (604 invoices) related to pre 2012 invoices. As part of the 'Sales to Cash' project work, aged sundry debt credits and the Council's policies for this will be reviewed.
4	Monitoring of External Care Homes	Care home providers should be reminded that the monthly performance reports and accident / incident reports should be sent through the Council's secure email system (Egress).	High	Through discussion with relevant officers it was identified that there is still an issue with some providers and contacts in this area not using Egress.
5	Monitoring of External Care Homes	Monitoring of care homes should be undertaken to ensure they are complying with the new Social Work Model Complaints Handling Procedure.	Medium	Our review identified there was scope to further improve our monitoring in this area.

No	Audit	Original Recommendation	Priority	Testing Results and Auditor's Comments
6	Monitoring of External Care Homes	Management should ensure adequate resource is in place to undertake periodic care plan reviews.	Medium	Residents have a care plan in place with the Care Home. This would normally be reviewed at least 6 monthly by Care Home staff, but could be more frequent depending on the resident's needs. Social Work officers would normally carry out a review of the Care Plan held by the Care Home annually to ensure that the Care Plan is appropriate. It was identified during the audit (issued in November 2017) that there was a backlog of these requiring review. This follow-up review identified that there is still a backlog that needs to be addressed.
7	Review of Utilisation of Assets Held Under PPP Contracts	The contractor should be requested to conduct an annual Customer Satisfaction Survey and report the outcome to the Council	Medium	A customer survey was completed for 2017 and a copy of this was received. A survey for 2018 needs to be requested from the contractor.

Appendix 2 – Further recommendations arising from this review

No	Recommendation	Priority	Manager	Target Date
1	Where staff fail to engage with the staff debt process, the process of issuing memos to Heads of Service to enable disciplinary action to be progressed needs to be re-established.	Medium	Head of Customer and Housing Services	31/12/2018
2	Invoices should refer to directorates as per the current Council structure and consideration should be given to providing a contact email address on invoices.	Low	Operational Support Manager	31/03/2019
3	A policy needs to be established, with appropriate guidance from Legal Services, to either refund credit balances or to update records (write back on the balance) if the customer in credit is not traceable. The aged Sundry Debt credit balances held by the Council should be addressed once the policy is agreed.	Medium	Operational Support Manager	31/03/2019
4	A further reminder should be issued to Care Home Providers to ensure Egress is used when sharing sensitive information. This should continue to be monitored by staff to ensure Egress is used consistently.	Medium	Service Manager, Communities Midlothian Health and Social Care Partnership	31/12/2018
5	In order to get assurance that Care Home providers are complying with the Social Work Model Complaints Handling Procedure, management should implement 1 or more of the following: - annually obtaining a sample of suppliers' Complaints registers and conducting a desk based review; - adding more requirements for Complaints information to be included in the monthly monitoring report; and/or - carrying out a sample review of complaints during Quality Assurance audits.	Medium	Service Manager, Communities Midlothian Health and Social Care Partnership	31/12/2018

No	Recommendation	Priority	Manager	Target Date
6	Management should address the backlog of Care Plans requiring review for Midlothian residents in Care Homes.	Medium	Service Manager, Communities Midlothian Health and Social Care Partnership	31/12/2018
7	The contractor should be requested to conduct an annual Customer Satisfaction Survey and report the outcome to management.	Medium	PPP Services Manager	31/12/2018

<u>Appendix 3</u> - Distribution List

- Members of the Audit Committee
- Grace Vickers, Chief Executive
- John Blair, Director, Resources
- Allister Short, Joint Director, Health and Social Care
- Mary Smith, Director, Education, Communities and Economy
- Gary Fairley, Head of Finance and Integrated Service Support
- Morag Barrow, Head of Primary Care and Older People's Services
- Garry Sheret, Head of Property and Facilities Management
- Kevin Anderson, Head of Customer and Housing Services
- Elizabeth McDonald, HR Business Partner
- Iain Johnston, Procurement Manager
- Jacqui Dougall, Business Services Manager
- Kathleen Leddy, Operational Support Manager
- Chris Lawson, Risk Manager
- Anthea Fraser, Service Manager, Communities Midlothian Health and Social Care Partnership
- Steven Small, PPP Services Manager
- EY, External Audit

Audit Team

Author:	James Polanski	Auditor
Reviewer:	Elaine Greaves	Principal Auditor
Audit Manager:	Jill Stacey	Chief Internal Auditor

Counter Fraud Annual Report 2017/18
Report by the Chief Internal Auditor

1 Purpose of Report

The purpose of this report is to provide an update to the Audit Committee on the Council's counter fraud responsibilities and the activities of the Corporate Fraud team over the past year as part of the arrangements to tackling fraud at the Council.

2 Background

In October 2015, following the transfer of housing benefit investigations to the Single Fraud Investigation Service (SFIS) of the DWP, the Council's counter fraud staff were transferred to the Internal Audit service. The aim of the transfer was to allow the Council to provide a Corporate Fraud Team.

The Council is committed to minimising the risk of loss due to fraud, theft or corruption and to taking appropriate action against those who attempt to defraud the Council, whether from within the authority or from outside, as set out within its counter fraud and corruption policy and strategy.

The primary responsibility for the prevention, detection and investigation of fraud rests with Management, supported by the corporate Fraud & Audit Officers. Internal Audit provides advice and independent assurance on the effectiveness of processes put in place by Management.

Part of the Audit Committee's role is to review the assessment of fraud risks and potential harm to the Council from fraud and corruption, and to monitor the counter fraud strategy, actions and resources.

3 Corporate Fraud Team Activity

3.1 Staff resources have been adversely affected during the year, mostly notably due to the Service Review that was undertaken on the Internal Audit function, the introduction of Shared Services arrangement from December 2017 (Chief Internal Auditor 0.5 FTE – shared with Scottish Borders Council), and the deployment of Internal Audit and Counter Fraud resources to the Roads Contract Management Investigation. This has had an impact on the delivery of the Counter Fraud planned work.

3.2 We have calculated, using Audit Scotland guidance (where relevant) that the Corporate Fraud Team has identified £1,027,288 of savings during 2017/18. These are detailed in Appendix 1. Areas of work undertaken by the Team and the savings identified during 2017/18 are detailed below.

3.3 In carrying out the National Fraud Initiative (NFI) data matching exercise between the Electoral Register and Council Tax Single Person Discount (SPD) records, the Corporate Fraud Team identified 36 overpayments equating to £25,261 of uncollected Council Tax which will provide £29,485 of additional Council Tax annually (as per NFI guidance the latter is an estimate for those future losses that have been prevented). This is an increase from that in the NFI Update 2016/17 report to Audit Committee in December 2017 (£41,248 SPD) as was work in progress and more cases have been investigated since then. Midlothian Council SPD was included as a case study example within the Audit Scotland NFI national report that was published in July 2018.

3.4 The Corporate Fraud Team responded to 34 notifications of Council Tax discounts and exemptions alleged fraud during the year to determine whether these discounts and exemptions are claimed legitimately. The activity highlighted 4 cases where circumstances had changed and Council Tax became payable but the Council had not been informed. This identified a total of £24,321 uncollected Council Tax and £2,980 future losses that have been prevented.

3.5 The Corporate Fraud Team received a query from Housing, made enquiries and gathered information that resulted in a referral to SFIS of the DWP who have notified the Council that this action resulted in a Housing Benefit overpayment of over £14k. This one case also had a £639 Discretionary Housing Payment that was detected.

3.6 The Team has received notifications from Housing Officers during the year to detect and investigate potential subletting or abandonment of Council owned properties. As a result of this, 54 allegations of potential tenancy fraud were investigated; ten of which resulted in the return of a property to the housing stock which were subsequently made available to those in genuine need. The saving for each of the houses, calculated according to Audit Scotland guidance, is £93,000 over 4 years.

3.7 The Corporate Fraud Team has delivered a Fraud Awareness training session to the Homelessness team, and delivered a Use of Social Media training session to the Revenues Arrears team. In addition fraud awareness-raising posters were circulated across the Council and media releases made to local press in order to encourage reporting of suspected frauds through the existing whistleblowing arrangements.

3.8 As part of the Internal Audit function, the Corporate Fraud Team has assisted with various audits during the year (including Purchasing Cards, Accounts Payable, and Construction Industry Scheme), providing their view on the potential fraud risk aspects of areas under review and performing compliance testing.

3.9 The Corporate Fraud Team has dealt with 53 enquiries from the Midlothian Council website page “Report a possible crime, fraud or similar concern” or the anonymous telephone reporting line which are available to staff or the public for whistleblowing purposes.

3.10 As specialist investigators, the Team has conducted significant and comprehensive work in respect of the Roads Contract Management Investigation, liaised with Police Scotland as required, and recommended improvements to reduce risks.

3.11 The Fraud & Audit Officers are members of the Scottish Local Authority Investigators Group (SLAIG) and represent Midlothian Council at SLAIG's quarterly meetings, therefore sharing best practice across Councils and the wider public sector and ensuring knowledge of emerging fraud risks and issues is up to date.

3.12 The Fraud & Audit Officers are part of the Council's Integrity and Contest Groups, relating to Serious and Organised Crime and Counter Terrorism. A member of the team acts as the Single Point of Contact for Midlothian Council with Police Scotland for Serious and Organised Crime Groups.

3.13 In conclusion, the Corporate Fraud Team has been successful in achieving the outcomes and making best use of resources to support Midlothian Council's objective of protecting the public purse as set out within its counter fraud and corruption policy and strategy.

4 Report Implications

4.1 Resource

There are operational costs of resourcing the two Fraud & Audit Officers (1 FTE counter fraud) within the Internal Audit service. Any additional costs arising from enhanced fraud risk mitigation within the Council's Services will have to be considered and prioritised against other pressures in the revenue budget.

4.2 Risk

The report sets out primary responsibility for the prevention, detection and investigation of fraud that rests with Management, and directly addresses fraud risk and outcomes arising from work undertaken by the Corporate Fraud Team to reduce the risks within the Council.

4.3 Single Midlothian Plan and Business Transformation

Themes indirectly addressed in this report:

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

4.4 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan (Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the gap in economic circumstances) by preventing and detecting fraud additional resources might be available to support the Council's objectives. Any loss of funds due to fraud and corruption might impact on the ability of Midlothian Council to achieve its priorities.

4.5 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit and Corporate Fraud work during the year assists the Council in improving its performance and outcomes which are designed to maintain and / or enhance fraud prevention and detection controls.

4.6 Adopting a Preventative Approach

Having a robust fraud prevention and investigation service contributes to safeguarding the Council's financial resources, for delivery of services, as part of protecting the public purse. Specific compliance and data matching work within the 2018/19 planned Corporate Fraud activity, approved by this Committee in March 2018, will assess fraud, theft, and corruption prevention and detection controls.

4.7 Involving Communities and Other Stakeholders

This report outlines outcomes arising from work undertaken by the Corporate Fraud Team, some of which arose from whistleblowing received from those within communities or other stakeholders.

4.8 Ensuring Equalities

There are no equalities issues with regard to this report.

4.9 Supporting Sustainable Development

There are no sustainability issues with regard to this report.

4.10 IT Issues

There are no IT issues with regard to this report.

5 Recommendations

The Audit Committee is therefore asked to consider the counter fraud work undertaken by the Corporate Fraud Team during the year to 31 March 2018, in support of the Council's counter fraud and corruption policy and strategy, and note the outcomes.

Date: **16 August 2018**
Report Authors: **Jill Stacey, Chief Internal Auditor**
E-Mail: **Jill.Stacey@midlothian.gov.uk**

Appendix 1 – Savings arising from Corporate Fraud Team activity

Actual Fraud Detected in 2017/18

Activity	**No. of Matches (NFI) or Referrals**	**No. with Fraud Detected**	**£ value Fraud Detected**	**£ value Future Losses Prevented**	**£ value Total Savings**
NFI 2016/17 Single Person Discount – Electoral Register Match. Exercise carried out from April 2017 to March 2018	2,679	36	£25,261	£29,485	£54,746
Investigations carried out resulting in Savings for Council Tax	34	4	£24,321	£2,980	£27,301
Investigations carried out resulting in Savings for Housing Benefit	1	1	£14,602		£14,602
Investigations carried out resulting in Savings in Discretionary Housing Payments	1	1	£639		£639
54 referrals resulting in investigations which recovered 10 Council houses and return to available housing stock. Value per Audit Scotland guidance (£93,000 over 4 years each).					£930,000
Total Savings identified as a result of Corporate Fraud Activity					**£1,027,288**

It should be noted that a single referral could lead to investigations relating to a number of different types of fraud.

Midlothian

Risk Management, Update for 1 April 2018 – 30 June 2018

Report by Chris Lawson, Risk Manager

1 Purpose of Report

Audit Committee has requested regular reporting on the Council's Strategic Risks. The Strategic Risk Profile seeks to provide a strategic look at the current issues, future risk and opportunities facing the Council at a specific point in time.

The purpose of this report is to provide Audit Committee with the 2018/19 quarter 1 strategic risk management update, covering the period 1 April 2018 to 30 June 2018.

2 Background

Midlothian Council continues to face challenges particularly around delivering a wide range of services to local communities with reducing budgets. The Council has done much to reduce spend while continuing to deliver services to our local communities. Transformational change has, and continues to be vitally important to the Council as it seeks to improve local outcomes with less money. Implementing successful transformation programmes can be challenging; audit work carried out in 2014 and a follow up audit action report in 2017 identifying areas for improvement.
The Accounts Commission report, Local government in Scotland – 'Challenges and Performance 2018' suggests that Midlothian Council has low general fund reserves and high savings targets for the transformation plans which will be challenging to meet. Not delivering expected savings could mean the general fund reserve falls or is depleted completely.

The Financial Monitoring 2017-18 General Fund Revenue report to Council on 26 June 2018 highlighted the current level of reserve of just above the recommended 2% minimum level at £4.3m. The continued financial outlook is challenging, with uncertainty associated with future years grant settlements, pay awards, the economic impact of Brexit and the potential costs as a consequence of the Limitation (Childhood Abuse) (Scotland) Act 2017. In addition the current projected budget gap for 2019/20 exceeds the level of reserves. While reserves have been used by a number of Council to manage budget shortfalls the current level of reserve and budget gap mean this is not a viable solution.

The UK decision to leave the European Union has seen some public organisations such as the NHS setting out the contingency arrangements they are beginning to implement in preparation for a no deal.

This is an area which Council Services will need to start giving consideration to, particularly where there are business critical functions/services reliant on goods or services from within the EU. Councillors and Senior Management, working closely with communities, will continue to be faced with difficult decisions on where limited resources should be allocated. It is therefore important the impact of these decisions on communities are transparent and understood.

2.1 Strategic Risk Profile update

The on-going risk associated with financial stability and balancing the budget in future years remains, with the change programme the most significant factor in seeking to identify and deliver on the reduction in expenditure and increased income generation needed to ensure the Council can balance its budget in future years.

2.2 The Scottish Governments planned legislation to restructure the governance of schools, Education (Scotland) Bill 2017, has been postponed with an agreement reached with COSLA intended to deliver the principles of school empowerment and achieve a teacher led education system without legislation.

2.3 Following the UK decision to leave the European Union the Council were advised of potential impacts in a report taken to Council with a focus on EU funding, broader economic impacts, societal, environmental and regulatory issues.

2.4 Strategic Risk Profile Summary

The Top Strategic Issues are summarised in table 1.

Top Issues	Likelihood	Impact	Score	Evaluation	
Financial Stability	5	5	25	Critical	
The Change Programme	5	5	25	Critical	
Welfare Reform	4	4	16	High	

The Strategic Risks for the Council are summarised in tabled 2 below.

Strategic Risks	Likelihood	Impact	Score	Evaluation	
Balancing budget in future years	5	5	25	Critical	
Growing Council	4	5	20	High	
Scottish Abuse Inquiry	5	4	20	High	
Historic Abuse Claims Project	4	5	20	High	
The Long Term Change Programme	4	4	16	High	
Review of Pay and Grading	4	4	16	High	
Information Security	3	5	15	Medium	
Health and Safety	3	5	15	Medium	
Political uncertainty – Education Governance Review	3	4	12	Medium	
Integration of health and social care	3	4	12	Medium	

Strategic Risks	Likelihood	Impact	Score	Evaluation	
UK decision to leave the EU	3	4	12	Medium	
Governance and standards	3	4	12	Medium	
Employee performance	3	4	12	Medium	
Emergency planning and business continuity	3	4	12	Medium	
Climate change	3	3	9	Medium	
Legal and regulatory compliance	3	3	9	Medium	
Working with other to deliver outcomes	3	3	9	Medium	
Asset management	3	3	9	Medium	
Internal control environment	3	3	9	Medium	
Corporate policies and strategies	2	3	6	Low	

The Strategic Opportunities for the Council are summarised in table 3.

Strategic Opportunities	Likelihood	Impact	Score	Evaluation	
Growing Council	5	5	25	Critical	
City deal	5	5	25	Critical	
Shawfair	5	4	20	High	
Borders rail	5	4	20	High	
Easter Bush - Penicuik	5	4	20	High	
Creating a world Class Education System	4	5	20	High	

2.6 STRATEGIC ISSUES – RATED CRITICAL AND HIGH

2.6.1 Financial Stability

The Financial Strategy Report to Council on 26 June 2018 set out updated projections for future years and the timeline and governance to arrive at the 2019/20 budget. This next update report to Council will be in October 2018 which will more fully articulate the impact of the Change Programme.

2.6.2 The Change Programme

The balanced budget approved on 13 February 2018 incorporated a range of savings which form the Change Programme and the delivery of the 2018/19 outturn within the approved budget which is highly dependent on the delivery of the Change Programme.

Monitoring the oversight of the Change Programme is delivered through dashboard reporting prepared by each Head of Service and reported (6 weekly) to the Business Transformation Board and the Business Transformation Steering Group. This is in addition to continued quarterly financial reporting by Financial Services.

2.6.3 Welfare Reform

The Universal Credit Programme closed gateways for legacy benefits, so existing benefits are no longer eligible for all new benefit claimants, except pension benefits. The migration of those remaining claimants on current benefit types continues until the digital rollout is complete for all of UK. The risk of income disruption to housing rent payments and Council Tax Reduction scheme is evident in the increased arrears, although this is currently within the bad debt provision anticipated.

2.7 STRATEGIC RISKS – RATED CRITICAL/HIGH

2.7.1 Balancing budget in future years

The updated Financial Strategy was presented to Council 26 June 2018 which set out the timetable to bring forward further Change Programme proposals for 2019/20 to both allow engagement and allow Council to set its budget before 11 March 2019

2.7.2 Growing Council

Midlothian Council has been identified in 2018 as the fastest growing Council in Scotland with a projected population growth of 26% between 2014 -2039. This would see the population of Midlothian grow from 86,220 – 108,369 by 2039. The growth is expected to see the 0-15 population increase by 20%. The fastest rate increase is expected in the 75+ population with a projected 106% increase between 2014 and 2039. Failure to resource and plan for these rises will significantly impact the Councils ability to fulfil its statutory obligations in relation to these groups.

To plan for the impact this growth will have on the school estate, Education have developed a Learning Estate Strategy to address the expected pressures from this and other known Government policies which will impact on capacity requirements within schools. Any delays in delivering the Learning Estate Strategy could impact on the Council's ability to respond effectively to future pupil growth projections.

2.7.3 Scottish abuse inquiry and Abuse Claims

The Council have an Abuse Inquiry Project Team and a Claims Project Team to support the Council to prepare for information requests to support the Inquiry and in preparation of any claims that may arise.

A communications plan and training plan are in place. A web page is available to provide information on the Limitation (Childhood Abuse) (Scotland) Act 2017 and guidance for childhood abuse survivors on claiming compensation.

2.7.4 Review of pay and grading

During 2016 Midlothian Council made an investment of £2.67million to reduce in-work poverty. While enabling the Council to achieve a position where all employees were paid at or above the national living wage, there was a desire to secure improvements in flexibility, productivity and service quality as a result of this investment.

While the employee grades, terms and conditions altered by these changes have now taken place, the risk to the Council is that following this substantial investment it does not realise the return in improved productivity and or flexibility across the workforce. The impact of pay and grading review is being kept under review by the Investing in our Workforce Project Board, with a focus on securing the gains.

2.7.5 The Long Term Change Programme

The strands of work that will continue to be necessary to address the projected budget shortfalls in the medium term, encompassing:-

- Business Transformation Steering Group;
- The Delivering Excellence programme;
- The Transformation Programme;
- The EWiM programme;
- An updated Capital Strategy and Reserves Strategy;
- Operational savings encompassing financial discipline measures;
- The development of further savings options for 2018/19 and beyond.

2.8 STRATEGIC OPPORTUNITIES

2.8.1 Shawfair

The Shawfair development with its new Rail link provides a major incentive for house builders, employers' retail and commercial interests including opportunities to secure a low carbon community through district heating from Zero Waste.

2.8.2 Borders Rail

Regeneration of priority communities of Midlothian through which the railway passes.

The line provides ready access to education/training at Edinburgh College, Borders College and Queen Margaret University with improved access to the labour markets in Edinburgh and the Borders. Also an opportunity to encourage sustainable travel by residents of major new housing developments in the rail corridor.
Ensuring Midlothian secures appropriate levels of Blueprint funding from the multi-agency Borders Rail 'Blueprint' funding group.

2.8.3 Easter Bush

Fast growing opportunities in Science Technology Engineering and Mathematics (STEM) with opportunities to link with education. Partnership links to schools and university sector at the 'Bush' to promote STEM.

2.8.4 City Deal

South East Scotland Region City Deal - bid for funding to Scottish and UK Governments to accelerate economic growth through investment in infrastructure/ housing/ skills and innovation was agreed by Council in June 2018.

2.8.5 Fastest Growing Council

Midlothian Council has been identified in 2018 as not only the fastest growing Council in Scotland in recent years, but projections show it will remain so, possibly for a further ten years.

This brings the opportunity to support the Council vision of being 'A Great Place to Grow'. As a growing Council this brings the opportunity to redevelop parts of Midlothian, improve infrastructure with a focus on area targeting, improving economic opportunities, improving education and health outcome.

This growth creates the opportunity to meet the housing need with 25% of new homes being built in the affordable housing sector, in addition to the expansion in Council House building. This construction will directly support employment in construction and will see a steady increase in the volume of Council tax received over time.

2.8.6 Creating a world Class Education System

The Centres of Excellence model is a core part of the Council's strategy to create a world-class education system in Midlothian. The newly built Newbattle high school opened its doors to pupils on 5 June 2018. This ambitious project is designed to deliver excellence and equity with a particular emphasis on interrupting the cycle of poverty.

3 Report Implications

3.1 Resource

There are no direct resource implications in this report although individual risks will have associated resource implications.

3.2 Risk

The Strategic Risk Profile seeks to articulate the significant issues, risks and opportunities facing the Council at a specific point in time. The Risks reported are generally those that impact on all parts of the Council and the strategic priorities of the Council. It appears that the presence of risk is understood and action is being taken to manage and respond to risk on an ongoing basis by officers.

The risks referred to in this report are set out within the Council's Strategic Risk Profile, attached as Appendix 1.

3.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

3.4 Impact on Performance and Outcomes

The purpose of the Council's risk management approach is to support a level of risk awareness, to inform decision making and support the Council to deliver on its key outcomes by highlighting and taking steps to mitigate potential disruption to delivery of services.

3.5 Adopting a Preventative Approach

The Risk Management approach being taken by the Council is founded on a preventative approach to managing risks, where appropriate and more generally to decision making with far greater risk awareness.

3.6 Involving Communities and Other Stakeholders

Consultation has taken place with Senior Managers responsible for leading responses to key Strategic Issues, Risk and Opportunities.

3.7 Ensuring Equalities

There are no direct equalities issues arising from this report.

3.8 Supporting Sustainable Development

Senior Managers must ensure the sustainability of the Council, which entails identifying, understanding and managing Strategic and Service level Issues, Risks and Opportunities.

3.9 IT Issues

No additional issues other than those relating to the Strategic Risk Profile.

4 Recommendations

Audit Committee is invited to:

Note the quarter 1 2018/19 Strategic Risk Profile report and consider the current response to the issues, risks and opportunities highlighted.

Date: 05 September 2018

Report Contact:
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Background Papers: **Appendix 1** Strategic Risks Profile Quarter 1 2018/19

Appendix1

Strategic Risk Profile Quarter 1 2018/19

ISSUES

SRP.IR.02 The Change Programme

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.02	**Risk cause** Change programme that doesn't address the budget shortfall; The Change Programme does not achieve the projected savings **Risk event** Delayed progress in applying various strands of the Change Programme including the Delivering Excellence framework. **Risk effect** Slow or delayed proposals/savings arising from service redesign. Potentially further eroding reserves or requiring short term service reductions which impact on the Council's ability to deliver against its priorities.	Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; . Head of Primary Care and Older People's Services; Ian Johnson; Joan Tranent	1. Change Programme including Delivering Excellence framework which addresses projected budget shortfalls. 2. Delivering Excellence Management Tools to support the application of the framework. 3. Section 95 Officer has sought assurance from Heads of Service that the 2018/19 saving proposals are deliverable: . Financial Strategy. . Leadership from Executive Team and Senior Leadership Group. . Appropriated governance in place across the Change Programme. . Links between Change Programme and Workforce Plans . Resilience planning. . Senior Leadership Group regularly considering Change Programme and budget position. . Capacity to deliver change. 4. Health and Social Care transformation board monitoring the 12 transformation strands on a monthly basis.	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.IA.02.01	Developing and implementing a Change Programme to ensure long term financial sustainability.	**Q1 18/19**: Monitoring the oversight of the Change Programme through the Change Programme Dashboard prepared by each Head of Service and reported (6 weekly) to the Business Transformation Board and the Business Transformation Steering Group. Supported in addition to continued quarterly financial reporting by Financial Services. The Financial Strategy Report to June Council set out updated projections for future years and timeline and governance to arrive at 2019/20 budget. This next update report will be in October 2018 which will more fully articulate the impact of the Change Programme.	John *Blair; Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Mary *Smith; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; Ian	31-Dec-2018	

			Johnson; A.Short (Joint Director Midlothian Health and Social Care Partnership); Joan Tranent		
SRP.IA.02.02	Bottom up Service Reviews - Phase 1	**Q1 18/19**: Bottom up Service review - remit of working group and proposed initial 3 phases of review programme set out in report to Council, June 2018.	Ricky *Moffat; Garry *Sheret	31-Mar-2019	

SRP.IR.06 Welfare Reform

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.06	**Risk Cause:** New Universal Credit scheme introduced by UK government replacing legacy benefit schemes with a single scheme. **Risk Event:** Universal Credit (UC) Live Service was introduced in Midlothian for newly unemployed single claimants, with or without housing costs, in Dalkeith and Penicuik Jobcentres from 27 April 2015. Universal Credit Full Service is being rolled out in Midlothian on 22 March 2017. **Risk Impact:** The Universal Credit Programme will close gateways for legacy benefits, so existing benefits will no longer be eligible, as Universal Credit rolls out as plans for the migration of those remaining claimants on current benefit types once the digital rollout is complete for all of Great Britain. Potential for larger numbers of people/families falling in to arrears on rent and those requiring discretionary payments.	Kevin Anderson	1. Applying discretionary housing payment to offset full impact of under occupancy charge (also known as bedroom tax) 2. Work with 3rd sector to mitigate individual case circumstance were applicable. 3. Scottish welfare fund available for hardship cases, emergency food packs available a relevant council offices. Food banks in operation within Midlothian. 4. Protocol established and in operation where families with children fall into arrears.	4	4	

SRP.IR.07 Financial Sustainability

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.07	**Risk cause** Reduction in long term funding from Scottish Government Increasing ageing population of over 75's Increasing population of 0-15 age group Rising customer expectations **Risk event** Change Programme and the flexibility available to Councils as part of the grant settlement does not address future years projected budget gaps **Risk effect A shortfall and or slow** or delayed savings arising from the Change Programme. Potentially further eroding reserves or requiring short term service reductions which impact on the Council's ability to deliver against its priorities.	Gary Fairley	1. Medium term Financial Strategy and multi-year Change Programme. 2. Maintaining a level of reserves to deal with unforeseen or one off cost pressures. 3. Sustainable Capital Strategy. 4. Continued work with Strategic Leadership Group to ensure financial sustainability. 5. Programme monitoring - continual reassessment of grant settlement prospects by the Finance Team. 6. Review of Capital Strategy, General Services Capital Plan and Reserves Strategy. 7. Working through COSLA to influence government spending decisions to influence Scottish Government's budget allocation to Councils.	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.IA.02.01	Developing and implementing a Change Programme to ensure long term financial sustainability.	**Q1 18/19**: Monitoring the oversight of the Change Programme through the Change Programme Dashboard prepared by each Head of Service and reported (6 weekly) to the Business Transformation Board and the Business Transformation Steering Group. Supported in addition to continued quarterly financial reporting by Financial Services. The Financial Strategy Report to June Council set out updated projections for future years and timeline and governance to arrive at 2019/20 budget. This next update report will be in October 2018 which will more fully articulate the impact of the Change Programme.	Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; . Head of Primary Care and Older People's Services; Ian Johnson; Joan Tranent	31-Dec-2018	

RISKS

SRP.RR.01 Balancing Budgets in future years

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.01	**Risk cause:** Reduction in long term funding from Scottish Government Increasing ageing population of over 75's Increasing population of 0-15 age group Population growth and time lag to fund pressures on public services. Policy decisions by UK & Scottish Governments which are not fully funded. Non or delayed savings from planned activities. Future year pay award settlements and implications of living wage increases. Inflation, interest rates, tax, income levels, service demand Rising customer expectations **Risk event:** Reducing grant settlement. Policies decisions at Government level not fully funded to Council's. Securing the extent of change required in order to deliver financial sustainability and a change program that recognises the size of the challenge. Cost pressures exceeding budget estimates. **Risk effect:** Gap in Council budget between budget commitments / pressures and funding level and inadequate options presented to address this, resulting in a structural deficit	Gary Fairley	1. The Financial Strategy to 2022-23 2. Delivery and expansion with further options presented to Council autumn 2018. Change Programme including the Delivering Excellence framework developed for the new Council Administration. 3. Maintaining a level of reserves to deal with unforeseen or one off cost pressures. 4. Draft Capital Strategy to June Council 5. Working through COSLA to influence government spending decisions to influence Scottish Government's budget allocation to Councils. 6. Consider a lobbying strategy with government to recognise the unique position Midlothian Council is in.	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.01.01	Developing and implementing a Change Programme to ensure the long term financial sustainability.	**Q1 18/19**: Monitoring the oversight of the Change Programme through the Change Programme Dashboard prepared by each Head of Service and reported (6 weekly) to the Business Transformation Board and the Business Transformation Steering Group. Supported in addition to continued quarterly financial reporting by Financial Services.	Gary Fairley	31-Dec-2018	

		The Financial Strategy Report to June Council set out updated projections for future years and timeline and governance to arrive at 2019/20 budget. This next update report will be in October 2018 which will more fully articulate the impact of the Change Programme.			
SRP.RA.01.02	Maintaining and ensuring sustainability of growth in asset base	**Q1 18/19**: Fundamental review of Capital Strategy and Capital Plan reported to Council June 2018	Gary Fairley	31-Oct-2018	

SRP.RR.02 The Long Term Change Programme

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.02	**Risk cause** A change program that doesn't address the budget shortfall or contextual factors relating to the Midlothian area Reduced resources Leadership fit for the future Lack of clarity or clear compelling vision for the future Delay or shortfall in securing savings Lack of or not securing transformational change in service provision **Risk event** Delayed progress in applying various strands of the Change Programme including Delivering Excellence Framework Slow benefits realisation and budget savings Cuts in service provision rather than service transformation **Risk effect** Objectives of change not actually met Adverse impact on services Slow or delayed proposals/savings arising from service redesign. Potentially further eroding reserves or requiring short term service reductions which impact on Council's ability to deliver against its priorities. Staff morale negatively affected, Government step-in Short term savings instead of transformation	Gary Fairley	1. Financial Strategy and Change Programme 2. Leadership from Executive Team and Senior Leadership Group. 2. Appropriated governance in place across the Change Programme. 3. Links between Change Programme and Workforce Plans 4. Resilience planning. 5. Senior Leadership Group regularly considering Change Programme and budget position. 6. Capacity to deliver change.	4	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA - 02.02	Continue to provide medium term financial projections to Council.	**Q1 18/19**: Updated Financial Strategy presented to Council in June 2018 which includes details of Change Programme to allow engagement. Bottom up reviews agreed by council in June 2018.	Gary Fairley	31-Mar-2019	

SRP.RR.03 Legal and Regulatory Compliance

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.03	**Risk cause** Current or new legislation applying to Midlothian Council **Risk event** Council and or Services not identifying all applicable legislation impacting Council activities and Service requirements. **Risk effect** Council failing to meet its statutory obligations resulting in a potential negative impact for service users or employees. Reputational impact of not meeting statutory obligations.	Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; . Head of Primary Care and Older People's Services; Ian Johnson; Joan Tranent	1. Directors and Heads of Service responsible for identifying applicable legislation and propose Council or Service responses to CMT and Cabinet/Council as required. 2. Annual Assurance Statement. 3. Internal Audit testing of internal controls as part of risk based audit plan. 4. External Audit. 5. Statutory Inspection. 6. Local Scrutiny Plan - Report to Council 8 May 2018.	3	3	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.03.01	Legal & Regulatory Compliance	**Q1 18/19**: Heads of Service ensuring compliance with statutory obligations and making CMT, Cabinet/Council aware as required.	Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; . Head of Primary Care and Older People's Services; Ian Johnson; Joan Tranent	31-Mar-2019	
SRP.RA.03.02	Governance Statement and Annual Assurance arrangements	**Q1 18/19**: Directors and Heads of Service progressing the actions in the annual governance statement and assurance arrangements.	Maria *Lloyd; Ricky *Moffat;	31-May-2019	

			Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; . Head of Primary Care and Older People's Services; Ian Johnson; Joan Tranent		
SRP.RA.03.03	Demographic Growth	**Q1 18/19**: The Council has prepared a Learning Estate Strategy to reflect the projected growth in demand through to 2040.Capital Strategy to set out infrastructure required to meet those demographic pressures will be presented to Council June 2018	Maria *Lloyd	31-Jul-2020	
SRP.RA.03.05	Participatory Budgeting	**Q1 18/19**: Development of a strategy or action plan to comply with requirements.	Ian Johnson	31-Mar-2021	
SRP.RA.03.06	Education Act 2000 to be repealed.	**Q1 17/18:** Education Service have implemented the Education Act 2016 which requires mandatory reporting on closing the attainment gap, duty to collaborate in new regional collaborative.	Maria *Lloyd	31-Mar-2019	

SRP.RR.04 Employee performance

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.04	**Risk cause** Employees not suitably qualified or developed for the roles required of them. limited availability of qualified practitioners in certain sectors Change program not informed by all key stakeholders Ageing work force Employees unclear on expected behaviours. Employees constrained to innovate as a result of management practice Employee productivity rate below the required level because of ineffective use of the People Policies particularly Maximising Attendance **Risk event** Employees not engaged/consulted as part of organisational transformation.	Marina Naylor	1. Focus on having the right people, here, healthy, performing, behaving and well led. 2. 'A Great Place to Grow' our values including respect ,collaboration, pride and ownership 3. Effective and progressive People Policies in place 4. Making performance matter 5. A range of initiatives to keep staff informed of change (In brief, Staff Magazine, Espresso Sessions for Managers on new People Management Policies) 6. Workforce planning 7. Investing in our workforce board 8. Healthy Working Lives Gold Award 9. Occupational Health provision in place 10. Employee Assistance and Physio therapy services to support employee health and attendance 11. Forward looking and progressing People Policies 12. Workforce strategy action plan	3	4	

	Experienced employees leaving the organisation Unacceptable behaviours demonstrated by employees Stated organisational culture not consistently reinforced by managers Poor employee performance will stifle transformational change **Risk effect** Difficulties recruiting the right staff Challenges retaining quality staff Low skill levels Low morale, especially during change High absence rates, loss of experience in service areas. 'A Great Place to Grow' our values including respect ,collaboration, pride and ownership not realised, potentially resulting in missing the opportunity to capitalise on the abilities, experience and ideas of team members. Poor employee performance will Exacerbate the financial challenge					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.02.03	Workforce Strategy	**Q1 18/19**: Continued ongoing delivery of the workforce strategy actions	Gary Fairley	31-Mar-2019	
SRP.RA.02.04	Wellness Strategy	**Q1 18/19**: Wellness Strategy developed and engagement session delivered to Leadership Team.	Gary Fairley	30-Jun-2018	
SRP.RA.02.05	Redeployment Arrangements	**Q1 18/19**: Work progressing to finalisation and obtain approval of Redeployment fund arrangements.	Gary Fairley	30-Sep-2018	

SRP.RR.05 Working with others to deliver outcomes

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.05	**Risk cause** Partners not engaged or focused to deliver specific outcomes. Public Sector Reform Agenda. **Risk event**	John *Blair; Mary *Smith; A.Short (Joint Director Midlothian Health and Social Care Partnership)	1. Key partners engaged in planning and delivery of Service outcomes, e.g. Midlothian Community Planning Partnership have developed a Single Midlothian Plan. Midlothian Integrated Joint Board (Adult & Social Care Integration) have developed and Strategic Plan. 2. Approved integration scheme. 3. Service Directions in Place.	3	3	

	Partners prioritising activity in areas not inline with delivery of defined outcomes. Community groups afforded legal right to make case to operate vacant properties for community use. **Risk effect** Delivery of outcomes delayed or not achieved Officer time to support the assessment of unsustainable business cases.					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.05.01	Cross Council approach to working with communities	**Q1 18/19**: Enterprising with Communities Working Group established – 5 key projects identified – Pavilions (£100,000 saving by 20/21), maximising income with communities from Loanhead Hub Pilot, Staff Time Donation Scheme, Grants Review and exploration of working differently with communities to generate income or reduce expenditure by £1 million by 2021/22.	Annette Lang	31-Mar-2021	

SRP.RR.06 Information Security

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.06	**Risk cause** General Data Protection Regulation is a new piece of legislation currently being formulated by the European Commission. It is expected to be agreed in the first part of 2016 with a two year lead in period. **Risk event** The Regulation has been agreed with implementation due on 25 May 2018. **Risk effect** The Regulations will bring about a number of requirements on the Council including mandatory reporting of all data breaches, appointment of a Data Protection Officer and the potential for fines ranging to 4% of turnover or 20million Euros which ever is greater.	Ian Wragg	1. Information Management Group 2. Public Sector Network Compliance. 3. Meta Compliance 4. Information Management, awareness raising program (Private-i) 5. General Data Protection Regulation Project Plan. 6. Public sector cyber security compliance	3	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status

SRP.RA.06.0 3	General Data Protection Regulation Project Plan information security PSN accreditation and public sector cyber security accreditation	**Q1 18/19**: General Data Protection Regulation project board reported end of stage and close report. Number of key activities handed over to services as business as usual. Working on Scottish Government Cyber Security action plan, first milestone achieved with essential minimum criteria in place.	Phil Timoney	25-May-2018	

SRP.RR.07 Integration of Health & Social Care

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.07	**Risk cause** Internal and External providers of Care at Home services unable to meet service and quality requirements as a result of a lack of capacity. **Risk event** Capacity of Community Support outstripped by demand **Risk effect** There is a risk that patients will have their discharge delayed because there is insufficient community supports to enable timely discharge leading to deterioration in their health, beds being blocked and elective operations potentially being cancelled.		1. Care at Home improvement action plan in place and near compaction 2. Appointment to Team Lead posts to support Complex care to enhance local leadership at operational level 3. New Framework agreement in place with significant improvement in quality from Providers 4. Flow management planning in development to maximise Care at Home capacity going forward 5. Weekly provider meetings in place 6. Additional locum team members recruited to for contingency cover 7. New Leadership model in place 8. Daily discharge meeting with Multidisciplinary and Multi-agency team planning to plan and coordinate discharge to ensure care at hone support in place	3	4	

SRP.RR.08 Asset Management – buildings, vehicles, roads and Digital assets/networks

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.08	**Risk cause** Many of the assets the Council own by their nature are in a position of on going deterioration through their normal use, e.g. roads - normal wear and tear, street lights and vehicles & buildings used to deliver services. **Risk event** Many assets will deteriorate under normal conditions although buildings, roads and street lights as an example	Ricky *Moffat; Garry *Sheret; Gary Fairley	1. There is provision in place within the capital plan for investment in the asset base. 2. Asset register 3. Conditional Survey 4. Understanding of future asset needs 5. Asset Strategy: . Roads . Land . Fleet . Digital Service Network	3	3	

	can be damaged during more extreme weather events or as a result of a lack of maintenance. **Risk effect** In the case of Roads Services there is a real risk of increased potholes and insurance claims, reduced skid resistance leading to higher accident potential and building up of higher costs in the future. In respect of vehicles, increased breakdowns, service failures, greater maintenance inevitable, higher short-term hire costs. In terms of property, health and safety issues arise, failure to meet current standards and higher running costs. There is also the risk of two-tier accommodation, some high quality, some low.		. Digital Service hardware 6. Capital program - investment in estate. 7. On going monitoring of properties by: Maintenance Surveyors, Facilities Management and Property Users. 8. Introduction of Capital Plan and Asset Management Board			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.08.02	Appropriate investment in capital works and remedial maintenance over the lifespan of each property asset.	**Q1 18/19**: Prioritise needs of assets against available spend. On-going need to assess, needs of assets, informed by conditional surveys. Capital spend works carried out during summer, on going through quarter 2. Continuing to develop property asset management plans, priority spend on basis of independent surveys.	Garry *Sheret	31-Mar-2019	
SRP.RA.08.03	Review of capital plan.	**Q1 18/19**: Draft Capital Strategy reported to June Council 2018, elected member seminar to be delivered with further update report planned for October 2018.	Garry *Sheret	31-Oct-2018	
SRP.RA.08.04	Reviewed Roads Asset Management Strategy	**Q1 18/19**: Roads Asset Strategy, work progressing to migrate to version 4 through 2018/19. Information to be taken to capital board on future need for next 5 years.	Ricky *Moffat;	31-Mar-2019	

SRP.RR.09 Emergency Planning and Business Continuity Management

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.09	**Risk cause** The Council not preparing Emergency Plans and testing arrangements to respond to Civil Contingencies Incidents **Risk event** There are a wide range of potential events the Council may be expected to respond to e.g. Severe weather incident, Pandemic, Utility disruption etc. **Risk effect**	Chris Lawson	Potential sub risks include:- 01 – Civil Contingencies Risk Register used to highlight key risks and record response, - Council's plans developed and maintained in response to identified risks, - Contingency Planning Group support development, peer review and roll out of plans. 02 – Establishment based incident response plans in place and maintained locally.	3	4	

	Censure through non compliance with the Civil Contingencies Act Not adequately recovering from the loss of major accommodation (eg secondary school, main offices), computer systems and staff Not able to respond to a major emergency in the community Fatal Accident Inquiries		03 – Emergency response plan setting out general approach to respond to a major emergency inline with key partner organisations. 04 – As part of the Council's Emergency response plan the importance of recording decisions made and information available at the time is highlighted as this would be scrutinised in the event of an FAI.			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.09.02	Development of Emergency Planning Improvement Plan	**Q1 18/19**: Contingency Improvement Plan well developed and due to be shared with Contingency Planning Group ahead of reporting to CMT for approval. Exploratory work carried out to establish what benefits could be gained from using technology systems to support the development and interrogation of Business Continuity application during an incident.	Chris Lawson	31-Mar-2019	
SRP.RA.09.03	Rest Centre Provision	**Q1 18/19**: Rest Centre Management report going to CMT.	Head of Adult and Social Care	31-Aug-2018	

SRP.RR.10 Governance and Standards in Public Life

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.10	**Risk cause** Code of conduct for Members and employees actions falling short of International Standards. **Risk event** Failure in openness, accountability, clarity. **Risk effect** Service, partnerships and project outcomes not achieved Non compliance with conduct standards and reduction in standards in public life	Alan Turpie	<u>Potential</u> sub risks include:- 01 Macro governance at the top – failure in openness, accountability, clarity; 02 Micro governance in services, partnerships and projects and outcomes not achieved 03 Non compliance with codes of conduct and reduction in standards in public life 04 Annual Assurance Statement.	3	4	

SRP.RR.11 Corporate Policies and Strategies

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.11	**Risk cause** Policies may not match the aspirations of the Council's Strategic priorities or cultural perspective. **Risk event** Policies not monitored may become out of date Policies not reviewed to ensure alignment with strategic priorities. **Risk effect** Policies not monitored could result in non compliance with legislation Policies not align to strategic priorities will inhibit the rather than support implementation of strategic priorities.	Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; . Head of Primary Care and Older People's Services; Ian Johnson; Joan Tranent	1. Single Midlothian Plan providing overarching direction 2. Service plans aligned to Single Midlothian Plan. 3. Leadership team to ensure correct approaches are adopted to get the right results. 4. Strategic housing investment plan, submitted to Scottish Government in December 2016, positive feedback with allocated funding. 5. Community Safety Strategic assessment in progress.	2	3	

SRP.RR.12 Internal Control Environment

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.12	**Risk cause** Work procedures/process inadvertently create the capacity for fraud and waste to occur. Internal Controls requiring more time, effort or cost than the risk being managed. Mangers failing to follow procedures and keep systems updated with accurate information **Risk event** Persons exploiting opportunities to commit fraud Waste and errors **Risk effect** Waste and loss Risks over managed with risk controls costing more than the potential loss being managed. Increased opportunity for fraud or financial loss has direct impact on management information. Has adverse effect on service performance	Maria *Lloyd; Ricky *Moffat; Garry *Sheret; Head of Adult and Social Care; Kevin Anderson; Gary Fairley; Ian Johnson; Joan Tranent	1. Services have been prompted to consider fraud and waste within Service Risk Registers. 2. Risk Management Guide, provides direction on the need to balance time, effort and cost against benefit of risk controls. 3. Internal Audit examine internal control arrangements based largely on the risk registers. 4. Whistleblowing Policy. 5. Internal and external assurance. .	3	3	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.12.03	Investigation on Road Contract Management	**Q1 18/19**: Investigation on Road Contract Management was reported to Special Audit Committee on 15 May 2018, with a follow up report presented on 18 June 2018.	Chief Executive	18-Jun-2018	

SRP.RR.13 Climate Change

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.13	**Risk cause** Council Services not adequately engaged, resourced or directed to fulfil the requirements of the Climate Change Act **Risk event** Council Services not responding to the Climate Change Act with sufficient pace. **Risk effect** Council failing to meet its obligation under the Climate Change (Scotland) Act 2009 and incurring the associated reputational damage.	Ian Johnson	1. Statutory requirement to report on compliance with the climate change duties. 2. Council Carbon Management Plan 3. Approval of a Corporate Climate Change and sustainable development action plan 4. Implementation of provisions of Internal Audit report approved by Audit Committee 1 May 2018.	3	3	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.13.0 1	Adaptive Planning	**Q1 18/19**: Adaptive planning proposal to be brought forward to CMT.	Ian Johnson	30-Nov-2018	

SRP.RR.14.1 Scottish Abuse Inquiry

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.14.1	**Risk Cause:** Midlothian Council and its legacy organisations, predating the creation of Midlothian Council in 1996, have been involved in the provision of care of children going back to living memory. During this time there is the likelihood that the care children received fell below standards of care now in place. There is the further potential the some people in the care of Midlothian Council and its legacy organisations were subject to abuse by those who were employed to care for them. **Risk Event:** The Scottish Government began an Inquiry into cases of Child Abuse occurring prior to 17 December	Joan Tranent	The Council have set up an Abuse Inquiry Project Team to support the Council to prepare for information requests to support the Inquiry. In addition we have now set up a Claims Project Team to map out how claims will be made to the Local Authority and how we shall then manage them The Inquiry Team have established a Project Plan covering: 1. Residential establishments, List D Schools and Foster Carers: identifying Children's homes, Foster Carers and any List D Schools in Midlothian over the last 100 years and researching historic records. 2. Record Audit: reviewing the Council's existing paper and electronic recordkeeping systems to identify relevant records and map them to	5	4	

	2014, the intention of this enquiry is to identify historic case of abuse which have to date gone unreported. **Risk Effect:** If the inquiry finds historic cases of abuse in Midlothian this could damage the reputation of the Council and could place doubt in the eyes of the public as to the safety of these currently in care. There is significant scope for a substantial financial impact arising from claims of historic abuse. Some existing employees may be affected by the inquiry and subsequent claims of abuse.		residential establishments. This also includes, where possible, noting the Council's historic recordkeeping policies, such as retention schedules. 3. Cataloguing/Indexing: checking and updating existing recordkeeping systems for accuracy and consistency, enabling effective information retrieval when requested by the Inquiry. The Project Team have established a Project Plan covering: 4. Ascertaining the succession and insurance position in relation to potential historic child abuse claims. 5. Ascertaining and agreeing Midlothian Council's legal position/ approach in dealing with the potential historic child abuse claims. 6. Identifying the need for guidance, protocol, templates etc should/if any claims be made against the council. 7. Consideration to identifying if additional staffing will be required as expected deluge of FOI's SAR's in 2018 from solicitors of potential claimants.			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.14.0 1	Implementation of Project Plan	**Q1 18/19**: A project team has been established. Project Plan has identified actions which are being progressed. Monthly meetings to progress project plan.	Joan Tranent	31-Mar-2019	

SRP.RR.14.2 Historic Abuse Claims Project

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.14.2	**Risk Cause:** Midlothian Council may receive claims as a result of the Limitation (Childhood Abuse) (Scotland) Act 2017 coming into force on 4th October 2017. The Limitation (Childhood Abuse) (Scotland) Act 2017 means survivors of child abuse no longer face the time-bar that requires person injury actions for civil damages to be made within three years of the related incident. The new limitation regime will have retrospective effect (up to including 1964) **Risk Event:** Midlothian Council has established a Claims Working Group to prepare for the management of any	Joan Tranent	1. Agreed further update to Council in December 2018 to keep them abreast of the current situation and potential implications around staffing and future financial costs. 2. The Qualified One Way Costs Shifting (QOCS) is a change in legislation that will mean we cannot recover costs unless the pursuer has made a fraudulent claim or has been ;manifestly unreasonable' This basically takes away all risk for pursuers so if the they lose they won't have to worry about paying the Council's costs. There is no definite date as yet but CoSLA suspect this could come into force around October 2018. The impact of this could result in more claims being made.	4	5	

	claim that is received (including support for victims). The Claims Working Group has established a process ('Claims Procedure') for dealing with the claims. **Risk Effect:** There is potential risk of reputational damage to the Council should any claims be made. In addition there is a financial risk should we have to either defend or pay out for any claims					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.14.2-1	Training staff	**Q1 18/19**: Training has been rolled out to all relevant staff and the website has additional information about making a referral and what supports are available as well as regular updates on the progress of the inquiry to all staff. Many solicitors will make initial contact with Midlothian Council via a Freedom of Information Request or a Subject Access Request. We have mapped out our insurance position in relation to potential historic child abuse claims and have regular discussions around any potential claims. We are exploring joint working opportunities with other Local Authorities who were once part of Lothian Region to agree how we shall deal with future claims.	Joan Tranent	31-Mar-2019	
SRP.RA.14.2-2	Communications Strategy	**Q1 18/19**: We have a communication strategy and ensure that our websites have up to date information relating to claims and support for survivors. It is planned to take an updated report to Council in December 2018.	Joan Tranent	31-Mar-2019	

SRP.RR.15 Review of Pay & Grading

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.15	**Risk cause** Investment to reduce in-work poverty need to improve flexibility, productivity and service quality. Many current policies and terms and conditions, including pay arrangements have been constructed around a Monday - Friday, 9 - 5 working week, with many services requiring to deliver services 7 days a week beyond 9-5. **Risk event**	Gary Fairley	1. Investing in our Workforce Project Board focussed on securing the gains. 2. Governance on the 4 strands of work from Council: Life Long Learning, Policy, Pay, Non Financial Benefits. 3. Launch of new People Policies on 1st March 2017. 4. Communications plan to ensure all employees know what is changing and how this will impact them and service delivery.	4	4	

	Council does not see improvements in productivity and flexibility across the workforce. Council services are not competitive against the voluntary 3rd or private sector. **Risk effect** Investment in pay and grading not translating into positive productivity gains for the Council.					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.15.01	Secure improvements in productivity and flexibility across the workforce.	**Q1 18/19**: Investing in our Workforce Board chaired by the Chief Executive focussed on securing these gains. Report to be taken to Audit Committee in September 2018.	Gary Fairley	30-Sep-2018	

SRP.RR.16 Growing Council

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.16	**Risk cause** Population growth in Midlothian over the next 10 - 15 years will see Midlothian become the fastest growing Council in Scotland. . 0-15 population increase, projected at 20% and 75+ population increase projected to increased by 100% between 2014 and 2039. **Risk event** Failure to resource and plan for these rises will significantly impact the Councils ability to fulfil its statutory obligations in relation to these groups. **Risk effect** Inadequate capacity within the school estate to cope with the projected increase in pupil numbers. In sufficient provision to support an aging population placing costly inefficiencies on other parts of the care sector. General population increase placing additional demand on infrastructure including GP services. Increased pressure on infrastructure, services e.g. waste collection and growth of road network as new development roads are adopted.	John *Blair; Mary *Smith; A.Short (Joint Director Midlothian Health and Social Care Partnership)	1. Local development plan 2. Services planning future service provision on the basis of anticipated service demands 3. The change programme 4. Learning Estate Strategy 5. Capital Strategy Strategy 6. Housing Strategy 7. IJB Strategic Plan	4	5	

SRP.RR.17 UK Decision to leave the EU

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.17	**Risk cause** UK vote to leave the European Union **Risk event** UK leaving the European Union **Risk effect** The impacts associated with the UK's decision to leave the UK have yet to be realised and will only become clear as negotiations progress following the triggering of article 50. There are some direct potential impacts such as an end to EU funding of Council co-ordinated projects and indirect impacts on industries undertaken within the geographical area which have relied on EU funding, such as agriculture. There are wider potential implications arising from uncertainty regarding the resident status of EU nationals, post any exit agreement, and the availability of workers from outside the UK accessing the job market here in the future. These factors have the potential to impact on the availability of the right people with the right skills being available to help grow the economy here in Midlothian. One area this could affect the Council could be in the delivery of future building projects within Midlothian which could curtail further economic growth.	John *Blair; Mary *Smith; A.Short (Joint Director Midlothian Health and Social Care Partnership)	01 - The Council will monitor the implications of the UK's decision to leave the EU on the Council through its risk management approach and will develop approaches to respond to specific risks as further clarity on impact becomes clearer.	3	4	

SRP.RR.18 Political uncertainty - Education Governance Review

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.18	**Risk cause** Delivering Excellence and Equity in Scottish Education: A Delivery Plan for Scotland and new Education (Scotland) Bill 2017. **Risk event**	Maria *Lloyd	01 - Midlothian Council has made a formal response to the Scottish Government on its consultation. 02 - Council has been kept informed of the Midlothian's response to the consultation	3	4	

	Future decision by Scottish Government on the outcome of governance review, which seeks a move to regional based Education. **Risk effect** Midlothian Council recognises that closing the attainment gap is not a task which can be achieved by schools or the Education Service alone but requires a total Midlothian approach. The delivery plan has made a commitment to regional working although is limited in detail on what this would look like. In the event the approach taken impedes the total Midlothian approach this could inhibit rather than support the efforts to close the attainment gap.					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.18.01	Government statement on Education (Scotland) Bill	**Q1 18/19**: On 26 June 2018 the Cabinet Secretary for Education published the bill but postponed bringing it to the Scottish Parliament to allow for 'collaboration' with local authorities to deliver the sought-after improvements instead. The agreement with COSLA is intended to deliver the principles of school empowerment and achieve a teacher led education system without legislation.	Maria *Lloyd	22-Jun-2018	✓

SRP.RR.19 Health & Safety

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.19	**Risk cause** Failing to identify and rectify non compliance with Health and Safety regulations. **Risk event** Employees required to undertake tasks they are not competent to. Statutorily driven health and safety protective arrangements for service users and employees not implemented correctly. Non compliance with policy and procedure Not undertaking audits and inspections to confirm adherence to policy and legislative requirements. **Risk effect**	John *Blair; Mary *Smith; A.Short (Joint Director Midlothian Health and Social Care Partnership)	01 - Suite of Health and Safety Management Arrangements developed setting out council response to statutory obligations 02 - Comprehensive range of Health & Safety Management & Assessment based development opportunities for line managers 03 - Use of Health & Safety Management Information System to enhance information transfer and organisational efficiency	3	5	⚠

	Serious injury of ill health impact on employees and or service users. Negative impact on outcomes for customers/service users. Service users and employees exposed to hazards where statutory requirements exist. Statutory health and safety - duty of care over services users and employees not met. Criminal prosecution of the Corporate body and or individuals through Corporate Homicide (Corporate Manslaughter) Significant financial penalties from Criminal Prosecution.					

OPPORTUNITIES

SRP.OP.01 Shawfair

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.01	The Shawfair development with its new Rail link provides a major incentive for house builders, employers retail and commercial interests including opportunities to secure a low carbon community through district heating from Zero Waste.	Ian Johnson	1. Shawfair Development Group. 2. Legal agreement with developers to secure developer contributions (Section 75) 3. Plan for entire community: 4. Business and industrial provision, including small business incubator space. 5. Circa 4000 new homes 6. A school campus comprising Early Years, Nursery, Primary, Secondary & Life Long Learning provision 7. New Primary schools	5	4	

SRP.OP.02 Borders Rail

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.02	Regeneration of priority communities of Midlothian through which the railway passes. The line provides ready access to education/training at Edinburgh College, Borders College and Queen Margaret University with improved access to the labour markets in Edinburgh and the Borders. Also a catalyst for housing growth. Ensuring Midlothian secures appropriate levels of Blueprint funding.	Ian Johnson	1. Designated Project Manager post. 2. Maximising the Impact: A blueprint for the Future - published by the blueprint group involving Scottish Government, Scottish Borders, Midlothian and City of Edinburgh Council, Transport Scotland, Scottish Enterprise and Visit Scotland. The document sets out the ambitions of the partners to realise the full potential of the new Railway. 3. Dedicated Tourism Development post - March 2019. 4. Timely submission of bids for approval by the Blueprint Group.	5	4	

SRP.OP.03 Easter Bush - Penicuik

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.03	Fast Growing opportunities in Science Technology Engineering and Mathematics (STEM) with opportunities to link with education. Partnership links to schools and university sector at the 'Bush' to promote STEM. Link to City Deal	Ian Johnson	1. Planning in place around creating Secondary Schools as centres for excellence linked to specialisms including STEM. 2. Land allocated for expansion. 3. Midlothian Science Zone.	5	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.OP.03.A 1	A702 Trunk Road Improvements	**Q1 18/19**: City Deal business case for Easter Bush expansion includes A702 road scheme to improve long term strategic access. Through liaison with Edinburgh University and Transport Scotland within the context of City Deal.	Ian Johnson	31-Mar-2019	

SRP.OP.04 City Deal

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.04	South East Scotland Region City Deal - a bid for funding to Scottish and UK Governments to accelerate economic growth through investment in infrastructure/ housing/ skills and innovation. 200 Council Houses linked to the City Deal.	Ian Johnson	1. Key projects identified. 2. Heads of terms agreed by partners (the six Councils of the region together with the private sector business community and higher/further education sectors) in July 2017. 3. Final full deal agreed by Council in June 2018. Formal signing due August 2018. 4. Securing best arrangements for Midlothian through close liaison with partners and conclusion of business cases.	5	5	

SRP.OP.05 Growing Council

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.05	Midlothian Council has been identified as the fastest growing Council's in Scotland. This brings the opportunity to support the Council vision of being 'A Great Place to	Ian Johnson	1. Community Planning Partnership 2. The Single Midlothian Plan 3. The Integration Joint Board	5	5	

	Grow'. As a growing Council this brings the opportunity to redevelop parts of Midlothian, improve infrastructure with a focus on area targeting, improving economic opportunities, improving education and health outcome. This growth creates the opportunity to meet the housing need with 25% of new homes being built in the affordable housing bracket, in addition to the expansion in Council House building. This construction will directly support employment in construction and will see a steady increase in the volume of Council tax received over time.					

SRP.OP.07 Creating a world Class Education System

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.07	The Centres of Excellence model is a core part of the Council's strategy to create a world-class education system in Midlothian. This is an ambitious project designed to deliver excellence and equity with a particular emphasis on interrupting the cycle of poverty.	Maria *Lloyd	1. Digital Centre of Excellence at Newbattle Community High School 2. Partnership agreement with the University of Edinburgh	4	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.OP.A.07 .01	Research and development	**Q1 18/19**: Research and development on the Centre of Excellence continues a number of work streams are planned to support its implementation. Work streams are set out in update report to Council in June 2018.	Maria *Lloyd	31-Mar-2019	

Audit Committee
Tuesday 25 September 2018
Item No: 5.7

Midlothian Council

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

25 September 2018

DRAFT

Building a better working world

Contents

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 Council (the Council) 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 Council 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

Executive Summary – purpose and scope

Purpose of this report

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as the external auditor of Midlothian Council (the Council) 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 Council and the Controller of Audit, and presented to both Council management and those charged with governance. After consideration by the Council, 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 Council. 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.

A key objective of our audit reporting is to add value by supporting the improvement of the use of public money. We aim to achieve this through sharing our insights from our audit work, our observations around where the Council employs best practice and where processes can be improved. We use these insights to form our audit recommendations to support the Council in improving its practices around financial management and control, as well as around key aspects of the wider scope dimensions of audit. These are highlighted throughout the report together with our judgements and conclusions regarding arrangements.

Scope and responsibilities

The Code sets out the responsibilities of both the Council and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the Audit Committee on 13 March 2018. We summarise these responsibilities of the Council 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. Through the course of the audit we subsequently updated our approach to reflect developments at the Council that impacted our risk assessment around the financial statements. These revisions are outlined in our report, as applicable. We applied the following level of materiality to our audit, which remained consistent with that outlined in our Annual Audit Plan.

Materiality for our audit – no change to that reported in our Annual Audit Plan	£4 million
Tolerable Error is our materiality applied at an individual account balance – no change	£2 million
Reporting threshold, set in line with our requirements in line with auditing standards – no change	£0.2 million

Financial statement audit

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

- whether they give a true and fair view of the financial position of the Council and its group 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 Council 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.

Executive summary – key messages

Key contacts

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Sarah Croft, Manager
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Ernst & Young LLP, Atria One, 144 Morrison Street, Edinburgh EH3 8EX

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 – key messages

We have issued unqualified audit opinions on the Council and group 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.

Management responded positively to audit comments to enhance the narrative and presentational aspects of reporting, with constructive relationships between the senior management team, finance and the audit team.

There were a number of presentational and disclosure adjustments as a result of the audit. These have been corrected by management but reflect that, consistent with our findings in the prior year, an increased focus is required and management should ensure that there is a robust review process to ensure the completeness and accuracy of the financial statements prior to being made available for audit and public inspection.

Recommendation one

A number of audit adjustments were required to the unaudited annual accounts which impacted on the reported surplus/deficit on provision of services in the year.

There was one unadjusted audit difference relating to a misstatement to fixed assets and the revaluation reserve of £229,000, with no impact on income and expenditure. We concur with management's view that the difference is not material and we do not consider this to require adjustment.

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.

Financial management	• Similar to prior years, the Council has not operated within approved budgets. Continued work is required to ensure that budgets are robust and realistic. • The Council continues to under deliver against its capital plans, due to recurring slippage in delivery of capital projects. The capital plan is a significant part of transforming the Council; ongoing slippage or unrealistic budgets have the potential to impede delivery of change. • Improvements remain to be made over financial reporting arrangements to better support budget holders and members in their roles. There is also a need for the Council to review the level of skills and capacity across finance and integrated support services to ensure these remain appropriate to support the Council and service transformation.	Red

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.

Financial sustainability	• The Council continues to experience acute financial pressures. Significant progress is urgently required to deliver on the approved 2018/19 recovery plan and to support approval of a robust 2019/20 budget. • There are significant funding gaps over the period to 2022/23. Difficult decisions will have to be taken to achieve financial balance. There is a need for a significant improvement in the pace of transformation, supported by enhanced reporting and scrutiny. • The Council is projecting that the uncommitted General Fund Reserve at 31 March 2019 will be £1.7 million. This poses a significant risk to the Council and provides limited ability to respond to unforeseen events.	Red
Governance & transparency	• The Council has an effective governance structure through committee meetings and the framework of Standing Orders. A number of aspects of the internal control framework require improvement. • An investigation into the Council's Road Division identified that £2.1 million of payments over a seven year period were made to a contractor not on the Council's Procurement Framework. A number of weaknesses in the systems of internal control over the seven year period were also highlighted. The matter has been passed to Police Scotland and further internal investigatory work is continuing.	Amber
Value for money	• Midlothian has the highest projected increase in population rates for all ages below pensionable age. These demographic changes bring significant challenges. Over the period 2015/16 to 2017/18 the Council has invested £40.2 million in schools, £47.4 million in housing and £2.4 million in care homes. Investment plans as a result of the City Deal offers the potential for further major investment. • The vision is set out in the Single Midlothian Plan. The Council's transformation programme and service plans outline how the Council intends to deliver its contribution. The Council scrutinises how it is performing primarily through the Cabinet and Performance, Review and Scrutiny committee. There is a focus on its five themes, three priorities, its customers and how it runs its business. • Council performance using the Local Government Benchmarking Framework indicators show performance has fluctuated since 2011/12. The Council is performing well in respect of its public performance reporting, with a commitment to being open and transparent and balanced in its reporting.	Green

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

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
Opinion on financial statements	Unqualified opinion
• Truth and fairness of the state of affairs of the Council and its group at 31 March 2018 and of the income and expenditure for the year then ended • Preparation of the financial statements in accordance with the relevant financial reporting framework	• Performance of audit procedures to respond to our assessed risk of misstatement, including significant risks • Accounting policies are appropriate and estimates are reasonable • Completion of financial statement disclosure checklists / consideration of relevant guidance issued by CIPFA / Audit Scotland
Conclusions relating to the going concern basis of accounting	No matters to report
• The use of the going concern basis of accounting used in the preparation of the financial statements is not appropriate	• Supported by our core financial statements audit work, supplemented by our wider scope audit procedures in respect of financial sustainability
Other information in the annual accounts	No matters to report
• 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.	• Review of committee minutes and papers / discussions with management / understanding of the business / participation in shared risk assessment
Opinions on matters prescribed by the Accounts Commission	Unqualified opinions
• The audited part of the Remuneration Report has been properly prepared in accordance with applicable regulations • Information in the Management Commentary / Annual Governance Statement is consistent with the financial statements, and prepared in accordance with the relevant guidance	• We agreed the form of the report to the regulations and agreed the disclosures to underlying accounting records and supporting schedules • We reviewed the content of the narrative statements to the information known to us in the audit, and against the requirements of the guidance
Matters on which we are required to report by exception	No matters to report
• Whether there has been a failure to achieve a prescribed financial objective • Whether adequate accounting records have been kept • Whether financial statements and the audited part of the Remuneration Report are not in agreement with the accounting records • Whether we have not received the information we require for our audit	• We have not identified any failures to achieve a prescribed financial objective • In respect of the other areas, we obtained the Council's accounting records by data download and agreed the financial statements and the audited part of the Remuneration Report to these • We were provided with all the information we required

The Council's Annual Accounts enables the Council to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year.

Financial Statements Preparation 2017/18

Compliance with requirements

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

The Council has complied with the relevant requirements.

The unaudited annual accounts were considered by the Audit Committee on 28 August, in advance of the deadline of 31 August. In responding to feedback received from members of the Audit Committee during 2017/18, management provided an overview presentation to support member understanding of the annual accounts. While this demonstrates good practice, we recommend this taking place earlier in the year, in advance of the audit commencing and prior to the summer recess.

Recommendation two

Management ownership of recommendations for improvement

We made five recommendations in our prior year Annual Audit Report in respect of financial statements preparation. These covered:

- a robust process to review the accuracy and appropriateness of valuations performed on PPE and the quality of the output (grade 2 and 2);
- effective oversight and scrutiny over the financial reporting process (grade 1);
- enhancing the account reconciliation process to ensure that part of this includes regularly reconciling feeder systems and applications to the ledger (grade 2); and
- treatment of capital funding costs through HRA reserves (grade 2).

Management has made insufficient progress during 2017/18 in addressing the recommendations in respect of the quality assurance over the PPE valuation process and output; and the oversight and scrutiny of the financial reporting process. This is evident in the number of audit adjustments and the requirement of the audit team to devote significant time to establishing the evidence for transactions recorded within the financial statements.

While management acknowledged the need to review their reconciliation process during 2017/18, further work by management is required. While reconciliations take place between feeder systems, interfaces and financial ledger transactions, there remains the opportunity for account reconciliation controls to be enhanced to ensure greater scrutiny and oversight of account balances. As a result of a review of the robustness of the account reconciliation process management processed a one-off write-off of £1 million of erroneous Housing Benefit debtors.

While we acknowledge that there are controls over journal entries, there is a risk that the absence of fuller reconciliations from the account balances and feeder systems could result in incorrect or fraudulent postings being undetected in a timely manner

Management has addressed the recommendation in respect of HRA reserves.

We have summarised the minimum improvements required to financial control arrangements at the Council in our recommendation to management.

Recommendation three

Audit logistics

We held a debrief with the finance team to learn lessons from the first year audit and to support efficiencies in the second year of audit. We advanced key elements of audit testing to earlier in the year, to reduce the burden of the audit on the finance and audit team over the summer period. We will arrange a further debrief following this year's audit process to continue to seek improvements to the overall processes. Many of these improvements will be linked to the implementation of recommendations made in this report.

Overall, in our view, the timeliness of the preparation of the annual financial statements could be enhanced. There continues to be good cooperation provided across the finance team to support our audit work. Significant improvements continue to be required to the financial reporting process, as noted above. Many of these themes are consistent to those identified as part of our 2016/17 audit.

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

Twelve adjusted audit differences were identified with a net aggregate impact of £6.5 million on the Comprehensive Income and Expenditure Statement which have been adjusted by management. Of these five related to Property Plant and Equipment. Other specific adjustments were made in respect of the valuation of the Council's interest in Lothian Buses, as a result of an adjustment to the actuarial assumptions relating to pension assets, to remove HRA developer contributions unapplied (as previously agreed) and a correction to the accounting entries for PFI. The remaining three adjustments related to the treatment of capital funds. Details can be found in Appendix E - Audit Differences.

There was one unadjusted audit difference relating to a misstatement to Property, Plant and Equipment fixed assets and the revaluation reserve of £229,000, with no impact on income and expenditure. We concur with management's view that the difference is not material and we do not consider this to require adjustment.

Internal charges and segmental reporting

Following discussion with management on their interpretation of the LASAAC Advisory Guidance in respect of internal recharges, management revised the presentation in the Comprehensive Income and Expenditure Statement (CIES) to include all internal recharges for both 2017/18 and prior year comparatives. This was on the basis that there was uncertainty around the exact recharges to be removed per the guidance without significant additional analysis around the Council's financial reporting information for the year. The presentation is compliant with the 2017/18 Code and management are currently performing analysis to correctly identify recharges in order to be compliant with the 2018/19 Code, which states that all recharges from controllable budgets should be removed from the CIES and presented separately in a note to the financial statements.

Recommendation three

Expenditure and Funding Analysis presentation

The Council's unaudited accounts included the Expenditure and Funding Analysis (EFA) as required by the Code. The initial presentation of the EFA was as a primary statement, however Audit Scotland clarifying guidance in the year confirmed that the analysis should be presented as a note to the financial statements. Management has made this amendment in the financial statements and the final version is now in line with the Code and clarifying guidance.

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

We rebutted the risk of improper recognition of income in respect of core grant funding from the Scottish Government, as well as in respect of council tax and non-domestic rate income. This was because we considered that there is no judgement in respect of the recognition of these income streams.

We undertook walkthroughs in respect of the processes management has established to account for key income and expenditure streams. We obtained data downloads of the Council's financial ledger in order that we could trace the key transactions through initiation to recording in the financial statements.

Key components of the Council's income	Significant risk	2017/18 (£m)
Council tax income	û	40.7
Non domestic rates distribution	û	29.2
Non ring-fenced government grants	û	122.4
Capital grants and contributions	ü	15.8
Service income	ü	149.8
Interest and investment income	û	0.7
Total income		358.6

Key components of the Council's expenditure	Significant risk	2017/18 (£m)
Employee Expenses	û	150.8
Other services expenditure	ü	184.5
Depreciation, amortisation & impairment	û	41.3
Interest payments	û	13.1
Gain on disposal of assets	û	(0.1)
Total Expenditure		389.6

What did we do in response to the significant risk over income and expenditure streams?

- Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias.
- Reviewed transaction listings for individually material transactions as well as unusual items (debits to income, credits to expenditure etc.) to agree to supporting documentation and third party evidence.
- Tested a representative sample of transactions across the remaining untested income and expenditure population to ensure coverage of testing across all balances.
- Reviewed and tested revenue cut-off around the year end through reviewing manual journals posted to revenue and reviewing material credit notes raised after year end.
- Performed a search for material receipts received after year end and ensured these had been accounted for in the correct period.

All audit procedures to address significant risks to the financial statements are performed at a lower materiality level than for other accounts.

Other audit procedures – non-significant risk areas:

Council tax / Non-domestic rates income: We established detailed expectations of income and expenditure and checked the reconciliation to the relevant feeder system.

Non ring-fenced grant income: Substantively tested these balances to grant confirmation letters. During the year £5.7 million of income in 2016/17 was reclassified from HRA to Taxation and Non-Specific Grant Income. There was no impact on the net deficit as a result of reclassification.

Employee expenses: Bespoke data analysers provided an understanding of all payroll transactions in the year, which were reconciled to payroll system.

Depreciation, amortisation & impairment: We undertook testing of these balances in conjunction with our work on property, plant and equipment.

Interest income / payments: We agreed balances to bank and other loan confirmations.

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.

Revenue recognition – looking ahead
IFRS 15 – Revenue From Contracts With Customers The applicable accounting framework is CIPFA's annual Code of Practice on Local Authority Accounting in the United Kingdom (which is IFRS based as adapted for Local Authorities). The 2018/19 Code will apply to accounting periods starting on or after 1 April 2018. The 2018/19 Code will determine how IFRS 15 *Revenue from Customers with Contracts* will be adopted by local government bodies. It is our view, that IFRS 15 will not have a material impact on this Council's financial statements. The vast majority of the Council's income streams are taxation or grant based. The following income streams are within the scope of IFRS 15, but are not expected to result in major adjustments to the accounting treatment: • fees and charges for services under statutory requirements; • sale of goods provided by the authority; and • charges for services provided by a local authority. We look forward to working with management to ensure any relevant changes in requirements are considered and dealt with effectively.

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?
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.	We have not identified any material weaknesses in controls or evidence of material management override in respect of our procedures performed in the financial statement audit to consider the design and implementation of controls around significant risk areas. We have identified a number of weaknesses in processes and controls through our audit work outlined in this report and summarised in recommendation three (see appendix D). However, these have not impacted our audit work directly designed to address identified significant risks. As a result of the ongoing fraud investigation (see our reporting in governance and transparency section 3.3) we revised our risk assessment around a number of potentially impacted areas of the financial statements. In particular, we enhanced our testing around non-payroll expenditure, reducing our testing thresholds to increase both the quantum and value of items to be tested. In addition to agreeing expenditure to remittances and bank statements, we evaluated whether expenditure from Commercial Operations and Property and Facilities Management Services departments was in line with the procurement decision and whether the procurement framework was followed. We also performed additional procedures around supplier contracts, examining the procurement process behind material suppliers and reviewing unusual movements between 2016/17 and 2017/18 suppliers.
Test the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements	We obtained a full list of journals posted to the general ledger during the year, and used our bespoke data analysers to identify any unusual journal types or amounts based on our identified risk areas for the audit. We then tested a sample of these journals, understood their purpose and agreed and corroborated them to supporting documentation. A record of who has requested and authorised journals is not maintained centrally. Instead, the only record available is the signed and authorised manual journal transfer form. If one of the binders or any page from the binder went missing then management would be unable to identify who raised or authorised journals in order to locate supporting documentation. Furthermore, supporting documentation behind journals raised is not held centrally in a way that makes it immediately apparent which journal it relates to. Instead, the individual who has raised the journal is expected to save the information and would have to locate where the information can be found. *Recommendation five*
Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates.	We identified and considered the appropriateness of key accounting estimates, including provisions, and their susceptibility to bias. Management has disclosed their consideration of the critical accounting judgements and key estimates in the financial statements. While we have reviewed and agreed these, in line with earlier comments, there is scope to improve the documentation by management of these key judgements. *Recommendation three*

Evaluate the business rationale for any significant unusual transactions	We did not identify any significant unusual transactions outside the normal course of business.
Review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.	We reviewed expenditure on property, plant and equipment to ensure that expenditure items were not being inappropriately capitalised to defer costs to future years. Likewise we performed analytical procedures and transaction testing of Housing Revenue Account expenditure to ensure funds were not being utilised to meet General Fund expenditure.
Consistency and application of accounting policies / overall presentation of financial information	We consider the accounting policies adopted by the Council to be appropriate. There are no significant accounting practices which materially departed from what is acceptable under IFRS or the Code. We have commented on the presentation of financial information as appropriate and material throughout this report.

What are our conclusions

- We did not identify any instances of evidence of management override of controls through our financial statement audit work.
- While we have not identified any fundamental weaknesses in the design and implementation of controls around journal processing, there is scope for the improvement of record keeping in relation to journal entries and supporting evidence.
- Management has included disclosure on the accounting judgements and estimates made, although we consider that there is scope for better supporting documentation underlying key accounting judgements and treatments adopted.

Higher inherent risk – valuation of property, plant and equipment: The fair value of PPE represent significant balances in the Council's financial statements and are subject to valuation changes, impairment reviews and depreciation charges.

What judgements are we focused on?

The Council's property, plant and equipment portfolio is significant, totalling £634 million of assets at the year end. In terms of the focus of our work, the main judgements are in respect of:

- Council dwellings – due to the materiality of the balance and the judgements in the methodology for social housing valuation
- Other land and buildings – this is the most material grouping of assets, covering most of the Council's operational assets. Asset categories included here which were valued in 2017/18 included Leisure Centre, Residential, Industrial, Office and Retail.

Infrastructure assets, assets under construction and vehicles, plant, furniture and equipment are valued at historical cost. As such, we consider these as having a lower inherent risk as there is no material valuation judgement required.

Category of Property, Plant & Equipment	2017/18 (£m)	2016/17 (£m)
Council Dwellings	267.3	270.6
Other Land and Buildings	304.7	289.1
Vehicles, Plant, Furniture and Equipment	10.4	9.5
Infrastructure Assets	27.6	27.8
Community Assets	7.9	7.1
Assets under construction	9.6	41.5
Surplus assets, not yet held for disposal	6.4	6.0
Total Property, Plant & Equipment	634	651.6

Source: Midlothian Audited Accounts 2017/18

What did we do?

- Consider the action taken by management to address the prior year recommendations.
- Review of the annual cycle of valuations to ensure assets have been valued in accordance with the requirements of the Code, and whether any specific changes to asset use have been communicated to the valuer.
- Consider the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.
- Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre).
- Review assets not subject to valuation to confirm that the remaining asset base is not materially misstated.
- Consider changes to useful economic lives as a result of the most recent valuation.
- Test accounting entries have been correctly processed in the financial statements.

What did we find

We reviewed the assumptions used by the Council's internal valuation team in the valuation of land and buildings and have challenged the accuracy and appropriateness of the assumptions, and agreed the workings back to underlying asset information.

We noted a number of errors that occurred in the preparation of asset schedules, and two instances where assets had been revalued but there was no support retained by the valuation team. These issues would be pre-empted by a robust review and scrutiny process. This is consistent with our observations from the 2016/17 audit. The full list of audit differences identified is provided in Appendix E.

We provided insight and suggestions to management on improvements to documentation in relation to considering the impact of market movements on asset value for assets not subject to valuation in the year, which were subsequently made by the Council. We noted there were no material changes from 2016/17.

Recommendation three

What are our conclusions

Consistent with our audit findings in 2016/17, we identified errors in the Council's valuations due to a lack of robust review and scrutiny of valuations. The cumulative impact of these errors on the carrying value of PPE was £4.5 million. These have, with one exception, been adjusted by management in the financial statements.

Higher inherent risk – accounting for retirement benefits: extensive disclosures are required in respect of the Council's participation in the Local Government Pension Scheme (LGPS). Management involves specialists in the preparation of this material accounting estimate.

Accounting for retirement benefits

In line with accounting standards, the Council recognises the cost of retirement benefits provided to its staff in the reported cost of service when they are earned by the employee and not when the pension benefits are actually paid.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

What did we do?

- We obtained responses to our enquiries of the auditor of Lothian Pension Fund, thus obtaining appropriate assurance over the information supplied to the actuary in relation to the Council's participation in the Fund.
- We have assessed the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team.
- We have reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

What did we find

We concluded that we were able to rely on the work of management's specialists – the pension fund actuaries – and were satisfied that the actuarial assumptions used in the preparation of the IAS 19 report were appropriate.

We obtained relevant assurances from the pension fund auditor to support our conclusions.

The timing of production of actuarial reports means that actuaries produce their IAS 19 reports using estimated data for the final part of the year. As estimates require to reflect the latest available, reliable information, we identified a potential material adjustment due to the estimated returns on investment assets which only impacts on the employer assets. We requested management obtain an update from the actuaries.

As a result, a revised IAS 19 report was produced by the actuaries based on actual outturn to 31 March 2018. This showed a £8.2 million increase in actuarial gains, compared to that previously reported. The impact of this is a decrease in the pension liability from £93.7 million to £85.5 million as at 31 March 2018.

What are our conclusions

- We identified a material adjustment in the actuarial assumptions due to the timing of the IAS 19 report. The total impact of this resulted in a reduction of the pension liability by £8.2 million.

2. Other audit areas

With local authorities in general developing new and different ways of working in partnership with other entities in delivering services, the accounting code of practice requires the Council to prepare group financial statements setting out its interests in other entities and the impact these have on the Council.

Group financial statements

The Council has identified and accounted for the following interests in other entities within its group financial statements.

Trusts, bequests, common good and trust funds and Pacific Shelf 826 Ltd - Subsidiaries

Management has assessed the above to be subsidiaries of the Council. These entities are below the materiality threshold.

Lothian Valuation Joint Board - associate

Management has assessed that it exerts significant influence, but not control, over Lothian Valuation Joint Board. We have agreed with the assessment and the treatment therefore as an associate entity.

Midlothian Integration Joint Board (IJB) – Joint Venture

The IJB is defined as a joint venture. In accordance with the requirements of the CIPFA Code of Practice on Local Authority Accounting, the IJB should be consolidated as part of the Group.

We have been appointed as auditor to the Midlothian integration Joint Board and we report separately on our audit of that entity.

Midlothian Council

Trusts	Pacific Shelf 826 Ltd	Midlothian IJB	Lothian Valuation Joint Board

Non-consolidated interests are set out in Note G6 to the group financial statements

The only significant component by size is the Council, which accounts for 99% of consolidated gross expenditure. While the IJB accounts for <1% of total expenditure, the joint venture accounting essentially leads to a gross-up of income and expenditure relating to the IJB, without additional third party spend outside of the Council/IJB relationship being incurred.

We did not identify any specific risks that may indicate a component is significant by risk, as the IJB does not affect the transactions as such, only the nominal funding agreement in and out of the IJB.

We are satisfied that management has conducted a suitable updated assessment in respect of other entities where the Council has a relationship, but it has been assessed that consolidation has not been required.

Impact on audit opinion: we are able to issue an unqualified opinion in respect of the Council's group financial statements

Our overall audit approach is based upon developing a detailed understanding of your significant classes of transactions and account balances, and the internal controls established by the Council. We use our data analysers to understand and visualise the interaction of these transactions within your financial ledger.

Overall audit approach

Financial controls

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operating effectiveness of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

We highlight the following matters, not reported elsewhere within this Annual Audit Report:

1. There is an absence of controls over the identification of new related parties. Management were unable to provide evidence of consideration of how the Council has assurance that related parties disclosed in the financial statements are complete. Additionally, there were no procedures undertaken by finance to identify whether there were any transactions with the companies / other parties where members have interests established. In respect of the 2017/18 financial statements, to ensure completeness of the disclosures, we performed our own completeness testing from our bespoke data analysers. We used full downloads of the Council's transactions in the year, of all transactions with suppliers listed on members interests. No matters were identified for reporting.

   Recommendation four

2. Within our payroll analysis through the procedures outlined on the following page, we identified one instance of an employee continuing to be paid for several months after leaving. The employee left the Council on 31 March 2017, but was paid every month until August 2017. This occurred as a result of the leaver's documentation not being properly provided on a timely basis to HR by the department manager. From our discussions with payroll, this was identified by payroll and the Council wrote to the employee to request repayment of the salary which was paid in error. As part of our audit response to this matter we subsequently utilised the EY data payroll analyser to gain reasonable assurance there were no other material misstatements within payroll.

   Recommendation three

Use of data analytics in our audit procedures
As the technology supporting audit develops, we increasingly utilise data analytics to support our audit conclusions over traditional sample testing arrangements. This is designed to provide a more thorough audit approach while simultaneously reducing the comparative burden of audit compliance on management. We use our bespoke data analysers to enable us to capture entire populations of your financial data. We capture the data through our formal data requests and the data transfer takes place through secured EY sites. These are in line with our data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information. In 2017/18, our analysers were used in the Council's audit to analyse and test journal entries, employee expenses and other income and expenditure. Journal entry analysis We obtained downloads of all financial ledger transactions posted in the year. We performed completeness analysis over the data, reconciling the sum of transactions to the movement from the opening to closing trial balances and financial statements to ensure we captured all data. Our analysers complete integrity checks over the data received, to identify possible indicators of incomplete or incorrect data, such as journals which do not balance to nil. Our analysers then review and sort transactions based on our identified risks, allowing us to more effectively identify and focus on journals that we consider to be higher risk, as identified in our audit planning report. Payroll analysis We also use our analysers for testing payroll expenditure. We obtain all payroll transactions posted in the year from the payroll system and perform completeness analysis over the data, including reconciling the total amount to the general ledger trial balance. We then analyse the data against a number of specifically designed procedures to address risks of misstatement in payroll. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation, such as where new employees appear to have been paid before their start date. Through our procedures, we identified one employee whose monthly salary continued to be paid after their termination date, as outlined on the previous page. This finding was communicated to management, who confirmed they had already identified this processing error and confirmed they were in the process of recovering the monies. We have included a recommendation around improving the processes around employee leavers in appendix D.

The narrative elements of a local authority's annual accounts form a key part of explaining the performance of the Council during the year. They also enable the local authority to demonstrate openness and transparency in governance and remuneration provided to members and key officers.

Other reporting requirements

Management Commentary

Requirement: Regulation 8(2)(a) of the Local Authority Accounts (Scotland) Regulations 2014

Relevant statutory guidance: Scottish Government Local Government Finance Circular 5/2015

Audit responsibility: 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 content provided:

- a fair and balanced review
- covers risks and uncertainties facing the Council
- provided an understanding of the financial performance of the business.

We suggested to management that there was scope to enhance certain aspects, in particular around the explanation of key financial performance measures and the linkages to the expenditure and funding analysis, as well as to set out further key elements of the steps the Council is taking to respond to the challenging environment it faces. Management updated the commentary to reflect key elements of our review. As part of our early planning discussions for the 2018/19 audit we will debrief with management and discuss additional areas the commentary can be further enhanced to support the robustness and usefulness of the financial statements.

Impact on audit opinion – unqualified opinion on management commentary

Remuneration Report

Requirement: Regulation 8(2)(d) of the Local Authority Accounts (Scotland) Regulations 2014

Audit responsibility: 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.

No amendments were required to the draft remuneration report to ensure its consistency with underlying records and presentation in accordance with the statutory requirements. The Council has disclosed appropriately exit packages provided to 78 staff totalling £2.5 million (*2016/17: 9 staff totalling £0.5 million*).

Impact on audit opinion – unqualified opinion on remuneration report

Annual Governance Statement

Requirement: Regulation 8(2)(c) of the Local Authority Accounts (Scotland) Regulations 2014

Audit responsibility: 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 set out our detailed findings as part of our wider scope audit work on governance and transparency in section 3.3 of this report.

Impact on audit opinion – unqualified opinion on annual governance statement

3. Wider scope audit & Best Value

3. Wider scope – Best Value overview

Together the Accounts Commission and the Auditor General for Scotland agreed the four dimensions set out in the Code which comprise the wider scope audit for public sector in Scotland. These are: financial sustainability, financial management, governance and transparency, and value for money.

Wider scope audit

The Accounts Commission agreed the overall framework to auditing Best Value in June 2016. Best Value will be assessed over the five year audit appointment, as an integral part of the wider scope annual audit process. Every council will have a Best Value Assurance Report (BVAR) considered by the Accounts Commission in every 5-year cycle. Midlothian Council will be subject to this review in 2018/19, It is expected that work will commence at the start of 2019 with the report likely to be published in summer 2019.

Our wider scope audit work, and the judgements and conclusions reached in these areas, therefore contribute to the overall assessment and assurance on the achievement of Best Value. We participate in the Local Area Network (LAN) for the Council, comprising representatives from different scrutiny bodies to agree the Council's local scrutiny plan (LSP).

The 2017/18 LSP was set in the context of the BVAR scheduled for the Council. No specific scrutiny risks were highlighted. The 2018/19 LSP was published in April 2018 and confirmed no scrutiny risks for 2018/19, consistent with the prior year. The LSPs formed the context for our audit and risk assessment.

Accounts Commission Strategic Audit Priorities

The Accounts Commission has set the following strategic audit priorities, which reflects their interest in:

A. The clarity of council priorities and quality of long-term planning to achieve these.

B. How effectively councils evaluate and implement options for significant changes in delivering services.

C. How councils are ensuring members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future.

D. How well councils are involving citizens in decisions about services and empowering local communities to identify and help deliver services they need.

E. The quality of councils' reporting of their performance to enhance accountability to citizens and communities.

The table below sets out our plan for our five year audit appointment, including coverage of the elements of Best Value statutory guidance as well as the Accounts Commission's strategic priorities, and how we will report these in accordance with the wider scope dimensions of public audit.

High level five year Best Value plan / audit coverage			
Element of Best Value, in accordance with the statutory guidance	Reported under wider scope audit dimension	Linked to Strategic Audit Priority	Audit year
Performance and outcomes	Value for money	B	Year 3
Improvement	Value for money	-	Year 3
Leadership, Governance and Scrutiny	Governance & transparency	A, C	Year 2
Equal Opportunities	Value for money	E	Year 3
Partnership Working and Empowering Communities	Governance & transparency	D	Year 3
Financial and service planning	Financial sustainability	A, C	Year 1
Financial governance and resource management	Financial management	-	Year 2
BVAR	All	All	Year 3
Follow up of BVAR	All	All	Year 4

Year 1 = 2016/17 Year 2 = 2017/18 (this year) Year 3 = 2018/19 Year 4 = 2019/20 Year 5 = 2020/21

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	
Red	• Similar to prior years, the Council has not operated within approved budgets. Continued work is required to ensure that budgets are robust and realistic. • The Council continues to under deliver against its capital plans, due to recurring slippage in delivery of capital projects. The capital plan is a significant part of transforming the Council; ongoing slippage or unrealistic budgets have the potential to impede delivery of change. • Improvements remain to be made over financial reporting arrangements to better support budget holders and members in their roles. There is also a need for the Council to review the level of skills and capacity across finance and integrated support services to ensure these remain appropriate to support the Council and service transformation.

2017/18 financial statements

The Council incurred gross expenditure on the provision of services of £374.5 million (*2016/17: £375.6 million*), and incurred an accounting deficit of £29.4 million (*2016/17: £30.4 million*) on those services.

This is shown in the surplus / deficit on provision of services line within the Comprehensive Income and Expenditure Statement (CIES) which sets out the cost of providing Council services in accordance with generally accepted accounting practices.

The Expenditure and Funding Analysis note to the financial statements provides an explanation of how this expenditure is used and funded by the Council. This is different from the accounting position shown in the CIES in accordance with the Code and, together with the Movement in Reserves Statement, demonstrates how the Council's statutory reserves, including the General Fund, have changed in the year.

As shown in the Expenditure and Funding Analysis, the outturn for the financial year against the Council's General Fund was a deficit of £2.7 million (*2016/17: deficit of £2.1 million*).

Focus on financial statements results	2017/18 £000	2016/17 £000	Commentary	RAG rating
(Surplus) / deficit on provision of services	29,380	30,406	2017/18 represented continued cost pressures across service areas, as well as failure to achieve all of the planned transformation savings. There were continued demand pressures in Children's Services of £1 million and a one-off write-off of £1 million in relation to Housing Benefit debtors.	R
(Surplus) / deficit on General Fund and HRA	2,764	2,132		
Uncommitted General Fund	4,337	8,557	This equates to around 2% of net expenditure which is consistent with 2016/17. This remains very low. Management's view of a prudent level of uncommitted General Fund is between 2% and 4% of net expenditure (between approximately £4 million and £8 million).	R
Earmarked Reserves	6,440	9,094	Earmarked Reserves have decreased, the main reason for this being used for the transformation programme which includes severance costs and investment activities.	R
Net current assets / (liabilities)	6,558	(6,275)	This year has seen a positive move from a net current liabilities to a net current assets position. The main reason for this is due to a reduction in borrowings due to slippage / rephasing of capital plans	G
Total Usable Reserves	66,991	67,211	No significant movement. Slight decrease in the General Fund reserve offset by an increase in HRA balance. £33.8 million of this balance is HRA with only limited headroom to utilise.	A
Total Unusable Reserves	211,861	198,408	The increase in unusable reserves has primarily arisen due to the reduction in the net pension liability, following the recent triennial valuation of the local government pension scheme.	G
Net increase / (decrease) in cash	(2,008)	184	The decrease in cash is primarily a result of repayment of short term and long term borrowing	A

3.1 Financial management (cont.)

Elements of financial management, and our assessment of the Council'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? ▶ Is financial forecasting an embedded part of financial management and reporting arrangements? ▶ How accurate is financial forecasting? ▶ How effectively is the Council managing its capital programme?

The Council's budget monitoring reports are presented quarterly to Council and show both capital and revenue reporting. They include both year to date position and full year forecasts against comparative budgets. These are prepared for both the General Fund position and Housing Revenue Account.

We have outlined in table one on the following page the revenue outturn position for the year against the final budget for the year. There were a number of approved revisions to the 2017/18 budget, the main ones being significant increases to Adult Social Care, Facilities Management and Customer and Housing Services.

There were also a number of material variances between the final budget and outturn position, amounting to an overall overspend against budget of £1.8 million. The most significant overspend occurred in Children's Services (£1.4 million), due to demand in services for children with disabilities and residential placements exceeding budget. There was also an overspend in Customer and Housing Services of £1.1 million, mostly due to a write-down of debtors relating to housing benefit overpayments which were deemed irrecoverable, and overspend in occupancy in homelessness accommodation. These overspends were partially offset by an underspend on loan charges of £1.1 million as a result of changes to financing arrangements in the year.

The 2017/18 outturn overspend of £1.8 million was partially offset from higher than forecast income, through additional Scottish Government revenue support grant and council tax receipts in the year. These offsets generated a final general fund utilisation of £0.6 million higher than budget.

For the past three years the Council has not delivered on its approved budget. As part of our 2016/17 audit, we concluded that the Council had failed to operate within established budgets and that this was predominantly through a failure to achieve financial savings planned through the Council's transformation programme. In our view, these pressures have not been addressed in 2017/18 and budgetary pressures are likely to increase in future years. It is imperative the financial planning arrangements to address budget gaps are underpinned by robust financial budgeting and monitoring arrangements to ensure budgets are robust and realistic at the start of the year, and developments identified and addressed in a timely manner during the year.

Recommendation six

Table 1 - Analysis of budget monitoring reports presented to the Cabinet during 2017/18				
Service area	Original Budget* £000	Revised Budget** £000	Outturn £000	Over / (under) spend £000
Management	1,604	1,918	1,901	(17)
Children's Services	14,543	14,675	16,098	1,423
Communities and Economy	3,987	3,861	3,515	(346)
Education	85,039	84,658	84,462	(196)
Adult Social Care	37,510	38,806	38,806	-
Customer and Housing Services	11,508	12,275	13,442	1,167
Commercial Services	15,473	15,881	15,801	(80)
Finance and Integrated Service Support	11,736	11,899	12,199	300
Properties and Facilities Management	12,950	14,295	14,604	309
Lothian Valuation Joint Board	556	556	562	6
Central and Non-distributable costs	2,953	1,817	1,541	(276)
Loan Charges	7,408	7,408	6,244	(1,164)
Investment income	(300)	(300)	(371)	(71)
Transformation savings	(1,517)	(830)	0	830
Allocations to HRA, Capital Account and others	(4,782)	(4,782)	(4,829)	(47)
Net Service Expenditure - Total	198,666	202,137	203,975	1,838

* Original budget approved by the Council February 2017
** Revised budget against which final outturn for the year reported

Table 2 - capital programme	2017/18 budget- £000	2017/18 actual - £000	Variance -£000
General Services	17,677	16,984	723
HRA	10,668	10,572	96
Total	28,345	27,556	819

Table 2 sets out the outturn against budget in respect of the 2017/18 Capital Programme. The budget figure noted is a revised budget following the re-phasing of £432,000 in General Fund and £2.1 million in the Housing Revenue Account into 2018/19. The underspend against the originally approved capital budget is £3.3 million (approximately 12% of the planned spend).

The underspend in the general fund programme is as a result of underspends on four school projects (Bilston, Paradykes, Roslin and Lasswade). In relation to Housing Revenue Account, the underspend mostly relates to lower demand for high value repairs due to continuing Social Housing Quality Standard investment in existing housing stock resulting in an underspend of £0.828 million

At the start of each financial year an element of re-phasing is built into the General Services Capital Plan forecasts. This is currently 35% and is based on the average level of actual / outturn "re-phasing" (compared with original service budget submissions) in previous financial years. This aims to reduce the risk of the plans containing unrealistic budgets or targets. Nonetheless, the Council continues to under deliver against its capital plans, due to recurring slippage in delivery of capital projects. As the Council continues to seek transformational change, the long term capital plan is a significant part of this and ongoing slippage or unrealistic budgets and targets have the potential to impede delivery of change.

Recommendation seven

Elements of financial management

- Are standing financial regulations comprehensive, current and promoted within the body?
- Does the body have arrangements to ensure systems of internal control are operating effectively?

We have reviewed the Council's Financial Regulations and are satisfied that these are comprehensive and subject to regular update. The Financial Regulations form part of the framework of Standing Orders. The Standing Orders were amended in December 2017. They are available through the Council's website.

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control which we identify. We have not identified any additional such matters, other than those matters reported elsewhere within this Annual Audit Report.

- Are there suitably qualified and experienced officials leading the body's finance team?
- Is there sufficient financial skills, capacity and capability in the body?

The Council's section 95 officer is the Head of Finance and Integrated Support Services. We considered the role and status of the section 95 officer and are satisfied that the Council adheres to the principles laid out within CIPFA's Statement on the role of the Chief Financial Officer in Local Government.

From our discussions with senior management, attendance at meetings, and review of papers and minutes, in our view there is a need for the Council to review the level of skills and capacity across finance and integrated support services to ensure that these remain appropriate to support the Council with service transformation. While the preservation of front-line services is understandably of prime concern to members and officers, maintenance of strong financial control to support service transformation necessitates the retention of suitable financial and other corporate support services. Keeping this balance will be a challenge for all local authorities in the current environment but the importance of doing so cannot be understated.

Recommendation eight

- Can the body demonstrate the effectiveness of the budgetary control system in communicating accurate and timely financial performance?
- Do finance reports support effective scrutiny and challenge?

Members are provided the opportunity to scrutinise and have oversight of financial performance through budget monitoring reports. These provide updates on the Council's financial position and forecast for the year, together with action being taken to address service budget pressures.

In 2016/17 we recommended that management consider the arrangements around financial monitoring reports to ensure that they provide greater focus across in year cost pressures and savings targets. Officers have responded to this recommendation with a number of refinements to financial reporting, particularly around the Council's change programme. Officers have also continued to respond to member requests for additional information and explanation in respect of the financial performance of the Council.

However, Directors and Heads of Service are provided with formal updates on their budget on a quarterly basis and budget monitoring reports are produced and reported to Council on a quarterly basis. This is supported by a range of regular monitoring activity and reporting to service management carried out by the Finance team throughout the year with a particular focus on volatile budgets or areas of particular risk. However the outturn position and variations from budget highlights the need to enhance both the scrutiny over budget proposals, to ensure they are robust and deliverable, and also to enhance the monitoring arrangements to strengthen the ability of senior officers to identify and resolve budget pressures on a timely basis. Directors and Heads of Service remain reliant on finance to provide budget monitoring reports rather than accessing information directly or being appraised of the service budget position by their service managers who are the budget holders. In addition to impacting accessibility this can impact the required sense of ownership for budget holders against the budget for which they are responsible. In our view improvements remain to be made over financial reporting arrangements to support budget holders and members in their roles.

Recommendation nine

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.	
Red	• The Council continues to experience acute financial pressures. Significant progress is urgently required to deliver on the approved 2018/19 recovery plan and to support approval of a robust 2019/20 budget. • There are significant funding gaps over the period to 2022/23. Difficult decisions will have to be taken to achieve financial balance. There is a need for a significant improvement in the pace of transformation, supported by enhanced reporting and scrutiny. • The Council is projecting that the uncommitted General Fund Reserve at 31 March 2019 will be £1.7 million. This poses a significant risk to the Council and provides limited ability to respond to unforeseen events

The context for financial sustainability

Since we issued our annual audit plan, the Accounts Commission issued the second part of their overview reporting for Local Government in Scotland: Challenges and performance 2018. This report recognised the complex and challenging environment facing local government, citing for example:

- the significant uncertainty around terms for the UK's withdrawal from the European Union (EU);
- revenue funding from the Scottish Government has fallen in real terms by 9.6% between 2010/11 and 2018/19; and
- Scotland's population is getting older, leading to increased demand for social care services and fewer working age people to fund public services.

Some national policies, however, combined with ongoing spending commitments such as pension and debt costs, mean there are limitations on where councils can make savings. Smaller service areas, which often include important regulatory functions, have seen the biggest budget reductions, while education and social care services take up a growing proportion of council spend.

Between 2014 and 2039 the Council is expected to see the biggest increase in population compared to any other Scottish local authority. Additionally, the Council is expected to see the largest increase in the population of children during this time of 25%. The change in population will have a significant impact on the Council and how it plans its services to respond to such unprecedented levels of demographic change.

Focus on EU Withdrawal

The Chief Executive provided two reports to Council that consider the potential implications of EU withdrawal. At a UK level, the reports cover Council EU operated programmes; potential implications for debt and borrowing; economic growth; education; employment; exports and inward investment; and foreign exchange rates.

At a Midlothian level, the following matters have been highlighted:

- The total number of residents from non-UK EU countries was 90,000 in Scotland, with over 30,000 in Edinburgh alone
- There is a significant risk to the Midlothian area of loss of external funds currently supporting employment, business development, and agricultural activities
- The impact of the referendum result has been calculated as leading to a possible 2.5% reduction in the total UK workforce over the next five years suggesting EU nationals will leave the UK causing a skill shortage in areas such as teaching

EY view: Management are sighted on this issue. As the implications become clearer in time, there is scope for greater focus on the particular and specific risks in respect of Midlothian which could crystallise in respect of, for example, delivery of social care services and economic investment.

Aspects of financial sustainability, and our assessment of the Council's arrangements

- Does the Council have a medium term financial strategy / long-term financial strategy?
- How has the Council factored in the demographic impact of changes in population, demography and demand within its financial plans?

In June 2018 the Head of Finance and Integrated Support Services provided Council with an updated Financial Strategy covering the period 2019/20 to 2022/23. The two key assumptions within the strategy relate to future Scottish Government grant settlements and the level of future pay inflation. Officers have drawn on the Scottish Government's medium term financial plan and the Scottish Fiscal Commission's assumptions, together with local demand and demographic pressure estimates to inform their financial planning.

In our prior year audit report we concluded that the Council faced significant financial challenges with budget shortfalls and a low uncommitted General Fund Reserve. The Council is continuing to face significant challenges in maintaining a sustainable financial position. As shown below, over the period to 2022/23 budgeted shortfalls are forecast to be £39 million. The budget shortfall in 2019/20 equates 4.4% of the net cost of services and the projections indicate this could rise to 16% by 2022/23. Sensitivity analysis demonstrates the potential impact to changes in the central planning assumptions used by officers.

Budget shortfalls	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m
Cost of services	209.186	217.134	226.074	236.185
Council tax	(47.919)	(48.519)	(49.119)	(49.719)
Scottish government grant	(152.073)	(150.583)	(149.091)	(147.598)
Budget Shortfalls – central assumptions	9.194	18.032	27.864	38.868
Transformation Programme savings	(2.650)	(5.210)	(9.610)	(9.610)
Council tax increases / fees and charges	(1.500)	(3.000)	(4.500)	(6.200)
Budget gap	5.054	9.793	13.643	23.002
Budget gap – best case scenario	0.375	0.379	(0.600)	3.868
Budget gap – worst case scenario	9.733	19.084	27.517	41.402

Source: Midlothian Council, Financial Strategy 2019/20 to 2022/23, June 2018

2018/19 financial position

The quarter one budget monitoring reports presented to Council in September 2018 showed a net overspend of £3 million for the year to date (1.45% of revised budget). Demand led pressures amounted to £2.8 million and other pressures amounted to £2.7 million. £2.4 million of these were associated with slippage in the delivery of £9.4 million of previously approved transformational, operational and service cost reduction and income generation measures. These were partly offset by some favourable movements totalling £2.3 million, of which £1.2 million was an underspend in loan charges following the application of a revised methodology to apportion costs associated with external borrowing between the General Fund and Housing Revenue Account.

In June 2018, the section 95 officer (Head of Finance and Integrated Support Services) took the significant step of formally writing to the former Chief Executive to express his concerns regarding the inadequacies of the actions being progressed by the Strategic Leadership Group in respect to the 2019/20 forecast budget position and ever increasing budget gap. At that time the projected 2019/20 budget gap, based on central sensitivity assumptions after taking into account, in the opinion of the Head of Finance and Integrated Support Services, optimistic brought forward savings proposals of £1.6 million, amounted to £3.4 million. He also noted that there was not a robust action plan being progressed to deliver a Senior Leadership Group solution, despite the challenges being known back in February 2018.

2018/19 financial position (continued)

Following taking up post on 1 August 2018, the new Chief Executive formally responded on 20 August 2018, explaining the actions put in place given the seriousness of the situation. The new Chief Executive instructed Directors and Heads of Service to a submit a robust recovery plan and method of monitoring, with a view to this being presented to Council on 2 October 2018. This is to include a recovery plan for 2018/19; list of priorities; their 'stop doing' list and; proposed budget savings for 2019/20. The Chief Executive has expressed the need for the Council to accelerate the pace in respect of delivering a balanced budget for 2018/19, achievement of the required savings plans to allow a balanced budget to be proposed for 2019/20 and in respect of the Council's transformation programme. The recovery plans are now complete and management estimate if fully implemented will deliver an underspend of £0.4 million by the end of financial year 2018/19. The Strategic Leadership Group have now drafted budget proposals for 2019/20.

The Corporate Management Team / Senior Leadership Group meet fortnightly and the recovery plan, along with the budgetary position is a standing item to ensure progress is being made. In further response to the acute financial position arrangements are established to control the filling of employment vacancies and enhanced controls introduced over non-essential expenditure in the final quarter of 2017/18 have been strengthened. The Council continues to experience acute financial pressures.

Significant progress is urgently required in delivering a balanced outturn for 2018/19 and to support approval of a robust 2019/20 budget.

The Council's transformation programme

The Council's transformation programmes focused on reshaping services as the most sustainable way to address the financial and service challenges and maintain financial sustainability. During 2017/18 the Council planned to deliver £2.8 million of transformational savings with £2.4 million actually delivered, a shortfall of £0.4 million. The Council has consistently found it challenging to deliver against in-year saving targets.

At the outset of the programme, the Council approved the set aside of £7.8 million of General Fund Reserve to fund costs associated with service transformation. By June 2018, £6.5 million had been applied or expected to be applied in 2018/19 with future commitments of £0.6 million identified for future years. This will leave £0.7 million as uncommitted. Of the £6.5 million, £2.8 million was utilised in 2017/18 for voluntary severance schemes, securing savings of £1.4 million and avoiding ongoing cost pressure of £0.75 million, representing a payback period of approximately one year.

As part of our 2016/17 audit, we recommended that management should review the transformation and change programmes to provide clearer reporting, oversight and scrutiny. In June 2018, the Council took the decision to close the pre 2018 programme, with a commitment to bring forward a revised, more comprehensive change and improvement programme to meet the scale of the challenges going forward. We also reported that significant work was required to ensure that Council has robust, fully costed savings plans which align to the Council's key priorities as set by members. Furthermore, that the Council should evaluate planned savings proposals to ensure that there is effective consideration and management of the risk of implementing these changes.

Despite the majority of the earmarked General Fund Reserves having been applied or expected to be applied by 2018/19 there remains significant work to be undertaken to support the transformation of services and financial sustainability of the Council. Given the acute financial position facing the Council there is a need for a significant improvement in the pace of transformation, supported by enhanced reporting and scrutiny.

Recommendation 10

Use of reserves – does the Council have clear plans for its usable reserves?

As shown in the table below, the Council's level of usable revenue reserves as a percentage of net expenditure on cost of services has had an upward trajectory, but is now declining. A significant element of this has been the strategy to strengthen the HRA fund in order to finance the investment in new build council housing. General Fund Reserves had also been increased in recent years, but have declined sharply over the past few years.

At 31 March 2018 the Council had uncommitted General Fund Reserves of £4.3 million. A prudent level of uncommitted reserves is viewed by the Head of Finance and Integrated Support Services to be between 2% and 4% of net expenditure which equates to between approximately £4 million and £8 million. As part of our 2016/17 audit we highlighted the large decrease over the period in available uncommitted reserves represented a significant risk.

The Council's financial strategy paper for 2019/20 to 2022/23 noted, given the level of available contingent reserves it would not be considered prudent for Council to meet additional spending pressures from the contingent reserve or to use the contingent reserve as part of the strategy to secure a balanced budget for 2019/20.

The Council is projecting that the uncommitted General Fund Reserve at 31 March 2019 will be £1.7 million. We continue to highlight that this poses a significant risk to the Council and provides limited ability for the Council to respond to unforeseen events.

Recommendation 11

Analysis of reserves	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000	2017/18 £000
Uncommitted general fund	11,964	12,843	16,804	4,587	4,337
Earmarked general fund	8,547	8,472	7,821	13,064	6,440
HRA fund	18,374	21,376	24,913	29,753	33,862
Repairs and renewals fund	2,553	3,073	3,607	3,100	2,889
Total Usable Revenue Reserves	**41,438**	**45,764**	**53,145**	**50,504**	**47,528**
As a % of net expenditure on cost of services	**16%**	**21%**	**26%**	**23%**	**21%**
Capital fund	10,658	14,853	15,378	16,707	19,463
Total Usable Reserves	**52,096**	**60,617**	**68,523**	**67,211**	**66,991**

Long Term Capital Plan
In line with the capital plan, the Council continued to invest in general fund assets, with total expenditure of £17 million in 2017/18. The level of expenditure was below budget by £0.7 million, mainly due to release of contingencies due to underspend on numerous school projects. In June 2018, the Council considered a draft capital investment strategy for the 10 year period 2018-28. This forecast expenditure of over £586 million over the period, including a borrowing requirement (affordability gap) of around £102 million. The Council's treasury strategy includes a cap on net debt of £124 million. In February 2018 the Head of Finance and Integrated Support Services reported that the overall level of debt is forecast to exceed this cap by 31 March 2020 and by 31 March 2021 is forecast to exceed the cap by £12 million. The Council recognised the possible impact on future revenue outturn should borrowing costs increase further, and a review of the capital plan driving future borrowing requirements is planned. The Council agreed to a seminar in September 2018 to consider more fully the draft capital investment strategy before it is finalised and presented to Council for approval. This will also include a review of borrowing levels and the debt cap.
Capital investment - housing
A ten year housing capital investment programme was approved in February 2018, covering the period to 2027/28. This totals £266 million, of which £175 million is allocated to new social housing. The programme will be principally funded by £224 million of capital funded by borrowing. Government grants of £43 million represents the remaining key funding element.

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.	
Amber	• The Council has an effective governance structure through committee meetings and the framework of Standing Orders. A number of aspects of the internal control framework require improvement. • An investigation into the Council's Road Division identified that £2.1 million of payments over a seven year period were made to a contractor not on the Council's Procurement Framework. A number of weaknesses in the systems of internal control over the seven year period were also highlighted. The matter has been passed to Police Scotland and further internal investigatory work is continuing.

Leadership and governance

The full Council of 18 members meets approximately every six weeks, with most of the Council's key decisions and policies made by Cabinet. The Cabinet is made up of five elected members and is the principal decision-making committee of the Council. Cabinet membership also includes three religious representatives who are appointed, under statute, to be included in all matters relating to education.

The Council has a set of Standing Orders which regulate the way it goes about its business, supported by the Scheme of Administration which sets out the membership, powers and responsibilities for full council, all its committees, sub-committees, working groups, policy development and local area committees. The Financial Regulations contain the Council's arrangements for the proper administration of its financial affairs. In line with good practice, documents are kept up to date to reflect any external or internal changes. The Standing Orders were amended in December 2017 and the Council's revised Procurement Strategy 2018 to 2023 was approved in August 2018.

In August 2018 there was a change in the senior management team with the previous Head of Education being appointed as the new Chief Executive.

In early October 2017, allegations regarding suspected procurement irregularities were brought to officers' attention. An internal investigation was commenced in January 2018 by the Council's Internal Audit and Corporate Fraud team. The initial allegations raised by employees related to the Council's Roads Division and centred on an inappropriately close relationship between contractors and Council employees, work regularly being awarded to contractors that could have been completed in house by the Council, and Council equipment being used for non-Council work.

The investigation identified that £2.1 million of payments over a seven year period were made to a contractor not on the Council's Procurement Framework. A number of weaknesses in the systems of internal control over the seven year period were also highlighted. A confidential report of the findings has been passed to Police Scotland who are currently completing their own investigation. The details of the suspected fraud were reported to the Audit Committee at a special committee meeting in May 2018 where concerns were raised by members over the time taken to initiate and complete the investigation.

In July 2018, to support the appointment of the new Chief Executive in August 2018, an independent consultant was appointed to lead the investigation to its conclusion, with continued external support. At the current time, the investigation has yet to conclude, with ongoing internal investigatory work continuing.

Commitment to transparency

Audit Scotland issued appointed auditors with supplementary guidance covering transparency in public sector bodies in Scotland. We have utilised this guidance as part of our audit work, and in particular the questions for auditors to consider.

We have identified the following relevant aspects of the Council's arrangements:

- Decisions are transparent as actions are documented within Council and committee minutes.
- There is a high level of transparency through the Council's website, which includes minutes and papers for all committee meetings.
- Corporate strategies and management plans are included on the website, and there are links to Council performance reports.

Internal Audit/Risk Management

The Council has an in-house internal audit team which is designed to provide members and management with independent assurance on risk management, internal control and corporate governance processes.

In line with Public Sector Internal Audit Standards (PSIAS), Internal Audit should have appropriate standing within the organisation to allow them to provide robust, independent scrutiny and challenge of management. Internal Audit consists of a relatively small size of team (4.5 FTE) which increases the inherent risk around the dependency and reliance on key individuals within the team.

During 2017/18 management completed a review of the internal audit function and took the decision to appoint, on a pilot arrangement, a shared Chief Internal Auditor between the Council and Scottish Borders Council. Management also considered that this created the opportunity for a wider exploration of joint working activities and benefits. The Chief Internal Auditor is professionally qualified and suitably experienced to lead and direct the Council's internal audit team. During the year, in line with PSIAS, an external quality peer review was completed. While the report has yet to be finalised, verbal feedback notes conformance with PSIAS, together with some areas for improvement.

National Fraud Initiative

The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. These exercises are undertaken every two years as part of the statutory audit of the participating bodies. Local authorities were required to submit datasets in autumn 2016 and matches from investigation and follow-up were released early in 2017. We reviewed the Council's arrangements for participation in the NFI in support of preparation of a return to Audit Scotland. We were satisfied that the Council had appropriate arrangements to respond to the NFI and had responded to the most recent exercise.

Risk management

The Council's approach to risk management is set out within the Risk Management Policy, this was formally approved in 2013 and is currently subject to review. There is periodic reporting of strategic risks, current issues and opportunities to the Council Management Team, with onward reporting to the Audit Committee. An important element of the planned review of risk management will be to consider the Council wide reporting of risk.

Adding value to the Council	We recommended in 2016/17 the importance of management considering the skills and capabilities required from the internal audit function to ensure that its position and standing within the organisation is such that it can provide robust independent challenge to senior management. The appointment of a shared Chief Internal Auditor between the Council and Scottish Borders Council enhances this ability.

Annual Governance Statement (AGS)

The AGS sets out the Council's governance framework. The Council supports its arrangements through its local code of corporate governance, and assessments are undertaken regularly of compliance against this. Other core support for the AGS is through the system of compliance statements which are obtained from key individuals in the Council's management team, relating to their areas of responsibility.

In the prior year, and again in 2017/18, we made suggestions to management on the form and content of the statement. Management used our comments to inform the content of the AGS. This enables the Council to set out both the framework for governance and also the impact that it had on the business of the Council during the year. Aspects of governance which have been strengthened during 2017/18 are now set out, along with areas identified for continual improvement in 2018/19.

The AGS sets out the ongoing unplanned investigation, noting that while the investigation has not yet concluded a number of required improvements to internal control, risk management and governance have been disclosed. The intention is to report progress on proposed actions to the Audit Committee on a quarterly basis to enable effective monitoring and scrutiny by members of implementation of areas for improvement.

Recommendation 12

The annual report from the Chief Internal Auditor is a further source of support for the AGS. The report concluded that *"the systems of internal control and governance are generally adequate though there are indications in some areas of non-compliance and a lack of evidence of management monitoring that they are operating satisfactorily; therefore improvements are required to the second line of defence consistently across the Council to ensure probity in systems and operations, including the prevention, detection and resolution of fraud and irregularities."*

Adding value to the Council	In response to audit recommendations in 2016/17 arrangements have been enhanced to allow members to contribute to and participate in both identifying training needs and participating in training events. We also contributed to training events for members. During 2016/17 we encouraged management to ensure a detailed workforce strategy, was developed, identifying the level of expected staff numbers, skills and capacity required to support the Council deliver it's strategic objectives. This was approved by Council in December 2017.

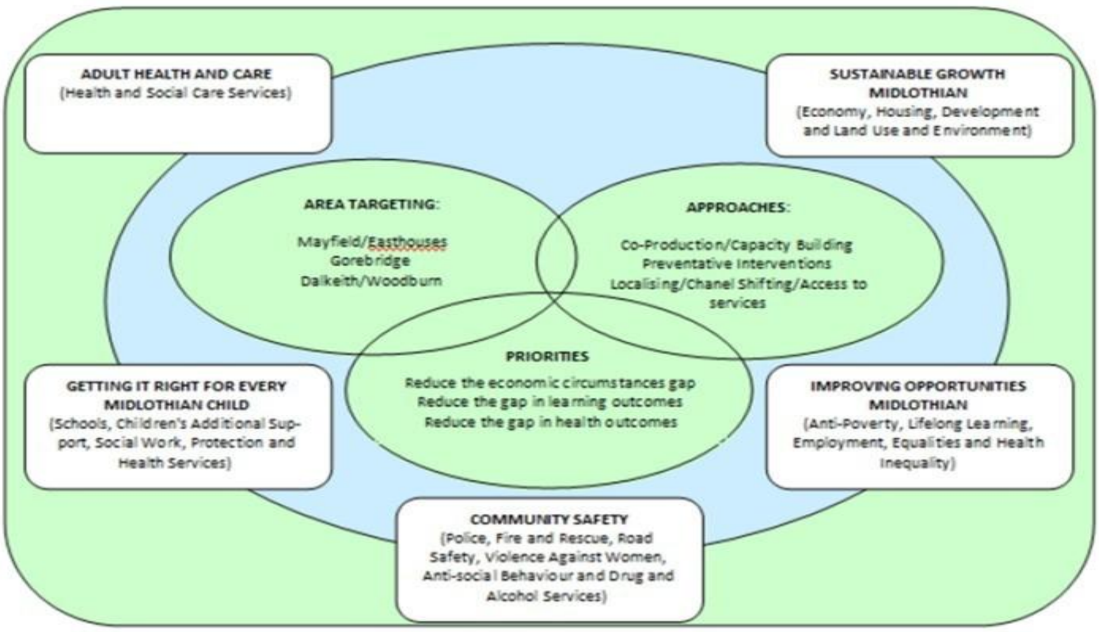
Value for money is concerned with using resources effectively and continually improving services. A focus for our work in this area is the Council's self-awareness and self-assessment of its performance.	
Green	• Midlothian has the highest projected increase in population rates for all ages below pensionable age. These demographic changes bring significant challenges. Over the period 2015/16 to 2017/18 the Council has invested £40.2 million in schools, £47.4 million in housing and £2.4 million in care homes. Investment plans as a result of the City Deal offers the potential for further major investment. • The vision is set out in the Single Midlothian Plan. The Council's transformation programme and service plans outline how the Council intends to deliver its contribution. The Council scrutinises how it is performing primarily through the Cabinet and Performance, Review and Scrutiny committee. There is a focus on its five themes, three priorities, its customers and how it runs its business. • Council performance using the Local Government Benchmarking Framework indicators show performance has fluctuated since 2011/12. The Council is performing well in respect of its public performance reporting, with a commitment to being open and transparent and balanced in its reporting.

The Council vision and priorities

The Council and community planning partners (the Partnership) have set out the vision for the area in the Single Midlothian Plan (the Plan). The Plan lays out how the Council will focus on service delivery and improve outcomes for its communities. The vision has evolved over time. In 2003 the Partnership set out a 2020 vision based on Sustainable Environment, Cultural Identity and Diversity and Social Inclusion.

The Partnership conducted a review of its vision in 2015. This led to the introduction of the overall vision statement 'Midlothian – A Great Place to Grow'. It also led to a focus on three priorities up to 2019/20 to reduce the economic circumstances gap; to reduce the gap in learning outcomes and to reduce the gap in health outcomes.

The Partnership reviews the Plan on an annual basis. This starts with a review of a core set of data which then informs a strategic assessment of the needs of Midlothian. In that way the Partnership can adapt its vision to changing circumstances.



Source: Single Midlothian Plan

Elements of value for money, and our assessment of the Council's arrangements

As shown above, the Plan 2018/19 sets out the vision of five broad thematic areas with three focused priorities. The five thematic areas are: Sustainable Growth, Improving Opportunities, Community Safety, Getting it Right for Every Midlothian Child and Adult Health and Care. The three priorities indicate where efforts will be concentrated up to 2020. The vision also sets out an area based approach, identifying Mayfield / Easthouses, Gorebridge, Dalkeith / Woodburn. These areas are in the top 20% of Scotland's areas of multiple deprivation. The Partnership has set out clearly in its vision that it wishes to improve outcomes for areas characterised by greater deprivation.

The context of Midlothian is one of a growing population. Midlothian has the highest projected increase in population rates for all ages below pensionable age. This growing population will bring significant challenges, including for house building and community expansion. Sustainable Growth is one of the five themes within the Council's vision, but there is no supporting short term priority to support this. We will look at this in more depth as part of the BVAR planned for 2018/19. The Council's transformation programme and individual service plans outline how the Council intends to deliver its contribution to the Plan. Each service is required to reflect on the overall vision set out in the Plan and what each service is going to deliver.

The Council has continued to make significant investments from 2015/16 to 2017/18 with £3 million in Secondary Schools; £37.2 million in Primary/Nursery/Early Years schools; £47.4 million invested in housing (new Social House Building Programme, Kitchen Replacements, SHQS central heating etc, aids/adaptations). Investment in Care Homes has seen £2.4 million with a further £0.3 million budgeted in the General Services Capital Plan.

Investment plans as a result of the City Deal for the area offers the potential for major investment in economic growth, especially in larger scale capital infrastructure developments. The overall deal is worth £1.3 billion for the City Deal Region over the next 15 years. Midlothian can expect to benefit proportionately from the City Deal investment in the integrated regional skills programme; and potentially with the provision of new secondary school 'centres of excellence', similar to that of the digital centre of excellence recently provided at the new Newbattle High School, and the planned centre of excellence for creative industries at Shawfair High School, part of the planned new settlement at Shawfair.

The Council's performance against its vision and priorities

The Council scrutinises how well it is doing against its vision and priorities primarily through the Cabinet and Performance, Review and Scrutiny committee. The Council's annual performance report is detailed. It is structured against the five vision themes and gives an eight page summary of progress against these five themes. In addition to the narrative, the report also contains sections showing performance against indicators. The document is lengthy but the upfront narrative helps set performance in context.

The balanced scorecard reports, a recent introduction to the performance reports, have a user-friendly format. The scorecards evaluate performance against the three vision priorities and against how the Council is performing in other categories. Our review of the annual balanced scorecard has identified there are a number of areas where data is not yet available or where indicators are not measured against a target. It is important the Council ensures it sets targets where it can or provides the most recent position on performance until updated data becomes available. We will look at this in more depth as part of the BVAR planned for 2018/19.

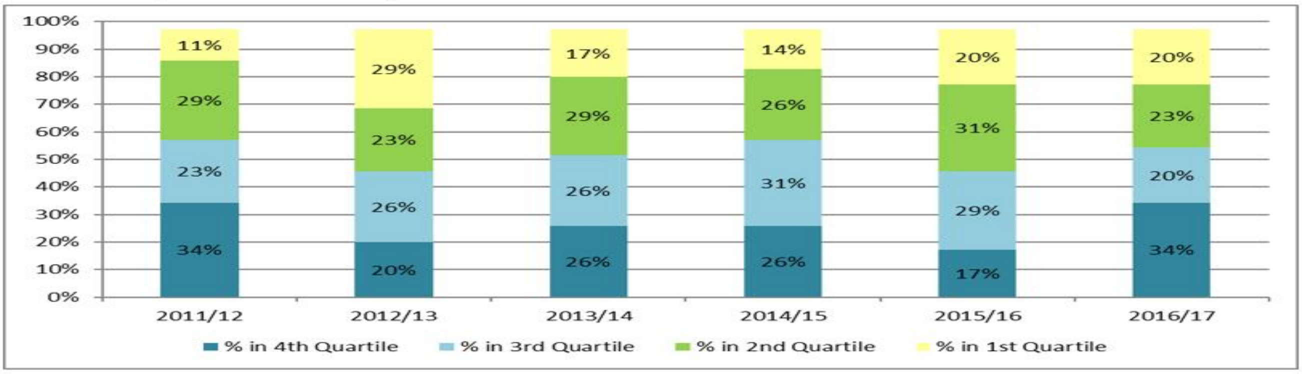
Based on current performance information the Council is on target for achievement of more indicators for Reducing the Gap in Economic Circumstances. Performance is more mixed for Reducing the Gap in Learning Outcomes with four indicators on target and four off target. The latest inspection report for wider Community Learning and Development in Midlothian, presented to Council in January 2017 noted a number of key strengths. Whilst seven key indicators have been identified for Reducing the Gap in Health Outcomes, data for 2 of the indicators was not available at the point of publication and 2 were shown as 'data only' and therefore no target set, this made this priority harder to assess in terms of progress.

In addition to the three priority areas of the vision, the Council measures its performance against Customer Perspective, Internal Processes, Financial Health, Learning and Growth. For each of these high-level areas in the scorecard there are individual performance measures. The Customer Perspective indicators also contain some outcome focused improvement areas such as reducing inequalities and growing the local economy. The Council has a broad approach to performance management with a focus on its five themes, three priorities, its customers and how it runs its business.

The Council's performance using the Local Government Benchmarking Framework

Council performance using the Local Government Benchmarking Framework indicators show that performance has fluctuated since 2011/12. The figure shown below presents the quartile splits from 2011/12 to 2016/17 for 35 of the total 68 LGBF indicators reported by the Council. The analysis of the 35 indicators show that the Council was in the bottom quartile for 34% of indicators in 2016/17 and there were more indicators in the bottom quartiles than the top quartiles in 2016/17.

LGBF relative performance over time, 2011/12 to 2016/17

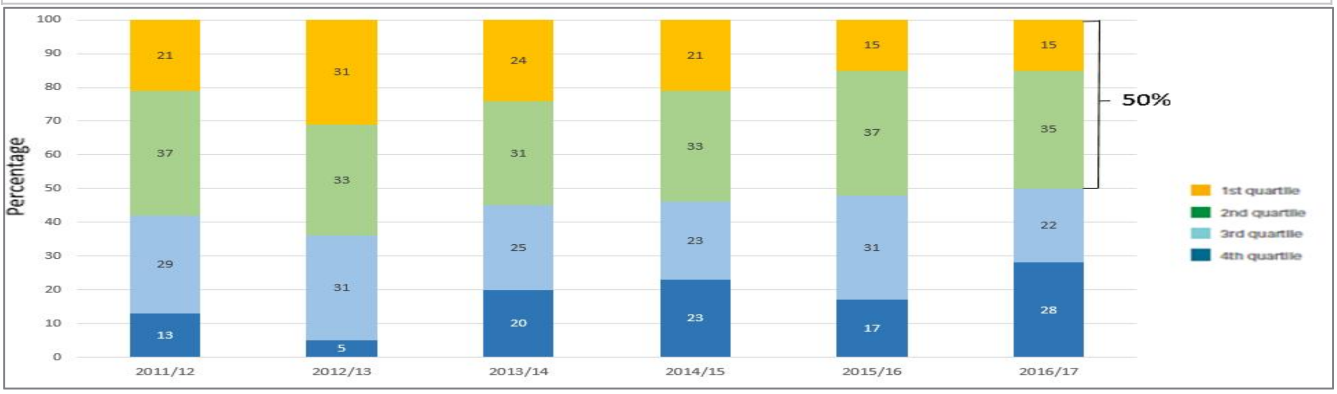


Note: This analysis is based upon 35 single year, mainly outcomes based, indicators which were reported on as part of the Local Government Benchmarking Framework every year within the 6 year period. Where a council failed to supply data for one of the 35 indicators we have excluded this from our analysis and so reported totals may not equal 100%.

Source: *Local Government Benchmarking Framework*, Improvement Service 2018

The Council's annual LGBF update report presents the outcome of the national comparison exercise with other local authorities across the identified performance, cost and satisfaction indicators, but also looks to use the information to support service improvement. The indicators are analysed across the seven categories of the LGBF and performance against the indicators is monitored as part of the performance management arrangements which includes quarterly reporting to Cabinet and the Performance, Review and Scrutiny Committee.

A report to Performance, Review and Scrutiny Committee in June 2018 presented the relative performance over time, 2011/12 to 2016/17 for the full set of LGBF indicators reported by the Council as shown below. This shows that the split between the top and bottom quartiles is 50/50 for the indicators in 2016/17.Performance improved from the previous year for 30 of the 68 indicators, 2 showed no change and 36 showed reduced performance. Performance within Education is now measured against a different data set, referred to as Insight leaver's data sets, all of which have improved over the last three years. The Council's Local Scrutiny Plan for 2018 also noted that overall, outcomes for children and young people were improving year on year against national measures but also recognised that at secondary stage more work was required to increase attendance, reduce exclusions and to improve aspects of attainment.



Source: Midlothian Council, Performance Review and Scrutiny Committee Report – 5 June 2018

Public performance reporting

The Council is performing well in respect of its public performance reporting. Its website is well organised and the Council provides further detail through hyperlinks. The Council also gives a commitment to providing performance reports in different languages and format. The Council demonstrates a commitment to being open and transparent with a balance between reporting good performance and areas it has identified for improvement.

4. Other work; audit deliverables

4. Timing and deliverables

We deliver our audit in accordance with the timeline set by the Council, in accordance with guidance from Audit Scotland. Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC

Audit Activity	Deliverable	Timing
Ø Onsite fieldwork, documentation and walkthrough of key accounting processes Ø Scoping of Best Value work for the year	Annual Audit Plan	13 March 2018
Ø Review of frauds reported to the audit committee.	Fraud Return Submission	Submitted – in line with frauds reported to audit committee
Ø Education Maintenance Allowance (EMA) grant claim testing	Certified EMA return	Issued 31 July 2018 – no matters to report
Ø Year-end substantive audit fieldwork on unaudited financial statements Ø Conclude on results of audit procedures Ø Issue opinion on the Council's financial statements Ø Performance of Best Value fieldwork	Whole of Government Accounts assurance statement to NAO Certify Annual Financial Statements Issue Annual Audit Report Submit Best Value Data Return to Audit Scotland	No longer required 30 September 2018 1 October 2018
Ø Criminal Justice Social Work (CJSW) return testing	Certified CJSW claim	No longer required
Ø Completion of Non-Domestic Rates return testing	Certified Non-Domestic Rates return	On track for 6 October 2018
Ø Completion of Housing Benefits claim testing	Certified Housing benefit subsidy claim	On track for 30 November 2018

Appendices

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	Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for: • 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. • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures. • ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority. • maintaining proper accounting records. • 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. 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. 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.
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	Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: • such financial monitoring and reporting arrangements as may be specified • compliance with any statutory financial requirements and achievement of financial targets • balances and reserves, including strategies about levels and their future use • how they plan to deal with uncertainty in the medium and longer term • the impact of planned future policies and foreseeable developments on their financial position.
Best Value	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. Specified audited bodies also have to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

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 Council.

What we are required to communicate

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY) and your Authority, and its directors and senior management and its affiliates, including all services provided by us and our network to your Authority, its directors and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the 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 19 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 have provided £68,000 of non-audit services in respect of forensic advice and assistance in respect of the unplanned investigation into the Council's Road Division.

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 Council 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 Council on 25 September 2018.

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

Component of fee:	2017/18	2016/17
Auditor remuneration – expected fee	*£138,040*	*£136,670*
Fees in respect of additional audit procedures*	£49,832	£14,890
Total agreed auditor remuneration	£187,872	£151,560
Audit Scotland fixed charges:		
Pooled costs	£12,270	£11,900
Performance audit and best value	£64,250	£65,680
Audit support costs	£8,770	£8,160
Total fee	£273,162	£237,300

* To be agreed (£39,450 of which relates to additional audit work in respect of unplanned investigation into Council's Road Division)

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. 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. 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 with a new leader.
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 Council since appointment can be found at: www.audit-scotland.gov.uk/uploads/docs/report/2018/as_audit_quality_1718.pdf.

Required communication	Our reporting to you
Terms of engagement / Our responsibilities 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
Planning and audit approach Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Annual Audit Plan
Significant findings from the audit • Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	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.
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	No conditions or events were identified, either individually or together to raise any doubt about the Council's ability to continue for the 12 months from the date of our report.
Misstatements • Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	This Annual Audit Report
Fraud • Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud	This Annual Audit Report
Consideration of laws and regulations ► 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 ► 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	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
Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	No significant matters have been identified. We have raised a recommendation for management to consider on how related party information is captured in the reporting process
Independence Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Annual Audit Plan This Annual Audit Report – Appendix B
Internal controls Significant deficiencies in internal controls identified during the audit	This Annual Audit Report – no significant deficiencies reported We have raised recommendations in relation to improving internal control.
Group audits • An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work • Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements	Annual Audit Plan This Annual Audit Report
Subsequent events • Where appropriate, asking the audit committee whether any subsequent events have occurred that might affect the financial statements.	We have asked management and those charged with governance. We have no matters to report.
Material inconsistencies Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	This Annual Audit Report

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 Council 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	There were a large number of presentational and disclosure adjustments to the financial statements as a result of the audit. These have been corrected by management but reflect that, consistent with our findings in the prior year, an increased focus is required by management to ensure that there is a robust review process over the completeness and accuracy of the financial statements prior to being made available for audit and public inspection.	Management should review its financial statement preparation arrangements. Particular focus should be given to: ► Ensuring preparation of the financial statements is assigned to appropriate individuals ► Ensuring sufficient time is built into the financial statement process to allow multiple levels of detailed review and subsequent updated versions of financial statements ► Ensuring a specific action plan is developed to pre-emptively address the themes and drivers around adjustments identified in the 2017/18 audit, to prevent similar errors occurring again. *Grade 1*	The annual review of the arrangements for the preparation and review of the financial statements, following the 2017/18 audit, will focus on the issues identified during the audit and the areas where adjustments were required, particularly in respect of the arrangements for valuation and accounting for PPE. This will build on the range of improvements which were made for the 2017/18 year end process following last year's audit recommendations and de-brief with EY. Head of Finance and ISS Timeframe: 31 March 2019
2	The unaudited financial statements were considered by the Audit Committee on 28 August, three days ahead of the deadline of 31 August. While this is compliant with statutory requirements, in our view better practice would be to ensure this process was completed earlier in the financial statements and audit cycle.	Management should ensure the Audit Committee consideration of the unaudited accounts earlier in the cycle, in advance of the audit commencing and prior to the summer recess. *Grade 2*	The schedule of meetings for 2019 will be determined by Council on 2 October 2018. That timetable would require that the accounts for 2018/19 be presented to audit committee on 20 August 2019. In consultation with the chair of audit committee arrangements will be made for a special meeting of audit committee in June 2019. The meeting schedule will also be amended for the future years. Democratic Services Officer Timeframe: 31 May 2019

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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
3	Insufficient progress has been made during 2017/18 in addressing recommendations in respect of quality assurance over PPE valuation process and output; and oversight and scrutiny of the financial reporting process. There were also instances where it was difficult to identify the evidence retained by the Council to establish support for a number of transactions recorded within the financial statements. Further work is required to update and enhance the financial reconciliation processes. While there are controls over journal entries, there is a risk that absence of fuller reconciliations from account balances and feeder systems could result in incorrect / fraudulent postings being undetected in a timely manner. There is scope to improve the documentation by management of these key judgements. While the 2017/18 financial statements are compliant with the requirements of the Code regarding internal recharges, management has identified that there is uncertainty around the exact recharges to be removed without significant additional analysis around the Council's financial reporting information. We identified one instance of an employee from Children's Services continuing to be paid for several months after leaving. This occurred as a result of the leaver's documentation not being properly provided on a timely basis to HR by the department manager.	Management should, in addition to the actions around the financial statement preparation process in recommendation one, implement revised financial processes and controls throughout the year to significantly enhance the robustness of: ▸ The yearend PPE valuation process, including both assets re-valued in the year and the assessment of assets not due for revaluation for possible triggers or indications of changes of value. ▸ The arrangements for provision / retention of supporting evidence for financial transactions processed across the Council and reported on by finance. ▸ Management's financial reconciliation processes and review arrangements for these. ▸ Documentation of key judgements. ▸ Processing, monitoring and reporting on internal recharges between Council services. ▸ Arrangements for services to inform payroll of employees who have left the Council during the year. *Grade 1*	The annual review set out for recommendation 1 will include these points and build on the improvements made for 2017/18. At this stage it is anticipated that the review will evidence that additional capacity will be required to ensure that the property valuations undertaken in house by Property and Facilities Management staff are robust, fully documented and completed timeously. It is also anticipated that similar additional capacity would be required to maintain the accounting arrangements for Property Plant and Equipment to the level expected. This will include the maintenance and management of the fixed asset accounting system. Responsible officer: Head of Finance and ISS Timeframe: 31 March 2019

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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
4	There is an absence of controls over the identification of new related parties. Management were unable to provide evidence of consideration of how the Council obtained assurance that related parties disclosed in the financial statements are complete. Additionally, there were no procedures undertaken by finance to identify whether there were any transactions with the companies / other parties where members have interests established.	Management should review and enhance its procedures to identify and monitor related party transactions, and ensure these are appropriately considered for reporting in the financial statements at the year end. *Grade 2*	A review process will be incorporated into the 2018/19 year end procedures. Responsible officer: Financial Services Manager Timeframe: 31 March 2019
5	A record of who has requested and authorised journals is not maintained centrally. Instead, the only record available is the signed and authorised manual journal transfer form. Furthermore, supporting documentation behind journals raised is not held centrally in a way that makes it immediately apparent which journal it relates to. Instead, the individual who has raised the journal is expected to save and retain the information and has to locate where the information can be found. These processes pose a risk to a that financial transactions cannot be sufficiently supported or understood by management.	Management should ensure a proper audit trail of all journals is created and maintained centrally for finance records. This should include at a minimum: ► A record of every journal posted and the source / preparer / approver ► Support for the underlying transaction depending on established guidelines based on the nature of the journal *Grade 2*	A review of journal entry arrangements processing and recording arrangements will be carried out with the objective of improving the audit trail, retention of underlying supporting documentation and efficiency of the process. Responsible officer: Financial Services Manager Timeframe: 31 March 2019

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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
6	For the past three years the Council has not delivered on its approved budget. Pressures around financial savings through the Council's transformation programme have not been addressed in 2017/18, with budgetary pressures are likely to increase in future years.	It is imperative the financial planning arrangements to address budget gaps are underpinned by robust financial budgeting and monitoring arrangements to ensure budgets are robust and realistic at the start of the year, and developments identified and addressed in a timely manner during the year. *Grade 1*	Revised reporting arrangements, including service change dashboards (reported to Business Transformation Board) were introduced in 2018. These will be further strengthened to ensure they are underpinned by robust financial assessments with added oversight from the Finance team. Furthermore, service recovery plans to address the quarter 1 projected overspend for 2018/19 will be presented to Council on 2 October 2018. To strengthen the quarterly monitoring arrangements are already being put in place to hold formal recorded review meetings between the Head of Finance and ISS and each Head of Service to review the budget projections, variations and corrective action. For the remainder of the 2019/20 budget timetable arrangements will be reviewed and changes put in place to help ensure greater robustness and deliverability for the resulting service budgets and that areas of risk are identified to support more effective in year monitoring. Responsible officer: Head of Finance and ISS Timeframe: 28 February 2019

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 Council 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
7	The underspend in the capital programme during 2017/18 follows a number of years where the Council has predominantly under delivered against its capital plans, due to recurring slippage in delivery of capital projects. As the Council continues to seek transformational change, the long term capital plan is a significant part of this and ongoing slippage or unrealistic budgets and targets have the potential to impede delivery of change.	Management should undertake a review of its capital programme, to ensure that the timeframes for delivery are achieved going forward and that monitoring and reporting mechanisms are enhanced to drive more accurate analysis and planning around capital work. *Grade 2*	See earlier comments regarding the phasing adjustment already applied. In addition, alongside the work to finalise the capital strategy, a review of the phasing of projects and expenditure will be carried out. Monitoring reports already highlight project slippage and this will be enhanced to help drive more accurate analysis of project slippage. Responsible officer: Senior Accountant - Treasury Timeframe: 28 February 2019
8	From our discussions with senior management, attendance at meetings, and review of papers and minutes, in our view there is a need for the Council to review the level of skills and capacity across finance and integrated support services to ensure that these remain appropriate to support the Council moving forward and to support transformation. While the preservation of front-line services is understandably of prime concern to members and officers, maintenance of strong financial control to support service transformation necessitates the retention of suitable financial and other corporate support services.	Management should review the skills and capacity across finance and integrated support services to ensure that these remain appropriate to support the Council moving forward and to support transformation. *Grade 1*	There is already a programme of review activity across Finance and Integrated Service Support which is being undertaken as part of the Integrated Service Support review. At 31 March 2018 this activity has taken £2.4 million out of service delivery costs. There are further savings targets in 2018/19 and 2019/20 which total £1.6 million. The forward review activity aims to protect as far as possible the professional skills and capacity across the service. The review activity for the second half of 2018 will include an assessment of the skills and capacity for the areas indicated by EY and which will be discussed in more detail as part of the debrief arrangements. Responsible officer: Head of Finance and ISS Timeframe: 30 April 2019

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 Council 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
9	Directors and Heads of Service are provided with formal updates on their budget on a quarterly basis and budget monitoring reports are produced and reported to Council on a quarterly basis, This is supported by a range of regular monitoring activity and reporting to service management carried out by the Finance team thought the year with a particular focus on volatile budgets or areas of particular risk. However the outturn position and variations from budget highlights the need to enhance both the scrutiny over budget proposals, to ensure they are robust and deliverable, and also to enhance the monitoring arrangements to strengthen the ability of senior officers to identify and resolve budget pressures on a timely basis. Directors and Heads of Service remain reliant on finance to provide budget monitoring reports rather than accessing information directly or being appraised of the service budget position by their service managers who are the budget holders. In addition to impacting accessibility this can impact the required sense of ownership for budget holders against the budget for which they are responsible. In our view improvements remain to be made over financial reporting arrangements to support budget holders and members in their roles.	In our view improvements remain to be made around the financial reporting arrangements to support budget holders and members in their roles. *Grade 1*	To strengthen, the quarterly monitoring arrangements are already being put in place to hold formal recorded review meetings between the Head of Finance and ISS and each Head of Service to review the budget projections, variations and corrective action. For the remainder of the 2019/20 budget timetable arrangements will be reviewed and changes put in place to help ensure greater robustness and deliverability for the resulting service budgets and that areas of risk are identified to support more effective in year monitoring. The existing monitoring and reporting arrangements across all three Directorates will be reviewed and enhancements implemented to better support budget holders and members in their roles. Responsible officer: Head of Finance and ISS Timeframe: 31 March 2019

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 Council 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
10	As part of our 2016/17 audit, we recommended that management should review the transformation and change programmes to provide clearer reporting, oversight and scrutiny. We also reported that significant work was required to ensure that Council has robust, fully costed savings plans which align to the Council's key priorities as set by members. Despite the majority of the earmarked General Fund Reserves having been applied or expected to be applied by 2018/19 there remains significant work to be undertaken to support the transformation of services and financial sustainability of the Council.	Given the acute financial position facing the Council there is a need for a significant improvement in the pace of transformation, supported by enhanced reporting and scrutiny. *Grade 1*	Service recovery plans in respect of 2018/19 provide some evidence of early improvement in the pace of change. These will be reported to Council on 2 October 2018. It is fully recognised that significant improvement in the pace of service transformation is required to ensure financial sustainability and this has to be addressed in the lead up to the Council considering its 2019/20 budget Responsible officer: Chief Executive and Executive Team Timeframe: 28 February 2019
11	At 31 March 2018 the Council has uncommitted General Fund Reserves of £4.3 million. The Council's financial strategy for 2019/20 to 2022/23 noted, given the level of available contingent reserves it would not be considered prudent for Council to meet additional spending pressures from the contingent reserve or to use the contingent reserve as part of the strategy to secure a balanced budget for 2019/20. The Council is projecting that the uncommitted General Fund Reserve at 31 March 2019 will be £1.7 million. We continue to highlight that this poses a significant risk to the Council and provides limited ability for the Council to respond to unforeseen events.	In advance of the approval of the 2019/20 Council budget, the Council should reassess its targeted reserves against the current financial environment and the impact this will have on setting a balanced budget in line with statutory requirements. *Grade 1*	The Reserves Strategy will be reviewed and recommendations presented to Council in advance of approval of the 2019/20 budget Responsible officer: Head of Finance and ISS Timeframe: 28 February 2019

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 Council 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
12	The Annual Governance Statement sets out the ongoing unplanned investigation, noting that while the investigation has not yet concluded a number of required improvements to internal control, risk management and governance have been identified.	The intention is to report progress on proposed actions to the Audit Committee on a quarterly basis to enable effective monitoring and scrutiny by members of implementation of areas for improvement. We support this approach of enhanced scrutiny by the Audit Committee of the implementation of agreed audit recommendations. Deadlines for implementation of improvements should also be specified. *Grade 1*	Progress on the actions in the annual governance statement will be reported quarterly to the Audit Committee. The first update will be presented to Audit Committee in December 2018. Responsible officer: Legal Services Manager Timeframe: 31 December 2018

This appendix sets out the reportable adjustments processed in the financial statements prior to their finalisation. We also report on the unadjusted audit differences identified.

Adjusted audit differences	Income and Expenditure impact / £	Balance Sheet impact / £
1. Adjustment to correct assets that do not meet criteria for assets held for sale		
Dr Property plant & equipment - Surplus		451,908
Cr Property, plant & equipment – Assets held for sale		(451,908)
2. Adjustment to pension assets as a result of an error in actuarial assumptions		
Dr Pension Assets		8,238,000
Cr Actuarial gains – return on pension assets	(8,238,000)	
3. Removal of asset additions double counted		
Dr Revaluation reserve		1,009,403
Cr Property, plant & equipment		(1,009,403)
4. Correction of classification of PPE to Assets Held for Sale		
Dr Property, plant & equipment – assets held for sale		2,700,162
Cr Property, plant & equipment – land		(2,574,162)
Cr Property, plant & equipment - buildings		(126,000)
5. To remove HRA developer contributions (unapplied)		
Dr Capital grants received in advance		2,593,580
Cr Unusable reserves		(2,593,580)
6. Correction of valuation errors in PPE		
Dr Revaluation reserve		2,468,316
Cr Property, plant & equipment		(2,468,316)
7. Correction to valuation of investment		
Dr Long term investment		3,131,715
Cr Reserves		(3,131,715)
8. Correction to PFI accounting		
Dr Deferred liabilities		229,572
Cr Capital adjustments account		(229,572)
9. insurance settlement to be moved from "movement in the capital fund" in OCI to taxation and non-specific grant income		
Dr Transfer to the capital fund (OCI)	2,436,000	
Cr Taxation & non specific grant income	(2,436,000)	
10. Correction to funding without conditions in CF received in advance		
Dr Capital funds received in advance		249,289
Cr Taxation and non-specific grant income	(249,289)	
11. Correction of HRA valuation error		
Dr HRA expenditure	1,046,850	
Cr Property, plant & equipment - HRA Houses		(1,046,850)

This appendix sets out the reportable adjustments processed in the financial statements prior to their finalisation. We also report on the unadjusted audit differences identified.

	Income and Expenditure impact / £	Balance sheet impact / £
12. Correction of treatment of movement in capital fund		
Movement in the capital fund (OCI)	319,000	
Adjustments between funding and accounting basis	(319,000)	

Unadjusted audit differences		
1. Correction of system errors for PPE revaluation postings		
Dr Property plant & equipment		222,900
Cr Revaluation reserve		(222,900)

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Financial Statements for the year ended 31 March 2018

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

1 Purpose of Report

The purpose of this report is to present the Council's draft audited Financial Statements for 2017/18 to Audit Committee and to provide a brief overview of the changes made during the audit process. The draft audited accounts are included separately on today's agenda.

2 Background

Council submitted its unaudited annual accounts to the external auditor by the required date of 30th June 2018 and they were examined in detail at a special Audit Committee on Tuesday 28th August 2018.

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

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

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

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

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

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

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

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

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

10 (7) Following the signature of the Annual Accounts, the proper officer must provide the Annual Accounts, including the signed statements, to the auditor.
10 (8) Any further report provided by the auditor following the signature of the Annual Accounts which relates to those accounts must be considered by the local authority or a committee of that authority whose remit includes audit or governance functions.

Accordingly the accounts are presented to Audit Committee today as required by the regulations as is the appointed external auditor, EY's, report in respect of 2017/18.

The external auditors report will also be presented to Council on Tuesday 13th November 2018 and a copy of audited accounts provided to all members.

2.1 Changes to Accounts through the Audit Process

There are no qualifications to the Financial Statements.

Twelve principal audit differences were identified and adjusted during the audit. These adjustments have no impact on the Council's reported outturn for the year. Given that, at the time of writing, the audit of the accounts remains to be finalised, members will be advised if any further material changes arise at the meeting.

The twelve adjustments agreed to date during the audit included:

- Five related to Property Plant and Equipment (PPE) which result in a reduction of £4.524 million in the combined value of PPE and Assets held for sale shown in the Balance Sheet. This is as a consequence of a of revisions to the carrying value of individual assets;
- An increase of £3.131 million in the value of Long Term Investments in the Balance Sheet. At the time of preparing the unaudited accounts Lothian Buses accounts to the year ended 31 December 2017 were not available but became available shortly thereafter. Lothian Buses have shown a considerable increase in their net assets from the prior year thus the value of Midlothian Council's shareholding increases in line;
- A reduction in the value of the Pension Liability of £8.237 million as a consequence of the actual value of Lothian Pension Fund assets compared to the estimation used by the actuary when compiling their assessment of Midlothian Councils pension liability at the year end. This was identified as a national issue during the audit process and for Midlothian the value of the difference required an adjustment to be made to the accounts.
- A reduction in the liability for Grant Receipts in Advance of £2.843 million. The first part of this (£2.594 million) relates to the treatment of Housing Revenue Account Developer Contributions which was reported as a non-adjusting error in 2016/17 with agreement to revise in 2017/18. Amended treatment no longer shows these as a liability in the Balance Sheet. The second part (£0.249 million) is a correction in the treatment of grants received which have no terms or conditions attached to them which may result in a repayment of said grant at some point in the future. The correct treatment for

those with no conditions is a credit to the Taxation and non-specific income line in the Comprehensive Income and Expenditure Account.

- A correction to the PFI accounting entries which resulted in a reduction increase in deferred liabilities of £0.230 million.
- The remaining two adjustments relate to the treatment of Capital Funds.

These adjustments have no impact on the General Fund Balance of £10.777 million or the Housing Revenue Account Reserve Balance of £33.863 million.

2.2 Management Commentary and Annual Governance Statement

During the audit a number of agreed enhancements were made to both the Management Commentary and the Annual Governance Statement.

3 Financial Management and Financial Sustainability

The annual report by EY also on today's agenda rates both Financial Management and Financial Sustainability as Red.

In respect of Financial Management the report highlights that:-

- *Similar to prior years, the Council has not operated within approved budgets. Continued work is required to ensure that budgets are robust and realistic.*
- *The Council continues to under deliver against its capital plans, due to recurring slippage in delivery of capital projects. The capital plan is a significant part of transforming the Council; ongoing slippage or unrealistic budgets have the potential to impede delivery of change.*
- *Improvements remain to be made over financial reporting arrangements to support budget holders and members in their roles. There is also a need for the Council to review the level of skills and capacity across finance and integrated support services to ensure these remain appropriate to support the Council and service transformation.*

In respect of Financial Sustainability the report highlights that:-

- *The Council continues to experience acute financial pressures. Significant progress is urgently required to deliver a balanced 2018/19 outturn and to support approval of a robust 2019/20 budget.*
- *There are significant funding gaps over the period to 2022/23. Difficult decisions will have to be taken to achieve financial balance. There is a need for a significant improvement in the pace of transformation, supported by enhanced reporting and scrutiny.*
- *The Council is projecting that the uncommitted General Fund Reserve at 31 March 2019 will be £1.7 million. This poses a significant risk to the Council and provides limited ability to respond to unforeseen events.*

EY's annual report sets out a number of recommendations and the management response to these. Whist the responses sit with officer's to implement the report sets out critical messages for all elected members to respond to in the coming months to strengthen the Council's financial position in response the acute financial pressures. As the report highlights difficult decisions will have to be taken to achieve financial balance.

4 Report Implications

4.1 Resource

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

4.2 Risk

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

4.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

4.4 Impact on Performance and Outcomes

The proposals in this report do not directly impact on performance or outcomes.

4.5 Adopting a Preventative Approach

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

4.6 Involving Communities and Other Stakeholders

No consultation was required.

4.7 Ensuring Equalities

There are no equality implications arising directly from this report.

4.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

4.9 IT Issues

There are no IT implications arising from this report.

5 Recommendations

Audit Committee is recommended to approve the 2017/18 accounts for signature having regard to the appointed auditor's report for 2017/18.

16th September 2018.

Report Contact:
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E mail david.gladwin@midlothian.gov.uk

Background Papers:

Midlothian

Midlothian Council

Audited

Financial Statements

2017/18

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Management Commentary by the Head of Finance and Integrated Service Support

The Financial Statements present the financial performance of Midlothian Council for the year to 31 March 2018. They are prepared in accordance with the International Financial Reporting Standards (IFRS) based on the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (The Code) and are necessarily technical in places. The management commentary outlines financial performance for the year, the financial outlook and risks and also provides non-financial strategic and contextual information about the Council.

Financial Performance

The Council's financial performance is presented in the Comprehensive Income and Expenditure Account (CIES) on page 34. To show the financial position of the Council it is necessary to adjust the CIES for statutory items that require to be taken into account in determining the General Fund and Housing Revenue Account (HRA) balances for the year. These are shown in the Expenditure and Funding Analysis on page 52, the Movement in Reserves Statement on page 36 and in more detail in note 6 on page 56.

General Fund

The General Fund is the statutory fund into which all the receipts of the Council are required to be paid and out of which all liabilities of the Council are to be met, except to the extent that statutory rules provide otherwise. The General Fund is funded by government grants, fees and charges, council tax income, non-domestic rates income and interest / returns on investments and is split between uncommitted balances, which are held to manage financial risks and unplanned expenditure, and balances which have been earmarked for specific purposes.

The outturn position for the General Fund compared to budget in 2017/18 is shown in the table on the following page. Full details were reported to Midlothian Council on 26th June 2018 and are available on the Council's website.

These annual accounts incorporate the "Telling the Story" presentational changes included in the 2016/17 local authority code of practice and include an Expenditure and Funding Analysis (EFA) on page 52. The EFA provides the link between the council's budget monitoring reports and the figures in the main financial statements. The section entitled "Building the Expenditure and Funding Analysis" has been included to assist users of the accounts in navigating from the budget outturn report through to the first column of the EFA and the CIES on page 34.

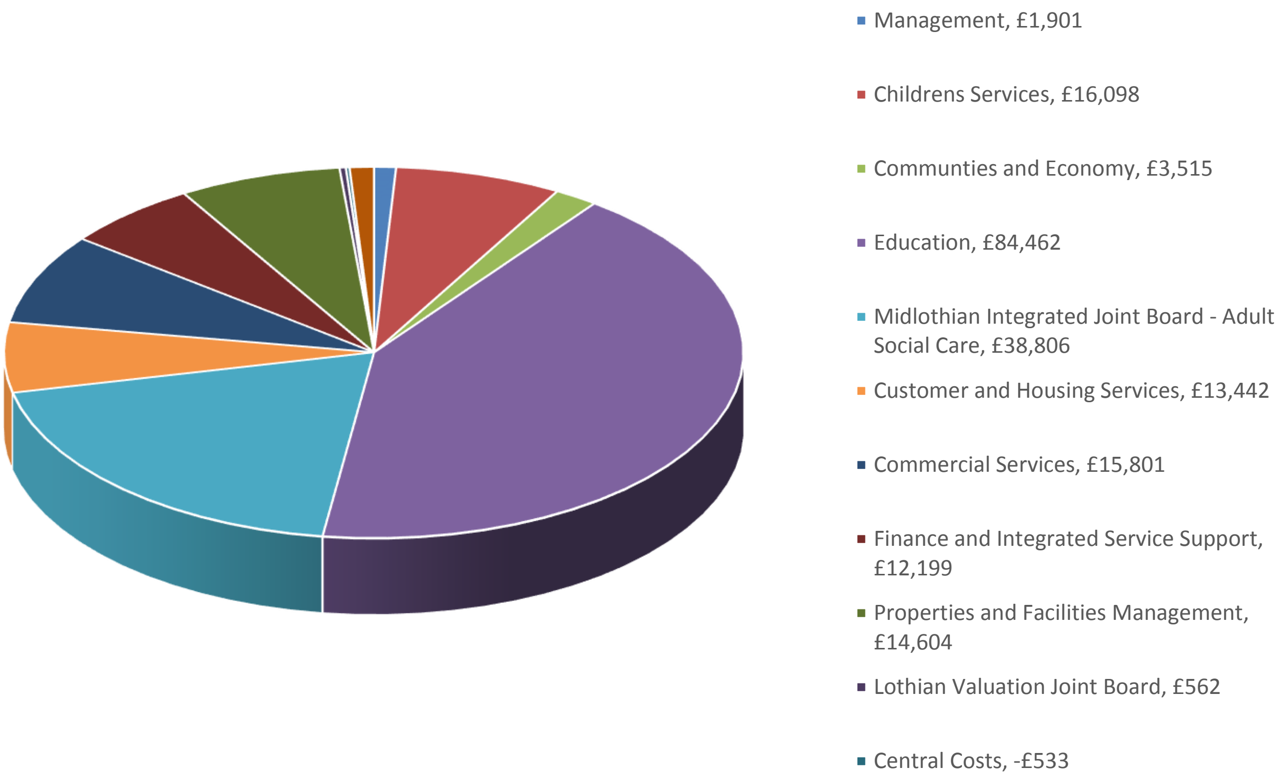
Midlothian Council Budget Monitoring				Building the Expenditure and Funding Analysis		
Service Area	**Budget**	**Net Expenditure**	**(Under) / Overspend**	**Budget Monitoring Net Expenditure**	**Adjustments between Council budget monitoring reports and statutory accounting requirement**	**Net expenditure chargeable to General Fund and HRA balances**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Management	1,918	1,901	-17	1,901	-44	1,857
Children's Services	14,675	16,098	1,423	16,098	0	16,098
Communities and Economy	3,861	3,515	-346	3,515	0	3,515
Education	84,658	84,462	-196	84,462	-6,584	77,878
Adult Social Care	38,806	38,806	0	38,806	0	38,806
Customer and Housing Services	12,275	13,442	1,167	13,442	-6,788	6,654
Commercial Services	15,881	15,801	-80	15,801	0	15,801
Finance and Integrated Service Support	11,899	12,199	300	12,199	-1,218	10,981
Properties and Facilities Management	14,295	14,604	309	14,604	-286	14,318
Lothian Valuation Joint Board	555	562	7	562	0	562
Central costs	-319	-533	-214	-533	0	-533
Non-distributable costs	2,136	2,075	-61	2,075	0	2,075
Loan charges	7,408	6,244	-1,164	6,244	15,615	21,859
Investment Income	-301	-371	-70	-371	0	-371
Transformation programme savings targets	-830	0	830	0	0	0
Allocations to HRA, Capital Account etc.	-4,782	-4,829	-47	-4,829	4,829	0
HRA	0	0	0	0	-14,461	-14,461
Net General Fund Expenditure	**202,135**	**203,976**	**1,841**	**203,976**	**-8,937**	**195,039**
Less Funding:						
Scottish Government Grant	150,879	151,645	-766	151,645	-68	151,577
Council Tax Income	45,004	45,457	-453	45,457	-4,759	40,698
General Fund Utilisation of Reserves	**6,252**	**6,874**	**622**	**6,874**	**-4,110**	**2,764**

The most significant factors which led to the variance from the budget were high levels of demand pressures within Children's Services, particularly for secure placements, residential placements, respite care and direct payments, these contributed to an overspend of £1.423 million. Within Customer and Housing Services there was an overspend of £0.548 million on homelessness accommodation mainly resulting from a delay to the opening of Pentland House by the service to meet demand and realise planned savings. Additional costs of £0.686 million were incurred in dealing with the exceptionally severe winter. There was also an overspend of £0.904 million resulting from the council's housing benefit overpayment debtor being overstated on the balance sheet, this expense required to be written off to the revenue account in the year. These contributed towards the services' net overspend of £1.167 million. There was also a shortfall in the achievement of transformation savings targets totalling £0.830 million. This figure is further broken down into Integrated Service Support savings of £0.266 million, procurement activity savings of £0.175 million, savings resulting from tactical reductions in contracted hours of £0.150 million and Customer Services savings of £0.239 million.

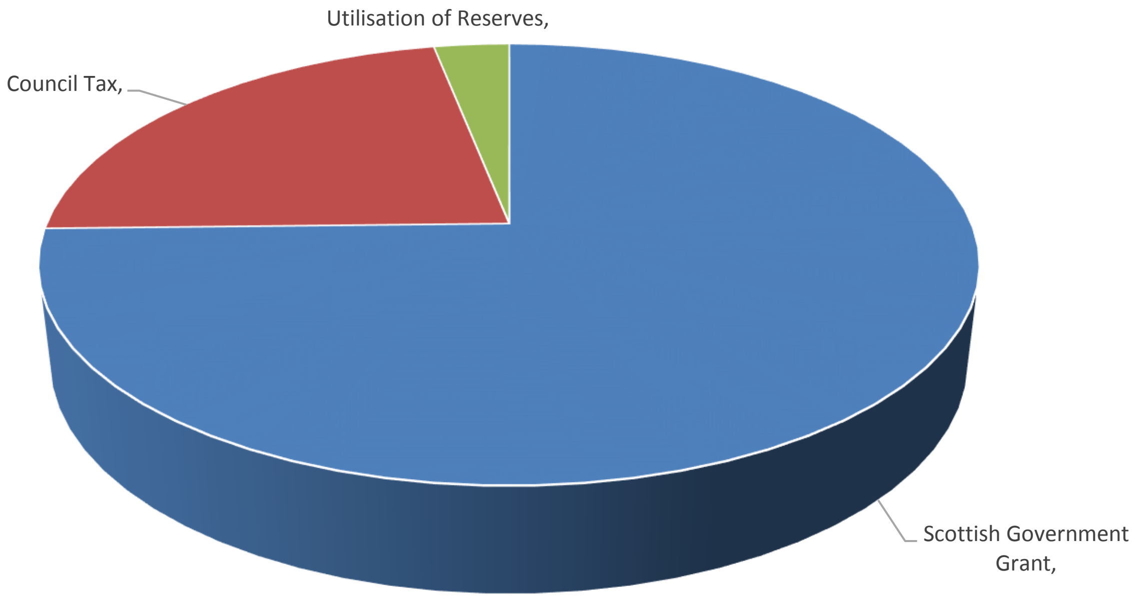
The Council revised its methodology for apportioning the interest costs associated with external borrowing between General Fund and HRA within its existing accounting policies to better reflect certainty associated with longer term borrowing to finance new council housing and investment in the existing stock relative to investment in other General Fund assets. This has resulted in a considerably reduced cost to General Fund. Additionally there was more slippage in capital programmes than anticipated in the budget for loan charges and borrowing took place at rates lower than anticipated. These factors resulted in an underspend on the Loan Charges budget of £1.164 million.

Actual net service expenditure for the year as set out in the budget monitoring report was £203.976 million representing 100.91% of the £202.135 million budget. General Fund services showed a net overspend against budget of £0.622 million. Funding through council tax was £0.453 million more than budgeted. The sustained increase in housing in Midlothian outstripped the level of council tax income growth built into budgets.

Graph 1 - 2017/18 Net Expenditure by Council Service £'000



Graph 2 - 2017/18 General Fund Revenue £'000



The General Fund reserve at the start of the year was £17.651 million, of which £9.094 million was earmarked for specific purposes in 2017/18. The position at 31st March 2018 is a reserve of £10.777 million of which £6.440 million was earmarked for specific purposes leaving £4.337 million. The Council's targeted level of minimum uncommitted reserve is between £4 million and £8 million which equates to between approximately 2% and 4% of net expenditure.

The earmarked element of the reserve includes budgets provided for specific purposes where spend has slipped into 2018/19 of £3.244 million, budgets for schools in accordance with the Scheme of Devolved School Management of £1.181 million and funding set aside to support the Council Transformation Programme of £2.015 million.

In line with previous Council decisions a number of specific initiatives were funded from earmarked reserves during the year including staff severance costs (£2.283 million) and a contribution towards establishing a digital centre of excellence (£0.056 million).

Housing Revenue Account

The Council has a statutory obligation to maintain a revenue account for its housing provision in accordance with the Housing (Scotland) Act 1987. The HRA records all income and expenditure relating to the Council's own housing stock. Revenue expenditure on housing management, repairs and maintenance is funded from rent paid by tenants.

The HRA showed a surplus of £4.110 million in 2017/18 and this increased the reserve to £33.863 million. There was an underspend of £0.515 million against budget mainly due to continuous capital investment in existing stock resulting in a decrease in spend on reactive repairs.

The council has an ambitious capital investment plan which currently runs to 2032/33 to build further new housing stock and continue to improve and upgrade its existing stock, particularly through Scottish Housing Quality Standards (SHQS) improvement works. The majority of this plan is funded through prudential borrowing with the costs of borrowing met from rental income and planned utilisation of the HRA reserve which is projected to reduce to approximately £2 million by the end of the plan. Since 2007 Midlothian Council has built 1,065 new council homes.

In 2017/18 £3.9 million was invested in new council houses and £4.7 million on SHQS improvement works. In the period to 31 March 2022 it is planned to invest a further £172 million on new council houses and £31.8 million on SHQS improvements.

Capital

The Council continues to make significant capital investment in its non-housing assets to provide essential infrastructure to meet the needs of a growing population. The Council spent £16.9 million in 2017/18. This included £8.1 million on the school estate, £2.4 million on roads, pavements and street lighting, £1.5 million on replacing and upgrading the Council's fleet, £1.5 million on digital assets and £1.4 million on centralised property upgrades. This expenditure was funded by a combination of government grants, external funding contributions from third parties, capital receipts, Section 75 developer contributions and borrowing. A full analysis of capital expenditure and financing is provided in note 31 to the financial statements.

The Council is able to regulate its own capital spending limits within a prudential framework recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) and endorsed by the Scottish Government, provided it operates within a series of indicators. The Council's capital expenditure is a key driver of treasury management activity and these indicators are relevant for the purposes of establishing an integrated treasury management strategy which demonstrates that the Council's capital investment plans are affordable, prudent and sustainable.

A revision to the 2011 Treasury Management Code has been published. It is titled “Treasury Management in the Public Services: code of practice and cross-sectoral guidance notes” and will apply from financial year 2018/19. The main changes include extension of the code to non-financial instruments that currently sit out with the Treasury function and clarification on governance arrangements.

The Capital Financing Requirement represents the Council’s underlying need to borrow for capital expenditure. It is not allowed to rise indefinitely and statutory controls exist to ensure debt is affordable and repaid over a reasonable timeframe. The Council’s underlying need to borrow for 2017/18 at the time the budget was set was £319.163 million. The actual position was £280.248 million with total debt at 31st March 2018 of £241.031 million demonstrating that the Council maintains its intention to have an under borrowed position. This means that the Council’s capital borrowing requirement has not been fully funded by loan debt and is using cash from working capital, reserves and balances to support capital programmes whilst investment returns are low.

During the year the Council’s aggregate external debt was contained within both the operational boundary and the authorised limit. The authorised limit of £482.021 million for 2017/18 reflects a level of debt which could be affordable in the short term but may not be sustainable in the long term. The operational boundary of £318.647 million for 2017/18 is an estimate of the most likely maximum debt requirement and represents the limit beyond which external debt is not expected to exceed.

The ratio of financing costs to net revenue stream represents the proportion of the budget that is allocated to the financing of capital expenditure and highlights the trend in this allocation through financial years. Actual figures for General Services were 3.25% which is in line with approved strategy and 38.24% for HRA which is reflected in long term HRA financial plans to 2032/33.

The General Services capital plan for future years will see further major investment in school infrastructure including a new primary school and community hub at Danderhall and a new denominational & non-denominational joint campus primary school at Hopefield. Early Years Expansion plans are expected to be fully implemented over this period across a number of current & new primary school facilities in the county. There will also be capital investment to complement the new Design, Build, Finance & Maintain (DBFM) projects for the Newbattle Centre and the Zero Waste Residual Treatment Facility. In addition, there will be continued investment in the roads and street lighting infrastructure and ongoing asset management replacement plans for buildings, fleet and digital assets. Investment in the construction of a new depot to replace the existing Stobhill depot and Council office accommodation is also scheduled in the medium term.

Long-term Borrowing

The council borrowed money throughout the year to meet actual and anticipated capital expenditure requirements and to refinance maturing loans after allowing for debt repayments. At 31st March 2018 long term borrowing amounted to £218.176 million which is a £9.360 million increase from the position at 31st March 2017. During 2017/18 new long term borrowing of £10.000 million was taken from the Public Works Loans Board (PWLB) and £10.000 million from a forward starting deal from Deutsche Pfandbriefbank. Interest rates on new borrowing remained at historically low rates. The average rate of interest paid on all external debt increased marginally to 3.37% in 2017/18 from 3.32% in 2016/17. The internal loans fund rate decreased from 3.24% in 2016/17 (lowest in mainland Scotland) to 3.08% in 2017/18 and is again expected to remain one of the lowest amongst Scottish mainland Local Authorities.

The borrowing strategy is prepared in accordance with the Code of Practice on Treasury Management in Local Authorities. The majority of the Council’s borrowing comes from the PWLB. Further details are provided in note 16 to the Financial Statements.

Assets and Liabilities

The Balance Sheet on page 38 summarises the Council's assets and liabilities as at 31st March 2018. Total net assets increased by £23.233 million from the position at 31st March 2017.

Long term assets decreased in value by £14.674 million mainly due to downward revaluations and the disposal of assets. Short term investments stayed at a similar level and cash and cash equivalents decreased in value by £2.008 million

The net pension liability of the Council as at 31st March 2018 was calculated in accordance with the requirements of International Accounting Standard 19 (IAS 19) and amounts to £85.513 million which is a decrease of £32.529 million from 31st March 2017. The main reason for this is the result of an increase in the net discount rate used in calculating the projected liability over the period. IAS 19 is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. It should be noted this is a snapshot of the position at 31st March 2018. The actuarial valuation of the Lothian Pension Fund, which takes a longer term view, will consider the appropriate employer's contribution rates and this, together with employee contributions and revenues generated from the Pension Fund investments, will be used to meet the fund's commitments as they arise. The last actuarial valuation at 31st March 2017 showed a funding level of 98% of liabilities which is a 5% increase from the position at the previous valuation at 31st March 2014. Employer contribution rates are agreed as part of the Contribution Stability Mechanism until 2020/21 and these are reflected in the Council's Financial Strategy.

The Council has made provisions for potential liabilities in respect of unsettled insurance claims of £0.940 million and staff release costs agreed at the 31st of March 2018 of £0.853 million.

The provision for non-collection of debt at 31st March 2018 was £35.4 million which is a slight increase on the position a year ago. There were a number of immaterial write offs approved by Cabinet during the year.

Financial Outlook and Key Risks

The current economic climate impacts on the Council and the services it provides in a number of ways. From a financial perspective 2017/18 saw continued demographic pressures particularly around looked after children, people with learning disabilities, elderly care and the significant population growth in Midlothian. It is expected that these pressures will grow and they present a considerable challenge to the Council in both financing them and transforming services to improve ways of managing some of the implications of these pressures. Welfare reform, the integration of health and social care and the implementation of the Children Act 2014 as well as the planned expansion in early learning and childcare are major policy developments that will not only impact on the council budgets but also change the way services are provided.

The Council has a medium term financial strategy which currently extends to 2022/23. Cost projections for pay inflation, price inflation and the impact of demographic changes are reflected in the strategy along with income projections and the impact of the Council's change programme which will be the means to address budget shortfalls. Pay inflation and Scottish Government Grant income projections are critical areas of modelling given their overall significance and uncertainty.

For 2017/18 and again for 2018/19 the Scottish Government published a one year budget and grant settlement, as such Councils are currently unaware of the level of funding that will be available to them beyond 2018/19. There are a number of factors which will influence the level of grant support Council might expect for 2019/20 and beyond. Among these will be a range of economic factors will influence the resources Scottish Government has at its disposal, whether from the UK Government block grant or through tax revenues directly controlled by Scottish

Government. The other main factors will be the taxation and spending priorities of the Scottish Government and the negotiations with other parties in the Scottish Parliament to support the passage of the budget bill.

Whilst an assessment of the economic factors can be made at this time based on the information available from the Office of Budget Responsibility, the Scottish Fiscal Commission and for the 2019/20 budget process Scotland's Fiscal Outlook, the Scottish Government's first five year medium term financial strategy, the impact of Scottish Government's tax and spending priorities will only become fully apparent when the Scottish Government's 2019/20 budget is published in December 2018.

In February 2018 the Council set a budget for 2018/19 which included savings of £11.559 million, increases in council tax funding of £1.274 million and a £0.200 million contribution to earmarked reserves.

In the context of reduced funding and growth in demand for services the Council has a considerable challenge to ensure its future expenditure plans are sustainable. The latest projections show the Council with a remaining budget gap of £5.054 million in 2019/20 rising to £23.002 million by 2022/23.

The Council continues to seek to work within approved Financial Strategies. Despite slippage in achieving savings targets the Council's transformation plan continues to deliver efficiencies and is regularly refreshed to ensure its scope and ambition remains focused and is in line with corporate aims.

Strategic Plans and Performance

Midlothian Council delivers its priorities through the Community Planning Partnership and the Single Midlothian Plan. Community Planning partners have agreed the vision for Midlothian as "Midlothian – a great place to grow".

Taking into consideration the comparative quality of life of people living in Midlothian, it is clear that less well-off residents experience poorer health, have fewer or no choices in how they use low incomes and also that there is a proven relationship between these factors and their learning. The top three priorities for 2016-19 and selected key performance measures for 2017/18 are:

Reducing the gap in learning outcomes

- Average primary school attendance was 94.47%, down slightly from 95% in 2016/17 and against a target of 96.5%.
- Average secondary school attendance was 89.39%, down slightly from 90.24% in 2016/17 and against a target of 92%.
- There were 373 exclusions from school, down from 419 in 2016/17 and against a target of 409.
- The percentage of Midlothian residents with no qualifications was 6.4% which is unchanged from 2016/17 and is against a target of 7%.

Reducing the gap in health outcomes

- 237 mental health assessments were carried out through the Gateway pilot project in 2017/18 (395 in 2016/17), against a target of 200.
- The percentage uptake of 27-30 month checks was 88.2% against a target of 86.7% and 84.6% in 2016/17.

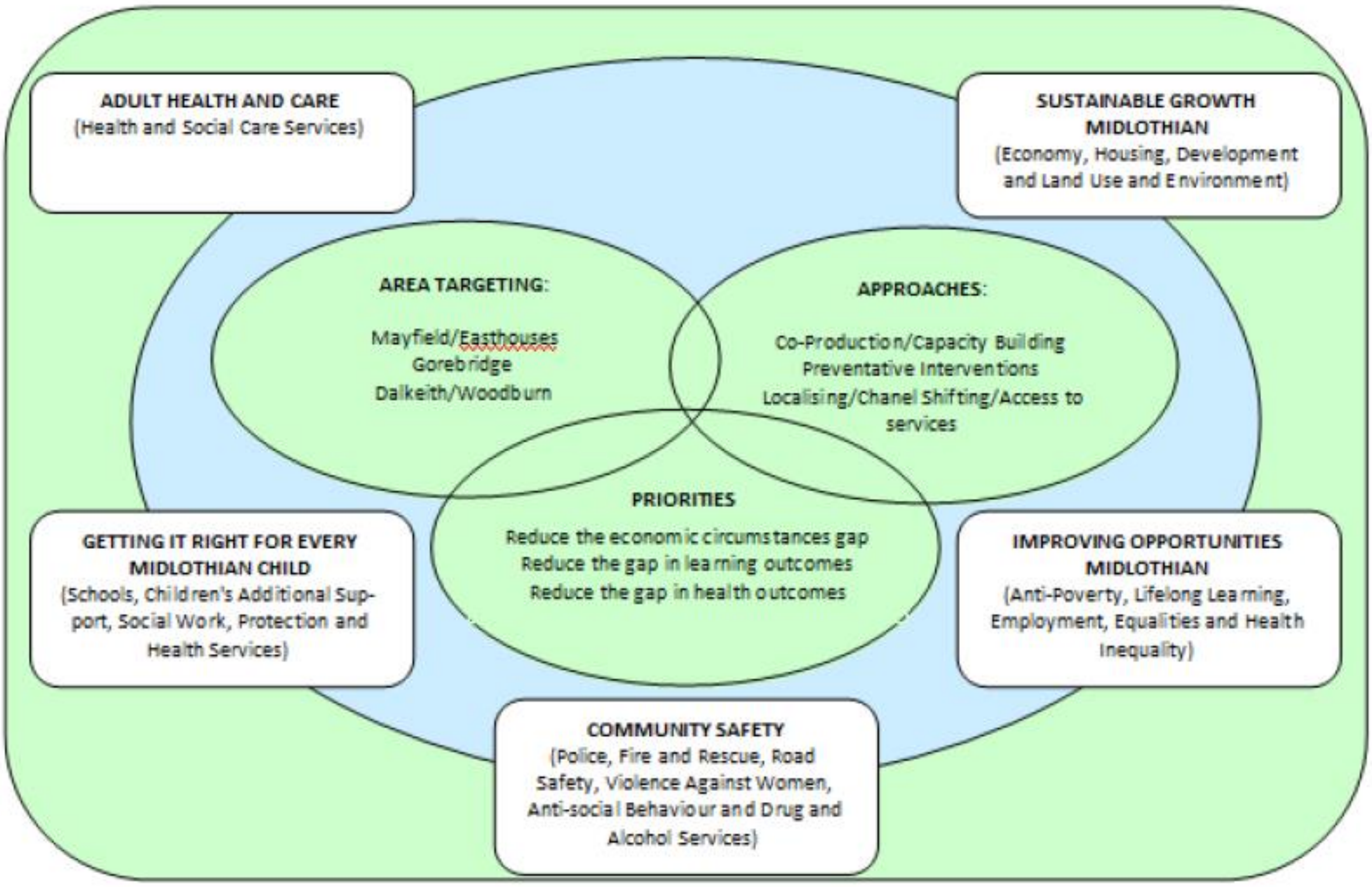
Reducing the gap in economic circumstances

- The percentage of school leavers securing a positive destination was 95% against a target of 95% and 95.1% in 2016/17.
- Midlothian Citizen Advice Bureaux delivered income maximisation of £3.7 million against a target of £2.5 million and £3.8 million in 2016/17.
- The percentage of young people working with the Homeless Prevention Service that went on to present as homeless was 65% against a target of 95% and 33% in 2016/17 (Despite the percentage of young people who went on to present as homeless, overall there has been a reduction in the number of households being assessed as homeless).
- 114 new homes completed against a target of 165 and 80 in 2016/17.

Three approaches to how the Council works with its communities have also previously been agreed – preventative intervention, co-production and capacity building and localising / modernising access to services.

In addition to the three key priorities and three approaches the Council will also focus on reducing the gap between outcomes for residents living in parts of the county which for many years have shown a significant gap between their outcomes and the average outcomes for Midlothian and Scotland as a whole. The areas targeted are Dalkeith Central/Woodburn; Mayfield/Easthouses and Gorebridge.

The Single Midlothian Plan incorporates five overarching thematic groups which support the achievement of outcomes. The interplay is shown in the diagram below.



The thematic approach is used for quarterly performance reporting and the themes and selected performance measures for 2016/17 are discussed below.

Adult Health Care – Responding to growing demand for the adult social care and health services;

- The percentage or people who say they are able to look after their health or who say they are as well as they can be was 86% compared to 83% in 2016/17 and against a target of 83%.
- The percentage of falls which resulted in hospital admission for clients aged 65+ was 3.87% compared to 5.03% in 2016/17 and a target of 6%.
- The percentage of people who say that they have a say in the way their care is provided was 81.7% compared to 78% in 2016/17 and against a target of 75%.

Community Safety – Ensuring Midlothian is a safe place to live, work and grow up in;

- The proportion of MAPPA clients convicted of a Group 1 or Group 2 offence was 5.3% against a target of 2% (No previous data is captured for comparison).
- The percentage of street light repairs completed within 7 days was 90.6% compared with 98.5% in 2016/17 and against a target of 100%.

Getting it Right for Every Midlothian Child – Improving outcomes for children, young people and their families;

- The number of children adopted was 10 compared with 11 in 2016/17 (Data only indicator, no target set).
- The number of children in residential placements was 8 compared with 10 in 2016/17 (Data only indicator, no target set).

Improving Opportunities for People in Midlothian – Creating opportunities for all and reducing inequalities;

- The number of activities offered by Ageing Well programmes was 23 compared to a target of 16 and 23 in 2016/17.
- The Tonezone retention rate was 49.25% compared with a target of 55% and 55.25% in 2016/17.

Sustainable Growth and Housing – Growing the local economy by supporting business growth and responding to growing demand for housing in a sustainable environment.

- The percentage of premises with access to next generation broadband was 98.1% compared with a target of 98% and 98.1% in 2016/17.
- The street cleanliness score was 100% compared with a target of 97.5% and 98.7% in 2016/17.

During 2017/18 the Council demonstrated significant progress towards their priorities and this is documented in more detail in the Midlothian Council Annual Performance Report – 2017/18, presented to Performance Review and Scrutiny Committee on 5th June 2018 and can be viewed on the Council website.

Key Achievements include:

Adult Health Care -

- The creation of a new Health and Care Partnership provides an opportunity to make significant change in how we deliver health and care services.
- Newbyres care home has introduced 24 specialist dementia beds in order to provide a long term, homely setting for people with a diagnosis of dementia who are no longer able to live independently in their own home or who have been delayed from leaving a hospital setting.
- The Grassy Riggs project in Woodburn has opened and features a daily drop-in cafe for older people living in the Dalkeith/Woodburn area who are at risk from the adverse effects of social isolation and loneliness.
- Work is continuing to embed Self Directed Support into a 'business as usual' activity.

Community Safety -

- The new structure for Community Justice came into being on 31st March 2017 and local partnerships now report to the national body, Community Justice Scotland.
- The Serious & Organised Crime Integrity Group has been established for Midlothian with a range of partners. The group will focus on the principles of the national agenda to deter, disrupt, divert and deter criminality and potential areas of activity. A parallel Prevent Strategy group is also focussed on the counter terrorism agenda.
- The council have completed the identified footway and road improvement programme thereby maintaining the road network in a steady state position with no deterioration for the last five years.
- As part of the drive towards lowering carbon emissions and reducing the consequent energy use, the programme to deliver LED lights across Midlothian has continued with a further 400 lights replaced during the year.

Getting it right for every Midlothian child -

- Midlothian Council were successful in winning the 'Policy Development Award' for the 'Framework for Permanence' at the Scottish Public Service Awards.
- Over the past year we have increased our current foster care numbers by 12.5% from 56 in to 63.
- Attainment in 2016 is now above both the virtual and the national average with attainment at level 5 in 2016 being more than double the percentage achieved in 2014.

Improving Opportunities for People in Midlothian -

- A number of projects and initiatives have been delivered across Midlothian, many of which are as a result of having identified and secured significant third party funding. This has included work for example in Auld Gala park in Gorebridge, new play equipment in various schools and play groups as part of the play strategy.
- Midlothian's Learning and Development in its Communities Service received a 'very good' rating; its best ever following inspection by Education Scotland.
- Delivery of a Scottish Government funded Participatory Budgeting project in Mayfield/Easthouses, at which 350 residents decided on the allocation of £30,000 amongst 17 locally based community projects.

- Kings Park and Strathesk primary schools were recognised with the prestigious SportScotland Gold School Sport Award, which is designed to encourage continuous improvement in physical education and sport, run by the Active School team.
- Substantial funding allocated by the Borders Rail Blueprint Fund to promote and develop the tourism sector along the route of the Borders Rail corridor.
- Homelessness presentations in Midlothian have reduced in the past year to continue that position over the past 3 years, which is now against the regional trend and results from the homeless prevention work and housing options developed.

Sustainable Growth and Housing -

- The Right to Buy policy in Scotland ended on 1 August, 2016. The introduction of the policy saw a significant reduction in the availability of affordable rented housing in Midlothian resulting in the commencement of a Social Housing Programme for new build housing with the initial developments delivered from 2006 and this year developments were completed and allocated to tenants in Penicuik, Loanhead and Bonnyrigg.
- We have achieved green flags status in five of our parks.
- As part of a unique partnership arrangement with City of Edinburgh Council the construction and commissioning of a food waste reprocessing plant has been completed on the jointly owned site at Millerhill.
- Midlothian achieved its highest level of recycling to date of 53.8% in 2016.
- As part of the agenda to drive down carbon emissions, the Council has installed new electric vehicle charging points across Midlothian, as well as taking delivery of seven new electric vehicles.

Structure of Council Leadership and Council Staff

Following the local government elections on the 4th of May 2017 the political makeup of the Council was 7 Labour members, 6 SNP members and 5 Scottish Conservative and Unionist members. The Labour party formed and continues to form a minority administration. The Leader of the Council is Derek Milligan and the Provost was Adam Montgomery until his death on the 10th of January 2018. There was a by-election in Penicuik on Thursday 22nd of March 2018 which was won by the SNP. The political makeup of the Council subsequently changed to 6 Labour members, 7 SNP members and 5 Scottish Conservative and Unionist members.

The Council's Chief Executive was Kenneth Lawrie until the 31st of July, Dr Grace Vickers took on the post from the 1st of August. The Council is structured into 3 Directorates:

- Health and Social Care (Director, Allister Short);
- Resources (Director, John Blair);
- Education, Communities and Economy (Director, Mary Smith).

Emerging Issues, Service Changes and Future Developments

Moving into 2018/19 and beyond the Council will continue the application of the Delivering Excellence framework – A programme for change which looks at how we do things, with a focus on improving outcomes for our residents and our communities within the context of the financial and other challenges ahead. To do this, we consider:

- What our priorities are;
- What we can change or do differently;

- Which services can be improved;
- Which services we can stop.

Employee engagement and empowerment is at the core of the Delivering Excellence framework with every council service being asked to look at what it does, how much it costs, how it performs and how it could be changed and improved. A key element of the framework is how we engage with our communities to inform and support changing the way we do things at Midlothian Council and ensure that services are fit for the future. We want residents to tell us what the priorities are for them, their families and their communities - and we want them to help us reshape our services to meet those priorities. The Single Midlothian Plan is developed by and with partners and informed by input via the citizens panel, community councils, neighbourhood plans and the Midlothian profile exercise which is refreshed annually.

Health and Social Care Integration continues to move forward with consultation on the 2018/19 Directions document issued to NHS Lothian and the Council and work on a refreshed strategic plan is underway. Two Heads of Service with responsibility for Primary Care and Older People and Adult Services now manage services across health and social care, integration at a service level is progressing well. There is a continuing requirement to rebalance care to meet growing demand, particularly in relation to older people and those with complex needs. The integration of budgets through the establishment of the Integration Joint Board provides an opportunity to make better use of collective resources.

The preparations for the implementation of the delivery of 1,140 hours of early years education and childcare by 2020 are ongoing. Whilst challenging this remains a key focus, Midlothian Council has been successful in receiving funding from the Scottish Government to carry out a trial to develop a blended approach to expansion in the Mayfield area. The new Woodburn Hub was recently recognised as demonstrating good practice in the recently published Scottish Government report “A blueprint for 2020”.

The Scottish Child Abuse Inquiry is a significant piece of work with a project team in place to deal with requests for information and a working group is now in place to write new protocols/ policies around how we manage any potential future claims. A significant amount of time and resources are being deployed at this time to ensure that Midlothian Council complies with the requests for information within the agreed time scales and responds to the implications of the enactment of the Limitation (Childhood Abuse) (Scotland) Act 2017.

The implications of Brexit for the Council in terms of potential changes to procurement, data protection, planning, environmental legislation, employment law and grant funding are being actively considered. The Council’s strategic risk register includes some initial analysis of the potential impact on the Council from the triggering of Article 50, this will clarify as negotiations progress at a UK level and the final agreement is reached.

Following serious allegations being raised by members of staff regarding suspected impropriety within the Council relating to Roads contract management arrangements an investigation of the allegations was instigated and conducted by the Council’s Internal Audit and Corporate Fraud team. The matter has also been passed to Police Scotland. During the Council investigation, it was discovered that payments had been made to a contractor not on the Procurement Framework and these amounted to £2.1 million including VAT over a period of seven years, £1.749 million excluding VAT. Of this £0.682 million was in respect of capital works and £1.067 million was revenue works. No allegations were made relating to work not being carried out or subject to inflated invoices. A detailed investigation has commenced looking at each invoice from initiation of order through to payment. Different methodologies are being developed in consultation with EY to examine capital and revenue payments and the evidence of loss for each category of work, if any.

To date there is no evidence that the actual works were not carried out. At this time there is no indication of a material misstatement of the financial statements.

The construction of the new Newbattle Community Campus commenced in January 2016 and opened in May 2018 as the Council's first centre of excellence in digital technology. This new facility provides enhanced educational and leisure facilities for Newtongrange, Mayfield, Gorebridge and the surrounding communities. New primary schools in Roslin and Loanhead were opened in August 2017. The photographs below show the old school, the work in progress and the newly completed school.

Conclusion

2017/18 remained a challenging year from a financial perspective, with continued increasing demand pressures and reduced real terms funding being the dominant issues. Despite this the Council continued to invest for the future in its asset base to provide the essential infrastructure to support the growing population. Despite the financial problems the council made significant improvements across a range of areas especially the integration of health and social care and pupil attainment and was successful in being shortlisted for the Living Wage Champion Awards for the review of pay and grading implemented in 2016. Very significant financial and service challenges lie ahead and work continues to prepare for these and to deliver a Financial Strategy that ensures the Council's financial sustainability.

I would like to acknowledge the significant effort in producing the Financial Statements and express my thanks to my own team and also to colleagues throughout the Council for the significant dedication and commitment shown throughout the year to financial matters.

Signed:

Gary Fairley

Head of Finance and Integrated Service Support

Date:

Statement of Responsibilities for the Financial Statements

This sets out the respective responsibilities of the Council and the Head of Finance and Integrated Service Support (Chief Finance Officer).

The Council is required:

- To make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this Council, that officer is the Head of Finance and Integrated Service Support;
- To manage its affairs to secure economic, efficient and effective use of resources and safeguard its assets.
- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).
- To approve the Statement of Accounts.

I confirm that these Annual Accounts were approved for signature by Midlothian Council Audit Committee at its meeting on the 25th of September 2018.

Signed on behalf of Midlothian Council

Councillor Derek Milligan

Date:

The Head of Finance and Integrated Service Support's Responsibilities

The Head of Finance and Integrated Service Support is responsible for the preparation of the Council's statement of accounts in accordance with proper practices as required by legislation and as set out in the IFRS Based Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

In preparing this statement of accounts, the Head of Finance and Integrated Service Support has:

- Selected suitable accounting policies and then applied them consistently;
- Made judgements and estimates that were reasonable and prudent;
- Complied with Legislation;
- Complied with the Code (in so far as it is compatible with legislation), except where stated in the policies and disclosure notes.

The Head of Finance and Integrated Service Support has also:

- Kept proper accounting records which were up to date;
- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

These Financial Statements present a true and fair view of the financial position of the Council and its group at 31 March 2018 and its income and expenditure for the year then ended.

Signed:

Gary Fairley

Head of Finance and Integrated Service Support

Date:

Annual Governance Statement

Midlothian Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards. This is to allow public funds and the assets at its disposal to be safeguarded and used efficiently and effectively in pursuit of best value.

Elected Members and senior management are responsible for the governance of the business affairs of Midlothian Council. This includes setting the strategic direction, vision, culture and values of the Council and establishing appropriate and cost effective systems, processes and internal controls to allow the strategic objectives to be delivered.

The Council's decision making and scrutiny is carried out through the Council and Committee structure and within the framework of Standing Orders. The Standing Orders are made up of:-

- Standing Orders which regulate the manner in which the Council, Cabinet, Committee and other meetings (both statutory and non-statutory are arranged, convened and governed
- Scheme of Delegation to Officials setting out the responsibilities and powers allocated to senior officers
- Scheme of Administration containing the remits and powers of all the bodies in the Council structure in which elected members are involved
- Procurement Strategy 2015-18 and associated procurement procedures which govern the Council's procurement activity; and
- Financial regulations which set the rules and procedures which set the rules for financial, budget and treasury management.

All these documents are subject to review at least once in each administrative term but in practice are reviewed and refreshed on a more frequent basis as circumstances require. The Standing Orders were amended on 17 December 2017 and the Procurement Strategy 2018 – 23 was approved by the Council on 21 August 2018.

The Council has a well-established framework of cabinet, committees and associated bodies. The various bodies, their remits and powers are set out in the Scheme of Administration which is part of the Council's Standing Orders. This structure is supported by a complementary Scheme of Delegation to officers which sets out the responsibilities and decision making powers the Council has delegated to officers, the scheme of Delegation is also part of Standing Orders.

The system of internal financial control is designed to provide assurance on the effectiveness and efficiency of operations and the reliability of financial reporting. In this regard, reports on financial monitoring, the Housing Revenue Account and the General Services Capital Plan are presented to the full Council on a quarterly basis.

The Council's current Risk Management approach is set out within the Risk Management Policy, this was formally approved in 2013 and is currently subject to review. The Policy is supported by the Risk Management Group and Risk Manager, who oversee the operation of the Council's Risk Management Framework and support officers to manage risk in line with the Council's framework. On a quarterly basis the Council Strategic Risk Profile is reviewed with direct input from all Heads of Service. The Strategic Risk Profile, consisting of those Strategic Risks, Current Issues and Opportunities, is reported to the Council Management Team (CMT) along with details of any action being taken to reduce/manage specific risk or exploit opportunities. Once approved by CMT the Strategic Risk Profile report is submitted to Audit Committee who provide scrutiny in the management of the risks recorded in the Strategic Risk Profile.

In order to support and achieve good governance, the Council has developed a Code of Corporate Governance based on the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives' (SOLACE) framework and guidance on Delivering Good Governance in Local Government: Framework (2016). The Code has been reviewed and updated in line with the new International Framework of Good Governance in the Public Sector which was implemented on 1 April 2017. The Council also has a number of officials in statutory posts who monitor governance and the supporting processes during the year. These are the Head of the Paid Service, the Monitoring Officer, the Chief Finance Officer, the Chief Social Work Officer and the Chief Education Officer.

The Code of Corporate Governance adopts the seven overarching principles from the Framework which are:

- Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law
- Ensuring openness and comprehensive stakeholder engagement
- Defining outcomes in terms of sustainable economic, social and environmental benefits
- Determining the interventions necessary to optimise the achievement of intended outcomes
- Developing the entity's capacity, including the capability of its leadership and individuals within it
- Managing risks and performance through robust internal control and strong public financial management
- Implementing good practices in transparency, reporting, and audit to deliver effective accountability

Each of the principles is broken down into sub-principles and then separate elements to allow a more focused approach to the components of each. In line with previous practice an exercise to assess the Council's adherence to the required standards forms part of the annual Internal Audit plans with any areas for concern identified for further action. Given the transition to the new Code the assessment for 2017/18 will be different to those used in recent years but careful analysis will still be able to identify any trends or long-term issues.

Midlothian Council's financial management arrangements conform to the requirements of the CIPFA Statement on the role of the Chief Financial Officer in Local Government. The Chief Financial Officer has overall responsibility for the Council's financial arrangements and is professionally qualified and suitably experienced to lead the Council's finance function.

The Council is responsible for conducting, each financial year, a review of the effectiveness of its governance framework, including risk management and the systems for internal control and financial control. The review of the effectiveness of the Council's governance framework is informed by:

- The work of the Corporate Management Team;
- The work of Council managers and Financial Services staff;
- The annual assurance questionnaires that are provided by all Heads of Service;
- Corporate and Service Risk Registers which are subject to regular review
- An annual review, by Internal Audit, of compliance with the Council's Local Code of Corporate Governance;
- The Chief Internal Auditor's annual assurance report which is based on internal audit reports from across the range of Council services;
- Reports from the Council's external auditor; and

- Reports from other external review bodies, agencies and inspectorates.

The key governance arrangements and controls are set out in the local Code of Corporate Governance. Each year, using an assurance template, Internal Audit samples elements in the code to determine whether these are working effectively and that therefore the governance framework is working effectively.

In addition each Head of Service is required to undertake an annual self assessment of their area of responsibility using an assurance template where key elements of governance are examined.

None of these assessments highlighted any issues that would impact on the level of effectiveness of the Council's governance framework. Improvements identified are noted below in the action plan.

It should be noted that an unplanned investigation is currently being undertaken by Internal Audit with external support. The investigation has not yet concluded however necessary improvements to internal control, risk management and governance have been identified and are referred to in this Statement. It is accepted that further such improvements may be recommended at the conclusion of the investigation and any such improvements will also be implemented. Those improvements that have been identified to date are highlighted in the table of improvements to the governance framework to be progressed in 2018/19 below.

The statement has also been informed by the work undertaken by Internal Audit. The Chief Internal Auditor's overall Audit Opinion for the Annual Governance Statement is included within the Internal Audit Annual Assurance Report for 2017/18 and concludes that overall the Council's framework of governance, risk management and internal control over the period 2017/18 are generally adequate but noted some areas of non-compliance and a lack of evidence of Management monitoring therefore noting that improvements are required to the second line of defence across the Council to ensure probity in systems and operations, including the prevention, detection and resolution of fraud irregularities. Where there is evidence of financial loss to the Council due to these irregularities, appropriate action will be taken to seek to reclaim the funds. Improvements in internal control, risk management and governance have been agreed by Management as highlighted in Internal Audit reports and recommendations made during the year or outstanding from previous years.

The range and breadth of Internal Audit work that has been performed during 2017/18 is sufficient to inform the Internal Audit assurance on the systems of internal control, governance arrangements and risk management.

The programme of Internal Audit work planned for 2017/18 was significantly impacted by resource changes introduced following the Internal Audit Service Review and the deployment of Internal Audit and Counter Fraud resources to an unplanned investigation.

The Chief Internal Auditor has responsibility for the Council's Internal Audit function and reports functionally to the Audit Committee and operationally to the Chief Executive to allow appropriate independence. There have been no threats to the independence of the internal audit activity during the period.

The Chief Internal Auditor is professionally qualified and suitably experienced to lead and direct the Internal Audit team.

The Public Sector Internal Audit Standards (PSIAS) require that an external assessment be conducted at least once every 5 years by a qualified, independent assessor from outside the organisation over the level of compliance against PSIAS by the Internal Audit Section. An internal self-assessment of Internal Audit practices against the Standards was carried out in 2017/18, as required by the PSIAS, which has indicated Internal Audit conforms with the Definition of Internal Auditing, Code of Ethics, Attribute Standards and Performance Standards. An External Quality Assessment (EQA) Peer Review by Highland Council was carried out in March 2018. The full report is awaited though verbal feedback indicates conformance with the PSIAS against the 13 Assessment Areas and has highlighted a few areas where improvements can be made.

A number of risks were effectively managed in 2017/18 and Midlothian Council continues to support the Integration Joint Board with its approach to risk management.

The following table sets out improvements to the governance framework progressed in 2017/18. Where these have not been completed or subsequent matters have arisen through the Roads Investigation, the improvements have been carried on into 2018/19.

Area for Improvement identified in 2016/17	**Action undertaken in 2017/18**	**Status**
Code of Corporate Governance	Midlothian Council's Code of Corporate Governance has been updated approved by Council in December 2017.	Complete
Workforce Plans	A corporate Workforce Strategy was approved by Council in December 2017 and is supported by a detailed workforce plan and eight service specific workforce plans.	Ongoing
Post Project Implementation Reviews	Although end of project post implementation reviews are completed for some projects, these are required to be completed for all projects. This continues to be an area for further improvement.	Ongoing
Business Continuity Policy	In November 2017 the Corporate Management Team approved the Business Continuity Policy as Phase 1 of a Business Continuity Management System and the development of supporting arrangements to provide a consistent approach across the organisation.	Ongoing
Register of Interests	A Register of Interests for senior Council Officials has been established.	Completed
Gifts and Hospitality	A standalone Gifts and Hospitality policy requires to be developed.	Carried forward to 2018/19
Internal Audit Plan	The Internal Audit Plan for 2017/18 was presented to Audit Committee in March 2017.	Completed

The following table sets out improvements to the governance framework which are to be progressed in 2018/19. Where areas have been identified specifically through the Roads Investigation, the reason for the necessary improvement has been noted.

Area for Improvement	Proposed Action in 2018/19
Ensure there are sufficient Contract Management Procedures and Controls in place to prevent unauthorised payments. During the investigation, it became apparent payments had been made to a non-contracted supplier	Review contract management procedures and controls ensuring that there are adequate segregation of duties and oversight / checking of compliance with the contract by Senior Management. Review the roles and responsibilities of Senior Managers to ensure an adequate understanding, awareness and accountability for day-to-day activities undertaken in their areas of responsibility.
Ensuring effective counter fraud and anti-corruption measures are in place Whistle-blowing allegations have been received relating to Council employees being too close to contractors.	Provide regular training to all staff to promote an understanding and awareness of the implications of the Bribery Act 2010, potential corruption in the workplace and the Council's policy on Bribery & Corruption, and client/contractor relationships. Instruct Staff involved in tendering contracts and allocating work to Contractors to read and acknowledge the Council's policies on Bribery & Corruption and Gifts & Hospitality. Review and promote the Council's Whistleblowing policy and the mechanisms for raising concerns, anonymously if desired, for Staff and Public
Ensuring members and officers behave with integrity and lead a culture where acting in the public interest is visibly and consistently demonstrated	Review and update policies across the Council including: Code of Conduct, the creation of a standalone Gifts and Hospitality Policy, Gifts and Hospitality Register, Register of Interests (to record and manage potential Conflict of Interests), and Secondary Employment. This should include appropriate authorisations (approvals and refusals) and the central recording of declarations to enable regular and discrete review (Gifts and Hospitality, Register of Interests, and Secondary Employment).
Enhance ongoing monitoring and review of payments to Suppliers to complement the Budget Monitoring processes. More robust processes may have highlighted payments to non-contracted suppliers sooner	Review the process for approving and setting up new Suppliers on the payments database to enhance controls over creating a new Supplier Regularly review payments to Suppliers to ensure they reflect the Council's contract arrangements with Suppliers.
Ensuring more robust recording and tracking of plant and equipment to optimise use of resources. The whistleblowing allegations also related to the use of Council equipment for non-Council related work. More robust recording and tracking of plant and equipment would address this concern.	Review the Asset Register and Fleet Management system to enable better recording of information and tracking of plant and equipment purchased by the Council. This should include a regular review of assets to ensure they can be accounted for.
Develop supporting arrangements to provide a consistent approach to Business Continuity across the organisation	Authority will be sought from the Corporate Management Team for the purchase of an online Business Continuity Management System which can be rolled out across the Council.
Internal Audit review of Governance	An exercise will be undertaken in 2018/19 to re-shape the Annual Governance Statement to align more fully with the 7 core principles of the Local Code with the expectation

Area for Improvement	Proposed Action in 2018/19
	that the Code will also be updated to reflect current practice within Midlothian Council

Progress on these Proposed Actions for 2018/19 will be reported to the Audit Committee on a quarterly basis to enable effective monitoring of the implementation of the Areas for Improvement.

On the basis of the Council's assurance system, and the elements of governance at its disposal, we are satisfied that overall, Midlothian Council's systems of internal control, risk management and governance arrangements are of a satisfactory standard. We are aware of areas where improvements are required and steps will be taken in the forthcoming year to address these areas, allowing the Council to advance its corporate governance arrangements and seek continuous improvement. Where the Council has experienced financial loss, appropriate action will be taken to seek to recover any loss.

Signed:

Derek Milligan, Leader of the Council / Dr. Grace Vickers, Chief Executive

Date:

Remuneration Report

The Remuneration Report provides details of the Council's remuneration policy for its senior employees and senior councillors and states how its remuneration arrangements are managed. Senior employees within the Council are defined as those having the responsibility for the management of the Council to the extent that they can direct or control the major activities and/or have statutory responsibilities.

As well as providing details of the Council's remuneration policy, the remuneration report also details:

- Remuneration paid to senior employees and senior councillors of the Council for 2017/18;
- The number of employees whose remuneration was £50,000 or more, disclosed in pay bands of £5,000;
- The number and total cost of exit packages, disclosed in pay bands of £20,000;
- The Council's senior employees and senior councillors who participate in the Local Government Pension Scheme, administered by the Lothian Pension Fund, and the benefits provided under the scheme.

Audit of Remuneration Report

All information disclosed in the tables in this report will be audited by Ernst & Young LLP and all other sections of the Remuneration Report will be reviewed to ensure that they are consistent with the financial statements.

Employees Remuneration Policy

The salary of senior employees is set by reference to national arrangements. The Scottish Joint Negotiating Committee (SJNC) for Local Authority Services sets the salaries for the Chief Executives of Scottish local authorities. For 2017/18 the salaries of the Directors were 87% of the Chief Executive's salary.

The salaries of all other employees are set by reference to:

a) Teaching Staff – The Scottish Negotiating Committee for Teachers (SNCT);
b) Other staff – Scottish Joint Negotiating Committee for Local Authority Services (SJNC).

Councillors Remuneration Policy

The remuneration of councillors is regulated by the Local Governance (Scotland) Act 2004 (Remuneration) Regulations 2007 (SSI No 2007/183) as amended. The Regulations provide for the grading of councillors for the purposes of remuneration arrangements, as either the Leader of the Council, the Civic head, senior councillors or councillors. The Leader of the Council and the Civic head cannot be the same person for the purposes of payment of remuneration. A senior councillor is a councillor who holds a significant position of responsibility within the Council's political structure.

The salary that is to be paid to the Leader of the Council is set out in the regulations and for 2017/18 this was £28,213. The regulations permit the Council to remunerate one civic head, the

Provost. The regulations set out the maximum salary that may be paid to the Provost and Council policy is to pay this salary which for 2017/18 was £21,160.

The regulations also set out the remuneration that may be paid to senior councillors and the total number of senior councillors the Council may have. The maximum yearly amount that may be paid to a senior councillor is 75% of the total yearly amount payable to the Leader of the Council. The total yearly amount payable by the Council for remuneration of all of its senior councillors shall not exceed £152,347. The maximum number of senior councillors allowable is eight. The Council is able to exercise local flexibility in the determination of the number of senior councillors and salary within these limits. The Council's policy is to pay seven senior councillors the maximum allowable salary of £21,160.

In addition to the senior councillors of the Council the regulations also set out the remuneration payable to councillors with the responsibility of a Convener or a Vice-Convener of a Joint Board. The regulations require the remuneration to be paid by the Council of which the Convener or Vice-Convener is a member. The Council is also required to pay any pension contributions arising from the Convener or Vice-Convener being a member of the Local Government Pension Scheme. The Council is reimbursed by the Joint Board for any additional remuneration paid to the member from being a Convener or Vice-Convener of a Joint Board.

Pension Entitlement

The Council's senior employees and senior councillors can participate in the Local Government Pension Scheme administered by the Lothian Pension Fund. This is an average salary pension scheme which means that pension benefits are based an average of the pay over the number of years that a person has been a member of the scheme. The scheme's normal retirement age for employees is the same as the state pension age with a minimum of 65.

From 1 April 2009 a five tier contribution system was introduced with employee contributions rates applied in tiers ranging from 5.5% to 12% depending on the member's rate of pensionable pay at the end of the preceding year. This is designed to give more equality between the cost and benefits of scheme membership.

The tiers and employees contributions rates for 2017/18 are as follows:

Actual Pensionable Pay	Contribution rate (%)
On earnings up to and including £20,700	5.5%
On earnings above £20,700 and up to £25,300	7.25%
On earnings above £25,300 and up to £34,700	8.5%
On earnings above £34,700 and up to £46,300	9.5%
On earnings above £46,300	12%

Using these tiers average employee contribution rates are calculated for any given pensionable pay and these range from 5.5% to 12%. If an employee works part-time their contribution rate is worked out on the whole time pay rate for the job, with actual contributions paid on actual pay earned.

There is no automatic entitlement to a lump sum on retirement. Pension scheme members may opt to commute pension for a lump sum payment up to the limit set by the Finance Act 2004. The accrual rate guarantees a pension based on 1/49th of career average salary and years of pensionable service. Prior to 2015 the accrual rate guaranteed a pension based on 1/60th of final pensionable salary and years of pensionable service. Prior to 2009, the accrual rate guaranteed a pension based on 1/80th and a lump sum based on 3/80ths of final pensionable salary and years of pensionable service.

The value of the accrued benefits has been calculated on the basis of the age at which the person will first become entitled to receive a pension on retirement without reduction on account of its payment at that age, without exercising any option to commute pension entitlement into a lump sum, and without any adjustment for the effects of future inflation.

Remuneration by Pay Band

Details of the Council's employees receiving more than £50,000 remuneration for the year, excluding employer's pension and national insurance contributions, are as follows:

Total Employees 2016/17	Remuneration Band	Non- Teaching Employees 2017/18	Teaching Employees 2017/18	Total Employees 2017/18
69	£50,000 - £54,999	21	42	63
26	£55,000 - £59,999	13	20	33
8	£60,000 - £64,999	4	4	8
7	£65,000 - £69,999	4	2	6
4	£70,000 - £74,999	0	1	1
7	£75,000 - £79,999	8	1	9
0	£80,000 - £84,999	0	0	0
1	£85,000 - £89,999	0	1	1
0	£90,000 - £94,999	0	0	0
3	£95,000 - £99,999	0	0	0
0	£100,000 - £104,999	2	0	2
0	£105,000 - £109,999	0	0	0
0	£110,000 - £114,999	0	0	0
1	£115,000 - £119,999	0	0	0
0	£120,000 - £124,999	1	0	1
126	**TOTAL**	**53**	**71**	**124**

Exit Packages by Band

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date or an officer's decision to accept voluntary redundancy. They are charged on an accruals basis to Services in the Comprehensive Income and Expenditure Statement when the Council is demonstrably committed to either terminating the employment of an officer or making an offer to encourage voluntary redundancy. The Council is only demonstrably committed to a termination when it has a detailed formal plan for the termination and it is without realistic possibility of withdrawal.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits and to replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Details of the cost to the Council of voluntary redundancy packages for the year are as follows:

Number of Employees 2016/17	Total Cost £000 2016/17	Package Band	Number of Employees 2017/18	Total Cost £000 2017/18
1	17	£0 - £19,999	27	314
3	91	£20,000 - £39,999	32	1,010
5	351	£40,000 +	19	1,131
9	**459**	**TOTAL**	**78**	**2,455**

Remuneration paid to Senior Employees

The table below details remuneration paid to senior employees within the Council.

For year to 31 March 2017		For year to 31 March 2018		
Total Remuneration	**Name and Post Title**	**Salary, Fees & Allowances**	**Non Cash Benefits**	**Total Remuneration**
£114,015	K Lawrie, Chief Executive	£115,156	-	£115,156
£5,485	K Lawrie, Returning Officer	£5,227	-	£5,227
£99,332	J Blair, Director Resources	£96,138	£4,146	£100,284
£49,668	E McHugh, Joint Director Health & Social Care (1) (2)	£29,263	-	£29,263
£0	A Short Joint Director Health & Social Care (1, 2)	£16,817	-	£16,817
£99,336	M Smith, Director Education, Communities and Economy	£100,330	-	£100,330
£77,110	G Fairley, Head of Finance & ISS	£74,256	£3,586	£77,842
£76,579	G Vickers Head of Education (2)	£74,256	£3,430	£77,686
£0	A White Head of Adult and Social Care (3)	£30,940	£1,408	£32,348
£52,936	A Turpie, Legal Services Manager	£63,394	-	£63,394
£574,461	**Total**	**£605,777**	**£12,570**	**£618,347**

Pension Entitlement of Senior Employees

The table below details employer's pension contributions made in respect of senior employees within the Council.

For year to 31-Mar-17	Name and Post Title	For year to 31-Mar-18
£23,176	K Lawrie, Chief Executive	£23,346
£1,108	K Lawrie, Returning Officer	£1,056
£19,228	J Blair, Director Resources	£19,420
£9,614	E McHugh, Joint Director Health & Social Care (1)	£5,664
£0	A Short, Joint Director Health & Social Care (1, 2)	£1,231
£19,228	M Smith, Director Education, Communities and Economy	£19,420
£14,852	G Fairley, Head of Finance & Integrated Service Support	£15,000
£14,420	G Vickers, Head of Education	£15,000
£0	A White, Head of Adult and Social Care (3)	£6,250
£10,693	A Turpie, Legal Services Manager	£11,129
£112,319	**Total**	**£117,516**

1 Post joint funded 50:50 with NHS Lothian. Full time equivalent salary £100,330. Full time equivalent employer's pension contributions £19,420.
2 E McHugh retired on the 30th of October 2017, A Short was appointed 1st of November 2017.
3 Following E McHugh's retirement A White is included as Chief Social Work Officer.

Accrued Pension Benefits

Name and Post Title	As at 31-Mar-18 Pension £'000	Lump Sum £'000	Difference from 31-Mar-17 Pension £'000	Lump Sum £'000
K Lawrie, Chief Executive	40	63	3	1
J Blair, Director Resources	46	92	2	1
E McHugh, Joint Director Health & Social Care	44	90	1	0
A Short, Joint Director Health & Social Care	13	30	0	0
M Smith, Director Education, Communities & Economy	30	43	2	0
G Fairley, Head of Finance & ISS	35	71	1	0
G Vickers, Head of Education	4	0	1	0
A White, Head of Adult & Social Care	14	7	0	0
A Turpie, Legal Services Manager	24	46	2	2
Total	**250**	**442**	**12**	**4**

All senior employees shown in the tables above except A Short are members of the Local Government Pension Scheme. A Short is employed by NHS Lothian and is a member of the NHS pension scheme. The pension figures shown relate to the benefits accrued as a consequence of total local government service, not solely the current appointment.

Remuneration of Senior Councillors

The following table provides details of the remuneration paid to senior councillors of Midlothian Council.

For year to 31 March 2017		For year to 31 March 2018		
Total Remuneration	**Name**	**Salary**	**Expenses**	**Total Remuneration**
£143	O Thompson, (3)	£0	£0	£0
£28,187	C Johnstone, Scottish National Party (SNP) Group Leader, (1)	£17,984	£240	£18,224
£21,247	B Constable, Not Re-elected, (1)	£1,983	£95	£2,078
£21,297	J Wallace, Councillor (1)	£1,987	£198	£2,185
£21,275	A Coventry, Not Re-elected, (1)	£1,983	£106	£2,089
£21,248	J Bryant, Not Re-elected, (1)	£1,983	£50	£2,033
£21,836	D Rosie, Not Re-elected, (1)	£1,948	£76	£2,024
£21,072	K Parry, Councillor (1, 4)	£20,947	£0	£20,947
£21,579	D Milligan, Leader of the Council, (2)	£26,995	£541	£27,536
£3,079	M Russell, Depute Provost, (2)	£20,843	£189	£21,032
£0	J Muirhead, Depute Leader, (2)	£20,554	£54	£20,608
£0	A Montgomery, Provost, (2, 5)	£15,833	£83	£15,916
£0	R Imrie, Senior Councillor, (2)	£20,554	£340	£20,894
£0	S Curran, Senior Councillor, (2)	£18,964	£135	£19,099
£0	J Hackett, Senior Councillor, (2)	£18,964	£195	£19,159
£0	P Winchester, Scottish Conservative and Unionist Group Leader, (2)	£18,964	£279	£19,243
£180,963	**Total**	**£210,486**	**£2,581**	**£213,067**

The Council paid £0.346 million (2016/17 £0.342 million) salaries to Councillors and expenses of £0.005 million (2016/17 £0.004 million). The annual return of Councillor’s salaries and expenses is available on the Council Website.

Pension Entitlement of Senior Councillors

31-Mar-17		31-Mar-18
£3,631	B Constable, Not Re-elected, (1)	£296
£3,639	J Wallace, Councillor (1)	£297
£3,631	D Rosie, Not Re-elected, (1)	£296
£4,048	C Johnstone, Scottish National Party (SNP) Group Leader, (1)	£0
£3,631	A Coventry, Not Re-elected, (1)	£296
£4,257	K Parry, Councillor (1, 4)	£4,231
£0	A Montgomery, Provost, (2, 5)	£3,121
£0	R Imrie, Senior Councillor, (2)	£4,075
£0	S Curran, Senior Councillor, (2)	£2,137
£0	J Hackett, Senior Councillor, (2)	£3,831
£0	P Winchester, Scottish Conservative and Unionist Group Leader, (2)	£3,831
£22,837		**£22,411**

1 The above list shows the current position of councillors, prior to the change of administration that resulted from the Council elections on 4th May 2017 the post of Council Leader was held by C Johnstone, Provost was J Wallace and others acted as Senior Councillors.

2 Prior to the change in administration the post of Opposition Leader was held by D Milligan, others acted as Councillors or were not elected members.

3 O Thompson stood down as Council Leader on 8th May 2015, being replaced by C Johnstone.

4 K Parry became the leader of the SNP group following the Council elections of the 4th of May 2017, she was replaced in this role by C Johnstone following the AGM of the SNP group from the 26th of March 2018

5 A Montgomery ceased to be Provost following his death on the 10th of January 2018.

Accrued Pension Benefits

Name and Post Title	As at 31-Mar-18 Pension	Lump Sum	Difference from 31-Mar-17 Pension	Lump Sum
	£0	**£0**	**£0**	**£0**
B Constable, not re-elected	5	1	2	0
J Wallace, councillor	2	0	0	0
D Rosie, not re-elected	2	0	0	0
A Coventry, not re-elected	2	0	0	0
R Imrie, Senior Councillor	3	1	0	0
K Parry, councillor	1	0	1	0
Total	**15**	**2**	**3**	**0**

Signed:

Derek Milligan
Leader of the Council

Grace Vickers
Chief Executive

Date:

Group and Council Comprehensive Income and Expenditure Statement

For the year ended 31 March 2018

This statement shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation or rents. The Council raises taxation and rents to cover expenditure in accordance with statutory requirements; these differ from the accounting cost. The taxation position is shown in both the Expenditure and Funding Analysis and the Movement in Reserves Statement. Following clarification within the CIPFA Code of Practice on Local Authority Accounting over the recognition of HRA capital grants, the Council has represented the 2016/17 figures to ensure these are consistent each year. Additionally the treatment of internal income and expenditure is different to that presented in the 2016/17 accounts. Internal income and expenditure is included increasing the Gross Income and Gross Expenditure lines for each Council service, it was excluded in the 2016/17 accounts, the prior-year figures have been restated. This change has no effect on the net expenditure reported.

Midlothian Council			Group			Midlothian Council			Group
Restated 2016/17 Gross Expenditure £000	Restated 2016/17 Gross Income £000	Restated 2016/17 Net Expenditure £000	Restated 2016/17 Net Expenditure £000	Service	Notes	2017/18 Gross Expenditure £000	2017/18 Gross Income £000	2017/18 Net Expenditure £000	2017/18 Net Expenditure £000
1,787	-66	1,721	1,721	Management	7	2,026	-82	1,944	1,944
16,210	-270	15,940	15,940	Children's Services	7	17,267	-354	16,913	16,913
7,123	-2,099	5,024	5,024	Communities and Economy	7	7,138	-3,318	3,820	3,820
99,237	-2,298	96,939	96,939	Education	7	99,503	-4,316	95,187	95,187
96,578	-56,745	39,833	39,833	Adult Social Care	7	99,202	-58,637	40,565	40,565
36,795	-31,049	5,746	5,746	Customer and Housing Services	7	31,505	-24,880	6,625	6,625
33,574	-11,573	22,001	22,001	Commercial Services	7	34,062	-10,932	23,130	23,130
12,527	-993	11,534	11,534	Finance and Integrated Service Support	7	12,507	-1,134	11,373	11,373
39,064	-19,381	19,683	19,683	Properties and Facilities Management	7	39,724	-19,060	20,664	20,664
30,739	-25,560	5,179	5,179	Housing Revenue Account	7	29,439	-27,058	2,381	2,381
560	0	560	560	Lothian Valuation Joint Board	7	562	0	562	562
Midlothian Council			**Group**			**Midlothian Council**			**Group**

Restated 2016/17 Gross Expenditure £000	Restated 2016/17 Gross Income £000	Restated 2016/17 Net Expenditure £000	Restated 2016/17 Net Expenditure £000	Service	Notes	2017/18 Gross Expenditure £000	2017/18 Gross Income £000	2017/18 Net Expenditure £000	2017/18 Net Expenditure £000
0	0	0	0	Central Costs	7	-533	0	-533	-533
1,449	0	1,449	1,499	Non-Distributable Costs	8	2,092	0	2,092	2,173
375,643	-150,034	225,609	225,659	**Net Cost of Services**		374,494	-149,771	224,723	224,804
		0	14	Share of operating results of associates				0	-342
		-1,855	-1,855	Other Operating Expenditure	9			-177	-177
		14,915	14,915	Financing and Investment Income and Expenditure	10			15,567	15,567
		-208,263	-208,263	Taxation and non-specific grant income	11			-210,733	-210,733
		30,406	**30,470**	**(Surplus) or Deficit on Provision of Services**				**29,380**	**29,119**
		-15,364	-15,364	(Surplus) or Deficit on revaluation of non-current assets				-1,899	-1,899
		44,365	44,365	Re-measurement of the net defined benefit liability	34			-44,600	-44,600
		95	623	Other (Gains) / Losses				-3,290	-3,879
		29,096	**29,624**	**Other Comprehensive (Income) and Expenditure**				**-49,789**	**-50,378**
		59,502	**60,094**	**Total Comprehensive (Income) and Expenditure**				**-20,409**	**-21,259**

Group and Council Movement in Reserves Statement

This statement shows the movement in the year on the different reserves held by the Council, analysed into ‘usable reserves’ (i.e. those that can be applied to fund expenditure) and other ‘unusable reserves’. This statement shows how the movements in year of the Council’s reserves are broken down between gains and losses incurred in accordance with generally accepted accounting practices and the statutory adjustments required to return to the amounts chargeable to council tax and rents for the year. The Net Increase/Decrease line shows the statutory General Fund Balance and Housing Revenue Account Balance movements in the year following these adjustments.

	Note / source	General Fund Reserve	HRA Balance	Capital Fund	Repairs and Renewals Fund	**Total Usable Reserves**	**Unusable Reserves**	**Total Council Reserves**	**Council's Share of Reserves of Associates, Subsidiaries and Joint Ventures**	**Total Group Reserves**
		£000	£000	£000	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Balance at 1 April 2016		**-24,625**	**-24,913**	**-15,378**	**-3,607**	**-68,523**	**-256,598**	**-325,121**	**274**	**-324,847**
Total Comprehensive Expenditure and Income	CIES	21,818	8,589	0	0	**30,407**	**29,095**	**59,502**	**593**	**60,095**
Adjustments between accounting basis and funding basis under regulations	6	-14,337	-13,429	-1,329	0	-29,095	29,095	0	0	**0**
Net increase/ (decrease) before transfers to other statutory reserves		**7,481**	**-4,840**	**-1,329**	**0**	**1,312**	**58,190**	**59,502**	**593**	**60,095**
Transfers to/(from) other statutory reserves		-507	0	0	507	0	0	0	0	**0**
Increase/(Decrease) in year		**6,974**	**-4,840**	**-1,329**	**507**	**1,312**	**58,190**	**59,502**	**593**	**60,095**
Balance at 31 March 2017		**-17,651**	**-29,753**	**-16,707**	**-3,100**	**-67,211**	**-198,408**	**-265,619**	**867**	**-264,752**
General Fund Analysed Over										
Amounts Earmarked	39	-9,094								
Amounts Uncommitted		-8,557								
Total General Fund Balance at 31 March 2017		**-17,651**								

	Note / source	General Fund Reserve	HRA Balance	Capital Fund	Repairs and Renewals Fund	**Total Usable Reserves**	**Unusable Reserves**	**Total Council Reserves**	**Council's Share of Reserves of Associates, Subsidiaries and Joint Ventures**	**Total Group Reserves**
		£000	£000	£000	£000	**£000**	**£000**	**£000**	**£000**	**£000**
Balance at 31 March 2017		**-17,651**	**-29,753**	**-16,707**	**-3,100**	**-67,211**	**-198,408**	**-265,619**	**867**	**-264,752**
Adjustments relating to revalued assets funded from developer contributions		0	0	0	0	0	-2,594	-2,594	0	-2,594
Adjustment relating to PPP long term liabilty		0	0	0	0	0	-230	-230	0	-230
Revised Balance at 31 March 2017		**-17,651**	**-29,753**	**-16,707**	**-3,100**	**-67,211**	**-201,232**	**-268,443**	**867**	**-267,576**
Total Comprehensive Expenditure and Income	CIES	21,039	8,341	0	0	**29,380**	**-49,789**	**-20,409**	**-850**	**-21,259**
Adjustments between accounting basis and funding basis under regulations	6	-16,391	-12,451	-318	0	-29,160	29,160	0	0	0
Net increase/ (decrease) before transfers to other statutory reserves		**4,648**	**-4,110**	**-318**	**0**	**220**	**-20,629**	**-20,409**	**-850**	**-21,259**
Transfers to/(from) other statutory reserves		2,226	0	-2,437	211	0	0	0	0	0
Increase/(Decrease) in year		**6,874**	**-4,110**	**-2,755**	**211**	**220**	**-20,629**	**-20,409**	**-850**	**-21,259**
Balance at 31 March 2018		**-10,777**	**-33,863**	**-19,462**	**-2,889**	**-66,991**	**-221,861**	**-288,852**	**17**	**-288,835**

General Fund Analysed Over		
Amounts Earmarked	39	-6,440
Amounts Uncommitted		-4,337
Total General Fund Balance at 31 March 2017		**-10,777**

Group and Council Balance Sheet
As at 31 March 2018

The Balance Sheet shows the value as at the Balance Sheet date of the assets and liabilities recognised by the Council. The net assets are matched by reserves which are reported in two categories. The first is 'usable reserves' which are available to the Council to provide services, subject to the need to maintain a prudent level of reserves and any statutory limitations on their use. The second category of reserves are those that the Council is not able to use to provide services. This includes reserves that contain unrealised gains and losses where amounts would only become available to provide services if the assets are sold; and reserves that hold timing differences shown in the Movement in Reserves Statement line "Adjustments between accounting basis and funding basis under regulations".

Midlothian Council 31/03/2017 £000	Group 31/03/2017 £000		Notes	Midlothian Council 31/03/2018 £000	Group 31/03/2018 £000
651,696	651,696	Property, Plant and Equipment	12	634,013	634,013
766	766	Intangible Assets	13	514	514
68	68	Heritage Assets	15	76	76
4,935	4,935	Long Term Investments	17	8,399	8,399
0	-1,037	Investments share of net assets of associates		0	-70
3,136	3,136	Long Term Debtors	18	2,927	2,889
660,601	**659,564**	**Long Term Assets**		**645,929**	**645,821**
65,072	65,072	Short Term Investments	16	65,221	65,221
1,950	1,950	Assets held for Sale	14	4,257	4,257
811	811	Inventories		881	881
19,641	19,641	Short Term Debtors	18	18,455	18,510
10,894	10,894	Cash and Cash Equivalents	19	8,886	8,886
98,368	**98,368**	**Current Assets**		**97,700**	**97,755**
51,270	51,270	Short Term Borrowing	16	25,725	25,725
28,998	28,828	Short Term Creditors	20	39,214	39,178
1,431	1,431	Provisions	21	1,793	1,793
22,944	22,944	Grants Receipts in Advance	29	24,410	24,410
104,643	**104,473**	**Current Liabilities**		**91,142**	**91,106**
208,816	208,816	Long Term Borrowing	16	218,176	218,176
179,892	179,892	Other Long Term Liabilities	22	145,459	145,459
388,707	**388,707**	**Long Term Liabilities**		**363,635**	**363,635**
265,619	**264,752**	**Net Assets**		**288,852**	**288,835**
67,211	67,438	Usable Reserves	6&23	66,991	67,567
198,408	197,314	Unusable Reserves	24	221,861	221,268
265,619	**264,752**	**Total Reserves**		**288,852**	**288,835**

Gary Fairley, Head of Finance and Integrated Service Support

Unaudited Accounts were authorised for issue on 26th June 2018 and the audited accounts were authorised for issue on 25th September 2018.

Cash Flow Statement

For the year ended 31 March 2018

This statement summarises the inflows and outflows of cash arising from the transactions with third parties on both day-to-day revenue transactions and expenditure on capital activities. The statement shows how the Council generates and uses cash and cash equivalents by classifying cash flows as operating, investing and financial activities. For the purpose of this statement, cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash and cash equivalents are shown net of bank overdrafts that are repayable on demand and form an integral part of the Council's cash management.

2016/17			2017/18
£000	**Revenue Activities**	**Notes**	**£000**
-30,406	**Net surplus or (deficit) on the provision of services**		**-31,034**
64,498	Adjustment to surplus or deficit on the provision of services for non cash movements	25	66,947
13,172	Adjust for items included in the net surplus or deficit on the provision of services that are investing and financing activities	25	-17,870
47,264	**Net Cash Flows From Operating Activities**		**18,043**
-65,902	Net cash flows from investing activities	26	-2,444
18,822	Net cash flows from financing activities	27	-17,607
184	**Net Increase or Decrease in Cash and Cash Equivalents**		**-2,008**
10,710	Cash and cash equivalents at the beginning of the reporting period	19	10,894
10,894	**Cash and cash equivalents at the end of the reporting period**		**8,886**

Notes to the Financial Statements

The notes to the Financial Statements present information about the basis of preparation of the Financial Statements and the specific accounting policies used. It discloses the information required by The Code that is not presented elsewhere in the Financial Statements together with other explanatory information.

1. Statement of Accounting Policies

1.1 General Principles

The Statement of Accounts summarise the Council's transactions for the 2017/18 financial year and its position as at 31 March 2018. The Council is required to prepare an annual Statement of Accounts in accordance with the Local Authority Accounts (Scotland) Regulations 2014. Section 12 of the Local Government in Scotland Act 2003 also requires the Statement of Accounts to be prepared in accordance with proper accounting practices. These practices comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (The Code) and the Service Reporting Code of Practice 2017/18 (SeRCOP), supported by International Financial Reporting Standards (IFRS) and statutory guidance issued under section 12 of the Local Government in Scotland Act 2003.

Accounting Concepts and Principles

The accounting concepts followed in the application of accounting policies are:

- Accruals - sums due to or from the Council during the year are included, whether or not the cash has actually been received or paid in the year.

- Going concern - this assumes that the Council will continue in existence for the foreseeable future.

The accounting concepts are supported by qualitative characteristics prescribed by the International Accounting Standards Board's Conceptual Framework for Financial Reporting:

- Two fundamental characteristics (relevance and faithful representation); and

- Four enhancement characteristics, which complement the fundamental characteristics (comparable, verifiable, timely and understandable).

Faithful representation has three characteristics:

- Completeness - the financial statements should include all information necessary for a user to understand them, including all necessary descriptions and explanations;

- Neutrality - the financial statements should be without bias in the selection or presentation of financial information; and

- Free from material error - there should be no errors or omissions in descriptions, or in the selection or application of the process used to produce the reported information.

1.2 Summary of Significant Accounting Policies

1.2.1 Accruals of Income and Expenditure

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- Revenue from the provision of services is recognised when the Council can reliably measure the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- Revenue from Council Tax and Non Domestic Rates is recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the Council, and the amount of revenue can be measured reliably. Revenue is measured at the full amount receivable (net of any impairment losses) as they are non-contractual, non-exchange transactions and there can be no difference between the delivery and payment dates.
- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the Balance Sheet;
- Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made;
- Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract;
- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or a creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

- National Non-domestic Rate debtors were previously shown on local authority balance sheets as debtors of the authority. Following a review of all types of local taxation, CIPFA/LASAAC concluded that local authorities act as an agent of the Government when collecting NDR. The code requires local authorities not to recognise NDR debtors in their balance sheets but instead to recognise a creditor or debtor for cash collected from NDR debtors as agent of the Government but not paid or overpaid to the Government.

1.2.2 Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e., in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council's financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

1.2.3 Charges to Revenue for Non-Current Assets

Services and support services are debited with the following amounts to record the cost of holding non-current assets during the year:

- Depreciation attributable to the assets used by the relevant service;
- Revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off;
- Amortisation of intangible non-current assets attributable to the service.

The Council is not required to raise Council Tax to fund depreciation, revaluation and impairment losses or amortisations. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement by way of loans fund principal charges. Depreciation, revaluation and impairment losses and amortisations are therefore replaced by the contribution in the principal repayment when determining the movement in the General Fund Balance by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

1.2.4 Employee Benefits

Benefits Payable during Employment

Short-term employee benefits are those due to be settled within 12 months of the year-end. They include such benefits as salaries, paid annual leave and flexi-time balances. They are recognised as an expense for services in the year in which employees render services to the Council. An accrual is made for the cost of holiday entitlements earned by employees but not taken before the year-end which employees can carry forward into the next financial year. The accrual is charged to the surplus or deficit on the provision of services, but then reversed out through the Movement in Reserves Statement so that holiday benefits are charged to revenue in the financial year in which the holiday absence occurs.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date or an officer's decision to accept voluntary severance and are charged on an accruals basis to the Non Distributed Costs line in the CIES when the Council is demonstrably committed to the termination of the employment of an officer or group of officers or making an offer to encourage voluntary severance.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Post-Employment Benefits

Employees of the Authority are members of two separate pension schemes:

- The Teachers' Pension Scheme, administered by the Scottish Public Pensions Agency (SPPA);
- The Local Government Pensions Scheme, administered by the Lothian Pension Fund operated by the City of Edinburgh Council.

Both schemes provide defined benefits to members (retirement lump sums and pensions), earned as employees work for the Council.

However, the arrangements for the teachers' scheme mean that liabilities for these benefits cannot be identified to the Council. The scheme is therefore accounted for as if it were a defined contribution scheme – no liability for future payments of benefits is recognised in the Balance Sheet and the education service revenue account is charged with the employer's contribution payable to teachers' pensions in the year.

In relation to retirement benefits, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, this means that there are appropriations to and from the Pension Reserve to remove the notional debits and credits for retirement benefits and replace them with debits for cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the Pension Reserve thereby measures the beneficial impact to the General Fund of being required to account for retirement benefits on the basis of cash flows rather that as benefits are earned by employees.

The Local Government Pension Scheme

The Local Government Scheme is accounted for as a defined benefits scheme:

- The liabilities of the Lothian Pension Fund attributable to the Council are included in the Balance Sheet on an actuarial basis using the projected unit method – i.e. an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions about mortality rates, employee turnover rates etc and projections of earnings for current employees;
- Liabilities are discounted to their value at current prices;
- The assets of Lothian Pension Fund attributable to the Council are included in the Balance Sheet at their fair value. Quoted securities at current bid price, unquoted securities at professional estimate, unitised securities at current bid price and property at market value.

The change in the net pensions liability is analysed into seven components:

- Current service cost – the increase in liabilities as a result of years of service earned this year – allocated in the CIES to the services for which the employees worked;
- Past service cost – the increase in liabilities arising from current year decisions whose effect relates to years of service earned in earlier years – debited to the Surplus or Deficit on the Provision of Services in the CIES as part of Non Distributed Costs;
- Net interest on the net defined liability (asset), i.e. net interest expense for the authority – the change during the period in the net defined benefit liability (asset) that arises from the passage of time charged to the Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement – this is calculated by applying the

discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability (asset) at the beginning of the period – taking into account any changes in the net defined benefit liability (asset) during the period as a result of contribution and benefit payments.;

- The return on plan assets – excluding amounts included in net interest on the net defined liability (asset) – charged to the pensions reserve as other comprehensive income and expenditure;
- Actuarial gains and losses – changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions – charged to the Pensions Reserve as other comprehensive income and expenditure;;
- Contributions paid to the Lothian Pension Fund – cash paid as employer's contributions to the pension fund in settlement of liabilities; not accounted for as an expense.

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme

1.2.5 Events After the Balance Sheet Date

Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Financial Statements are authorised for issue. Two types of events can be identified:

- Those that provide evidence of conditions that existed at the end of the reporting period – the Financial Statements are adjusted to reflect such events;
- Those that are indicative of conditions that arose after the reporting period – the Financial Statements are not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the Financial Statements.

1.2.6 Financial Instruments

Financial Liabilities

Financial liabilities are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value and are carried at their amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the CIES for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

For most of the borrowings that the Council has this means that the amount presented in the Balance Sheet is the outstanding principal repayable (plus accrued interest); and interest charged to the CIES is the amount payable for the year according to the loan agreement.

Where premiums and discounts have been charged to the CIES, regulations allow the impact on the General Fund or HRA Balances to be spread over future years. The Council has a policy of spreading the gain or loss over the term that was remaining on the loan against which the premium was payable or discount receivable when it was repaid.

The reconciliation of amounts charged to the CIES to the net charge required against the General Fund Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

Gains and losses on the repurchase or early settlement of borrowing are credited and debited to the Financing and Investment Income and Expenditure line in the CIES in the year of repurchase/settlement. However, where repurchase has taken place as part of a restructuring of the loan portfolio that involves the modification or exchange of existing instruments, the premium or discount is respectively deducted from or added to the amortised cost of the new or modified loan and the write-down to the CIES is spread over the life of the loan by an adjustment to the effective interest rate.

Financial Assets

Financial assets are classified into two types:

- Loans and receivables – assets that have fixed or determinable payments but are not quoted in an active market;
- Available-for-sale assets – assets that have a quoted market price and/or do not have fixed or determinable payments.

Loans and Receivables

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument. For most of the loans that the Council has made, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made, the asset is written down and a charge made to the relevant service (for receivables specific to that service) or the Financing and Investment Income and Expenditure line in the CIES.

The impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate.

Any gains and losses that arise on the de-recognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

Available for Sale Assets

Available-for-sale assets are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value. Where the asset has fixed or determinable payments, annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the amortised cost of the asset multiplied by the effective rate of interest for the instrument. Where there are no fixed or determinable payments, income (e.g., dividends) is credited to the CIES when it becomes receivable by the Council.

Assets are maintained in the Balance Sheet at fair value. Values are based on the share of net assets basis as a proxy for quoted market prices.

Changes in fair value are balanced by an entry in the Available-for-Sale Reserve and the gain/loss is recognised in the Surplus or Deficit on Revaluation of Available-for -Sale Financial Assets. The exception is where impairment losses have been incurred – these are debited to the Financing and Investment Income and Expenditure line in the CIES, along with any net gain or loss for the asset accumulated in the Available-for-Sale Reserve.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made (fixed or determinable payments) or fair value falls below cost, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the CIES. If the asset has fixed or determinable payments, the impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate. Otherwise, the impairment loss is measured as any shortfall of fair value against the acquisition cost of the instrument (net of any principal repayment and amortisation).

Any gains and losses that arise on the de-recognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES, along with any accumulated gains or losses previously recognised in the Available-for-Sale Reserve.

<u>1.2.7 Interests in Companies and Other Entities</u>

The Council has an interest in companies and other entities that have the nature of subsidiaries, associates and jointly controlled entities. In the Council's own single-entity accounts, the interests in companies and other entities are recorded as the share of net assets.

<u>1.2.8 Long Term Contracts</u>

Long term contracts are accounted for on the basis of charging the Surplus or Deficit on the Provision of Services with the value of works and services received under the contract during the financial year.

<u>1.2.9 Property, Plant and Equipment</u>

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others or for administrative purposes and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment

Recognition

Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an asset's potential to deliver future economic benefits or service potential (i.e., repairs and maintenance) is charged as an expense when it is incurred.

Measurement

Assets are initially measured at cost, comprising:

- The purchase price;

- Any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The Council does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of assets acquired other than by purchase is deemed to be its fair value, unless the acquisition does not have commercial substance (i.e. it will not lead to a variation in the cash flows of the Council). In the latter case, where an asset is acquired via an exchange, the cost of the acquisition is the carrying amount of the asset given up by the Council.

Assets are carried in the Balance Sheet using the following measurement bases:

- Council Houses are valued using the Beacon principle based on valuations carried out by the Council's Property Investment Manager. The main valuation basis used in is existing use – social housing. Gross valuations are reduced by applying a discount factor which is designed to reflect that houses are only available for social use. Any new build housing and newly purchased houses are valued at historic cost;
- Land and operational properties, including schools, have been valued at current value, determined as the amount that would be paid for an asset in its existing use;
- Community and Infrastructure assets are valued at depreciated historic cost;
- Vehicles, Plant and Equipment have been valued at depreciated historic cost;
- Assets Under Construction are held at historic cost;
- Surplus Assets are valued at open market value;
- Heritage Assets are valued at insurance replacement value where available, otherwise assets are held at depreciated historic cost since the cost of obtaining a valuation would outweigh the benefits to users of the financial statements.

Where there is no market-based evidence of current value because of the specialist nature of an asset, depreciated replacement cost (DRC) is used as an estimate of current value.

Where non-property assets that have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for fair value.

Assets included in the Balance Sheet at fair value are re-valued sufficiently regularly to ensure that their carrying amount is not materially different from their fair value at the year-end, but as a minimum every five years. As part of the Council's plan for revaluation, a move has been made to revalue all items in a specific category in the same year, if one of the assets in the category has been re-valued. Increases in valuations are matched by credits to the Revaluation Reserve to recognise any unrealised gains. Exceptionally, gains might be credited to the CIES where they arise from the reversal of a loss that has been previously charged to a service.

Where decreases in value are identified, they are accounted for by:

- Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the CIES.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

Impairment

Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for by:

- Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the CIES.

Where an impairment loss is reversed subsequently, the reversal is credited to the Revaluation Reserve or the relevant service line(s) in the CIES, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for on all Property, Plant and Equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e., freehold land and certain Community Assets) and assets that are not yet available for use (i.e., assets under construction).

Deprecation is calculated on the following bases:

- Dwellings and other buildings – straight-line allocation over the useful life of the property as estimated by the valuer;
- Vehicles, plant and equipment – straight-line allocation over the useful life of the assets in the Balance Sheet, as advised by a suitably qualified officer;
- Infrastructure – straight-line allocation.

The following useful lives are used in the calculation of depreciation for the categories of assets, except where the useful life is known to be different from these as a consequence of a Council decision:

- Council Dwellings – 40 to 60 years;
- Buildings – 10 to 30 years;
- Vehicles, Plant and Equipment – 5 to 10 years;
- Infrastructure – 15 years.

Where an item of Property, Plant and Equipment asset has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately. Council policy is to only consider any asset with a gross book value of £1.5 million or above. The assessment of which components of these assets require to be recognised and depreciated separately is based on the cost of each component. Significance is determined by comparing the cost of components against the overall cost of the asset. This threshold is set at 15% or more of the overall cost of the asset.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals and Non-Current Assets Held for Sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an Asset Held for Sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the CIES. Gains in fair value are recognised only up to the amount of any previous losses recognised in the Surplus or Deficit on Provision of Services. Depreciation is not charged on Assets Held for Sale.

If assets no longer meet the criteria to be classified as Assets Held for Sale, they are reclassified back to non-current assets and valued at the lower of their carrying amount before they were classified as held for sale; adjusted for depreciation, amortisation or revaluations that would have been recognised had they not been classified as Held for Sale, and their recoverable amount at the date of the decision not to sell.

Assets that are to be abandoned or scrapped are not reclassified as Assets Held for Sale.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet (whether Property, Plant and Equipment or Assets Held for Sale) is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the CIES also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

Amounts received for a disposal in excess of £10,000 are categorised as capital receipts. The balance of receipts is credited to the Capital Fund and can then only be used for new capital investment or to defray debt. Receipts are appropriated to the Reserve from the General Fund Balance in the Movement in Reserves Statement.

The written-off value of disposals is not a charge against Council tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

1.2.10 VAT

Income and Expenditure excludes any amount relating to Value Added Tax (VAT), as all VAT collected is payable to H.M. Revenue & Customs and all VAT paid out is recoverable from them.

2. Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2018/19 Code.

- IFRS 9 *Financial Instruments*
- IFRS 15 *Revenue from Contracts with Customers* including amendments to IFRS 15 *Clarifications to IFRS 15 Revenue from Contracts with Customers*
- Amendments to IAS 12 *Income Taxes*: Recognition of Deferred Tax Assets for Unrealised Losses
- Amendments to IAS 7 *Statement of Cash Flows*: Disclosure Initiative.

These changes will be effective from April 2018 and therefore have no impact on these accounts

3. Critical Judgements in Applying Accounting Policies

In applying the accounting policies set out in Note 1, the Council has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the Statement of Accounts are:

- There is a high degree of uncertainty about future levels of funding for Local Government, however, the Council has determined that this uncertainty is not yet sufficient to provide an indication that the assets of the Council might be impaired as a result of a need to close the facilities and to reduce levels of service provision.
- Accounting for public-private partnerships. The council is deemed to control the services provided under the agreement for the provision of educational establishments in accordance with IFRC12. The council controls the services provided under the scheme and ownership of the schools will pass to the council at the end of the contract. The schools are therefore recognised on the council's balance sheet.

4. Assumptions made about the future and other major sources of estimation uncertainty

The Financial Statements contain estimated figures that are based on assumptions made by the Council about the future or events that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Council's Balance Sheet as at 31 March 2018 for which there is significant risk of material adjustment in the forthcoming year are as follows:

4.1 Property, Plant and Equipment

Uncertainties

Assets are depreciated over useful lives that are dependent on assumptions about the level of repairs and maintenance that will be incurred in relation to individual assets. The current economic climate makes it uncertain that the Council will be able to sustain its current spending on repairs and maintenance, bring into doubt the useful lives assigned to assets.

Effect if Actual Results Differ from Assumptions

If the useful life of assets is reduced, depreciation increases and the carrying amount of the assets falls. It is estimated that the annual depreciation charge would increase by £4.223 million for every year that useful lives had to be reduced.

4.2 Pension Liabilities

Uncertainties

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which earnings are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. Hymans Robertson LLP are engaged to provide the Council with expert advice about the assumptions to be applied.

Effect if Actual Results Differ from Assumptions

The following table shows the sensitivity of the results to the changes in assumptions used to measure the scheme liabilities. Approximate percentage changes and monetary values are shown below:

	Approximate % increase to Employer Obligation	Approximate monetary amount £000
Sensitivities at 31 March 2018		
0.5% decrease in Real Discount Rate	10%	58,836
0.5% increase in the Salary Increase Rate	2%	11,888
0.5% increase in the Pension Increase Rate	8%	45,788

In addition it is estimated that a one year increase in life expectancy would approximately increase the Employer's Defined Benefit Obligation by around 3-5%.

4.3 Collectability of debtors

A provision for bad debt is used to estimate the collectability of debtors. This is calculated as a percentage of debt outstanding using historical debt collection rates.

5. Expenditure and Funding Analysis

For the year ended 31 March 2018

The Expenditure and Funding Analysis demonstrates how the funding available to the Council (government grants, rents, council tax and business rates) has been used in providing services in comparison with those resources consumed or earned in accordance with generally accepted accounting practices. It also shows how resources have been allocated for decision making purposes between the Council's Services. Income and expenditure accounted for under generally accepted accounting practices is presented more fully in the Comprehensive Income and Expenditure Statement. The table entitled **Building the Expenditure and Funding Analysis** in the Management Commentary reconciles the budget monitoring report to the Net Expenditure chargeable to the General Fund and HRA balances.

2016/17 Net expenditure chargeable to the General Fund and HRA balances	2016/17 Adjustments between the funding and accounting basis (1)	2016/17 Net expenditure in the Comprehensive Income and Expenditure Statement (3)	Service	2017/18 Net expenditure chargeable to the General Fund and HRA balances	2017/18 Adjustments between the funding and accounting basis (1)	2017/18 Net expenditure in the Comprehensive Income and Expenditure Statement (3)
£000	£000	£000		£000	£000	£000
1,574	146	1,721	Management	1,857	87	1,944
15,431	509	15,940	Children's Services	16,098	815	16,913
4,334	690	5,024	Communities and Economy	3,515	305	3,820
75,810	21,129	96,939	Education	77,878	17,309	95,187
38,237	1,596	39,833	Adult Social Care	38,806	1,759	40,565
5,305	441	5,746	Customer and Housing Services	6,654	-29	6,625
15,850	6,151	22,001	Commercial Services	15,801	7,329	23,130
11,159	375	11,534	Finance and Integrated Service Support	10,981	392	11,373
13,943	5,740	19,683	Properties and Facilities Management	14,318	6,346	20,664
-13,621	18,800	5,179	Housing Revenue Account	-14,461	16,842	2,381
560	0	560	Lothian Valuation Joint Board	562	0	562
0	0	0	Central Costs	-533	0	-533
1,407	42	1,449	Non-Distributable Costs	2,075	17	2,092
169,989	**55,619**	**225,609**	**Net Cost of Services**	**173,551**	**51,172**	**224,723**

2016/17	2016/17	2016/17		2017/18	2017/18	2017/18
Net expenditure chargeable to the General Fund and HRA balances	**Adjustments between the funding and accounting basis (1)**	**Net expenditure in the Comprehensive Income and Expenditure Statement (3)**	**Service**	**Net expenditure chargeable to the General Fund and HRA balances**	**Adjustments between the funding and accounting basis (1)**	**Net expenditure in the Comprehensive Income and Expenditure Statement (3)**
£000	**£000**	**£000**		**£000**	**£000**	**£000**
8,002	-9,857	-1,855	Other Income and Expenditure	9,102	-9,279	-177
12,477	2,437	14,915	Financing and Investment Income and Expenditure	12,386	3,181	15,567
-188,336	-19,927	-208,263	Taxation and non-specific grant income	-192,275	-18,458	-210,733
2,132	**28,272**	**30,406**	**(Surplus) or Deficit on Provision of Services**	**2,764**	**26,616**	**29,380**
-49,538			**Opening General Fund and HRA Balance**	**-47,406**		
2,132			**Less/Plus (Surplus) or Deficit on General Fund and HRA Balance in year**	**2,764**		
-47,406			**Closing General Fund and HRA Balance (2)**	**-44,642**		

1. See **note 5** for further analysis of the movements
2. For the split of this balance between the General Fund and the HRA see the **Movement in Reserves Statement**
3. See **note 7** for further analysis of these totals

5a. Note to the Expenditure and Funding Analysis

Adjustments between Funding and Accounting Basis **2016/17**

Adjustments from General Fund to arrive at the Comprehensive Income and Expenditure Statement Amounts	Adjustments for Capital Purposes (1)	Net change for the pension adjustments (2)	Other Differences (3)	Total Adjustments
Service	**£000**	**£000**	**£000**	**£000**
Management	71	35	40	146
Children's Services	136	187	186	509
Communities and Economy	440	133	117	690
Education	18,283	1,953	893	21,129
Adult Social Care	647	473	476	1,596
Customer and Housing Services	295	0	146	441
Commercial Services	5,472	351	328	6,151
Finance and Integrated Service Support	771	-695	299	375
Properties and Facilities Management	4,693	498	549	5,740
Housing Revenue Account	18,640	160	0	18,800
Lothian Valuation Joint Board	0	0	0	0
Non-Distributable Costs	0	0	42	42
Net Cost of Services	**49,448**	**3,095**	**3,076**	**55,619**
Other income and expenditure from the Expenditure and Funding Analysis	-29,776	2,436	-7	-27,347
Difference between General Fund Surplus or Deficit and CIES Surplus or Deficit on the Provision of Services	**19,672**	**5,531**	**3,069**	**28,272**

Adjustments between Funding and Accounting Basis **2017/18**

Service	**£000**	**£000**	**£000**	**£000**
Management	0	84	3	87
Children's Services	400	452	-37	815
Communities and Economy	6	321	-22	305
Education	12,455	4,720	134	17,309
Adult Social Care	637	1,143	-21	1,759
Customer and Housing Services	-23	0	-6	-29
Commercial Services	6,514	848	-33	7,329
Finance and Integrated Service Support	688	-268	-28	392
Properties and Facilities Management	5,191	1,204	-49	6,346
Housing Revenue Account	16,455	387	0	16,842
Lothian Valuation Joint Board	0	0	0	0
Central Services	0	0	0	0
Non-Distributable Costs	0	0	17	17
Net Cost of Services	**42,323**	**8,891**	**-42**	**51,172**
Other income and expenditure from the Expenditure and Funding Analysis	-27,729	3,181	-8	-24,556
Difference between General Fund Surplus or Deficit and CIES Surplus or Deficit on the Provision of Services	**14,594**	**12,072**	**-50**	**26,616**

This note provides a reconciliation of the main adjustments to Net Expenditure Chargeable to the General Fund and HRA Balances to arrive at the amounts in the Comprehensive Income and Expenditure Statement. The relevant transfers between reserves are explained in the Movement in Reserves Statement. For statutory accounting purposes, the undernoted adjustments are required to be included within the Comprehensive Income and Expenditure Statement. These adjustments are not charged to the Council for Council Tax or Rent setting purposes and are excluded for the General Fund and HRA Balances available to support services.

1) Adjustments for Capital Purposes

This column adds in depreciation, impairment and revaluation gains and losses in the Council Service lines, and for:

- **Other operating expenditure –** adjusts for capital disposals with a transfer of income on disposal and the amounts written off for those assets.
- **Financing and investment income and expenditure** – the statutory charges for financing, i.e. the minimum revenue provision and other revenue contributions are deducted as these are not chargeable under generally accepted accounting practices.
- **Taxation and non-specific grant income and expenditure –** capital grants are adjusted for income not chargeable under generally accepted accounting practices. Revenue grants are adjusted from those receivable in the year to those receivable without conditions or for which conditions were satisfied throughout the year. Capital grants receivable in the year without conditions or for which conditions were satisfied in the year are credited to the account.

2) Net change for the pension adjustments

Net change for the removal of pension contributions and the addition of IAS 19 Employee Benefits pension related expenditure and income:

- **For services** this represents the removal of the employer pension contributions made by the authority as allowed by statute and the replacement with current service costs and past service costs.
- **For Financing and investment income and expenditure** the net interest on the defined benefit liability is charged to the CIES.

3) Other Differences

Other differences between amounts debited/credited to the Comprehensive Income and Expenditure Statement and the amounts payable/receivable to be recognised on a statutory basis:

- **For Services** this represents the accrual made for the cost of holiday/Flexi-time/Time-off-on-lieu entitlement earned by employees but not taken before the year end which employees can carry forward into the next financial year. These require to be included within the net cost of services under generally accepted accounting practices, however are not chargeable to the General Fund.
- **For Financing and investment income and expenditure** this is an effective interest adjustment on the Council's Lender Option/Borrower Option (LOBO) debt.

6. Adjustments between accounting basis and funding under regulations

2016/17	General Fund Reserve £000	HRA Balance £000	Capital Fund £000	Total Useable Reserves £000	Total Unusable Reserves £000
Adjustments Primarily involving the Capital Adjustment Account					
Reversal of items debited or credited to the CIES					
Charges for depreciation of non-current assets	-28,392	-7,098	0	**-35,490**	**35,490**
Amortisation of intangible assets	-187	0	0	**-187**	**187**
Revaluation losses on PPE and assets held for sale	-1,797	-11,542	0	**-13,339**	**13,339**
Net gain or loss on sale of non-current assets	51	1,804	0	**1,855**	**-1,855**
Statutory Provision for the financing of capital investment	4,840	3,661	0	**8,501**	**-8,501**
Net revenue expenditure financed from capital under statute (REFFCUS)	-22	0	0	**-22**	**22**
Adjustments primarily involving the Capital Grant Unapplied Account					
Application of grants to capital financing transferred to the CAA	13,818	5,698	0	**19,516**	**-19,516**
Adjustments primarily involving the Capital Fund					
Capital Receipts Transferred to the Capital Fund	0	0	-1,329	**-1,329**	**1,329**
Adjustments involving the Financial Instruments Adjustment Account					
Amount by which finance costs charged are different from finance costs chargeable in year in accordance with statutory requirements	8	0	0	**8**	**-8**
Adjustments primarily involving the pensions reserve					
Reversal of items relating to retirement benefits debited or credited to the CIES	-17,729	-254	0	**-17,983**	**17,983**
Employers Pension contributions and direct payments to pensioners payable in the year	12,452	0	0	**12,452**	**-12,452**
Adjustments primarily involving the Employee Statutory Adjustment Account					
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	-3,077	0	0	**-3,077**	**3,077**
Total Adjustments	**-20,035**	**-7,731**	**-1,329**	**-29,095**	**29,095**

2017/18	General Fund Reserve £000	HRA Balance £000	Capital Fund £000	Total Useable Reserves £000	Total Unusable Reserves £000
Adjustments Primarily involving the Capital Adjustment Account					
Reversal of items debited or credited to the CIES					
Charges for depreciation of non-current assets	-22,247	-7,125	0	**-29,372**	**29,372**
Amortisation of intangible assets	-206	0	0	**-206**	**206**
Revaluation losses on PPE and assets held for sale	-3,414	-9,330	0	**-12,744**	**12,744**
Net gain or loss on sale of non-current assets	-255	432	0	**177**	**-177**
Statutory Provision for the financing of capital investment	5,222	4,083	0	**9,305**	**-9,305**
Net revenue expenditure financed from capital under statute (REFFCUS)	0	0	0	**0**	**0**
Adjustments primarily involving the Capital Grant Unapplied Account					
Application of grants to capital financing transferred to the CAA	16,021	0	0	**16,021**	**-16,021**
Adjustments primarily involving the Capital Fund					
Capital Receipts Transferred to the Capital Fund	0	0	-319	**-319**	**319**
Adjustments involving the Financial Instruments Adjustment Account					
Amount by which finance costs charged are different from finance costs chargeable in year in accordance with statutory requirements	8	0	0	**8**	**-8**
Adjustments primarily involving the pensions reserve					
Reversal of items relating to retirement benefits debited or credited to the CIES	-25,431	-510	0	**-25,941**	**25,941**
Employers Pension contributions and direct payments to pensioners payable in the year	13,869	0	0	**13,869**	**-13,869**
Adjustments primarily involving the Employee Statutory Adjustment Account					
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	41	0	0	**41**	**-41**
Total Adjustments	**-16,392**	**-12,450**	**-319**	**-29,161**	**29,161**

This note details the adjustments that are made to the total Comprehensive Income and Expenditure Statement recognised by the Council in the year in accordance with proper accounting practice to the resources that are specified by statutory provisions as being available to the Council to meet future capital and revenue expenditure

7 Group and Council Expenditure and Income Analysed by Segment and Nature

2016/17 Service Area	Employee Expenses	Other Service Expenses	Depreciation, Amortisation and Impairment	Interest Payments	Loss/Gain on Disposal of non-current assets	Share of Operating Results of Associates	**Total Expenditure**	Fees, Charges and Other Service Income	Interest and Investment Income	Income from Council Tax	Government Grants and Contributions	**Total Income**	**Net Expenditure**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Management	1,416	300	71	0	0	0	**1,787**	-66	0	0	0	**-66**	1,721
Children's Services	6,424	9,649	137	0	0	0	**16,210**	-194	0	0	-76	**-270**	15,940
Communities and Economy	4,066	3,050	7	0	0	0	**7,123**	-1,505	0	0	-594	**-2,099**	5,024
Education	62,588	18,366	18,283	0	0	0	**99,237**	-1,664	0	0	-634	**-2,298**	96,939
Adult Social Care	16,469	79,462	647	0	0	0	**96,578**	-55,411	0	0	-1,334	**-56,745**	39,833
Customer and Housing Services	4,978	31,522	295	0	0	0	**36,795**	-3,925	0	0	-27,124	**-31,049**	5,746
Commercial Services	11,429	16,673	5,472	0	0	0	**33,574**	-11,309	0	0	-264	**-11,573**	22,001
Finance and Integrated Service Support	9,551	2,205	771	0	0	0	**12,527**	-993	0	0	0	**-993**	11,534
Properties and Facilities Management	18,957	15,414	4,693	0	0	0	**39,064**	-18,996	0	0	-385	**-19,381**	19,683
HRA	0	12,099	18,640	0	0	0	**30,739**	-16,940	-8,620	0	0	**-25,560**	5,179
Lothian Valuation Joint Board	0	560	0	0	0	0	**560**	0	0	0	0	**0**	560
Non-distributable costs	1,499	0	0	0	0	0	**1,499**	0	0	0	0	**0**	1,499
Costs not included in a Service	2,437	0	0	13,330	-1,855	14	**13,926**	0	-852	-36,416	-171,847	**-209,115**	-195,189
Total	**139,814**	**189,300**	**49,016**	**13,330**	**-1,855**	**14**	**389,619**	**-111,003**	**-9,472**	**-36,416**	**-202,258**	**-359,149**	**30,470**

2017/18 Service Area	Employee Expenses	Other Service Expenses	Depreciation, Amortisation and Impairment	Interest Payments	Loss/Gain on Disposal of non-current assets	Share of operating results of associates	**Total Expenditure**	Fees, Charges and Other Service Income	Interest and Investment Income	Income from Council Tax	Government Grants and Contributions	**Total Income**	**Net Expenditure**
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Management	1,716	310	0	0	0	0	**2,026**	-82	0	0	0	**-82**	1,944
Children's Services	6,086	10,781	400	0	0	0	**17,267**	-208	0	0	-146	**-354**	16,913
Communities and Economy	3,898	3,234	6	0	0	0	**7,138**	-1,892	0	0	-1,426	**-3,318**	3,820
Education	68,687	18,361	12,455	0	0	0	**99,503**	-1,185	0	0	-3,131	**-4,316**	95,187
Adult Social Care	18,008	80,557	637	0	0	0	**99,202**	-57,204	0	0	-1,433	**-58,637**	40,565
Customer and Housing Services	5,248	26,280	-23	0	0	0	**31,505**	-1,715	0	0	-23,165	**-24,880**	6,625
Commercial Services	11,934	15,614	6,514	0	0	0	**34,062**	-10,763	0	0	-169	**-10,932**	23,130
Finance and Integrated Service Support	10,057	1,762	688	0	0	0	**12,507**	-1,134	0	0	0	**-1,134**	11,373
Properties and Facilities Management	19,889	14,645	5,190	0	0	0	**39,724**	-18,707	0	0	-353	**-19,060**	20,664
HRA	0	12,984	16,455	0	0	0	**29,439**	-27,058	0	0	0	**-27,058**	2,381
Lothian Valuation Joint Board	0	562	0	0	0	0	**562**	0	0	0	0	**0**	562
Central Costs	0	-533	0	0	0	0	**-533**	0	0	0	0	**0**	-533
Non-distributable costs	2,173	0	0	0	0	0	**2,173**	0	0	0	0	**0**	2,173
Costs not included in a Service	3,181	0	0	13,136	-177	-342	**15,798**	0	-750	-40,698	-170,035	**-211,483**	-195,685
Total	**150,877**	**184,557**	**42,322**	**13,136**	**-177**	**-342**	**390,373**	**-119,948**	**-750**	**-40,698**	**-199,858**	**-361,254**	**29,119**

8. Non-distributable costs

£000		£000
1,449	Pension Costs	2,092
1,449	**Total Non-distributable Costs**	**2,092**

9. Other operating income and expenditure

£000		£000
-1,855	(Surplus)/Deficit on sale of non current assets	-177
-1,855	**Total Other Operating Income and Expenditure**	**-177**

10. Financing and investing income and expenditure

£000		£000
13,983	Interest payable and similar charges	13,678
2,437	Pension interest cost on defined benefit obligation and interest income on plan assets	3,181
-1,505	Interest received and similar income	-1,292
14,915	**Total**	**15,567**

11. Taxation and non-specific grant income

2016/17		**2017/18**
£000	**Credited to Taxation and Non-Specific Grant Income**	**£000**
36,415	Council Tax Income	40,698
31,945	Non Domestic Rates Income	29,204
119,976	Non-Specific Government Grants	122,373
19,927	Capital grants	18,458
208,263	**Total Taxation and Non-Specific Grant Income**	**210,733**
	Credited to Services	
26,767	Housing Benefit Subsidy	23,162
0	Pupil Equity Funding	2,273
979	Community Justice Grant	1,108
127	LEADER Programme	370
0	Early Years Expansion	370
241	Business Gateway	252
0	Borders Railway Blueprint	237
121	Gorebridge CARS	220
289	Other grants	211
213	Active Schools	210
165	Big Lottery funding	163
0	Penicuik THI	113
130	Youth Music Initiative	111
0	Early Years Trial	105

0	European Social Fund	104
108	Opportunities for All	102
91	Caledonian Funding	85
79	Smarter Choices Smarter Places	85
50	Unaccompanied Asylum Seeking Children	81
0	Track 2 Train	72
0	Life Changes Trust	65
0	Get Going	60
44	Transforming Care After Treatment	42
49	East Lothian & Midlothian Domestic Abuse Advisor Service	41
40	Aging Well	41
0	Paticipatory Budgeting funding	40
45	Inward Investment Funding	37
33	Bus Service Operators Grant	31
38	Switched on Fleet Grant	31
358	Discretionary Housing Payments Contribution	0
105	Youth Employment Scotland	0
77	Technology Enabled Care	0
76	Innovation Fund	0
68	Hop-on Hop-off bus	0
45	Developing Scotland's Young Workforce	0
40	Active Choices	0
35	Spirit of 2012	0
30,412	**Total**	**29,822**

31-Mar-17 £000	**Grants Receipts in Advance**	**Note**	**31-Mar-18 £000**
	Revenue Grants		
0	Scottish Government Blueprint Grant Gorebridge Connected		1,018
0	Scottish Government Blueprint Grant Track to Train		141
0	Scottish Government Regeneration Capital Grant Track to Train		338
	Capital Grants		
20,359	Section 75 contributions from private developers		22,880
96	Scottish Government Inspiring Learning Spaces Grant		34
2,489	Hopefield Insurance Receipt	1	0
22,944	**Total**		**24,410**

1 Hopefield Insurance Receipt held in Grant Receipts in Advance as at 31 March 2017 and subsequently recognised as income in Taxation and non-specific grant income in 2017/18.

12. Movement in non-current assets, property, plant and equipment

The Council carries out a rolling programme which ensures that the Property, Plant and Equipment required to be measured at current value, Council Dwellings, Land and Buildings and Surplus Assets, undergoes revaluation at least every five years. Professionally qualified valuers (RICS: Royal Institute of Chartered Surveyors) employed within the Council’s Asset Management Team carry out valuations of all property-based assets held by the Council

	Houses	Buildings	Land	Vehicles, Plant & Equipment	Infrastructure Assets	Community Assets	Under Construction	Surplus Assets	Total
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cost or Valuation as at 31 March 2016	**300,814**	**306,530**	**15,274**	**27,023**	**58,855**	**7,687**	**16,147**	**8,087**	**740,417**
Additions	8,170	2,447	35	3,207	3,628	346	31,229	26	49,088
Disposals	-4,422	-214	-315	-1,050	0	0	0	0	-6,001
Reclassification	11,783	503	-5,720	0	0	0	-5,866	-700	0
Revaluation to I&E	-11,542	-292	-2,600	0	0	-11	0	0	-14,445
Revaluation to Revaluation Reserve	-846	-7,191	4,634	0	0	-363	0	-1,400	-5,166
Gross Book value at 31 March 2017	**303,957**	**301,783**	**11,308**	**29,180**	**62,483**	**7,659**	**41,510**	**6,013**	**763,893**

	Houses	Buildings	Land	Vehicles, Plant & Equipment	Infrastructure Assets	Community Assets	Under Construction	Surplus Assets	Total
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Depreciation as at 31 March 2016	**-26,653**	**-23,501**	**0**	**-17,737**	**-31,348**	**-276**	**0**	**2**	**-99,513**
Depreciation Charge for the Year	-7,098	-20,931	0	-2,885	-3,345	-534	0	-696	-35,489
Disposals	243	0	0	946	0	0	0	0	1,189
Reclassification	0	0	0	0	0	0	0	0	0
Revaluation to I&E Depreciation	0	457	0	0	0	0	0	650	1,107
Revaluation to Revaluation Reserve Depreciation	133	20,046	0	0	0	330	0	0	20,509
Depreciation as at 31 March 2017	**-33,375**	**-23,929**	**0**	**-19,676**	**-34,693**	**-480**	**0**	**-44**	**-112,197**
Net book value as at 31 March 2016	**274,161**	**283,029**	**15,274**	**9,286**	**27,507**	**7,411**	**16,147**	**8,089**	**640,904**
Net book value as at 31 March 2017	**270,582**	**277,854**	**11,308**	**9,504**	**27,790**	**7,179**	**41,510**	**5,969**	**651,696**

	Houses	Buildings	Land	Vehicles, Plant & Equipment	Infrastructure Assets	Community Assets	Under Construction	Surplus Assets	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Cost or Valuation as at 31 March 2017	**303,957**	**301,783**	**11,308**	**29,180**	**62,483**	**7,659**	**41,510**	**6,013**	**763,893**
Adjustment	644	-4,485	3,838	3	0	0	0	0	**0**
Restated Opening balance 01 April 2017	**304,601**	**297,298**	**15,146**	**29,183**	**62,483**	**7,659**	**41,510**	**6,013**	**763,893**
Additions	7,766	9,503	25	3,505	3,072	19	3,383	3	27,276
Disposals	-1,850	-423	-5	-1,388	0	0	0	0	-3,666
Reclassification	6,317	28,636	-2,436	0	0	0	-35,272	452	-2,303
Revaluation to I&E	-9,330	-3,212	-1,364	0	0	0	0	0	-13,906
Revaluation to Revaluation Reserve	0	-9722	138	4	0	301	0	0	-9279
Gross Book value at 31 March 2018	**307,504**	**322,080**	**11,504**	**31,304**	**65,555**	**7,979**	**9,621**	**6,468**	**762,015**

	Houses	Buildings	Land	Vehicles, Plant & Equipment	Infrastructure Assets	Community Assets	Under Construction	Surplus Assets	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Depreciation as at 31 March 2017	**-33,375**	**-23,929**	**0**	**-19,676**	**-34,693**	**-480**	**0**	**-44**	**-112,197**
Adjustment	78	-60	0	-16	0	0	0	-2	**0**
Restated Opening balance 01 April 2017	**-33,297**	**-23,989**	**0**	**-19,692**	**-34,693**	**-480**	**0**	**-46**	**-112,197**
Depreciation Charge for the Year	-7,048	-16,147	0	-2,430	-3,215	-484	0	-46	-29,370
Disposals	216	0	0	1,211	0	0	0	0	1,427
Reclassification	0	0	0	0	0	0	0	0	0
Revaluation to I&E Depreciation	0	1,162	0	0	0	0	0	0	1,162
Revaluation to Revaluation Reserve Depreciation	0	10,122	0	0	0	854	0	0	10,976
Depreciation as at 31 March 2018	**-40,129**	**-28,852**	**0**	**-20,911**	**-37,908**	**-110**	**0**	**-92**	**-128,002**
Net book value as at 31 March 2017	**270,582**	**277,854**	**11,308**	**9,504**	**27,790**	**7,179**	**41,510**	**5,969**	**651,696**
Net book value as at 31 March 2018	**267,375**	**293,228**	**11,504**	**10,393**	**27,647**	**7,869**	**9,621**	**6,376**	**634,013**

13. Intangible Assets

Expenditure on non-monetary assets that do not have physical substance but are controlled by the Council as a result of past events (e.g. software licences) is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the Council.

Internally generated assets are capitalised where it is demonstrable that the project is technically feasible and is intended to be completed and the Council will be able to generate future economic benefits or deliver service potential by being able to sell or use the asset. Expenditure is capitalised where it can be measured reliably as attributable to the asset and is restricted to that incurred during the development phase.

Intangible assets are measured initially at cost. Amounts are only revalued where the fair value of the assets held by the Council can be determined by reference to an active market. In practice, no intangible asset held by the Council meets this criterion, and they are therefore carried at amortised cost. The depreciable amount of an intangible asset is amortised over its useful life to the relevant service line(s) in the CIES. An asset is tested for impairment whenever there is an indication that the asset might be impaired – any losses recognised are posted to the relevant service line(s) in the CIES. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the CIES.

Software licences are held for a number of systems operated by the Council which cost £1.811 million (2016/17 £1.595 million). This cost is being written off over 3 or 5 years depending on the life of the licence. A total of £1.380 million has been written off (2016/17 £1.174 million).

The Council is required to participate in the Carbon Reduction Commitment Energy Efficiency Scheme. The Council is required to purchase allowances either prospectively or retrospectively, and surrender them on the basis of emissions. The Council currently holds £0.082 million of allowance as intangible assets (2016/17 £0.345 million), all of which were purchased as additions during 2014/15. £0.262 of the original allowances was surrendered in line with the scheme during the year.

2016/17 £000		2017/18 £000
2,061	**Gross carrying amount at start of year**	**1,941**
-988	Accumulated amortisation	-1,175
1,073	**Net carrying amount at the start of year**	**766**
166	Additions – purchased	216
-286	Surrender of CRC Allowance	-262
-187	Amortisation	-206
766	**Net Book Value at Year End**	**514**

14. Movement in assets held for sale

2016/17 £000		2017/18 £000
2,535	**Balance Outstanding as at 1 April**	**1,950**
0	Transfers from Non Current Assets during the year	2,303
0	Revaluations and Restatements	-1
40	Additions	5
-625	Asset Disposal - Other	0
1,950	**Balance Outstanding as at 31 March**	**4,257**

All assets included above would come under the fair value hierarchy category of Level 2 – Fair Value measured using inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

15. Heritage assets

The Council's chain of office is the main heritage asset and has been included in the Balance Sheet at reinstatement cost, obtained from the Council's insurer. There has been expenditure of £0.009 million on heritage assets and depreciation of £0.001 million. Heritage assets are valued at £0.076 million (2016/17 £0.068 million).

16. Financial instruments

The code requires that financial instruments are to be shown at fair value which is defined as the amount for which an asset could be exchanged for or a liability settled, assuming the transaction was negotiated between parties knowledgeable about the market in which they are dealing and willing to buy / sell at an appropriate price, with no other motive in their negotiations other than to secure a fair price.

The Council has adopted CIPFA's Treasury Management in the Public Services Code of Practice and set treasury management indicators to control key financial instrument risks in accordance with CIPFA's Prudential Code.

Financial Instrument Balances

31-Mar-17 Long Term £000	31-Mar-17 Current £000		31-Mar-18 Long Term £000	31-Mar-18 Current £000
		Financial Liabilities		
208,816	51,270	External Borrowings at amortised cost	218,176	25,725
53,659	1,313	PPP Liability (see Note 33)	52,233	1,426
0	15,960	Creditors	0	26,567
262,475	**68,543**	**Total Financial Liabilities**	**270,409**	**53,718**
		Financial Assets		
0	65,072	Loans and Receivables	333	65,221
4,935	0	Available-for-sale Financial Assets	8,066	0
0	10,894	Cash and Cash Equivalents (see Note 18)	0	8,886
0	10,458	Debtors	0	2,370
4,935	**86,424**	**Total Financial Assets**	**8,399**	**76,477**

Long Term borrowing as shown in the Balance Sheet of £218.176 million fully comprises principal to be repaid later than 12 months (PWLB Maturity Loans of £187.224 million, PWLB Annuity Loans of £0.674 million, LOBO Loans of £20.597 million, Market Loans of £9.464 million and Salix Loans of £0.216 million). Lender Option Borrower Options (LOBO's) of £20.597 million have been included in long term borrowing (inclusive of the Effective Interest Rate adjustment), this reflecting the contractual period to maturity for these instruments, given the unlikelihood of call within the next 12 months.

Short Term borrowing as shown in the Balance Sheet of £25.725 million comprises accrued interest of £2.264 million, the LOBO Effective Interest Rate adjustment to be amortised in 2018/19 of £0.009 million and principal to be repaid within 12 months of £23.452 million (£13.000 million Temporary Loans; £10.000 million PWLB Maturities; £0.357 million Market Loans, £0.062 million Salix Loan, £0.034 million PWLB Annuities).

Gains and Losses on Financial Instruments

There were no gains on Available for Sale Financial Assets recognised in the Comprehensive Income and Expenditure Statement for the year.

Total Interest Income/Expense

Total interest income and total interest expense (calculated using the effective interest method) for financial assets and liabilities that are not at fair value through profit or loss for 2017/18 was £8.074 million equating to £8.615 million interest paid on external borrowings less £0.542 million interest received on loans and receivables and cash and cash equivalents.

Fee Income and Expense

Total fee expense for financial assets and liabilities that are not at fair value through profit or loss for 2017/18 was £0.127 million.

Fair Value of Assets and Liabilities Carried at Amortised Cost

The fair value of each class of financial assets and liabilities which are carried in the balance sheet at amortised cost is disclosed below.

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. It is determined by calculating the Net Present Value (NPV) of future cash flows, which provides an estimate of the value of payments in the future in today's terms.

The discount rate used in the NPV calculation is the rate applicable in the market on the date of valuation for an instrument with the same structure, terms and remaining duration. For debt, this will be the new borrowing rate since premature repayment rates include a margin which represents the lender's profit as a result of rescheduling the loan; this is not included in the fair value calculation since any motivation other than securing a fair price should be ignored.

The rates quoted in this valuation were obtained by Link, the Council's treasury management consultants, from the market on 31 March 2018.

The calculations are made with the following assumptions:

- Fair values have been calculated for all financial instruments in the portfolio;
- The fair value of trade and other receivables is taken to be the invoiced or billed amount.
- Interpolation techniques have been used between available rates where the exact maturity period was not available;
- The valuation of Loans Receivable is made by utilisation of the prevailing benchmark market rates;
- The valuation of fixed term deposits (maturity investments) is made by comparison of the fixed term investment with a comparable investment with the same/similar lender for the remaining period of the deposit;
- For PWLB debt, the discount rate used is:-
    - a) the "Standard New Loan Rate (net of certainty rate discount) for new borrowing "Fair Value (New Loan)" column of table below; and
    - b) the Premature Repayment Rate "Fair Value (Premature Redemption)" column of table below; as per rate sheet number 127/18 issued by PWLB on 31 March 2018.
- For Fixed Rate market debt the discount rate used is:-
    - the New market Loan Rate for an instrument with the same terms from a comparable lender ["Fair Value (New Loan)" column of table below]; and
    - the Premature Repayment Rate ["Fair Value (Premature Redemption)" column of

table below]; as per rate sheet number 127/18 issued by PWLB on 31 March 2018.

- For non-fixed rate LOBO debt the discount rate used is:-
    - The relevant Gilt Rate plus 80 basis points [“Fair Value (New Loan)” column of table below]; and
    - the Premature Repayment Rate [“Fair Value (Premature Redemption)” column of table below]; as per rate sheet number 127/18 issued by PWLB on 31 March 2018.

Fair values of financial liabilities (where available) are calculated as:

31-Mar-17				31-Mar-18					
Carrying Amount	**(a) Fair Value**	**(b) Fair Value**	**Liability**	**Principal Outstanding**	**Add LOBO Accounting Adjustment**	**Add Accrued Interest**	**Carrying Amount**	**(a) Fair Value (New Loan)**	**(b) Fair Value (Premature Redemption)**
£000	**£000**	**£000**		**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
199,858	249,228	292,610	PWLB	197,933	0	1,921	199,854	246,817	291,927
20,885	31,707	38,458	LOBO	20,000	606	273	20,879	31,029	38,277
			Market Loans	9,821	0	65	9,886	10,266	12,350
39,004	39,001	39,006	Short Term Borrowing	13,000	0	5	13,005	13,005	13,006
339	318	331	Salix	277	0	0	277	248	263
260,086	**320,254**	**370,405**	**Total**	**241,031**	**606**	**2,264**	**243,901**	**301,365**	**355,823**

Fair values of assets are calculated as:

31-Mar-17			31-Mar-18			
Carrying Amount	**Fair Value**	**Investments**	**Principal Advanced**	**Add Accrued Interest**	**Carrying Ammount**	**Fair Value**
£000	**£000**		**£000**	**£000**	**£000**	**£000**
10,894	10,895	Cash and Cash Equivalents	8,881	5	8,886	8,886
65,072	65,060	Short Term Investments	64,985	236	65,221	65,088
75,966	**75,955**	**Total**	**73,866**	**241**	**74,107**	**73,974**

Nature and extent of risks arising from Financial Instruments

The Council's management of treasury risks actively works to minimise the Council's exposure to the unpredictability of financial markets and to protect the financial resources available to fund services.

The Council has fully adopted CIPFA's Code of Treasury Management Practices and has written principles for overall risk management as well as policies and procedures covering specific areas such as credit risk, liquidity risk and market risk.

Credit Risk

Credit risk arises from the short-term lending of surplus funds to banks, building societies and other local authorities as well as credit exposures to the Council's customers. It is the policy of the Council to place deposits only with a limited number of banks and building societies whose credit rating is independently assessed as sufficiently secure by the Council's treasury advisers and to restrict lending to a prudent maximum amount for each institution. The Council also has a policy of limiting deposits to £15 million per institution, other than for UK Nationalised and Part Nationalised institutions where this maximum is extended to £30 million.

The following analysis summarises the Council's potential maximum exposure to credit risk based on past experience and current market conditions. No credit limits were exceeded during the financial year and the Council expects full repayment on the due date of deposits placed with its counterparties.

	Amounts at 31 March 2018	Historical experience of default	Historical experience adjusted for market conditions as at 31 March 2018	Estimated maximum exposure to default and non-collectable amounts
	£000	**%**	**%**	**£000**
Cash & Cash Equivalents & Short Term Investments	74,107	0	0	0

No credit limits were exceeded during the reporting period and the Council does not expect any losses from non-performance by any of its counterparties in relation to deposits.

An age analysis of cash and cash equivalents and short term investments is shown in the table below:-

31-Mar-17		31-Mar-18
£000		**£000**
18,735	Less than 3 months	8,886
35,069	3 to 6 months	35,208
30,004	6 months to 1 year	15,010
0	More than 1 year	15,003
83,808	**Total**	**74,107**

Liquidity Risk

No credit limits were exceeded during the reporting period and the Council does not expect any losses from non-performance by any of its counterparties in relation to deposits.

An age analysis of external borrowings is shown in the table below:-

Age Analysis

31-Mar-17 £000		31-Mar-18 £000
49,031	Less than 1 year	23,452
10,034	1 to 2 years	8,855
17,733	2 to 5 years	11,030
2,256	5 to 10 years	3,270
55,665	10 to 20 years	59,162
0	20 to 30 years	2,679
80,534	30 to 40 years	85,534
37,049	40 to 50 years	42,049
5,000	Greater than 50 years	5,000
257,302	**Total**	**241,031**

Market Risk

The Council is exposed to interest rate risk in two different ways; the first being the uncertainty of interest paid or received on variable rate instruments, and the second being the effect of fluctuations in interest rates on the fair value of an instrument.

The current interest rate risk for the council is summarised below:

Decreases in interest rates will affect interest earned on variable rate investments, potentially reducing income credited to the CIES;

Increases in interest rates will affect interest paid on variable rate borrowings potentially increasing interest expense charged to the CIES. However, the Council has partially hedged against this risk for an element of its loan portfolio by entering into two forward starting loan transactions, where loans are drawn at pre-defined future dates and where the interest rate was fixed at the point of execution of the loans in February 2016. The first of these loans was drawn in June 2017 and the second will be drawn in November 2018;

The fair value of fixed rate financial assets will fall if interest rates rise. This will not impact on the balance sheet or the CIES for the majority of assets held at amortised cost, but will impact on the disclosure note for fair value. It would have a negative effect on the balance sheet for those assets shown on the balance sheet at fair value;

The fair value of fixed rate financial liabilities will rise if interest rates fall. This will not impact on the balance sheet or CIES for the majority of liabilities held at amortised cost, but will impact on the disclosure note for fair value.

The Council has a number of strategies for managing interest rate risk. Policy is to aim to keep a maximum of 30% of its borrowings in variable rate loans. During periods of falling interest rates, and where economic circumstances make it favourable, fixed rate loans will be repaid early to limit exposure to losses.

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget and which is used to update the budget quarterly during the year. This allows any adverse changes to be accommodated. The analysis will also advise whether new borrowing taken out is fixed or variable.

According to this assessment strategy, at 31 March 2018, if interest rates had been 1% higher with all other values held constant, the financial effect would have been:

Interest Rate Risk

	£000	£000
Increase in interest payable on variable rate borrowings	275	
Increase in interest receivable on variable rate instruments	(847)	
Increase in government grant receivable for financing costs	0	
Impact on CIES	**(572)**	
Share of overall impact credited to the HRA	**(250)**	
	A	**B**
Decrease in fair value of fixed rate investment assets (no impact on the Surplus or Deficit on the Provision of Services or Other Comprehensive income & Expenditure)	**533**	**533**
Decrease in fair value of fixed rate borrowing liabilities (no impact on the Surplus or Deficit on the Provision of Services or Other Comprehensive income & Expenditure)	**(44,375)**	**(57,998)**

Note: Column A reflects the decrease in fair value of fixed rate investment assets & borrowing liabilities using the "New Loan" rate measurement of Fair Value. Column B reflects the decrease in fair value of fixed rate investment assets & borrowing liabilities using the "Premature Repayment" rate measurement of Fair Value. The impact of a 1% fall in interest rates would be as above but with the movements being reversed.

Price Risk

The Council has a 5.5% shareholding in Lothian Buses which is available for sale to other company shareholders. The Council also have a subordinated debt investment in Newbattle DBFMCo Limited. There is no price risk associated with either of these.

Foreign Exchange Risk

The Council has no financial assets or liabilities denominated in foreign currencies so has no exposure to loss arising from movements in exchange rates.

17. Long Term Investments

2016/17 £000		2017/18 £000
4,935	Lothian Buses plc	8,066
0	Newbattle DBFMco Ltd	333
4,935	**Total Long Term Investments**	**8,399**

Midlothian Council holds a 5.5% shareholding in Lothian Buses plc, a company incorporated in January 1986 under the terms of the Transport Act 1985 to operate buses in the City of Edinburgh and its surrounding area.

The valuation basis for the Council's shareholding (350,000 £1 ordinary shares) is calculated as net share of assets. In line with the published results of Lothian Buses.

The most recent published results of the company are as follows:-

Year to 31-Dec-16 £000		Year to 31-Dec-17 £000
146,915	Turnover	152,884
13,995	Profit before taxation	10,008
-2,013	Taxation	-2,639
11,982	Profit after taxation	7,369
6,592	Ordinary dividend	6,790
-4,645	Transfer to / (from) reserves	57,258
90,225	**Net assets at end of year**	**147,483**

In 2017/18, Midlothian Council subscribed £0.333 million of subordinated debt in Newbattle DBFMCo Limited, a company set up specifically to deliver the Council's Schools for the Future Newbattle Community Campus project.

Whilst the investment is sellable in the secondary market, the valuation basis for the Council's shareholding (nominal value of loan stock £0.333 million) is calculated based on the subscription value as there is no equivalent market data to estimate the resale value.

The principal on this investment will be repaid according to the profile outlined below with the principal fully repaid over the 25-year project life. Interest will be paid biannually at a 10.50% coupon based on the average principal outstanding over the relevant 6 month period.

Maturity Period	Principal Repaid £000's
0-1 years	3
1-2 years	2
2-5 years	1
5-10 years	3
10-15 years	9
15-20 years	7
20-25 years	308
Total	**333**

18. Debtors

The debtors balance consists primarily of debts in respect of Council Tax, House Rents and other recoverable accounts.

Short Term Debtors

Short Term Debtors

2016/17 £000	2016/17 £000		2017/18 £000	2017/18 £000
29,539		Council Tax and Community Charge	30,144	
-27,590		Less: bad debt provision	-28,544	
	1,949			1,600
	4,766	Central Government Bodies		3,804
	208	Other Local Authorities		261
	1,097	NHS Bodies		888
	2,625	Rents		3,564
15,260		Grants, External Debtor accounts and other Income due	15,225	
-6,264		Less: bad debt provision	-6,887	
	8,996			8,338
	19,641	**Net Debtors**		**18,455**

Long Term Debtors

2016/17 £000		2017/18 £000
3,100	Prepayment to PPP Contractor	2,889
36	Pacific Shelf	38
3,136	**Total Long Term Debtors**	**2,927**

19. Cash and cash equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours, or card payments made by customers with a two business day settlement period (T+2) or less. Cash equivalents are investments that mature in three months or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

Cash and cash equivalents at the end of the reporting period as shown in the statement of cash flows can be reconciled to the related items in the Balance Sheet as follows:

2016/17 £000		2017/18 £000
54	Cash and Bank Balances	436
18,681	Short Term Deposits Considered to be Cash Equivalents	8,031
-7,841	Bank Overdraft	419
10,894	**Total Cash and Cash Equivalents**	**8,886**

20. Creditors

The creditors balance consists primarily of amounts due in respect of trade creditors, external interest payments and other sundry creditors.

2016/17 £000		2017/18 £000
15,467	Trade Creditors	15,105
1,631	Central Government Bodies	6,640
6,368	Accumulated Absences	6,327
425	Other Local Authorities	3,469
735	NDR/Council Tax	3,116
2,601	Payroll Costs Due	1,549
71	NHS Bodies	250
1,700	Other Entities and Individuals	2,758
28,998	**Total Creditors**	**39,214**

21. Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. For instance, the Council may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the CIES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year – where it becomes

less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.
A provision for potential uninsured losses arising from claims is also made and this amounted to £0.940 million at 31 March 2018 (2016/17 £1.431 million) and is shown in other provisions.

The Council had in place for a period during 2017/18 a time limited Voluntary Severance Scheme. A provision for £0.853 million has been made for staff release costs where employees have an agreed departure date as at 31 March 2018, no provision was made in 2016/17.
Provision for Uninsured Losses

2016/17 £000		2017/18 £000
1,640	**Balance at 1st April**	**1,431**
455	New insurance provisions made in the period	499
104	Increases to existing insurance provisions made in the period	258
-127	Decrease to existing insurance provisions made in the period	-217
-641	Full settlement of existing insurance provisions made in the period	-1,031
1,431	**Balance at 31st March**	**940**

Provision for the cost of staff released under voluntary severance

2016/17 £000		2017/18 £000
0	**Balance at 1st April**	**0**
0	Provision for costs of staff released under voluntary severance	853
0	**Balance at 31st March**	**853**

Total provisions

2016/17 £000		2017/18 £000
1,431	Provision for potential uninsured losses	940
0	Provision for costs of staff released under voluntary severance	853
1,431	**Balance at 31st March**	**1,793**

22. Other long term liabilities

31/03/2017 £000		31/03/2018 £000
118,041	Net Pension Liability	85,513
53,658	PPP Liabilities	51,956
8,193	Borders Railway Liability	7,990
179,892	**Total Long Term Liabilities**	**145,459**

The Borders Railway opened to the public on Sunday 6th September 2015 running from Tweedbank in the Scottish Borders through Midlothian to Waverley Station in Edinburgh. There are four stations in Midlothian at Gorebridge, Newtongrange, Eskbank and Shawfair. Midlothian's contribution to the project was capped at £11.673 million, of which £3.209 million is an in-kind contribution and £8.464 million (at 2012 prices and subject to BCIS inflation) is payable to the

Scottish Government in planned instalments over the coming years. At the Balance Sheet date the indexed value of future year payments is £9.583 million. £1.593 million has been collected leaving a further liability of £7.990 million. Further contributions totalling £8.091 million have been secured through legally binding Section 75 planning agreements fully securing the funding for the recognised long term liability.

23. Usable reserves

Reserves are created by appropriating amounts out of the General Fund Balance in the Movement in Reserves Statement. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the Surplus or Deficit on the Provision of Services in the CIES. The reserve is then appropriated back into the General Fund Balance in the Movement in Reserves Statement so that there is no net charge against Council tax for the expenditure.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement and employee benefits and do not represent usable resources for the Council – these reserves are explained in the relevant policies.

The Council operates a Capital Fund under the terms of Schedule 3 to the Local Government (Scotland) Act 1975 and an Insurance Fund in accordance with Schedule 13 of the Local Government etc. (Scotland) Act 1994.

Movement in the Council's usable reserves are detailed in the Movement in Reserves Statement and in note 6.

31/03/2017 £000		**31/03/2018 £000**
-17,651	General Fund Reserve	-10,777
-29,753	HRA Balance	-33,863
-16,707	Capital Fund	-19,462
-3,100	Repairs and Renewals Fund	-2,889
-67,211	**Total Usable Reserves**	**-66,991**

24. Unusable reserves

31/03/2017 £000		**Notes**	**31/03/2018 £000**
-202,329	Capital Adjustment Account	24.1	-197,754
-118,403	Revaluation Reserve	24.2	-110,563
118,041	Pension Reserve	24.3	85,513
6,368	Employee Statutory Adjustment Account	24.4	6,327
2,500	Financial Instruments Adjustment Account	24.5	2,333
-4,585	Available for Sale Financial Instruments Reserve	24.6	-7,717
-198,408	**Total Unusable Reserves**		**-221,861**

24.1 Capital Adjustment Account

The Capital Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for the consumption of non-current assets and for financing the acquisition, construction or enhancement of those assets under statutory provisions. The account is debited with the cost of acquisition, construction or enhancement as depreciation, impairment losses and amortisations are charged to the Comprehensive Income and Expenditure Statement (with reconciling postings from the Revaluation Reserve to convert fair value figures to a historical cost basis). The account is credited with the amounts set aside by the Council as finance for the costs of acquisition, construction and enhancement.

The Account also contains revaluation gains accumulated on property, plant and equipment before the 1st of April 2007, the date that the Revaluation Reserve was created to hold such gains.

Note 6 provides further details of transactions posted to the Account.

2016/17 £000		2017/18 £000
-208,227	**Balance at 1st April**	**-202,329**
	Adjustments to the opening balance	
0	Adjustments relating to revalued assets funded from developer contributions	-2,594
0	Adjustment relating to PPP long term liabilty	-230
-208,227	**Revised Balance at 1st April**	**-205,153**
	Reversal of items relating to capital expenditure debited or credited to the Comprehensive Income and Expenditure Statement:	
35,490	- Charges for Depreciation of non-current assets	29,372
13,339	- Charges for Downward Revaluation of non-current assets	12,744
187	- Amortisation of intangible assets	206
5,437	- PPE non-current assets written off on disposal or sale	2,239
-625	- Revaluation loss on disposal or sale	-301
-13,907	- Adjusting amount written out to Revaluation reserve	-9,235
22	- Net revenue expenditure financed from capital under statute (REFFCUS)	0
-45	Other movements	-203
-168,329	**Net written out amount of the cost of non-current assets consumed in year**	**-170,331**
	Capital Financing for the year:	
-7,312	- Use of Capital Receipts to finance new Capital expenditure	-2,416
1,329	- Capital Receipts transferred to the Capital Fund	319
-19,516	- Capital Grants and Contributions credited to the CIES	-16,021
-8,501	- Statutory Provision for the financing of capital investment	-9,305
-202,329	**Balance at 31st March**	**-197,754**

24.2 Revaluation Reserve

The Revaluation Reserve contains the gains made by the Council arising from increases in the value of its Property, Plant and Equipment (and Intangible Assets). The balance is reduced when assets with accumulated gains are revalued downward or impaired and the gains are lost, used in the provision of services and the gains are consumed through depreciation, or disposed of and the gains are realised. The reserve contains only revaluation gains accumulated since 1st April 2007, the date that reserve was created. Accumulated gains arising before that date are consolidated into the balance on the Capital Adjustment Account.

2016/17 £000		2017/18 £000
-117,635	**Balance at 1st April**	**-118,403**

5,165	(Upward) / downward Revaluation of Assets	9,111
-20,510	Downward revaluation of assets and impairment losses not charged to the Surplus / (Deficit) on the provision of services	-10,806
13,907	Adjusting amount from Capital Adjustment Account	9,235
625	Accumulated losses on assets sold	301
45	Other movements	-1
-118,403	**Balance at 31st March**	**-110,563**

24.3 Pension Reserve

The Pension Reserve absorbs the timing differences arising from the different arrangements for accounting for post-employment benefits and for funding benefits in accordance with statutory provisions. The Council accounts for post-employment benefits in the CIES as the benefits earned by employees accruing years of service, updating the liabilities recognised to reflect inflation, changing assumptions and investment returns on any resources set aside to meet the costs. However, statutory arrangements require benefits earned to be financed as the Council makes employer's contributions to pension funds or eventually pays any pensions for which it is directly responsible. The debit balance on the Pension Reserve therefore shows a substantial shortfall in the benefits earned by past and current employees and resources the Council has set aside to meet them. Statutory arrangements will ensure that funding will have been set aside by the time benefits come to be paid.

2016/17		**2017/18**
£000		**£000**
68,145	**Balance at 1st April**	**118,041**
	Return on Pension Assets	
44,365	Actuarial (gains) / losses arising on changes in financial assumptions	-44,600
17,983	Reversals of items relating to retirement benefits debited or credited to the surplus or deficit on the provision of services in the CIES	25,941
-12,452	Employer's pension contributions	-13,869
118,041	**Balance at 31st March**	**85,513**

24.4 Employee Statutory Adjustment Account

The Employee Statutory Adjustment Account absorbs the differences that would otherwise arise on the General Fund Balance from accruing for compensated absences earned but not taken in the year. An example of this is annual leave entitlement carried forward at 31st March. Statutory arrangements require that the impact on the General Fund Balance is neutralised by transfers to or from the account. The amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements was -£0.041 million (2016/17 £3.078 million).

2016/17		**2017/18**
£000		**£000**
3,291	**Balance at 1st April**	**6,368**
-3,291	Settlement or cancellation of accrual made at end of preceding year	-6,368
6,368	Amounts accrued at the end of the current year	6,327
6,368	**Balance at 31st March**	**6,327**

24.5 Financial Instruments Adjustment Account

The Financial Instruments Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for income and expenses relating to certain financial instruments and for bearing losses or benefiting from gains per statutory provisions.

2016/17		2017/18
£000		**£000**
2,667	**Balance at 1st April**	**2,500**
-7	Proportion of equivalent interest rate calculation on lender option / borrower option loans	-8
-160	Change in share of equivalent interest rate calculation	-159
2,500	**Balance at 31st March**	**2,333**

24.6 Available for Sale Financial Instruments Reserve

The Available for Sale Financial Instruments Reserve contains the gains made by the Council arising from increases in the value of its investments that have quoted market prices or otherwise do not have fixed or determinable payments. The balance is reduced when investments with accumulated gains are revalued downwards and the gains are lost or disposed of and the gains are realized

2016/17		2017/18
£000		**£000**
-4,839	**Balance at 1st April**	**-4,585**
254	Revaluation of investments	-3,132
-4,585	**Balance at 31st March**	**-7,717**

25. Cash Flow Statement – operating activities

2016/17 £'000		2017/18 £'000
-30,406	**Net surplus or (deficit) on the provision of services**	**-31,034**
	Adjustment to surplus or deficit on the provision of services for noncash movements	
35,490	Depreciation	29,372
13,339	Impairment & downward revaluations (& non-sale derecognitions)	11,697
187	Amortisation	206
482	Adjustment for internal interest charged	0
15	(Increase)/Decrease in Inventories	-69
-1164	(Increase)/Decrease in Debtors	533
-31	(Increase)/Decrease in Interest and Dividend Debtors	-149
-8	Adjustment for effective interest rates	-8
5,366	Increase/(Decrease) in Creditors	10,553
74	Increase/(Decrease) in Interest Creditors	95
5,531	Movement in Pension Liability	12,072
5,457	Carrying amount of non-current assets sold	1,938
-209	Contributions to Other Reserves/Provisions	362
	Surrender of CRC allowances	262
-31	Other non-cash movements and transfers to investing activities	83
64,498		**66,947**
	Adjust for items included in the net surplus or deficit on the provision of services that are investing and financing activities	
40,000	Proceeds from short-term (not considered to be cash equivalents) and long-term investments (includes investments in associates, joint ventures and subsidiaries)	0
-7,312	Proceeds from the sale of PP&E, investment property and intangible assets	-2,098
-19,516	Capital grants included in Service expenditure and "Taxation & non-specific grant income"	-15,772
13,172		**-17,870**
47,264	**Net Cash Flows from Operating Activities**	**18,043**
	Operating activities within the cash flow statement include the following cash flows relating to interest	
262	Interest Received	772
-13,435	Interest Paid	-13,583
361	Dividends Received	371

26. Cash Flow Statement - investing activities

2016/17 £000		2017/18 £000
-49,459	Purchase of PP&E, investment property and intangible assets	-28,312
-50,000	Purchase of Short Term Investments (not considered to be cash equivalents)	-25,000
7,141	Proceeds from the sale of PP&E, investment property and intangible assets	2,416
26,416	Other Receipts from Investing Activities	48,452
-65,902	**Net Cash flows from Investing Activities**	**-2,444**

27. Cash Flow Statement - financing activities

2016/17 £000		2017/18 £000
429,000	Cash Receipts from Short and Long Term Borrowing	320,500
-1,208	Cash payments for the reduction of the outstanding liability relating to a finance lease and on-Balance Sheet PFI contracts	-1,336
-408,970	Repayment of Short and Long Term Borrowing	-336,771
18,822	**Net Cash flows from Financing Activities**	**-17,607**

28. Audit fees

The Accounts Commission for Scotland has appointed Ernst and Young LLP as the Council's external auditor for the financial years 2016/17 to 2021/22.

The anticipated fee payable to Audit Scotland in respect of external audit services undertaken in accordance with the Code of Audit Practice for 2017/18 is £0.291 million (2016/17 £0.222 million).

29. Capital grants received in advance

The Council has received a number of grants and contributions that have yet to be recognised as income as they have conditions attached to them that will require the monies to be returned to the grantor. All monies held in the Capital Grants Received in Advance account are as a result of developers contributions, the balances are as follows:

16,395	**Balance at 1st April**	**22,944**
11,611	New capital grants received in advance, conditions of use not met	9,219
-5,062	Amounts released to CIES, conditions of use met	-5,159
0	Adjustment in respect of prior year revaluations	-2,594
22,944	**Balance at 31st March**	**24,410**

30. Related parties

The Council is required to disclose material transactions with related parties, that is bodies or individuals that have the potential to control or influence the Council, or to be controlled or influenced by the Council.

The Scottish Government

The Scottish Government has significant influence over the general operations of the Council, being responsible for providing the statutory framework within which the Council operates. The Scottish Government also provides the majority of the Council's funding in the form of grants and prescribes the terms of many of the transactions that the Council has with other parties (such as Council Tax bills and Housing Benefits).

Officers

There are no related party transactions with Officers of the Council.

Elected Members

Elected members of the Council have direct control over the Council's financial and operating policies. The total of members' allowances paid in 2017/18 is shown in the Remuneration Report.

Members' Register of Interests can be viewed on the Council's website. A review of these interests has been conducted. Related party interests for which transactions exist in 2017-18 were declared by 8 members:

with voluntary bodies or charitable organisations that received funding totalling an estimated value of £0.209 million.

with businesses or other organisations that have contracted for goods and services with the Council to the estimated value of £0.722 million.

In addition to the above many members have relationships of hold positions with other public bodies and voluntary organisations with which the Council does not have a financially material relationship but with which the Council has a financial or influential relationship.

Entities Controlled or Significantly Influenced by the Council

During the year the Council entered into material transactions with the Lothian Valuation Board. This amounted to £0.562million (2016/17 £0.560 million There was no balance due to or from the Lothian Valuation Board as at 31 March 2018.The Council works in partnership with NHS Lothian, providing a range of Health and Social Care services across Midlothian. NHS Lothian transferred £4.903 million of resource transfer funding to the Council in 2017/18 in respect of activities delegated to the Midlothian Integration Joint Board, as well as an additional £4.845 million in relation to Social Care Fund and £1.423 million from the Integrated Care Fund. The funding supports various Adult Social Care services, both purchased and in-house.

The Council delegated resources totalling £38.806 million to the Midlothian Integration Joint Board in 2017-18. These resources were allocated to the Council for the provision of Adult Social Care services. NHS Lothian also delegated financial resources to the Board. The Board provides the strategic direction in relation to the delivery of Health and Adult Social Care Services in Midlothian. The Council provides assistance in kind in terms of Board staff (Chief Officer) and administrative support for the operation of the Board. In addition no charge is made for central support functions provided over and above the resources delegated which relate specifically to Adult Social Care. As at 31 March 2018 the Council held £0.783 million on behalf of the Board.

31. Capital expenditure and capital financing

The total amount of capital expenditure incurred in the year is shown in the table below (including the value of assets acquired under finance leases and PFI/PPP contracts), together with the resources that have been used to finance them.

2016/17 £000	2016/17 £000		2017/18 £000	2017/18 £000
	310,204	**Opening Capital Financing Requirement**		**333,757**
		Capital Expenditure		
54,949		Property, Plant and Equipment	27,290	
166		Intangible Assets	216	
434		Revenue Expenditure funded from capital under statute	0	
8,193		Long Term Liabilities	-203	
	63,742			**27,303**
		Capital Financing		
-11,761		Capital Receipts	-2,098	
-13,952		Government Grants	-11,515	
-5,975		Contribution from Other Bodies	-4,257	
-8,501		Loans Fund and Lease Repayments	-9,282	
	-40,189			**-27,152**
	333,757	**Closing Capital Financing Requirement**		**333,908**
	23,553	**Increase in Capital Financing Requirement**		**151**

32. Commitments under capital contracts

As at 31 March 2018, the Council was contractually committed to capital works which amounted to £23.022 million (31 March 2017 equivalent £10.062 million).

The value of work completed as at 31 March 2018 has been established using a stage of completion methodology based on Contract Administrator's Certificates obtained at year end.

The main capital contracts the Council is committed to are as follows:-

- HRA Phase II Housing: Site 53, Morris Road, Newtongrange. £9.874 million original contractual commitment; £9.866 million remaining commitment outstanding;
- HRA Phase II Housing: Site 32/34, Newbyres, Gorebridge. £8.110 million original contractual commitment; £8.044 million remaining commitment outstanding;
- Modular Units for Primary Schools – Various. £1.960 million original contractual commitment; £1.960 million remaining commitment outstanding.

- HRA Phase II Housing: Site 23, Woodburn Terrace, Dalkeith. £1.444 million original contractual commitment; £1.429 million remaining commitment outstanding.
- The new Loanhead hub. £13.879 million original contractual commitment; £0.715 million remaining commitment outstanding;

The total value of retentions held as at 31 March 2018 amount to £0.951 million.

33. Public-private partnership

PFI and similar contracts are agreements to receive services, where the responsibility for making available the property, plant and equipment needed to provide the services passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes, and as ownership of the property, plant and equipment will pass to the Council at the end of the contracts for no additional charge, the Council carries the assets used under the contracts on its Balance Sheet as part of Property, Plant and Equipment.

The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) was balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment.

Non-current assets recognised on the Balance Sheet are re-valued and depreciated in the same way as property, plant and equipment owned by the Council.

The amounts payable to the PFI operators each year are analysed into five elements:

Fair value of the services received during the year – debited to the relevant service in the CIES;

Finance cost – an interest charge of 8.99% on the outstanding Balance Sheet liability for Dalkeith Schools PPP and 7.44% for Midlothian Primary Schools, debited to the Financing and Investment Income and Expenditure line in the CIES;

Contingent rent – increases in the amount to be paid for the property arising during the contract, debited to the Financing and Investment Income and Expenditure line in the CIES;

Payment towards liability – applied to write down the Balance Sheet liability towards the PFI operator (the profile of write-downs is calculated using the same principles as for a finance lease);

Lifecycle component replacement costs – proportion of the amounts payable is posted to the Balance Sheet as a prepayment and then recognised as additions to Property, Plant and Equipment when the relevant works are eventually carried out.

The Council has entered into five Public Private Partnerships.

The first is for the provision and facilities management of the Dalkeith School Campus and is a 30 year contract with Dalkeith SPV Ltd. When the agreement ends in 2034 the Campus facilities will transfer to the Council with a guaranteed maintenance-free life of five years. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with one contract months' notice.

The second is a contract with Midlothian Schools Ltd for the provision and facilities management of Stobhill, Gorebridge, Tynewater, Moorfoot, Loanhead and St Margaret's, Lawfield and Strathesk

Primary Schools. When the agreement ends in 2037 the facilities will transfer to the Council in a useable condition as defined by the contract. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with 6 months' notice.

The third is for the provision and lifecycle maintenance of the Newbattle Centre and is a 25 year contract with hubCo. At the 31 March 2018 the contract was still in the construction phase. The facility opened in financial year 2018/19 on 25 May 2018. When the agreement ends in 2043 the facilities will transfer to the Council in a useable condition as defined by the contract. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with variable notice periods as defined in the contract.

The fourth is for the provision of a food waste treatment plant at Millerhill, jointly procured between Midlothian and the City of Edinburgh Council. The contract is for 20 years and at the end of the concession period in 2036, the asset will not revert back to the partner Councils and will remain under the full control of the DBFO operator, who has the option to continue to operate the asset from year 20 through to year 40, paying a market rent for the lease of the land over this period. At the end of the 40th year, the asset will be decommissioned and the decommissioned site shall be transferred back to the ownership of the Councils. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with 40 days' notice.

The fifth is for the provision of a residual waste treatment plant at Millerhill, jointly procured between Midlothian and the City of Edinburgh Council. The contract is for 25 years with an expected commissioning start date of October 2018 and full service commencement in May 2019. The asset is to be fully maintained throughout the life of the contract in accordance with the Partner Council's requirements and will be inspected 18 months prior to the end of the contact (contract end date 6th of May 2044) to the ensure that is has been so maintained. The asset will then be handed back to the Partner Councils in a condition that is commensurate with such maintenance. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice, the issue of an Partner Council Default notice, or voluntary termination by the Partner Councils with variable notice periods as defined in the contract.

The assets used to provide the services at the Dalkeith Schools Community Campus and the Primary Schools PPP are recognised in the Council's Balance Sheet under the Property, Plant and Equipment category.

The value of assets held under PFI arrangements at 31 March 2018 is £64.284 million (2016/17 £65.388 million). The movement is in year depreciation of £1.117 million, written back depreciation on revaluation £0.000 million, revaluation £0.000 million and additions £0.013 million (2016/17 £1.237 million depreciation, £2.929 written back depreciation, £1.718 million revaluation and £0.045 million additions). There is a deferred liability at 31 March 2018 for the financing of these assets of £53.406 million (2016/17 £54.972 million). Details of payments to be made under PFI arrangements are:

During the year a total of £1.336 million (2016/17 £1.208 million) was paid in relation to finance lease liabilities under the PFI contracts.

Dalkeith Campus

	Liability	Interest	Service Charge	Total
Period	**£000**	**£000**	**£000**	**£000**
Within 1 year	697	2,230	1,954	4,881
Within 2 to 5 years	3,530	8,177	8,318	20,025
Within 6 to 10 years	6,712	7,923	11,623	26,258
Within 11 to 15 years	10,657	3,977	13,150	27,784
Within 16 to 20 years	1,421	138	1,508	3,067
Within 21 to 25 years	0	0	0	0
Total Contract	**23,017**	**22,445**	**36,553**	**82,015**

Primary Schools

	Liability	Interest	Service Charge	Total
Period	**£000**	**£000**	**£000**	**£000**
Within 1 year	752	2,216	1,943	4,911
Within 2 to 5 years	3,598	8,276	8,272	20,146
Within 6 to 10 years	6,185	8,657	11,557	26,399
Within 11 to 15 years	8,795	6,047	13,076	27,918
Within 16 to 20 years	11,059	2,337	13,284	26,680
Within 21 to 25 years	0	0	0	0
Total Contract	**30,389**	**27,533**	**48,132**	**106,054**

34. Retirement benefits

The Council participates in two different pension schemes which meet the needs of employees. Both schemes provide members with defined benefits related to pay and service.

Teachers

The Scottish Teachers Superannuation Scheme is an unfunded scheme administered by the Scottish Government. The scheme is excluded from the accounting requirements of IAS 19 as it is a national scheme which does not allow for the identification of pension liabilities consistently and reliably between participating authorities. The accounts, therefore, only include the payments made by the Council to the scheme in year and do not reflect the estimated pension assets or liabilities of the scheme. The exception to this are payments in relation to unfunded pension enhancements for members of the scheme as they are administered through the Local Government Pension Scheme and are taken into consideration in accounting for pension costs under IAS 19.

In 2017/18 the Council paid £6.098 million (2016/17 £5.851 million) to the Scottish Government in respect of teachers' pension costs. The rate of contribution was 17.2% (2016/17 17.2%).

Local Government Pension (Scotland) Scheme

Employees other than teachers are eligible to join the Local Government Pension Scheme. The pension costs charged to services in respect of these employees have been calculated under IAS 19 – Retirement Benefits.

In 2017/18 the Council paid an employer contribution of £13.869 million (2016/17 £12.452 million) into the Lothian Pension Fund, representing 21.8% (2016/17 21.8%) of pensionable pay. This is the expenditure met from Government Grants and Local Taxation. It is estimated that the employer contribution for the period to 31 March 2019 will be £12.867 million.

The Council recognises the cost of retirement benefits in the net cost of services when they are earned by employees, rather than when the benefits are eventually paid as pensions. The following transactions have been made in the CIES and the Movement in Reserves Statement

CIES

2016/17 £'000		2017/18 £'000
	Net cost of services:	
15,448	Current Service Cost	22,694
98	Past Service Costs (including curtailments)	66
	Net operating expenditure:	
16,332	Interest cost	15,898
-13,895	Expected return on scheme assets	-12,717
17,983	**Net charge to CIES**	**25,941**
	Adjustment between accounting basis & funding basis under regulation	
-17,983	Reversal of net charges made for retirement benefits in accordance with IAS 19	-25,941
12,452	Employers contributions payable to pension fund	13,869

The service cost figures include an allowance for administration expenses of 0.3% of payroll.

In addition to the recognised gains and losses included in the CIES, actuarial gains of £44.601 million (2016/17 gain of £44,365 million) were included in other comprehensive income and expenditure in the CIES.

Assets and Liabilities in relation to retirement benefits

2016/17	Reconciliation of present value of the scheme liabilities:	2017/18
£000		**£000**
£464,544	Opening Balance	**£605,968**
15,448	Current Service Costs	22,694
16,332	Interest Cost	15,898
3,374	Contribution by Members	3,629
120,235	Actuarial losses/(gains)	-54,266
98	Past Service Costs (including curtailments)	66
-798	Estimated Unfunded Benefits Paid	-828
-13,265	Estimated Benefits Paid	-13,614
605,968	**Balance at 31 March**	**579,547**

2016/17	Reconciliation of fair value of the scheme assets:	2017/18
£000		**£000**
396,398	Opening Balance	487,926
13,895	Expected return on Assets	12,717
3,374	Contributions by Members	3,629
11,654	Contributions by the Employer	13,041
798	Contribution in respect of unfunded benefits	828
75,870	Actuarial gains / (losses)	-9,665
-798	Unfunded Benefits paid	-828
-13,265	Benefits paid	-13,614
487,926	**Balance at 31 March**	**494,034**

The expected return on scheme assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

The liabilities show the underlying commitments the Council has in the long term to pay retirement benefits. The total liability of £579.547 million has a substantial impact on the net worth of the Council as shown in the Balance Sheet, resulting in a net liability of £85.513 million.

However, under pension regulations, contribution rates are set to meet 100% of the overall liabilities of the fund. The fund’s actuary reported that, at 31 March 2017, the funding level was 98% and that a period of 20 years has been adopted in assessing the level of contribution required to fund that deficiency. The employer’s contribution in 2017/18 was 348% of employee’s contributions.

Basis for estimating assets and liabilities

Liabilities have been assessed on an actuarial basis using the protected unit credit method, an estimate of the pensions that will be payable in future years are dependent on assumptions about mortality rates, salary levels etc. The pension fund liabilities have been assessed by the actuary and are based on the latest full valuation of the scheme as at 31 March 2017.

The main assumptions used by the actuary have been:

2016/17		2017/18
	Longevity at 65 for current pensions (Mortality):	
22.1	Men (years)	21.7
23.7	Woman (years)	24.3
	Longevity at 65 for future pensions (Mortality):	
24.2	Men (years)	24.7
26.3	Woman (years)	27.5
2.40%	Inflation / Pension Increase Rate	2.40%
4.40%	Salary Increase Rate	4.10%
2.60%	Discount Rate	2.70%

Commutation

An allowance is included for future retirements to elect to take 50% of the maximum additional tax-free cash up to HMRC limits for pre-April 2009 service and 75% of the maximum tax-free cash for post-April 2009 service.

The Pension Funds Assets consist of the following categories, by proportion of the total assets held:

31/03/2017	Period Ended 31 March 2018	Quoted prices in active markets £(000)	Quoted prices not in active markets £(000)	Total £(000)	Percentage of Total Assets
	Equity Securities				
16%	Consumer	67,689.7		67,689.7	14%
16%	Manufacturing	73,550.7		73,550.7	15%
7%	Energy and Utilities	30,905.8		30,905.8	6%
7%	Financial Institutions	43,890.5		43,890.5	9%
6%	Health and Care	24,220.5		24,220.5	5%
5%	Information Technology	30,118.8		30,118.8	6%
7%	Other	31,002.2		31,002.2	6%
	Debt Securities				
0%	Corporate Bonds (investment grade)				0%
0%	Corporate Bonds (non investment grade)		9,625.7	9,625.7	2%
0%	UK Government	47,895.5		47,895.5	10%
10%	Other				0%
	Private Equity				
14%	All	1,574.5	7,445.4	9,019.9	2%
	Real Estate				
6%	UK Property		31,753.3	31,753.3	6%
0%	Overseas Property		516.6	516.6	0%
	Investment Trusts and Unit Trusts				
1%	Equities	4,748.5		4,748.5	1%
0%	Bonds				0%
0%	Hedge Funds				0%
0%	Commodities				0%
0%	Infrastructure		58,550.8	58,550.8	12%
0%	Other		1,128.3	1,128.3	0%
	Derivatives				
0%	Inflation				0%
0%	Interest Rate				0%
0%	Foreign Exchange	227.3		227.3	0%
0%	Other				0%
	Cash and Cash Equivalents				
5%	All	29,189.9		29,189.9	6%
100%	**Totals**	**385,014**	**109,020**	**494,034**	**100%**

Projected defined benefit cost for the period to 31 March 2019

Analysis of projected amount to be charged to operating profit for the period to 31 March 2019

Period ended 31 March 2019	**Assets**	**Obligations**	**Net Liability / (asset)**	
	£000	£000	£000	% of pay
Projected Current Service cost *		23,088	-23,088	-38.20%
Past service cost including curtailments		-	-	-
Effect of settlements	-	-	-	-
Total Service Cost	**0**	**23,088**	**-23,088**	**-38.20%**
Interest income on plan assets	13,380		13,380	22.10%
Interest cost on defined benefit obligation		15,814	-15,814	-26.10%
Total Net Interest Cost	**13,380**	**15,814**	**-2,434**	**-4.00%**
Total Included in Profit and Loss	**13,380**	**38,902**	**-25,522**	**-42.20%**

*The current service cost includes an allowance for administration expenses of 0.3% of payroll. The monetary value is based on a projected payroll of £60.518 million.

The contributions paid by the Employer are set by the Fund Actuary at each triennial valuation (the most recent being as at 31 March 2017), or at any other time as instructed to do so by the Administering Authority. The contributions payable over the period to March 2019 are set out in the Rate and Adjustments certificate.

Investment Returns

Actual Returns from 31 March 2017 to 31 March 2018	1.4%
Total Returns from 1 April 2017 to 31 March 2018	1.4%

Local Government legislation provides that Local Authorities have an obligation to meet their share the expenditure of the Joint Boards of which they are constituent members. At 31st March 2018 the liability for Pensions sits at £5.933 million. As a consequence the Council has additional liabilities arising from the pension deficit of the Lothian Valuation Joint Board.

35. Contingent liability

The council recognises the potential for compensation claims deriving from the Scottish Government's Limitation (Childhood Abuse) (Scotland) Act 2017 which removes the three-year time limit on claims of child abuse. Some claims will be historic and relate to Lothian Regional Council, Midlothian District Council or their predecessors some will date post-reorganisation and relate to Midlothian Council. To date there are three ongoing cases. These are currently with our insurers, the extent of our cover and the level of excess payable is being investigated.

Whilst the Council has settled the majority of Equal Pay claims and made appropriate provision for those outstanding, the Council recognises the potential for additional unknown liabilities resulting from historic pay arrangements.

36. Contingent assets

The Council procured the completion of 64 council houses in Newbyres Crescent and Gore Avenue in 2009. In September 2013 it was discovered that the homes contained high levels of carbon dioxide due to the ingress of ground gasses from disused mine workings beneath the properties. The houses had been built without an adequate ground gas defence system. Due to public health concerns, the Council decided in June 2014 to move residents out of the properties. The houses were subsequently demolished in March 2016. The Council has lodged a formal legal claim in the Court of Session against certain contractors and consultants in an effort to recover its losses. The claim is currently progressing through the court.

37. Midlothian council trusts, bequests, common good fund and community funds

There are some 18 active trusts, bequests and community funds of varying size managed by the Council, each of which has specific objectives and conditions. None of the funds are currently registered charities.

The main funds are:

31/03/2017 £000		31/03/2018 £000
14	Dalkeith Common Good	13
2	Penicuik Common Good	2
94	Community Mining Funds	56
60	Other Funds	20
170	**Total**	**91**

A total of £0.038 million has been committed to be spent from these funds.

The funds do not represent assets of the Council and are included in the Balance Sheet as creditors except the Community Mining Funds which are held in separate bank accounts.

38. Post balance sheet events

There are no post balance sheet events.

39. General Fund Balance

The following amounts have been earmarked within the General Fund Balance.

	Balance at 1 April 2016 £'000	Transfers Out 2016/17 £'000	Transfers In 2016/17 £'000	Balance at 1 April 2017 £'000	Transfers Out 2017/18 £'000	Transfers In 2017/18 £'000	Balance at 1 April 2018 £'000
General Fund Balance	**-24,625**			**-17,651**			**-10,777**
Movement in Earmarked Reserves							
Scheme of Devolved Budget Management carry forwards	-4,559	4,559	-3,635	-3,635	3,635	-3,244	-3,244
Business Transformation Programme	-2,918	161	-1,850	-4,607	2,592	0	-2,015
Delegated to schools under the Devolved School Management policy	-1,020	1,020	-1,425	-1,425	1,425	-1,181	-1,181
Borders Rail	-69	69	-196	-196	196	0	0
Total in Earmarked Reserves	**-8,566**	**5,809**	**-7,106**	**-9,863**	**7,848**	**-4,425**	**-6,440**
Uncommitted General Fund Balance at 31 March	**-16,059**			**-7,788**			**-4,337**

40. Notes to the Group Accounts

The Code of Practice on Local Council Accounting in the United Kingdom 2017/18 (The Code) requires local authorities to consider their interests in all types of entity. This includes other local authorities or similar bodies defined in section 106 of the Local Government (Scotland) Act 1973 e.g. statutory bodies such as Integration Joint Boards and Valuation Boards. Authorities are required to prepare a full set of group accounts in addition to their own Council's accounts where they have a material interest in such entities. The Group Accounts of Midlothian Council are prepared in accordance with the accounting policies of the Council with the additions and exceptions shown below. The Group Accounts consolidate the results of the Council with other entities. These organisations are entirely independent of the Council under law and for taxation.

Valuation of Property, Plant and Equipment
The basis of valuation across the combining entities is in accordance with the Code and there are no material inconsistencies with the policies adopted by Midlothian Council. The Integration Joint Board has no Property, Plant or Equipment.

Depreciation
The basis of valuation across the combining entities is in accordance with the Code and there are no material inconsistencies with the policies adopted by Midlothian Council

Goodwill
The Council has not paid any consideration for its interests and thus no goodwill is involved in the acquisition.

Basis of Consolidation
Subsidiaries are consolidated on a line-by-line basis. All other entities are accounted for under the accounting conventions of the "acquisition basis" using the equity method – the Council's share of the net assets or liabilities of each entity is incorporated and adjusted each year by the Council's share of the entities' results and its share of other gains and losses (recognised in the Group CIES). All entities have the same reporting date as the Council.

Restrictions on transfer of funds
The Council's share of the reserves of its associate and joint ventures is unusable i.e. it cannot be used to fund the Council's services or to reduce taxation. Further details for each entity are as follows:

	Share	Share of Assets	Share of Liabilities	Share of Revenues	Share of (Profit)/Loss
	%	£000			
Subsidiaries					
Trusts, bequests, common good fund and community funds	100	91	91	-1	79
Pacific Shelf 826 ltd	100	0	38	0	2
Associates					
Lothian Valuation Joint Board	9.19	220	740	-1,509	486
Midlothian Integration Joint Board	50	450	0	-69	-450

The information above agrees to the group accounts after the elimination of inter-company transactions.

Combining Entities
The following table provides further details about the entities incorporated into the Council's Group Accounts:

Subsidiary	Nature	Accounts Available from
Trusts, bequests, common good fund	To award grants across Midlothian.	Midlothian Council, Midlothian House Dalkeith

and community funds		
Pacific Shelf 826 ltd	Property Development	Midlothian Council, Midlothian House Dalkeith
Associates		
Lothian Joint Valuation Board	Maintains the electoral, council tax and non-domestic rates registers for the Edinburgh, Midlothian, West Lothian and East Lothian Councils	The Treasurer, Lothian Joint Valuation Board, Edinburgh Council, Waverley Court, Edinburgh
Midlothian Integration Joint Board	Its purpose is to improve the well-being of families, our communities and of people who use health and social care services. The Integration Scheme determines when the Council will have shared responsibility for additional funding with NHS Lothian and is linked to demographic shifts and demand volumes linked to service delivery.	Midlothian Council, Midlothian House Dalkeith

Non-material interests in other entities

In addition to the organisations outlined above, the Council also has an interest in the following organisations:

Seemis Group LLP who provide Scottish Local Authorities with an Education Management system. Midlothian have a 1.90% interest in Seemis. Net assets at 31st March 2018 were £2.859 million which would equate to a share of £0.054 million for Midlothian.

Housing Revenue Account

Income and expenditure account

The HRA reflects the statutory requirement to account separately for local authority housing provision, as defined in the Housing (Scotland) Act 1987. The Income and Expenditure Statement reports the net cost for the year and shows how these costs were funded from rents and other income. The Movement in HRA balances reconciles the financial position shown in the Comprehensive Income and Expenditure Statement to the movement in the HRA reserve for the year.

For the year ended 31 March 2018

The following statement shows how much the Council spent in fulfilling its statutory responsibility to provide, improve and manage its Housing Stock.

2016/17 £000		**2017/18 £000**	**per house per week £**
	Income		
24,966	Gross dwelling rents	26,676	75.52
541	Non dwelling rents	344	0.97
53	Other Income	38	0.11
25,560		**27,058**	**76.60**
	Expenditure		
5,407	Repairs and Maintenance	5,536	15.67
4,692	Supervision and Management	4,966	14.06
7,098	Depreciation of Non-Current Assets	7,125	20.17
11,542	Impairment of Non-Current Assets	9,330	26.41
1,940	Other Expenditure	1,881	5.33
60	Increase / (Decrease) in Bad Debt Provision	600	1.70
30,739		**29,438**	**83.34**
5,179	**Net Cost of HRA services per the whole Council Comprehensive Income and Expenditure Account**	**2,380**	**6.74**
250	HRA share of Corporate and Democratic Core	250	0.71
5,429	**Net Cost of HRA Services**	**2,630**	**7.46**
	HRA share of the operating income and expenditure included in the whole Council accounts		
-1,804	Loss / (Gain) on sale of HRA non-current assets	-432	-1.22
5,091	Interest Payable and similar charges	6,226	17.63
-222	Interest and Investment Income	-207	-0.59
94	Net Defined Benefit Liability and Expected Return on Pension Asset	123	0.35
8,588	**Deficit / (Surplus) for the year on the HRA Services**	**8,340**	**23.62**

Movement on the HRA Statement for year ended 31 March 2018

This statement shows how the balance for the year on the HRA Comprehensive Income and Expenditure Account reconciles to the balance for the year on the Housing Revenue Account.

£000		£000	£
8,588	**Deficit for the year on the HRA Income & Expenditure Account**	**8,340**	**23.62**
	Items included in the HRA Income & Expenditure Account but excluded from the movement on HRA balance for the year		
1,804	Gain/(loss) on sale of HRA non-current assets	432	1.22
-14,978	Transfer to/(from) Capital Adjustment Account	-12,372	-35.02
-254	HRA share of contributions to/from pension reserve	-510	-1.44
-4,840	**(Surplus) or deficit for the year on the Housing Revenue Account Income and Expenditure Account**	**-4,110**	**-11.62**
-24,913	**Housing Revenue Account Balance brought forward**	**-29,753**	**-84.23**
-29,753	**Housing Revenue Account Balance carried forward**	**-33,863**	**-95.85**

Notes to the Housing Revenue Account

1. General

This account reflects the statutory requirement to account for local council housing provision, as defined in the Housing (Scotland) Act 1987. It shows the major elements of housing revenue expenditure and capital financing costs, and how these are met by rents and other income.

2. Housing Stock

At 31 March 2018 the Council had 6,793 houses (31 March 2017 6,842) which can be analysed as follows:

2016/17	**Type of Dwelling**	**2017/18**
Number		Number
855	1 Bedroom	878
3,798	2 Bedroom	3,767
1,863	3 Bedroom	1,828
316	4 Bedroom	310
10	5 / 6 Bedroom	10
6,842	Total	**6,793**

3. Rent Arrears

At the end of the year rent arrears amounted to £3.229 million (2016/17 £2.573 million) for which a provision for bad and doubtful debts of £1.6 million (2016/17 £1 million) exists.

4. Void Properties

The total value of uncollectable void rents for main provision properties amounted to £0.554 million (2016/17 £0.402 million).This has been netted against rental income.

Council Tax Income Account

Income and expenditure account

For the year ended 31 March 2018

Councils raise taxes from residents by way of a property tax – the Council Tax – which is based on property values. Each dwelling in a local Council area is placed into one of eight valuation bands, A to H. The Council declares a tax for band D properties and all other properties are charged a proportion of this, lower valued properties pay less; higher valued properties pay more. The Council Tax Income Account (Scotland) shows the gross income raised from Council taxes levied and deductions made under statute. The resultant net income is transferred to the Comprehensive Income and Expenditure Statement of the authority.

The Council Tax Reduction Scheme was introduced in 2013/14 by the Scottish Government. This scheme replaced Council Tax Benefits, with funding being provided through the General Revenue Grant. Prior to 2013/14, funding for Council Tax Benefit was provided by the Department for Works and Pensions (DWP).

2016/17 £000		**2017/18 £000**
47,474	Gross Council Tax levied and Contributions in Lieu	52,045
	Less :	
5,039	Discounts	5,211
4,730	Council Tax Reduction Scheme	4,759
1,267	Write-off of Uncollectable Debts and Allowances for Impairment	1,398
36,438		**40,677**
-23	Adjustments to previous years Community Charge and Council Tax	21
36,415	**Transfers to the General Fund**	**40,698**

Notes to the Council Tax Income Account

Calculation of the Council tax base for the year 2017/18

Property Bands

	A - disabled	A	B	C	D	E	F	G	H	Total
Properties	0	979	12,528	10,866	5,380	4,864	3,410	2,128	171	40,326
Disabled relief	2	37	25	-37	2	-3	-7	-18	-1	0
Less										
Exemptions	-	60	437	269	84	194	48	31	3	1,126
Discounts (25%)	1	147	1,438	910	377	247	111	59	4	3,294
Discounts (50%)	-	1	6	5	2	2	3	2	-	21
Other Discounts	-	3	22	13	7	4	4	3	2	58
Council Tax Reduction Scheme	1	250	2,605	1,475	284	120	38	22	-	4,795
Effective properties	-	555	8,045	8,157	4,628	4,294	3,199	1,993	161	31,032
Ratio to band D	5/9	6/9	7/9	8/9	9/9	473/360	585/360	705/360	882/360	
Band D equivalents	-	370	6,257	7,251	4,628	5,642	5,198	3,903	394	33,643
Contributions in lieu – Band D equivalents										220
Total Council Tax Base										**33,863**
Provision for non payment										-1,132
Total										**32,731**

Number of 'effective' properties and charges for each band

Band	**A - disabled**	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**Total**
Numbers	-	555	8,045	8,157	4,628	4,294	3,199	1,993	161	31,032
£	692.22	830.66	969.11	1,107.55	1,246.00	1,637.10	2,024.75	2,440.08	3,052.70	

Non-Domestic Rates Income Account

Income and expenditure account

For the year ended 31 March 2018

The rates collected from non-domestic ratepayers during the year are shown below. Any difference between the rates collected and the amount the Council is guaranteed to receive under the National Pooling arrangements is adjusted via the Government's Revenue Support Grant to the Council. The non-domestic rate income is redistributed from the national pool in proportion to the resident population of each local Council and therefore bears no direct relationship with the amount collected by those authorities.

£000		£000
39,024	Gross rates levied	40,828
	Less:	
7,380	Reliefs and other deductions	8,609
500	Write-offs of uncollectable debts and allowance for impairment	513
2,291	Adjustments to previous years	-866
28,853	**Net Non Domestic Rate Income**	**32,572**
0	Non-Domestic Rate Income Retained by Authority (BRIS)	0
28,853	**Contribution to Non-Domestic Rate Pool**	**32,572**
	Allocated:	
28,934	Contribution to national non-domestic rates pool	32,641
-81	Midlothian Council	-69
28,853		**32,572**

Notes to the Non-Domestic Rates Income Account

1. The amount distributed to Midlothian Council from the national non-domestic rate income pool in the year was £29.273 million (2016/17 £32.026 million).

2. Occupiers of non-domestic property pay rates based on the valuation of the property within the valuation roll for Midlothian. The non-domestic rate poundage is determined by the Scottish Government, and was 46.6p per £ (2016/17 48.4p per £) where the rateable value was less than or equal to £29,000 and 49.2 per £ (2016/17 51p per £) where the rateable value exceeded £51,000.

3. Small Business Bonus Scheme - From 1 April 2017, a ratepayer who occupies or is entitled to occupy one or more non-domestic properties which have a combined rateable value of £18,000 or less then they may be eligible for a discount of between 25% and 100% on their bill. In addition, where the cumulative rateable value of a businesses properties falls between £18,000 and £35,000, the Scheme will offer 25% relief to individual properties with a rateable value of up to £18,000.

4. Rateable Value as at the start of the year

Number 2016/17	Rateable Value 2016/17 £000		Number 2017/18	Rateable Value 2017/18 £000
1,699	45,934	Shops, Offices and Other Commercial Subjects	1,862	48,898
928	14,609	Industrial and Freight Transport	937	17,258
295	17,391	Miscellaneous (Schools etc)	302	20,705
2,922	**77,934**		**3,101**	**86,861**

The Business Rate Incentivisation Scheme (BRIS) permits the authority to retain half of the NDR income which exceeds the income target set by the Scottish Government

Independent Auditor's Report

Glossary of Terms

While much of the terminology used in this report is intended to be self-explanatory, the following additional definitions and interpretation of terms may be of assistance.

1. Gross Expenditure

This includes all expenditure attributable to the service and activity including employee costs, expenditure relating to premises and transport, supplies and services, third party payments, support services and capital charges.

2. Gross Income

This includes the charges to individuals and organisations for the direct use of the Council's services.

3. Corporate and Democratic Core

Corporate and Democratic Core costs include the costs of policy making and all other Councillor based activities together with costs which relate to the general running of the Council. The Best Value Accounting Code of Practice stipulates that such costs are to be excluded from the "total cost" relating to service activity.

4. Non Distributable Costs

Non Distributable Costs represent costs which cannot be allocated to specific services and again, under the Best Value Accounting Code of Practice, are excluded from the total cost relating to service activity. Examples of Non Distributable Costs are charges for added pension years and early retirement.

5. Employee Costs

This includes salaries, wages, overtime, bonus, enhancements, employer's pension and national insurance contributions, travelling and subsistence expenses and other employees' allowances.

6. Property Costs

This includes rents and rates, property insurance, repairs and maintenance of property, upkeep of grounds, heating and lighting, furnishings and fittings and allocations of central support for accommodation costs.

7. Supplies and Services

This includes food, materials, books, uniforms and protective clothing, the purchase and maintenance of equipment and tools and various services carried out by external contractors.

8. Transport Costs

This includes the costs of operating vehicles and plant such as fuel, repairs and maintenance, tyres, licenses, insurance and procurement of transport for school children.

9. Administration

This includes printing and stationery, advertising, postages, telephone costs and central support services allocations for administration.

10. Financing Costs

This includes the annual costs of financing the sums borrowed by the Council to finance its capital repayment of loans, interest charges and debt management expenses, as well as external repayments for operational leases.

11. Capital Charges

A charge to service revenue accounts to reflect the cost of non-current assets used in the provision of services.

12. Payments to Other Bodies

This includes grants to individuals and organisations, bursaries and payments to other local authorities, Health Boards, Joint Boards and organisations and agencies providing services complementing or supplementing the work of the Council.

13. Capital Financed from Current Revenue

This heading covers the costs of creating, acquiring or improving assets where the expenditure is charged directly to the Revenue Account

14. Other Costs

This heading covers items of expenditure which cannot be accommodated in any of the other categories.

15. Specific Government Grant

This includes grants received from Central Government in respect of a specific purpose or service e.g. housing benefit, education, community regeneration and community services.

16. Capital Expenditure

This is expenditure incurred in creating, acquiring or improving assets where the expenditure is normally financed by borrowing with repayment over a period of years, or by utilising the income from the sale of existing assets.

17. Intangible Assets

These are non-financial assets that do not have any physical substance but are identifiable and are controlled by the Council through custody or legal rights.

18. Non-Current Assets

These are created by capital expenditure incurred by the Council. This includes buildings and property, vehicles, plant and machinery, roads, computer equipment etc.

19. Revaluation Reserve

The Revaluation Reserve records unrealized revaluation gains arising (since 1 April 2007) from holding non-current assets.

20. Capital Adjustment Account

The Capital Adjustment Account provides a balancing mechanism between the different rates at which assets are depreciated under the Code.

21. Useable Capital Receipts Reserve

The Useable Capital Receipts Reserve represents the capital receipts available to finance capital expenditure in future years, after setting aside the statutory amounts for the repayment of external loans.

22. Pension Reserve

This represents the difference between accounting for pension costs in line with UK Accounting Standards, and the funding of pension costs from taxation in line with statutory requirements, and is equal to the change in the pensions liability, i.e. the commitment to provide retirement benefits.

23. Associate

An entity other than a subsidiary or joint venture in which the reporting Council has a participating interest and over whose operating and financial policies the reporting Council is able to exercise significant influence.

24. Entity

A body corporate, partnership, trust, unincorporated association, or statutory body that is delivering a service, or carrying on a trade or business, with or without a view to profit. It should have a separate legal personality and is legally required to prepare its own single-entity accounts.