# East Lothian Council

## 2017/18 Annual Audit Report

AUDIT SCOTLAND

Prepared for the Members of East Lothian Council and the Controller of Audit

25 September 2018

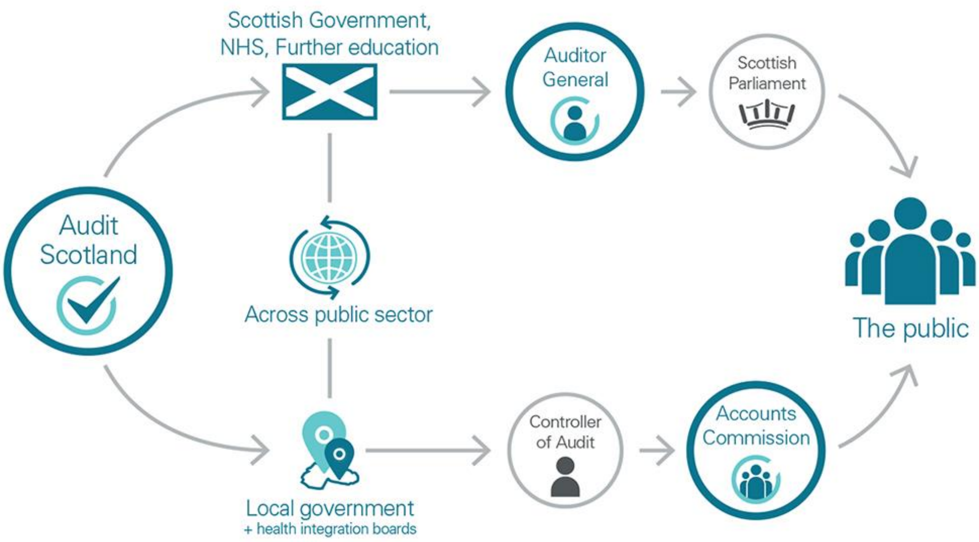
# Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.




# About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

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# Key messages

## 2017/18 annual accounts

1 In our opinion, East Lothian Council and its group financial statements give a true and fair view and were properly prepared.

2 The audited part of the remuneration report, management commentary and annual governance statement are all consistent with the financial statements and prepared in accordance with proper accounting practices.

3 The statement of accounts of the Dr Bruce Charitable Fund section 106 charity administered by the Council is free from material misstatement.

## Financial management

4 Financial management is effective with a budget process focussed on the Council's priorities.

5 Our testing of the design and operation of the financial controls over significant risk areas confirmed that controls relating to financial systems and procedures are designed appropriately and operating effectively.

## Financial sustainability

6 The Council and its group financial position is sustainable in the foreseeable future although rising demand, increasing costs of services and reductions to central funding will continue to place a strain on the Council's capacity to deliver services at the current levels.

7 There is a five-year financial strategy that is aligned to the Council's priorities and demonstrates how it will address future budget challenges. The Council has made savings over the past few years however the scale of the savings required to address future funding gaps will mean that more will need to be identified.

## Governance and transparency

8 The Council has appropriate governance arrangements in place that support the scrutiny of decisions made by the Council.

9 The Council is open and transparent in the way it conducts its business and the public can attend meetings of the Council and its standing committees.

## Value for money

10 A best value audit was carried out during the year and will be formally reported to the Accounts Commission on 11 October 2018. Recommendations have been made and these will form part of our audit work in 2018/19.

11 **Formal reporting and monitoring arrangements should be revisited, clarified and strengthened for the significant group components (e.g. Enjoy East Lothian Ltd. and Musselburgh Racing Associated Committee) to ensure the Council is complying with the duties set out in the Code of Guidance on Funding External Bodies and Following the Public Pound. This includes ensuring a report is brought to the Audit and Governance Committee at least once a year. This remains an area requiring further improvement.**

# Introduction

**1.** This report summarises the findings arising from the 2017/18 audit of East Lothian Council and its group (the Council).

**2.** The scope of the audit was set out in our Annual Audit Plan presented to the 20 February 2018 meeting of the Audit & Governance Committee. This report comprises the findings from:

- an audit of the annual accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the *Code of Audit Practice 2016* as illustrated in Exhibit 1.

## Exhibit 1
Audit dimensions


Source: *Code of Audit Practice 2016*

**3.** The main elements of our audit work in 2017/18 have been:

- an audit of the Council and its group 2017/18 annual accounts and the statement of accounts of the Dr Bruce Charitable Fund (section 106 charity) administered by the Council including the issue of independent auditor's reports setting out our opinions
- a review the Council's key financial systems
- audit work covering the Council's arrangements for securing Best Value to be reported in the Best Value Assurance Report on 11 October 2018
- consideration of the four audit dimensions.

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

**5.** The Council is also responsible for compliance with legislation, and putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.

**6.** Our responsibilities as independent auditor appointed by the Accounts Commission are established by the Local Government in Scotland Act 1973, the *Code of Audit Practice (2016)* and supplementary guidance, and International Standards on Auditing in the UK.

**7.** As public sector auditors we give independent opinions on the annual accounts. We also review and provide conclusions on the effectiveness of the Council's performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability. We also report on the Council's best value arrangements and in doing this we aim to support improvement and accountability.

**8.** Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016*.

**9.** This report raises matters from the audit of the annual accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

**10.** Our annual audit report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.

**11.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and the 2017/18 audit fee of £237,010 as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

## Adding value through the audit

**12.** Our aim is to add value to East Lothian Council by providing insight into, and offering foresight on, financial sustainability, risk and performance by identifying areas of improvement and recommending and encouraging good practice. In so doing, we aim to help the council promote improved standards of governance, better management and decision making and more effective use of resources.

**13.** This report is addressed to both the Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk.

**14.** We would like to thank all management and staff who have been involved in our work for their co-operation and assistance during the audit.

# Part 1

## Audit of 2017/18 annual accounts

### Main judgements

**In our opinion, East Lothian Council and its group financial statements give a true and fair view and were properly prepared.**

**The audited part of the remuneration report, management commentary and annual governance statement are all consistent with the financial statements and prepared in accordance with proper accounting practices.**

**The statement of accounts of the Dr Bruce Fund section 106 charity administered by the Council is free from material misstatement.**

### Audit opinions on the annual accounts

**15.** The annual accounts for the Council and its group for the year ended 31 March 2018 were approved by the Audit and Governance Committee on 25 September 2018. We reported, within our independent auditor's report that, in our opinion:

- financial statements give a true and fair view and were properly prepared
- the audited part of the remuneration report, management commentary and the annual governance statement were all consistent with the financial statements and properly prepared in accordance with the guidance

**16.** We have nothing to report in respect of misstatements in information other than the financial statements; the adequacy of accounting records; the information and explanations we received; or the achievement of prescribed financial objectives.

The Council and its group annual accounts are the principal means of accounting for the stewardship of resources and performance in the use of resources.

### Audit opinion on section 106 charity – Dr Bruce Fund

**17.** A separate independent auditor's report is required for the statement of accounts of each registered charity where members of East Lothian Council are sole trustees, irrespective of the size of the charity (section 106 of the Local Government in Scotland Act 1973). The Dr Bruce Fund is the only registered charity for which this applies in East Lothian Council.

**18.** We received the Dr Bruce Fund accounts on 25 July, in line with the agreed timetable.

**19.** Some presentational adjustments were required to the unaudited accounts to align the disclosures to the FRS 102 based on the Statement of Recommended Practice. There were no adjusted or unadjusted audit differences raised. However, the following issues were noted during the audit. These are the same issues raised in 2016/17.

- The Dr Bruce Fund's accounts were not advertised in line with the requirements under Regulation 9 of the Local Authority Accounts (Scotland)

Regulations 2014 issued under section 105 of the Local Government in Scotland Act 1973

- The unaudited accounts submitted to audit were not signed on behalf of the trustees, and
- The Dr Bruce Fund was set up to provide relief for the poor of Musselburgh. The Dr Bruce Fund awarded the same two individuals £60 in 2017/18 (2016/17: £50). More could be done by East Lothian Council to promote the trust.

**20.** The Council has begun a project aimed at reducing or removing the number of charitable trusts where it is the sole trustee. This is still in the early stages of development and commenced after July 2018. It is recommended that progress of the consolidation of trust funds and the Section 106 charity be a priority to allow for effective and focussed management of the funds.

**21.** After completing our audit, we reported in our independent auditor's report that, in our opinion:

- the financial statements give a true and fair view of the section 106 charity's financial position and are properly prepared in accordance with charities legislation
- the trustees' annual report is consistent with the financial statements and prepared in accordance with proper accounting practices.

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**Recommendation 1 (appendix 1, action plan point b/f 1)**

**The unaudited accounts should be advertised in line with the Regulations.**

**The unaudited accounts should be signed on behalf of the trustees prior to submitting for audit.**

**Recommendation 2 (appendix 1, action plan point b/f 2 and b/f 3)**

**The Council should review the method(s) used to promote this (and other) charitable trusts to ensure that the potential availability of these funds are known to the wider community.**

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## Submission of the Council and its group annual accounts for audit

**22.** We received the unaudited annual accounts on 26 June 2018 in line with the audit timetable set out in our 2017/18 Annual Audit Plan.

**23.** The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team during the audit. This helped ensure that the audit of the annual accounts process ran smoothly.

**24.** The 2017/18 group accounts were prepared on the basis of the unaudited accounts of the subsidiaries and associates. Audited accounts have recently been received for East Lothian Land Ltd and East Lothian Investments and no changes were identified. However audited accounts were received for the remaining group entities (Lothian Valuation Joint Board, Enjoy East Lothian Limited, Musselburgh Joint Racing Committee and Brunton Theatre Trust) late in the audit process.

**25.** This impacts on the ability to ensure the most up to date, audited figures have been used. We have raised this issue with the Council and found that they are working with the group to bring these timelines forward for 2018/19. An up-to-position as at 18 September for the group accounts is below. Of the six group components, two have recently been received - East Lothian Land Ltd and East Lothian Investment and the accounts have been updated to reflect this. Four were in various stages of completion during our audit and recent developments include:

- Lothian Valuation Joint Board – received 4 September 2018
- Brunton Theatre Trust – signed on 7 September 2018
- Musselburgh Joint Racing Committee – due to be approved by the Racecourse Board on 18 September
- Enjoy East Lothian Ltd – due to be approved by the Enjoy Board on 27 September

**26.** The council has ensured that the most up to date figures (the audited figures) were used in the 2017/18 accounts.

**Recommendation 3 (appendix 1, action plan point 1)**

**The Council needs to work with the various subsidiaries and associates to plan and agree a suitable timetable for receipt of audited accounts for the group components.**

## Whole of Government Accounts

**27.** The Council submitted a draft consolidation pack for the whole of government accounts (WGA) audit on 4 July 2018 in line with the submission deadline. Due to the threshold for auditor assurance being increased from £350 million (2016/17) to £500 million for 2017/18, there is no requirement for a full audit of the Council's WGA and only an assurance statement is required. The assurance statement will be provided to the National Audit Office by 28 September.

## Risk of material misstatement

**28.** Appendix 2 provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team and the wider audit dimension risks identified.

## Materiality

**29.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement. It is affected by our perception of the financial information needs of users of the financial statements.

**30.** Our initial assessment of materiality for the annual accounts was carried out during the planning phase of the audit and is summarised in Exhibit 2. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

**31.** On receipt of the annual accounts we reviewed our planning materiality calculations and concluded that they remained appropriate.

## Exhibit 2
Materiality values

| Materiality level | Amount |
|---|---|
| Overall materiality | £3.8 million |
| Performance materiality | £1.9 million |
| Reporting threshold | £38,000 |

Source: Audit Scotland, Annual Audit Plan 2017/18

### How we evaluate misstatements

**32.** There were two monetary adjustments to the unaudited financial statements arising from our audit. Details of the adjustments and their impact on the financial statements are included in Exhibit 3.

**33.** One error above the reporting threshold but below materiality was identified but has not been adjusted in the financial statements. Appendix 3 gives details of the unadjusted error and the impact on the financial statements.

**34.** It is our responsibility to request that all errors above the reporting threshold are corrected although the final decision on this lies with those charged with governance considering advice from senior officers and materiality. Management do no propose to adjust for the above item as the amount is not considered material in the context of the financial statements. We agree that this amount is not material.

### Significant findings from the audit in accordance with ISA 260

**35.** International Standard on Auditing 260 (UK) requires us to communicate significant findings from the audit to those charged with governance. These are summarised in Exhibit 3. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 has been included.

**36.** The findings include our views about significant qualitative aspects of the Council's accounting practices including:

- Accounting policies
- Accounting estimates and judgements
- Significant financial statements disclosures
- Timing of transactions and the period in which they are recorded
- The impact on the financial statements of any uncertainties
- The effect of any unusual transactions on the financial statements
- Misstatements in the annual accounts
- Disagreement over any accounting treatment or financial statements disclosure

## Exhibit 3
Significant findings from the audit of the financial statements

| Finding | Resolution |
|---|---|
| **1. IAS 19 actuarial valuation**<br><br>The actuarial valuation of the IAS 19 pension assets and liabilities in the unaudited accounts was initially based on a methodology which estimated the year end position using an earlier date of valuation. Due to greater levels of market volatility around the year-end than in previous years, the difference between the actuaries' estimated valuation and the actual position at 31 March 2018 was assessed as being material to the financial statements and requiring amendments. | The Council obtained a revised actuarial valuation reflecting the actual position at the financial year end (31 March) and adjusted the financial statements to reflect the revised pension assets and liabilities position. The impact of the adjustment was to increase net assets in the balance sheet by £9.3m with a corresponding actuarial gain on pension assets in the comprehensive income and expenditure statement. |
| **2. Accumulated absences provision**<br><br>The unaudited accounts included a provision of £3.7 million for accumulated absences within long term liabilities on the Council's balance sheet. This relates to benefits that employees have earned as part of their contracts of employment but have not yet taken, such as holiday pay. As such benefits are mainly taken by employees in the year after they are earned, it was judged more appropriate for this provision to be included within current liabilities. | An adjustment has been made in the audited accounts to transfer the accumulated absences provision of £3.7 million from long term to current liabilities. There was no impact on the comprehensive income and expenditure account or net assets position within the balance sheet. |
| **3. Assets under Construction**<br><br>Audit testing identified that capital expenditure relating to the Law Primary School extension was included within Other Land & Buildings in Property Plant and Equipment Note 12 in the unaudited accounts, although the work had not been completed at the financial year end as the project is still on-going. | An adjustment has been made in the audited accounts to transfer assets of £4.8 million from Other Land & Buildings to Assets under Construction in Property Plant and Equipment Note 12.<br><br>As the Council's policy is not to charge depreciation in the year of acquisition, there was no impact on depreciation charge and there was no impact on the comprehensive income and expenditure account or the Property Plant and Equipment amount in the balance sheet. |
| **4. Common Good assets**<br><br>The Council identified assets with a total value of £1.1 million which were held on the Council's balance sheet which related to the Common Good. The Council had correctly transferred these assets to the Common Good balance sheet but had included them within the additions total in the Common Good Notes to the financial statements. | The Council has amended the disclosure in the Common Good Notes to the financial statements to provide separate disclosure of those assets transferred from the Council balance sheet. This is part of the wider piece of work being done by the Council in reviewing all their fixed assets. |
| **5. Cash flow**<br><br>We identified that within the cash flow statement capital accruals and capital retentions were included within the movement in creditors under operating activities. These should have been included within 'investing activities' instead. | The Council has amended the cash flow statement to adjust for capital accruals and capital retentions and included the correct figures in within 'investing activities'. The net cash outflow from operating activities and Purchase of Property, Plant and Equipment amount included in investing activities have both decreased by £1.136 million. There is no change in the net increase in cash and cash equivalents. |

## Good practice in financial reporting

**37.** The annual report and accounts reflect good practice as set out in Audit Scotland guidance on 'Improving the quality of local authority accounts – expenditure and funding analysis'.

## Follow up of prior year recommendations

**38.** We have followed up actions previously reported and assessed progress with implementation, these are reported in Appendix 1 and identified by the prefix b/f (brought forward).

**39.** In total, six agreed actions were raised in 2016/17. Of these:

- Two have been fully implemented.
- Four are either partly actioned or have not been actioned.

**40.** Overall the Council has made some progress in implementing these actions. For those actions not yet implemented, revised responses and timescales have been agreed with management as set out in Appendix 1.

## Integration Joint Board

**41.** For the second year the Council included its share of the financial transactions of East Lothian Integration Joint Board (the IJB) within its group financial statements. We have completed the audit of the IJB and will report our findings separately to the IJB Audit and Risk Committee on 27 September 2018 where the accounts are due to be approved. We are satisfied that the Council had adequate arrangements in place to agree year end balances between itself and its partners. During 2017/18, the council produced a recovery plan to address overspending in the Health and Social Care Directorate. Our audit testing also confirmed that the council properly identifies transactions that relate to work commissioned by the IJB.

## Other findings

**42.** Our audit identified several presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited annual accounts.

## Objections

**43.** The Local Authority Accounts (Scotland) Regulations 2014 require a local authority to publish a public notice on its website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period. The Council complied with the regulations. There were no objections to the accounts.

# Part 2
## Financial management

### Main judgements

**Financial management is effective with a budget process focussed on the Council's priorities.**

**Our testing of the design and operation of the financial controls over significant risk areas confirmed that controls relating to financial systems and procedures are designed appropriately and were operating effectively.**

### Financial performance in 2017/18

**44.** In February 2017 the Council approved a General Services budget of £232.97 million for 2017/18. The budget was aligned to the Council's main priorities and vision.

**45.** The Council has a good track record in delivering services within budget over the last two years. The 2017/18 end of year financial review presented to full council on 26 June reported an underspend £0.38 million against the planned budget. This position was, however, assisted by a number of non-recurring items including additional grant from the Scottish Government in respect of severe weather, release of a provision previously held on the balance sheet and an additional contribution from NHS Lothian to support the IJB related functions. Without these items, the Council would have overspent on its General Services budget by £0.67 million.

**46.** While the Council's spending remained in line with its overall budget, there are significant variations in how different services have performed. The more significant under and overspends are summarised in Exhibit 4.

### Exhibit 4
Summary of significant under / overspends against budget

| Area | Under/over spend (£m) | Reason for variance |
|---|---|---|
| **Underspends** | | |
| Resources and People Services | £1.37 | Underspends on staff budgets, driven through vacancy management, and schools PPP costs. |
| Partnerships and Services for Communities | £0.35 | Underspends mainly on staff budgets, additional income, increase in building |

| Area | Under/over spend (£m) | Reason for variance |
|---|---|---|
| | | warrants and a decrease in wider service expenditure budgets. |
| **Overspends** | | |
| Health and Social Care Partnership | £0.89 | Increased demand for services and increased complexities and needs of clients, within Children's and Adults' services. |

Source: East Lothian Council 2017-18 End of Year Financial Review

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

**47.** The Health Social Care Partnership directorate has overspent against budget in both the current and previous financial years. These overspends have been offset by underspends in other services to maintain financial balance. Given that the council would have overspent on its general services budget in 2017/18 if it had not benefited from a number of non-recurring income items, this is unlikely to be sustainable in future. During 2017/18, the council implemented recovery actions to allow the IJB break-even. We will continue to monitor the Council's progress in this area for the remainder of our audit appointment.

## Housing revenue account

**48.** The Council is required by legislation to maintain a separate housing revenue account (HRA) and to ensure that rents are set to at least cover the costs of its social housing provision. Rent levels are therefore a direct consequence of the budget set for the year.

**49.** The 2017/18 end of year financial review presented to full council in June 2018 reported that HRA approved spending plans for 2017/18 had anticipated an in-year surplus of £1.62 million however the HRA delivered an in-year surplus of £2.87 million, exceeding the budgeted surplus by £1.25 million. The higher surplus can be attributed to, but not limited to, underspends on repairs and maintenance and loan charges, an underspend on staffing largely due to delays in recruitment pending the outcome of a wider service review, and a lower than planned increase to the bad debt provision.

**50.** The HRA reserve balance has increased by £0.37 million during the 2017/18 financial year and there was a transfer of £0.99 million from the HRA reserve to the general fund.

**51.** The HRA reserve balance at 31 March 2018 was £5.39 million. This is in line with the Council's five-year financial strategy for 2018-23 which has a stated policy of maintaining an HRA reserve balance of at least £1 million, to allow the Council to maintain a cushion against any unexpected increase in costs or loss of income, and to protect against the risks inherent in the UK welfare reform proposals. Given the uncertainty that exists over the timing and scale of capital investment in new affordable housing, there is no upper limit on reserves.

## Efficiency savings

**52.** With reduced funding from government and increased demand for financial services, efficiency savings are an important means of bridging the gap between funding received and spending commitments.

**53.** The Council is required to make an annual return to the COSLA in respect of recurring efficiency savings. The Cabinet and Council routinely receive budget monitoring reports including savings plans which have been risk assessed.

**54.** The 2017/18 annual return to the Scottish Government indicated that £2.1 million of savings were planned. The Council achieved actual savings of £2.7 million. Some of the planned savings in relation to Health and Social Care Integration and Buysmart were not delivered in-year however this was offset by efficiencies and underspends in corporate expenditure.

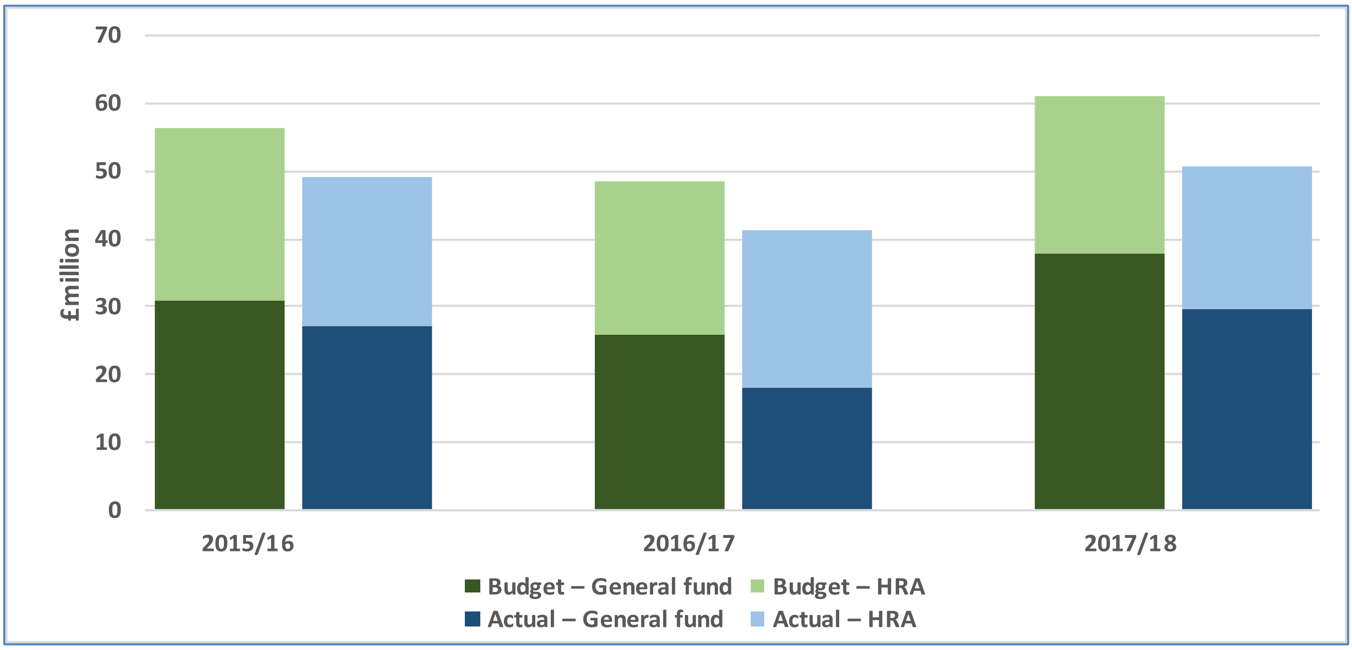
## Capital programme 2017/18

**55.** The total capital expenditure budget for 2017/18 was £61.1 million. Of the total capital budget, £37.7 million related to general services and £23.4 million to the HRA.

**56.** Capital spend was £10.1 million below budget. For the last three years, the Council has reported slippage in its capital programme as outlined in Exhibit 5. The HRA slippage comprised 21% of this total.

## Exhibit 5

Capital slippage compared to budget (general fund and HRA)




Source: End of Year Financial Reviews (2015/16, 2016/17, 2017/18)

**57.** The majority of the capital underspend for general services relates to slippage and will be carried forward to the 2018/19 capital programme. The most significant underspends relate to delayed project starts at the new Wallyford Primary School and Dunbar Grammar School. The council is monitoring both projects and expects the new Wallyford Primary School to be completed on time, with the Dunbar Grammar School extension expected to be completed two months later than originally planned.

**58.** A budget of £0.44 million was allocated for cemeteries within the 2017/18 capital programme. The actual spend in the year was nil due to protracted negotiations with landowners.

**59.** The HRA capital programme had a total underspend of £2.12 million. Within HRA, £10.6 million was spent on modernisation with an underspend of £1.5 million. Spending of new affordable homes was £10.4 million, which was £0.1 million below the approved budget. Two mortgages to rent applications were processed during the year, resulting in an underspend against the approved budget of £0.5 million.

**60.** Whilst management has an understanding of capital slippage and does not consider this to be problematic in 2017/18, there is a risk that ongoing delays in capital projects could impact on service plans going forward.

## Borrowing in 2017/18

**61.** The Council's outstanding loans at 31st March 2018 were £358 million, an increase of £14 million on the previous year. During the year, £6 million of loan repayments were made and there were £22 million of new loans taken out. The increase in borrowing reflects the increase in the Council's capital financing requirements as per its treasury management strategy.

**62.** Total external debt (which includes the Council's long-term liabilities) was within the authorised limit and operational boundary set by the treasury management strategy. The current borrowing position is prudent, and the Council will continue to consider the affordability of future borrowing.

## Budgetary process

**63.** The *Local Government in Scotland: Financial overview 2016/17* (November 2017) highlighted that the need for budgets and forecasts to reflect actual spending becomes increasingly important for councils with decreasing (or low levels) of usable reserves to rely on. We noted that the Council's budget and savings plan is aligned to the Council priorities as set out in its strategic plan This is consistent with good practice.

**64.** The Council used scenario planning to calculate estimated funding gaps for the five-year period as part of its 2018 -23 financial strategy. Three scenarios were used ranging from best to worse case, based on a limited number of key variables (Revenue Support Grant, pay and non-pay inflation) and different assumptions based on potential outcomes.

**65.** Since early 2018, the full council receives revenue and capital monitoring reports and provides detailed scrutiny of financial performance. From our review of these reports and attendance at council meetings we concluded that these reports provide an overall picture of the budget position at service level. The report includes forecast out-turn position for the year and good explanations for significant variances against budget. The reports allow both members and officers to carry out scrutiny of the Council's finances.

## Systems of internal control

**66.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the Council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**67.** Our findings were included in our management letter that was presented to the Audit and Governance Committee on 12 June 2018. We concluded that the key controls were appropriate and operating effectively for the key financial systems we reviewed. No significant control weaknesses were identified which could affect the Council's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

## Financial capacity

**68.** The Head of Council Resources is the Section 95 officer with responsibility for finance and information technology, is a member of the corporate management team and has direct access to the chief executive and Council members. We concluded that the Section 95 officer has appropriate status within the Council.

**69.** The finance team has remained stable in recent years and includes sufficient numbers of qualified and experienced staff. The Corporate Finance Manager, who is a senior and experienced member of the finance team, will be leaving the Council towards the end of 2018 and it is important that the Council puts adequate succession arrangements in place.

**70.** It is important that members continue to receive adequate training on how the Council works and how it is financed if they are to exercise their scrutiny responsibilities effectively. We reviewed the induction training and materials provided to new and existing members and concluded that it was fit for purpose.

# Part 3
## Financial sustainability

### Main judgements

**The Council and its group financial position is sustainable in the foreseeable future although rising demand, increasing costs of services and reductions to central funding will continue to place a strain on the Council’s capacity to deliver services at the current levels.**

**There is a five-year financial strategy that is aligned to the Council’s priorities and demonstrates how it will address future budget challenges.**

**The Council has made savings over the past few years however the scale of the savings required to address future funding gaps will be challenging for it to deliver.**

### Financial planning

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

**71.** It is important that long-term financial strategies (typically covering five to ten years) are in place which link spending to the Council's strategies. Although councillors approve a three-year budget, they only approve the council tax budget for a single year. This should be supported by indicative future spending plans (covering three years at least) that forecast the impact of relevant pressures on the Council.

**72.** The Accounts Commission recommended that when future Scottish Government funding is not known, councils should plan for a range of scenarios, so they are prepared for different levels of funding and income.

**73.** The Council has a five-year financial strategy in place covering the period 2018/19 to 2022/23, which includes funding gap projections for the five-year period based on scenario planning. Spending plans for the three-year period from 2018/19 to 2020/21 were approved as part of the 2018/19 annual budget process.

**74.** The Council used the funding gap projections within its financial strategy effectively to develop a package of savings, and additional income generating measures amounting to £12.5 million to enable it to set a balanced budget for the three-year period from 2018/19 to 2020/21. This was presented to members in February 2018.

**75.** The Council recognises that delivery of the £12.5 million budgeted efficiencies over the next three years and development of further measures to address future funding gaps will be a significant challenge and work is ongoing in this area. The projected funding gap figures within the five-year financial strategy are due to be updated as part of the 2019/20 budget process and this will assist the Council to identify the level of savings required going forward.

## Funding position

**76.** The Council approved its 2017/18 budget in February 2017. The budget was set at £233 million which included planned savings of £2.1 million and a transfer of £2.5 million from reserves to address the identified funding gap.

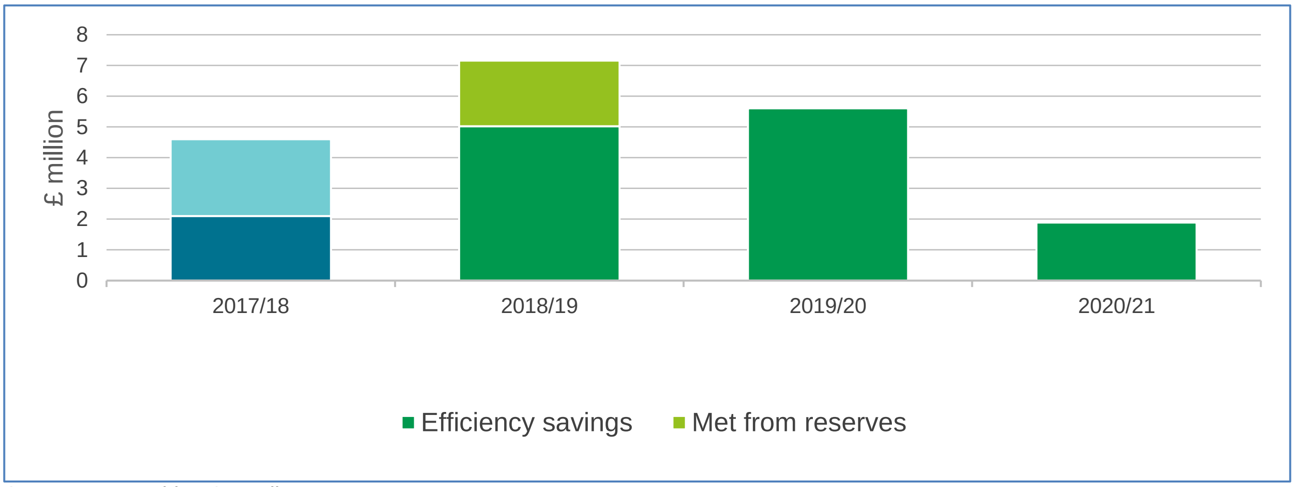
**77.** The Council is facing several challenges in maintaining a sustainable financial position in future. These include rising demands for services, increasing cost of services (pay and non-pay) and continued reductions in local government funding.

**78.** In December 2017, the council approved its first five-year financial strategy for 2018 to 2023. The strategy refers to the council's overarching aim of 'reducing inequalities within and across our communities' and the four themes of Growing our Economy, Growing our People, Growing our Communities and Growing our Capacity. The purpose of the strategy is to provide direction on how the council will manage its financial resources in order to deliver the Council Plan.

**79.** During the annual budget process, the council updated its projected funding gap assumptions for the three-year period from 2018/19 to 2020/21 and estimated that it faced a funding gap of £12.5 million for that period. The three-year budget approved in February 2018 included a package of measures to either reduce expenditure or increase income amounting to £12.5 million, enabling the council to set a balanced budget for the period from 2018/19 to 2020/21. The Council plans to bridge these gaps mostly by efficiency savings and the transfer of reserves from the general fund as illustrated in Exhibit 6.

## Exhibit 6

Identified funding gaps 2017/18 – 2020/21




Source: East Lothian Council

## New financial powers

**80.** Proposals have been made for changes to the Scottish Government's budget process, with these likely to be introduced for the 2019/20 budget. The Council considers Scottish Government budget issues within its annual Financial Prospects reports and when preparing its five-year financial strategy.

**81.** Overall, we concluded that the Council is facing a challenging situation in the short term. Rising costs, ending of the public sector pay cap combined with small increases in funding and dependency on efficiency savings will make it difficult to achieve financial balance.

**82.** The medium to longer term financial position is difficult to predict given the uncertainty around EU withdrawal and new financial powers and future funding settlements. The Council needs to consider and plan for these events and continue to develop its longer term financial plans based on scenario planning.

## Savings plans

**83.** As outlined above the Council achieved its efficiency savings target in 2017/18. The Council has identified that it needs to make efficiency savings of £12.5 million in the three-year period from 2018/19 to 2020/21 as part of its plans to maintain financial balance. To manage this effectively the Council needs to continue to prepare medium and long-term plans and closely monitor the delivery of its planned savings.

## Reserves

**84.** One of the key measures of the financial health of a local authority is the level of reserves held. The general fund is the largest usable reserve. This reserve is used to fund the delivery of services. It also provides a contingency fund to meet unexpected expenditure and a working balance to help cushion the impact of uneven cash flows.

**85.** The level of general fund reserves held by the Council decreased from £20.5 million in 2016/17 to £19 million in 2017/18 as illustrated in Exhibit 7.

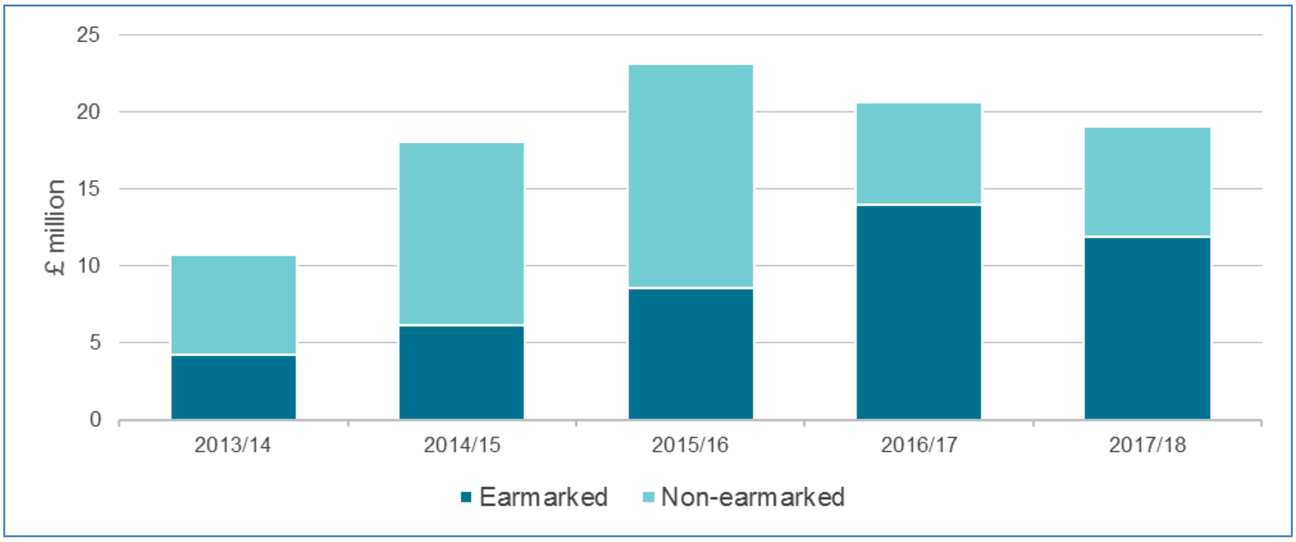
**86.** The Council was able to build up its general fund balance between 2013/14 and 2015/16. In the past two financial years it has made transfers from the general fund to help to balance its budgets. In 2017/18 it planned to use £2.5 million of reserves but actually only used £1.5 million therefore the year end position is slightly more favourable than planned. The Council plans to use a further £2.1 million of reserves to balance its budget in 2018/19 but no further use of reserves is planned in the following two financial years in line with the financial strategy.

**87.** The Council reviews the level of its uncommitted reserves when setting the budget each year. The 2018-23 financial strategy considers the level of reserves held in total and the amounts required for different purposes. It also recommends the need to establish a minimum level of uncommitted general fund reserve balances to help with any unforeseen or unquantifiable event. This level is to equate to 2 per cent of the council's annual running costs (about £4 million). The council currently meets this minimum at just under £4.3 million (taking into account the civil emergency fund and the general services capital fund).

**88.** Exhibit 7 provides an analysis of the general fund over the last five years split between earmarked and non-earmarked reserves. This shows a slight reduction in reserves in the past two years as reserves have been used to maintain financial balance however the level of reserves held is still in line with the Council's policy.

## Exhibit 7

Analysis of general fund over last five years




Source: End of year Financial Reviews (2014/15, 2015/16 and 2016/17) end of year reserves forecast 2017/18

## EU withdrawal

**89.** There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce - the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour.
- Funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports.
- Regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

**90.** The Council has flagged the economic uncertainty in relation to Brexit as a challenge within its current Council Plan as follows: East Lothian's economy will also feel the impact of the decision to leave the EU. Key sectors of East Lothian's economy – farming, food and drink and tourism – and Edinburgh's financial and Higher Education sectors, which employ a significant proportion of East Lothian's population, could be negatively impacted by 'Brexit' through loss of EU subsidies, changes in trade agreements and negative changes in currency values. Work is still ongoing to identify the potential impact of any changes at the Council. The Council should ensure it closely monitors developments and has plans in place to mitigate any emerging operational risks.

# Part 4

## Governance and transparency

### Main Judgements

**The Council has appropriate governance arrangements in place that support the scrutiny of decisions made by the Council.**

**The Council is open and transparent in the way it conducts its business and the public can attend meetings of the Council and its standing committees.**

### Governance arrangements

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.

**91.** We reviewed the Council's governance and accountability arrangements in 2017/18 as part of the annual audit planning and Best Value Audit Review. This included:

- confirming that the governance framework and governance arrangements, including decision-making and scrutiny, are regularly reviewed and updated to ensure they remain effective – we found these arrangements to be satisfactory.
- assessing the effectiveness of decision-making to ensure it is balanced by effective scrutiny and challenge by those independent of the body – we found sound processes in place surrounding decision making and effective scrutiny and challenge by Members during 2017/18.
- confirming that there is effective scrutiny and challenge in place over policy decisions, service performance, and programme management – we observed through committee attendance effective scrutiny and challenge however we did note that there is scope to improve the depth of challenge given.
- confirming that decision makers have the information they need to scrutinise, challenge and make transparent decisions – we found that decision makers were given appropriate information to make decisions.
- ensuring that it is clear what decisions have been made, who made them and the rationale supporting those decisions – we found that documentation over decisions and rationale was clear and available.

**92.** Overall we concluded that the Council's governance arrangements are appropriate and effective and support good governance and accountability.

### Transparency

**93.** Transparency means that the general public have access to understandable, relevant and timely information about how the Council is taking decisions and how it is using resources such as money, people and assets.

**94.** There is evidence from several sources which demonstrate the Council's commitment to transparency. Members of the public can attend meetings of the full Council, Cabinet, Audit and Risk Committee as well as other committees. Minutes of these committee meetings and supporting papers are readily available on the Council's website.

**95.** The Council's website allows the public to access a wide range of information including the register of members' interests, current consultations and surveys and how to make a complaint. In addition, the website provides details of the citizen's panel and how to join it. The panel provides information and feedback on services as well as information on the needs of local communities.

**96.** The Council makes its annual accounts available on its website. These include a management commentary which provides details of performance against budget, information on the use of reserves and risks and uncertainties facing the Council.

**97.** Overall, we concluded that the Council conducts its business in an open and transparent manner.

## Internal audit

**98.** The Council's internal audit function is carried out by an in-house provider. Each year we consider whether we can rely on internal audit work to avoid duplication of effort. When we plan to place reliance on internal audit work we carry out an assessment of the internal audit function to ensure that it is sufficient in terms of documentations standards, reporting procedures and quality, and is performed in accordance with Public Sector Internal Audit Standards (PSIAS)

**99.** We reviewed the Council's internal audit arrangements in accordance International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could rely on the work of internal audit. Overall, we concluded that we would place reliance on aspects of internal audit work in the following areas – council tax and non-domestic rates (IT access controls) – for our financial statements responsibilities. The internal audit programme of work for 2017/18 was completed in line with their plans.

**100.** A formal external quality assessment (EQA) of internal audit's compliance with the PSIAS is required at least once every five years. An EQA was undertaken in 2018 by the chief internal auditor at Argyll and Bute Council. The report provided high level assurance on internal audit's compliance with PSIAS, meaning the overall internal control, governance and the management of risk were of a high standard. There were eight recommendations made in the report (two medium and six low priority) to help further strengthen overall PSIAS compliance.

**101.** We have reviewed these recommendations and in line with our own observations at Audit and Governance Committee and our review of internal audit reports, that internal audit reports would be strengthened by:

- Having an overall audit opinion in the summary report provided to members - this will help focus members' attention and scrutiny to those areas where there are more significant issues noted.
- Summarising the area tested including the population, samples tested, instances of failure, impact and overall value – this additional information will add value to the covering report.

**Recommendation 4 (appendix 1, action plan ref. 2)**

**Internal audit should provide an audit opinion for each area it audits as well as providing some further summarised contextual information to enable more focussed scrutiny of the areas audited.**

## Management commentary, annual governance statement and remuneration report

**102.** The Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 requires councils to prepare and publish, 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. The management commentary should be fair, balanced and understandable and clearly address the longer-term financial sustainability of the body.

**103.** Based on our knowledge and work performed, we concluded that the management commentary, annual governance statement and remuneration report are consistent with the financial statements.

## National Fraud Initiative

**104.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

**105.** NFI activity is summarised in Exhibit 8. We undertook a review of the Council's NFI activity in February 2018 and concluded that it was satisfactory. At that time the council had completed 477 investigations out of a total of 578 recommended matches. The Council has now completed 494 investigations. Internal Audit intend to undertake further work on the remaining matches as part of their 2018/19 audit plan.

## Exhibit 8
NFI activity

| | | |
|---|---|---|
| **3152** | **578** | **494** |
| **Matches** | **Recommended for investigation** | **Completed/closed investigations** |

Source: NFI secure website: www.nfi.gov.uk

**106.** The results of the Council's NFI activity were reported to the Audit and Governance Committee in February 2018 by Internal Audit. They reported that, of the 477 investigations completed at that time, they found that:

- In 363 cases, no fraud or errors were identified;

- In 109 cases, errors were identified in respect of blue badges and residents parking permits and in each case appropriate action was taken by the Council's Transportation section to either cancel the permit/badge or to update the system with the correct information;

**107.** In the remaining 5 cases, overpayments of £52,515 were identified, the main ones being:

- £5,513 related to payments which the Council had continued to make to a residential home after the resident's death. This amount has now been recovered from the residential home.

- £35,023 related to 2 duplicate payments (£24,533.18 and £10,490.24) made to the same contractor. The contractor has acknowledged both overpayments and the Council is currently in the process of recovering these amounts.

- £11,808 relates to a duplicate payment made to a separate contractor. The service area is currently liaising with the contractor to ensure recovery of the overpayment.

## Standards of conduct for prevention and detection of fraud and error

**108.** The Council has a range of established procedures for preventing and detecting fraud and irregularity including a whistleblowing policy, anti-fraud strategy and codes of conduct for members and officers. We assessed these at the planning stage of our audit to ensure that they were appropriate, readily available to staff and are regularly reviewed to ensure they remain relevant and current.

**109.** We concluded that the Council has appropriate arrangements in place for the prevention and detection of bribery and corruption. We are not aware of any specific issues we require to bring to your attention.

## Cyber security

**110.** The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017 which requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate.

**111.** We reviewed the Council's arrangements to mitigate cybersecurity risks and confirmed that the Council complies with ISO27001 the International standard for Information Security (which sets out a risk-based approach to ensure the confidentiality, integrity and availability of Council held information & information systems).

## General Data Protection Regulation

**112.** The new General Data Protection Regulation (GDPR) came into force on 25 May 2018. This replaced the UK Data Protection Act 1998. As a Regulation, all EU member states must implement it in the same way. GDPR sets out further requirements than the DPA and has introduced new and significantly changed data protection concepts.

**113.** GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to comply with new GDPR data handling arrangements could result in the Council incurring significant fines.

**114.** The Council revised and updated its Data Protection Policy in June 2018 to comply with the new GDPR.

**115.** Information security, data protection and records management awareness training forms part of the Council's induction process. This now incorporates a mandatory GDPR module which is supplemented by paper and person-to-person training. Data Protection, GDPR and information security awareness training is mandatory for all employees and must be renewed every two years. The Council's Data Protection Officer has developed a GDPR toolkit including templates, guidance and information to support GDPR compliance.

**116.** Overall, we concluded that the Council has taken appropriate steps to comply with GDPR.

## Integration of health and social care

**117.** The Scottish Government's 2020 vision places greater emphasis on enabling people to stay in their homes, or another homely setting, where possible, sharing their lives with their family and friends and doing the things that give life meaning and value. The integration of health and social care is a mechanism to achieve this.

**118.** The East Lothian Integration Joint Board (IJB) is provided in partnership with NHS Lothian and was established on 27 July 2015. It assumed responsibility for the delegated health and social care services set out in its Integration Scheme from 1 April 2016. The financial transactions of the East Lothian IJB have been consolidated into the Council's group accounts and we have audited these with satisfactory results.

**119.** The IJB broke even in 2017/18 but only with the additional funding support from the partners, which included £611,000 from the Council. The Council has indicated that in the event of future IJB overspends further financial support is not guaranteed. We have included recommendations in our Annual Audit Report to the IJB that the IJB needs to continue to engage with its partners to ensure that the partners' planned efficiencies for 2018/19 are identified, monitored and achieved in order to break-even. Partners have stated that the provision of additional funds to cover future overspends is not a sustainable position.

## Local scrutiny plan

**120.** The 2018/19 Local Scrutiny Plan (LSP) prepared by the Local Area Network (LAN) of scrutiny partners for the Council was submitted on 23 April 2018. It was presented to the Full Council on 26 June 2018. The LAN and Strategic Risk Assessment did not identify any new scrutiny risks in the year which would require specific scrutiny work during 2018/19. The Council will be subject to a range of nationally driven scrutiny activity as set out in the LSP.

**121.** The Community Empowerment Act 2015 gave local communities new powers to take control of and manage community assets. The Council has taken steps to engage with local communities and this has been subject to review in the 2017/18 BVAR due to be published in October 2018.

## Equal pay

**122.** There remain some 27,000 equal pay claims across Scotland however East Lothian Council has no new / live claims in 2017/18 with the last settlement being in 2015/16. Workers could potentially still make new claims against councils. This means that councils need to be confident that they have fair and transparent pay arrangements and take necessary action, such as regular equal pay audits, to deliver pay equality in line with their public sector equality duty.

# Part 5
## Value for money

### Main judgements

**A best value audit was carried out during the year and will be formally reported to the Accounts Commission on 11 October 2018. A number of recommendations have been made and these will form part of our audit work in 2018/19.**

**It is important that there is alignment of objectives between the Council and Group components. We recommended that formal reporting and monitoring arrangements should be put in place for significant group components. This remains an area requiring further improvement.**

### Best value

**123.** Best value is assessed over the five-year audit appointment, as part of the annual audit work. A Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in this five-year period. The BVAR report for East Lothian Council will be discussed by the Accounts Commission on 11 October 2018 with intended publication on 30 October 2018.

**124.** The findings in the report and the Council's response will be followed up and reported on as part of the 2018/19 annual audit.

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

### Following the public pound

**125.** Local authorities have a statutory responsibility to comply with the Accounts Commission / COSLA Code of Guidance on funding external bodies and following the public pound.

**126.** The Council's financial regulations contain a specific section on following the public pound. These emphasise that services must adhere to the Council's guidance for allocating funds to external organisations. The guidance applies where funding is provided, or transferred, to arms-length bodies such as companies, trusts, voluntary and community-based organisations.

**127.** In our 2016/17 annual audit report we recommended that formal reporting and monitoring arrangements should be put in place for significant group components (e.g. Enjoy East Lothian Ltd. and Musselburgh Joint Racing Committee) to ensure the Council is complying with the duties set out in the Code of Guidance on Funding External Bodies and Following the Public Pound.

**128.** During 2017/18 we noted the following from attendance at the Audit and Governance committee with respect to those two subsidiaries:

- Enjoy East Lothian Ltd – an update was provided in November 2017 by the general manager summarising the objectives, activities of the business and its operations. The report was useful and provided necessary context for effective scrutiny. Members welcomed the report. A commitment to providing an annual report to the committee was made, as well as circulating the audited accounts once approved by the Enjoy East Lothian Ltd. Board. However, despite this commitment, there have been no further reports during 2017/18 to the committee.

- Musselburgh Racing Associated Committee (formerly Musselburgh Joint Racing Committee) – during the year a mix of verbal updates and one paper (June 2018) were provided to the committee on the status of the organisation and future direction of travel. However, we did note that the outcome of the governance review of the racecourse was presented as a private paper to the full council in February 2018. We have noted that the newly formed Musselburgh Racing Associated Committee working group papers are now publicly available on the Council's website with papers being available from June 2018 onwards.

**129.** This remains an area still requiring further improvement and we have reiterated the recommendation made in our 2016/17 annual audit report. There is still a lack of evidence of any routine performance monitoring / reporting to Council committee for significant group components in a timely fashion on an annual basis.

**Recommendation 5** **(appendix 1, action plan ref. 3)**

**Formal reporting and monitoring arrangements should be revisited, clarified and strengthened for the significant group components (e.g. Enjoy East Lothian Ltd. and Musselburgh Racing Associated Committee) to ensure the Council is complying with the duties set out in the Code of Guidance on Funding External Bodies and Following the Public Pound. This includes ensuring a report is brought to the Audit and Governance Committee at least once a year.**

## Governance arrangements for subsidiaries included in Group Accounts

**130.** In line with the Code of Practice on Local Authority Accounting, the following organisations are defined as subsidiaries within East Lothian Council for the purposes of preparing group accounts:

- Musselburgh Racing Associated Committee (formerly Musselburgh Joint Racing Committee) whose purpose is to organise and develop horse racing at Musselburgh Links.
- East Lothian Land Ltd. – set up to manage land to support economic development in East Lothian.
- Common Good Funds – used to further the common good of the residents of the areas of the former Burghs of Dunbar, Haddington, Musselburgh and North Berwick
- 46 Trust funds with various purposes and objectives.

**131.** We found the Council's annual Group Boundary assessment to be satisfactory and that the above bodies met the definition of a subsidiary and have been appropriately included in the group accounts.

**132.** During the course of 2016/17 issues relating to the governance of the racecourse were brought to our attention and we reported this in our 2016/17 annual audit report. During 2017/18 significant progress has been made in this area with a newly formed Musselburgh Racing Associated Committee working group (MRAC). The MRAC working group will consider and recommend the best operating model for the future of the racecourse.

**133.** In June 2018, the deputy chief executive submitted a report to the Member's Library outlining the MRAC working group's recommendation that a third party operate the racecourse. In July 2018 a further paper was presented by the MRAC working group noting that the preferred option is that the long-term operation of Musselburgh Racecourse should be carried out by a third party operator. The Council will now commence the procurement process to appoint a third party to operate the racecourse. The racecourse's license is valid until December 2018. We will continue to monitor progress in this area.

## Overview of performance targets

**134.** The Council participates in the *Local Government Benchmarking Framework* (LGBF). The framework aims to bring together a wide range of information about how all Scottish Councils perform in delivering better services to local communities, including the cost of services and how satisfied citizens are with them.

**135.** The most recent *National Benchmarking Overview Report 2016/17* by the Improvement Service was published in February 2018 and covered the 2016/17 reporting period. This report was submitted to the Policy and Performance Review Committee on 20 June 2018. Overall the Council performed well in comparison to other councils with the majority of indicators (56%) falling within the top two quartiles. The committee report highlighted some specific areas where the Council had performed well or improved, including the number of business gateway start-ups and costs of planning/ trading standards sickness absence days per employee (non-teacher). The report highlighted some areas for further investigation including sickness absence days per teacher, average time per planning application and percentage of secondary pupils in S4 achieving 5 or more awards at level 5.

**136.** The Policy and Performance Review Committee receives regular performance reports throughout the year and an annual performance report. These reports monitor progress against the Council's key priorities. The Council uses red/amber/green ratings to show which indicators are below, near or on target. Based on the most recent report submitted to the committee in June 2018 several positives were highlighted including:

- 24 indicators are rated green, 4 amber and 14 red
- Average number of days to rehousing has reduced by 34.6% in quarter 4 to 349 days.
- Homelessness assessments completed in under 28 days improved from 72% in Q3 to 83% in Q4.
- Number of delayed discharge patients waiting more than 2 weeks has decreased in Q4 from 13 to 8

**137.** At the same time the Council recognises that it should improve service delivery in areas such as contact centre call response times. Performance will continue to be reviewed by the Policy and Performance Review Committee to assess progress.

## Statutory performance indicators (SPIs)

**138.** The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report this information but expects them to provide the public with fair, balanced and engaging performance information.

**139.** For 2017/18 two SPIs were prescribed:

- SPI 1: covering a range of information relating to areas of performance such as improving local public services, improving local outcomes, engaging with communities and achieving best value
- SPI 2: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

**140.** The Council's performance in relation to SPI 1 has been covered as part of our best value assurance report due to be presented to the Accounts Commission on 11 October. For SPI 2, we placed reliance on the work of internal audit and we have also commented on this in paragraphs 134-137. Overall we found this to be satisfactory.

## National performance audit reports

**141.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2017/18 Audit Scotland published a number of reports were issued which are of direct interest to the Council. These are outlined in Appendix 4.

**142.** We found from attendance and observation at Full Council meetings as well as the Audit and Governance committee that the Council's arrangements for considering national reports is appropriate. A covering paper is prepared by the appropriate officer summarising the national report providing important contextual background for the Council to be aware of. The covering paper sets out the actions/recommendations for the Committee to take as result of the report. Normally these refer the officers and members to consider the recommendations in the national report.

**143.** The covering paper for the latest national report presented to the Audit and Governance Committee on 12 June 2018 *Local Government in Scotland: Challenges and Performance 2018,* recommended that the Committee should use the recommendations in the Accounts Commission report and the questions it poses for elected members to identify any further information or scrutiny activity it would wish to have reported back to future meetings of the Audit and Governance committee.

# Appendix 1

## Action plan 2017/18

### 2017/18 recommendations for improvement

| No. | Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|---|
| **Recommendations brought forward from 2016/17 still requiring action** | | | |
| **b/f 1** | **Dr Bruce Fund**<br>The trust's accounts were not advertised in line with the requirements under Regulation 9 of the Local Authority Accounts (Scotland) Regulations 2014 issued under section 105 of the 1973 Act.<br>The unaudited accounts were not signed on behalf of the trustees.<br>**Risk**<br>There is a risk of non-compliance with statute/legislation. | The unaudited accounts should be advertised in line with the Regulations.<br>The unaudited accounts should be signed on behalf of the trustees prior to submitting for audit.<br>Paragraph 21 | Agreed - formal arrangements have now been put in place to ensure that advertising and signing is incorporated within the Council's planning timelines for 2018/19<br>Service Manager – Business Finance<br>June 2019 |
| **b/f 2** | **Dr Bruce Fund**<br>The Dr Bruce Fund was set up to provide relief for the poor of Musselburgh. One of the risks identified for managing this is the financial demands placed on those funds. In 2016/17 there was a net movement in funds of £6,800, of which £3,291 was income received. In the same period only £50 was disbursed.<br>**Risk**<br>The fund may not be operating the way in which it was intended i.e. providing relief for the poor of Musselburgh. | The Council should review the method(s) used to promote this (and other) charitable trusts to ensure that the potential availability of these funds are known to the wider community.<br>Paragraph 20 | A project group has been established to review the Trusts and Common Good Funds, and this will be considered as part of that review.<br>Service Manager – Licensing & Democratic Services & Service Manager – Business Finance<br>June 2019 |
| **b/f 3** | **Trust Funds**<br>Of the 46 trusts being administered by the Council, only 16 were actively used, i.e. incurred expenditure or earned income, in 2016/17. | The Council should ensure that the trusts it administers are promoted more widely amongst the public, and the trust objectives clarified legally to help facilitate their use. An exercise should also | A project group has been established to review the Trusts and Common Good Funds, and this will be considered as part of that review. |

| No. | Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|---|
| | **Risk**<br>There is a risk that trust funds held could become dormant due to lack of use and lack of wider knowledge in the community as to their existence. | be undertaken by the Council to consider whether any trusts could be consolidated.<br>Paragraph 20 | Service Manager – Licensing & Democratic Services & Service Manager – Business Finance<br>June 2019 |
| **2017/18 recommendations** | | | |
| 1 | **Group accounts**<br>The 2017/18 group accounts were prepared using the unaudited accounts of the subsidiaries and associates. Audited accounts have recently been received for two of the six group components. Audited accounts have not yet been received for the remaining group entities (Lothian Valuation Joint Board, Enjoy East Lothian Limited, Musselburgh Joint Racing Committee and Brunton Theatre Trust) until recently.<br>**Risk**<br>There is a risk that the group accounts are not up to date and based on complete and audited information. Further delays could impact on the statutory deadline for the Council's accounts. | The Council needs to work with the various subsidiaries and associates to plan and agree a suitable timetable for receipt of audited accounts for the group components.<br>Paragraphs 24 -26 | All Group components were made aware of the appropriate timelines for submission of group accounts, and all signed audited accounts have been incorporated within the final signed accounts. We will continue to work with Group components during the planning for 2018/19 to ensure that audited accounts are available within appropriate timescales.<br>Service Manager – Business Finance<br>Implemented for 2018/19 accounts |
| 2 | **Internal audit**<br>From observation and attendance at Audit and Governance committees internal audit reports would be strengthened by having an overall audit opinion and, a high level summary of key information in the summary reports provided to members.<br>**Risk**<br>There is a risk that unnecessary time is spent focussing on every report instead of ones that have the most impact or those requiring more significant actions to be addressed by officers. | Internal audit should provide an audit opinion for each area it audits as well as providing some further summarised contextual information to enable more focussed scrutiny of the areas audited.<br>Paragraph 101 | The External Quality Assessment report issued in May 2018 recommended that an overall audit opinion should be provided in the final audit report - this has been implemented.<br>Internal Audit Manager<br>Date – in place |

| No. | Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|---|
| 3 | **Following the public pound**<br>There have been limited reports presented to the Audit and Governance Committee during 2017/18 (as well as 2016/17) for significant group components and we cannot find evidence of any routine performance monitoring/ reporting to the Council committees in this area. | Formal reporting and monitoring arrangements should be revisited, clarified and strengthened for significant group components (e.g. Enjoy East Lothian Ltd. and Musselburgh Racing Associated Committee) to ensure the Council is complying with the duties set out in the Code of Guidance on Funding External Bodies and Following the Public Pound.<br>A report should be provided to the Audit and Governance committee at least once a year to update member on these significant group components.<br>Paragraphs 128-129 | Work has progressed during 2017/18 to incorporate more formal reporting arrangements for Group entities, and this requirement will continue to be embedded in future A&G Committee workplan<br>Head of Council Resources<br>During 2018/19 financial year |

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual accounts and those relating our wider responsibility under the *Code of Audit Practice 2016*.

| | Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|---|
| | **Risks of material misstatement in the financial statements** | | |
| 1 | **Management override of controls (example)**<br>ISA 240 requires that audit work is planned to consider the risk of fraud which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements. | Detailed testing of journal entries.<br>Review of accounting estimates.<br>Focused testing of accruals and prepayments.<br>Evaluation of<br>significant transactions that are outside the normal course of business. | Satisfactory – we found no evidence of management override of controls during our normal audit procedures. |
| 2 | **Risk of fraud over income**<br>ELC receives a significant amount of income in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA 240, there is an inherent risk of fraud. | Analytical procedures on income streams.<br>Detailed testing of revenue transactions focusing on the areas of greatest risk. | Satisfactory – we found no evidence of this during our normal audit procedures. |
| 3 | **Risk of fraud over expenditure**<br>Most public sector bodies are net expenditure bodies and therefore the risk of fraud is more likely to occur in expenditure. | Reviews work on the National Fraud Initiative matches.<br>Assess high level key controls in areas of significant expenditure.<br>Focused substantive testing of expenditure and housing benefit transactions. | Satisfactory – we found no evidence of fraud during our audit work. |
| 4 | **Estimation and judgements**<br>There is a significant degree of subjectivity in the measurement and valuation of the material account areas such as non-current assets and provisions. This subjectivity represents an | Completion of 'review of the work of an expert' in accordance with ISA 500 for the professional valuer.<br>Focused substantive testing of asset valuations and asset useful lives. | Satisfactory – we found the estimates and judgements (where applied) where appropriate. |

| | Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|---|
| | increased risk of misstatement in the financial statements. | Focused substantive testing of provisions. | |
| 5 | **Rent arrears**<br><br>The Council's risk register (at November 2017) includes a high residual risk in relation to Welfare Reform and the rollout of Universal Credit (UC). It notes that rent arrears for UC claimants are increasing with 82% of ELC tenants claiming UC now in arrears.<br><br>There is a risk that debtors could be overstated if the provision for doubtful debts is not adequate in light of rising rent arrears. There is an increased risk to the overall delivery of services in line with the Council's strategic objectives. | Monitor rent arrears levels and provision for doubtful debts. | Satisfactory – Housing rent debtors and bad debt provision have both increased by less than 1% compared to the previous year. |
| **Risks identified from the auditor's wider responsibility under the Code of Audit Practice** | | | |
| 5 | **Financial sustainability**<br><br>ELC's 2018-19 to 2022-23 Financial Strategy recognises that it faces significant financial challenges resulting from the expected reduction in grant funding and a rapidly expanding population.<br><br>Current approved spending plans require the delivery of over £9 million of additional efficiencies between 2017-18 and 2019-20.<br><br>The total estimated level of revenue savings required over the next 5 years in addition to the current planned savings has been calculated based on a number of different scenarios and ranges from £12.4 million to £39 million.<br><br>The Council recognises that the scale of the further savings required over the coming years presents a significant challenge. | Review the Council's change / transformation plans as part of the Best Value Audit Review.<br><br>Assessing the robustness of the Council's transformation plans and other items supporting longer term plans. | Delivering the transformation programme will be challenging alongside increasing demands on services from a growing population. The council should ensure it reviews its transformation programme to ensure it can deliver any changes within the timescale and prioritise the projects that are most likely to result in major change and opportunities for savings. Audit Scotland will continue to monitor the delivery of this programme in future years. |
| 6 | **Financial management**<br><br>The Quarter 2 financial report for 2017/18 identifies two services areas (Adult Wellbeing and Children's Wellbeing) as | Review of financial monitoring reports and the Council's financial position. | The end of year financial review reported that Adult Wellbeing and Children's Wellbeing both overspent against budget for 2017/18 however this was offset |

| | Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|---|
| | high risk of not operating within approved budgets. Both service areas had difficulty operating within budget and required additional funding in the last financial year.<br><br>There is a risk that the Council will not achieve a balanced year end position and also of future budget overspends if a sustainable budget is not developed timeously. | | by underspends in other services and additional income and overall the Council reported a small underspend. Audit Scotland will continue to monitor the Council's financial position in future years. |
| 7 | **Following the Public Pound**<br><br>In our 2016/17 Annual Audit Report, we reported that no reports were presented to the Audit and Governance Committee during 2016/17 regarding Enjoy East Lothian Ltd. or the other significant Group components and we could not find evidence of any routine performance monitoring / reporting to Council committees in this area. Formal reporting and monitoring arrangements should be put in place for significant Group components.<br><br>There remains a risk that the Council is not complying with the duties set out in the Code of Guidance on Funding External Bodies and Following the Public Pound ensuring they are holding the various group components to account. | Attendance / observation of relevant Committee(s).<br><br>Review of arrangements put in place by the Council in response to 2016/17 recommendation. | Limited progress - Reports were presented to the Audit and Governance committee on Enjoy East Lothian Ltd. (November 2017) East Lothian Land Limited (February 2018) and East Lothian Investments Limited (June 2018). An update report on Musselburgh Racecourse was also presented in June 2018.<br><br>This remains an area requiring further improvement and we have brought forward the recommendation made in our 2016/17 annual audit report.<br><br>Audit Scotland will continue to monitor the Council's reporting to elected members in relation to group components. |

# Appendix 3

## Summary of uncorrected misstatements

**We report all uncorrected misstatements that are individually greater than our reporting threshold of £38,000.**

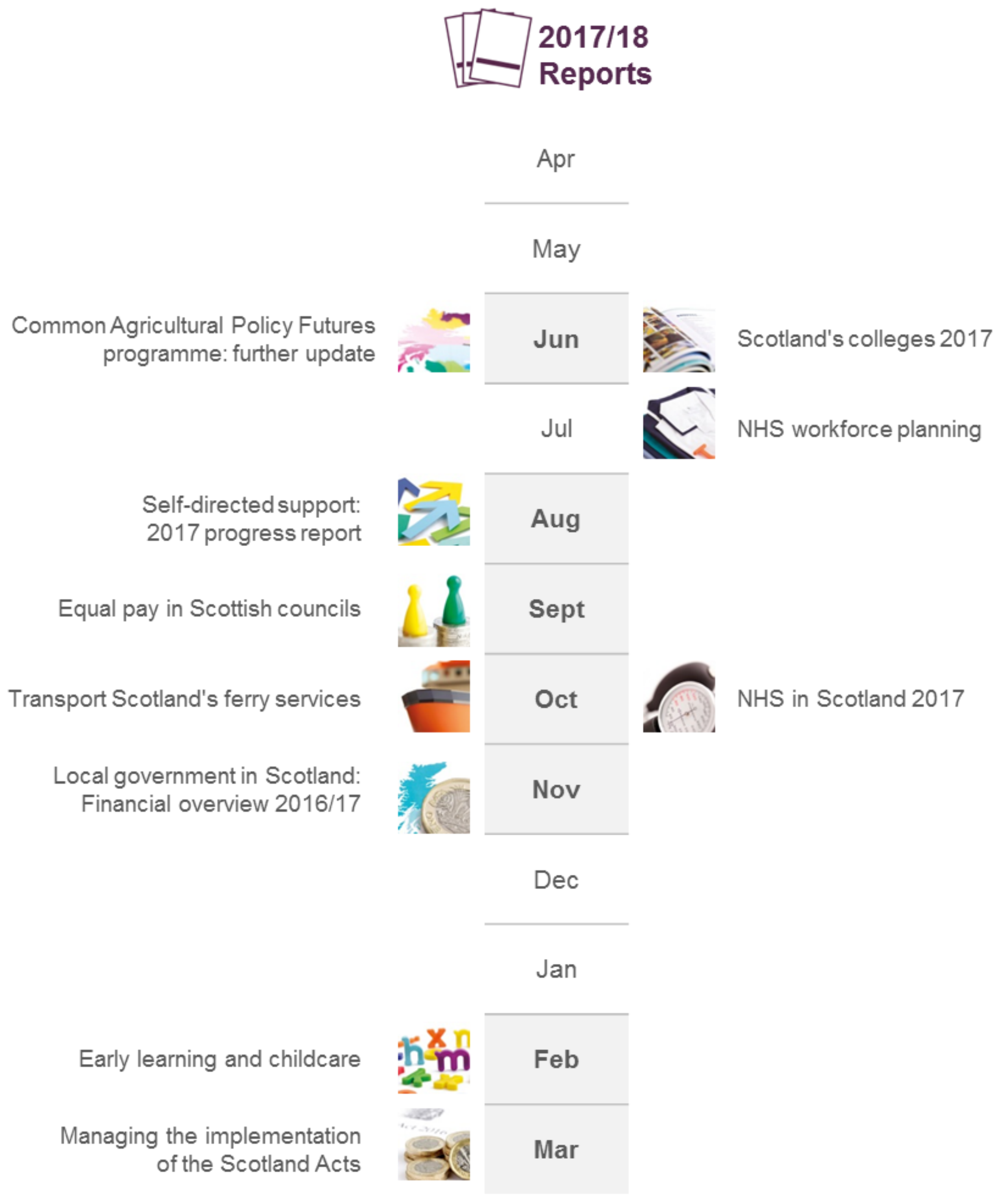
The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in Exhibit 3. We are satisfied that these errors do not have a material impact on the financial statements.

| No. | Account areas | Comprehensive income and expenditure statement | | Balance sheet | | Movement in Reserves Statement |
|---|---|---|---|---|---|---|
| | | Dr £000 | Cr £000 | Dr £000 | Cr £000 | |
| **1** | Over-accrual of capital invoice | | | 69 | 69 | |
| **Net impact** | | | | **69** | **69** | |

Notes:
Entry 1 relates an over-accrual of a capital invoice which led to non current asset additions and creditors being overstated

# Appendix 4

## Summary of national performance reports 2017/18




### Local government relevant reports

*Principles for a digital future* – May 2017

*Self-directed support: 2017 progress report* – August 2017

*Equal pay in Scottish councils* – September 2017

*Local government in Scotland: Financial overview 2016/17* – November 2017

# East Lothian Council

## 2017/18 Annual Audit Report

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