East Lothian Council

Annual audit report to the Members of East Lothian Council and the Controller of Audit

Audit: year ended 31 March 2014

14 October 2014

Contents

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

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

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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Headlines

This annual audit report summarises our findings in relation to the audit for the year ended 31 March 2014. Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ('the Code').

This report also sets out those matters specified by ISA (UK and Ireland) 260: *Communication with those charged with governance* in relation to the financial statements for the year ended 31 March 2014.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Council staff during the course of our work.

Area	Summary observations	Analysis
Strategic overview and use of resources		
Key issues and challenges	There are a number of service challenges emerging, with demand and resource pressures growing against a backdrop of reform in public services. Management undertake regular analysis of the key areas of public reform, which should support achievement of strategic priorities in a changing environment.	Pages 6-7
Financial position	The Council recorded a statutory deficit of £3.6 million in 2013-14 (2012-13: £2.5 million), £2.6 million lower than the budgeted statutory deficit. This gave rise to a decrease in the general fund reserves of £2.7 million and housing revenue account and capital fund reserves of £0.9 million. Of this decrease, £3.6 million related to the utilisation of the cost reduction fund, primarily to cover the in year costs of the voluntary early release scheme ("VERS"). There was a £0.6 million increase in general service funds, including earmarked reserves. £2.9 million of remaining non-earmarked general fund reserves was allocated to the general services capital fund, which will be used to directly fund future capital expenditure to reduce the need for further borrowing. The capital underspend has led to lower than budgeted borrowing requirement and consequently a reduced interest cost than budgeted. Short term borrowing has significantly increased (£20 million) in contrast to the smaller increase in long term borrowing (£4.8 million). The key driver is in respect of taking advantage of competitive interest rates on short term borrowing; decreasing the short term interest costs.	Pages 8 – 11
Financial planning	The 2014-15 budget forecasts a breakeven position, after a further £0.2 million utilisation of reserves. The Council is planning to utilise most usable un-earmarked general reserves by 31 March 2016. In 2016-17 the Council is budgeting a break-even position.	Pages 12-13
Financial statements and accounting		
Audit conclusions	We have issued unqualified audit opinions on the 2013-14 financial statements, following their approval in September 2014. An emphasis of matter paragraph is included in our audit opinion with respect to the facilities management significant trading operation not meeting the statutory requirement to break even on a three year rolling basis. The financial statements, foreword, governance statement and remuneration report were received by the start of audit fieldwork. There are opportunities for further improvement in the financial statement process to achieve sector leading practice.	Pages 15, 23
Significant risks and audit focus areas	We have considered inherent significant risks that the ISAs would require us to raise with you covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas. Other significant risks and other areas of audit focus have been considered and satisfactorily concluded.	Pages 16 - 21
Accounting policies	There are no substantial changes in accounting policies compared to the prior year. The Council applied IAS 19 (revised) and we concur with the decision to not restate prior year comparatives, due to the immaterial nature of the adjustment. No newly effective accounting standards are expected to have a material impact on next year's financial statements. The financial statements have been appropriately prepared on a going concern basis.	Page 22

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Headlines (cont.)

Governance and narrative reporting		
Governance arrangements	Over-arching and supporting corporate governance arrangements provide a sound framework for organisational decision-making. Risk management practices have been considered throughout the year, and the whistle blowing policy updated. Weaknesses were noted in the remuneration report and in procurement procedures.	Pages 25 – 29
Control observations	Our testing of the design and operation of financial controls over significant risk points confirms that generally controls relating to financial systems and procedures are designed appropriately and operating effectively. In our interim management report we noted opportunities for management to further strengthen the control environment in relation to council wide policies, bank reconciliations and journals. We have identified eight recommendations in the action plan in this report at appendix five. These relate to accounts preparation, accounting for property, plant and equipment, provisions and bank accounts.	Page 29
Performance management arrangements		
Performance management	The Council has developed Best Value and performance management arrangements further during the year and demonstrates commitment to continuous improvement. The Council monitors statutory performance indicators throughout the year and completes the Local Government Benchmarking Framework exercise. The Accounts Commission report on public performance reporting highlighted many areas of good practice and management are considering the identified areas for improvement, particularly in respect of procurement.	Pages 31 – 33
National reports	In response to the Audit Scotland national study *Health Inequalities in Scotland*, the East Lothian Partnership is developing a health inequalities strategy. Audit Scotland's *Major Capital Investment in Councils* and *Arms Length External Organisations: Are you getting it right?* reports have been considered by the audit and governance committee. Good progress has been made against the action plan for capital investment, however no action plan was prepared in response to the latter report.	Page 32

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Scope and responsibilities

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit of the Council's financial statements for 2013-14. It is addressed to both those charged with governance at the Council and the Controller of Audit. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit and governance committee at the outset of our audit.

The context of our audit is one of an overall reduced level of risk, based on the shared risk assessment of the Council's arrangements.

Responsibilities

Audit Scotland's Code of Audit Practice ('the Code') sets out the Council's responsibilities in respect of preparation of financial statements, systems of internal control, prevention and detection of fraud and irregularities, standards of conduct and arrangements for the prevention and detection of bribery and corruption, financial position and Best Value.

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements, but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified are only those which have come to our attention during our audit work in accordance with the Code, and may not be all that exist. Communication of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised or to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 Communication with those charged with governance, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the audit committee, together with previous reports to that committee during the year, discharges the requirements of ISA 260.

Context of the audit

The Scottish Government's response to the Crerar report in 2007 was to simplify the approach to delivering local government scrutiny. As a result, scrutiny bodies that engage with local government established a shared assessment of the risks in each Council and developed a range of proportionate approaches in response to the risk assessment. A local area network ('LAN') of local audit and inspection representatives undertake a shared risk assessment for each local authority in Scotland, to identify targeted, risk-based scrutiny. Following a review of the shared risk assessment process in 2013, there has been a shift in focus to identifying the Council's position in implementing the Scottish Government's reform agenda.

This results in each council receiving an annual Assurance and Improvement Plan ('AIP'). During 2013-14, a refresh of the Council's AIP for the period 2014-17 was undertaken, which was subsequently published in June 2014. The change in focus from the review of the shared risk assessment process is reflected in the structure of the AIP.

The Council's AIP reported that there continued to be areas of strong performance and a number of improvement activities continue to make good progress. Inspection and audit work during 2013-14, including a joint inspection of services for children and young people in the East Lothian Community Planning Partnership area, resulted in broadly positive reports.

No areas were assessed as 'scrutiny required', one area as 'further information required' and the remaining 18 as 'no scrutiny required'. There is further activity planned as a follow up to the Children's Services inspection and a Scottish Housing Regulator performance inquiry on rent arrears management. This is an improvement on the 2013-16 AIP when two areas were identified as 'scrutiny required', 15 as 'further information required' and the remaining 21 as 'no scrutiny required', albeit there was a different focus and different areas assessed in the 2013-16 AIP.

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Strategic overview and use of resources

Our perspective on the Council’s approach to key issues affecting the local government sector, and its use of resources

Key issues

There are a number of service challenges emerging, with demand and resource pressures continuing to build, against a backdrop of reform in public services.

Management undertake regular analysis of the key areas of public reform, which should support achievement of strategic priorities in a changing environment.

Sector overview

Audit Scotland's report "An overview of local government in Scotland 2014" highlighted the challenges of reducing budgets and increasing demands. This is coupled with further expected budget reductions, the public's expectation of service delivery and demographics becoming more biased towards older people, who typically need more public services.

In previous years management prepared an analysis of the contents of the report, considering the Council's position against each report recommendation. This process was considered an example of best practice and completing the exercise for the 2014 report will allow management to identify opportunities for continuous improvement.

Quarterly reports to Cabinet or Council outline the financial position, forecast position and a financial risk assessment of the overall Council and individual departments. An underlying surplus on the general fund was achieved in 2013-14, excluding the costs of the voluntary early release scheme. Additional reserves have been earmarked to a general services capital fund to support the capital plan and alleviate the need for further additional borrowing. Continued monitoring against the financial strategy and planned use of reserves is needed to support achievement of financial sustainability.

Management undertakes regular analysis of the key areas of public reform, which should support achievement of strategic priorities in a changing environment.

A new Single Outcome Agreement ('SOA') has been developed by the Council and related partners. The SOA is an agreement between the East Lothian Partnership and the Scottish Government, setting out how each party will work to improve outcomes and reduce inequalities for East Lothian residents.

Integration of health and social care

In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Government. This requires all Councils and NHS Boards to formally and legally establish integration of health and social care by April 2016. Detailed legislation and broader statutory guidance is being devised. Two sets of regulations have been released for consultation and management are writing responses.

The Council has agreed that in conjunction with NHS Lothian, the body corporate model should be adopted and the scheme of integration should be based on this model. A shadow board has been formed and has been meeting during the year. A jointly accountable officer took up post on 1 August 2013, working in adult wellbeing services with responsibility for NHS services in East Lothian. This position is jointly accountable to the chief executive of the Council and Lothian NHS Board. Management feels reasonably well placed to implement the changes but recognise the challenge of developing the integration plan.

Welfare reform

As a result of the Welfare Reform Act 2012, a number of significant changes were implemented on 1 April 2013, changing how councils deliver benefit services. Further reform will see the introduction of 'Universal credits', which is an integrated working age benefit which will replace existing benefits, including housing benefit. Universal credits will be administered by the Department of Work and Pensions ("DWP").

The Council's welfare reform task group continues to consider the service implications. An action plan has been produced and a reference group, which meets quarterly, has facilitated liaison between council services, partners and stakeholders.

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Key issues (cont.)

The Scottish Government's council tax reduction scheme came into force from 1 April 2013. There is little or no change financially to recipients and therefore this has had a low financial impact on the Council. Funding will remain the same in 2014-15, however there is greater financial risk due to the an increase in the number of properties in the Council boundaries as the funding is a fixed sum instead of being demand led.

The housing benefit under occupancy supplement was introduced on 1 April 2013, although mitigated by the payment of discretionary housing payments. The welfare cap was implemented from 15 July 2013, with the Council identifying that 18 households were affected. Continued monitoring of the welfare reform changes will ensure that the council is able to respond in an agile manner and ensure it continues to support its most vulnerable constituents.

The benefits team have been administering the two year interim Scottish welfare fund since 1 April 2013 which covers crisis grants and community care grants. The government has confirmed this will become a permanent scheme from April 2015. The Council achieved 100% disbursement of its share of the Scottish welfare fund, and will receive the same budget in 2014-15. The additional work involved has led to a 26% rise in caseload. Management are developing a Scottish welfare fund policy to support administration of the fund within an East Lothian context.

Workforce planning

A voluntary early release scheme was approved by Cabinet on 12 March 2013. 96 members of staff were approved on the basis that their departure would not adversely impact upon services and that they satisfied certain financial criteria. Of these, 94 left the Council in 2013-14 and the remaining two had left by August 2014.

Management analysis in May 2014 identified savings of £2.9 million has been secured against a £3 million budget. Further savings of £1.5 million have been secured from the ongoing workforce management plan secured from the ongoing workforce management plan against a budget of £1.8 million, which relate to the outcomes of service reviews and tighter management of casual workers, overtime and agency workers.

Management recognises that it is not yet possible to fully assess the impact on service delivery, although feedback has indicated that workloads remain challenging, coupled with an inherent loss of tacit knowledge. A staff engagement survey was undertaken in March 2014; management is analysing the results of this process, with initial results indicating the level of participation and positive engagement remaining consistent with previous surveys. The results have also been fed into the How Good Is Our Council ('HGIOC') process to identify areas of concern and inform the development of improvement plans. In September, the Council received confirmation that it had achieved Investors in People accreditation.

Efficiency savings and change projects

To ensure the Council is best placed to mitigate the changing service requirements and reducing funding a number of change projects have been implemented.

Each change project is listed within the Rivo software and assigned to a department and responsible officer. Alongside this information the start and expected completion date are documented. Reminders are sent to the responsible officer on a quarterly basis to ensure progress is noted. Quarterly progress reports will then be produced with RAG ratings against each projects likely achievement of the expected completion date.

The 2014 – 2017 budget requires efficiency savings to be achieved to deliver a balanced budget. Each efficiency saving has also been assigned to a responsible officer in Rivo detailing the expected efficiency saving or increased income. Achievement of these savings will be monitored through quarterly reports to the chief executive. Internal audit are facilitating the implementation and monitoring of the reports.

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Financial position

The Council recorded a statutory deficit of £3.6 million in 2013-14 (2012-13: £2.5 million), including £3.6 million in respect of VERS from the cost reduction fund.

The budgeted use of reserves was £5.2 million, including £3 million in respect of the cost reduction fund.

Financial position

The Council recorded a statutory deficit of £3.6 million in 2012-13 (2012-13: £2.5 million). This resulted in a decrease in the general fund and insurance fund reserves of £2.7 million and in the housing revenue account and capital fund reserves of £0.9 million.

Use of reserves – general fund

A three-year budget was approved on 12 February 2013, which assumed a £5.2 million utilisation of reserves in 2013-14. Management's forecast, prepared in quarter three, projected a reduced utilisation of £4.9 million. The final outturn utilisation was £3 million (2012-13: £1.4 million), representing 25% of opening useable reserves (2012-13: 11%). In line with the Council's financial strategy, the lower than budgeted utilisation has been earmarked in a new general services capital fund within the general fund.

The key changes in the general fund against budget are illustrated in the table below.

£m	Budgeted utilisation of reserves	Actual utilisation of reserves
General fund[(a)]	2.2	(0.6)
Cost reduction fund	3.0	3.6
Total	**5.2**	**3.0**

Note: (a) Includes actual utilisation £0.2 million of earmarked reserves; excludes insurance fund.
Source: East Lothian Council.

£2.9 million of remaining non-earmarked general fund reserves has been allocated to the general services capital fund which will be used to directly fund future capital expenditure to reduce the need for further borrowing.

The cost of VERS is accounted within the utilisation of the cost reduction fund. The outturn of each budget against utilisation of reserves is reconciled in the table below.

General fund budget	£m
Budgeted use of reserves	**2.2**
Resources and people services	(0.8)
Health and adult care partnership	0.5
Partnerships and services for communities	(2.5)
Actual utilisation of reserves	**(0.6)**

The key variance to budget within resources and people services relates to the receipt of windfall income relating to the PPP contract of £0.7 million in the secondary school budget. Within partnerships and services for communities the key budget movements are:

- underspends within the community housing group and surpluses produced by the property services trading activity; and
- underspends in landscape and countryside management (£0.8 million) due to non-recruitment to vacant posts.

As in previous years there is an underspend against budget, and there is an inherent risk that this could impact on service delivery. Management monitors the budget throughout the year, although as identified in previous years, the majority of underspend is presented in the final quarter of the financial year.

Management presented the salient features of the financial statements to the audit and governance committee in July 2014. This facilitated an early discussion by members of the financial position reflected within the unaudited financial statements. We consider this to be an example of good practice in the governance of council resources.

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Financial position (cont.)

The outturn on the housing revenue account is a deficit of £1.9 million. Following adjustments between the accounting basis and funding basis and transfers between reserves, the decrease in the year was £0.1 million.

Housing revenue account ('HRA')

The outturn on the HRA is a deficit of £1.9 million. After making adjustments between the accounting basis and funding basis under statute (credit of £2.9 million) and recognising a transfer from the capital fund (£1.1 million), netted against a transfer (£1 million) to the general fund, the decrease in the year was £0.1 million. The carry forward balance at 31 March 2014 is £2 million. The use of reserve including the housing capital fund in 2013-14 is £0.9 million, against a budget of £0.9 million.

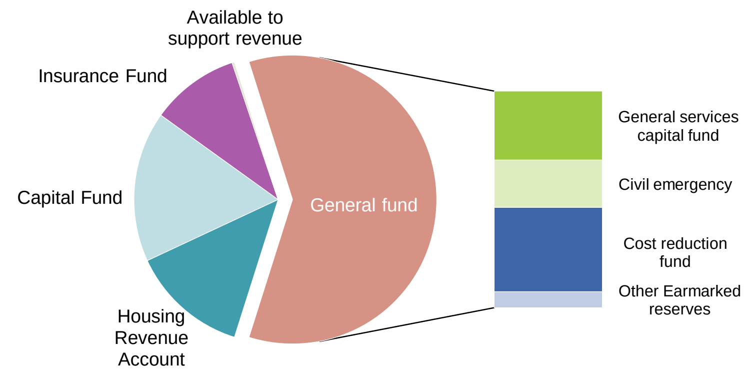
Rental income was below budget, reflecting delayed delivery of affordable homes. Repair costs were £0.4 million more than budgeted, of which half relates to costs for repairing fire damage. Further repair costs were in relation to bringing some of the open market acquisition and mortgage to rent properties to the appropriate standard.

These costs are net against compensating variations in the budget including debt charges being £1.2 million under budget.

Composition of reserves

As at 31 March 2014, the Council had usable reserves of £15.3 million. These consisted of the general fund (£9.2 million), the housing revenue account (£2 million), the housing capital fund (£2.6 million) and the insurance fund (£1.5 million). The housing capital fund is used to fund capital expenditure within the housing revenue account. The funds are illustrated in the diagram opposite.

In benchmarking undertaken by Audit Scotland from analysis of the 2013-14 unaudited financial statements of Scotland's 32 local authorities, the Council's decrease in usable reserves is the tenth highest, clearly impacted by utilisation of the cost reduction fund. More than half of all councils utilised usable reserves in 2013-14.



Source: East Lothian Council

The Council has the third lowest amount of usable revenue reserves as a percentage of net revenue stream plus dwelling rents (2012-13: fifth lowest). Regular financial monitoring performed by management, against budgets which include limited utilisation of reserves, will continue to improve the financial position.

HRA dwelling rents per council dwelling is the second lowest in Scotland, indicating that rental charges for residents continue to be lower than the majority of Councils. The Council had the highest level of gross rent arrears as a proportion of dwelling rents in Scotland. We have considered the overall profile of Council debtor balances and related provisions at page 21.

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Financial position (cont.)

Total capital expenditure in 2013-14 was £45.6 million, below the approved capital plan of £58 million. This level of capital investment represented a 13% decrease over 2012-13 levels and reflects the lower limits approved in October 2012.

Capital programme

Total capital expenditure in 2013-14 was £45.6 million, below the original revised capital plan of £58 million. This level of capital investment represented a 13% (£6.6 million) decrease from 2012-13. The table below provides analysis across general services and the housing revenue account, comparing actual capital expenditure to budget and the prior year.

£m	Total	HRA	General services
2013-14 budget	58.0	25.6	32.4
2013-14 actual spend	45.6	20.8	24.8
(Under)/overspend	**(12.4)**	**(4.8)**	**(7.6)**
Financed by			
Grant	12.5		
Asset sales	1.6		
Other receipts	3.6		
Borrowing	27.9		
Total	**45.6**		

Source: East Lothian Council.

In respect of the housing revenue account the largest element of the capital under spend (£4.8 million) was in relation to extensions, roughcasting and building envelope works.

Actual capital expenditure on general services was £24.8 million and the largest projects are shown opposite, including significant HRA projects. The outturn was an under spend of £7.6 million against budget.

The largest underspends were in relation to replacement vehicles (£1.7 million), coastal car parks and toilets (£0.7 million), support for business - land acquisition, infrastructure and broadband (£0.5 million) and reprovision of pathways home (£0.5 million).

A significant amount of the capital underspend is due to slippage and therefore could affect future years' capital budgets, albeit management apply the capital limits flexibly over the rolling five year period. A refreshed capital plan will be presented as part of the ongoing quarterly monitoring reports in 2014-15. Initial changes to the capital plan were presented to the Council in April 2014 which advised of changes to six projects.

Summary of key capital projects: 2013-14

£m	
Project	**Expenditure**
Modernisation (HRA)	10.9
Affordable housing	9.9
Tranent care centre	7.2
Roads	5.7
Gullane medical centre	2.7
House purchases	2.1

Source: East Lothian Council analysis.

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Financial position (cont.)

The lower capital limits approved in October 2012 gave rise to lower than budgeted borrowing requirement and consequently a reduced interest cost.

The Council's level of debt places significant pressure on future revenue funding as debt and associated interest is paid. Robust monitoring will continue to be required.

Borrowing

The Council's capital expenditure is largely funded through borrowing, which inherently increases the level of indebtedness which the Council must repay, with interest, from future revenue budgets. East Lothian has one of the fastest growing populations in Scotland and this gives rise to higher demand for investment in new and refurbished service facilities, such as schools and a growing need for affordable housing.

The additional in year borrowing of £24.8 million was lower than that of the previous year of £30.7 million. This is due to the impact of increased capital grants and project income. The table below shows the split between HRA and general services capital expenditure and borrowing in 2013-14.

Sources of funding

	HRA £m		General Services £m	
	Budget	*Actual*	*Budget*	*Actual*
Borrowing	18.8	14.5	18.7	13.4
Grants	5.7	5.5	7.0	7.0
Project income	-	-	4.6	2.8
Asset sales	1.1	0.8	1.4	0.8
Developer contrib.	-	-	0.7	0.8
Total	**25.6**	**20.8**	**32.4**	**24.8**

Source: East Lothian Council.

The proportion of capital expenditure funded from borrowing is higher for HRA projects (70%) than general services projects (54%). Management expects borrowing for HRA projects to be fully repaid from associated rental income generated.

The capital underspend has led to lower than budgeted borrowing requirement and consequently a reduced interest cost than budgeted. Short term borrowing has significantly increased (£20 million) in contrast to the smaller increase in long term borrowing (£4.8 million).

The key driver has been in taking advantage of competitive interest rates available on short term borrowing, therefore decreasing the short term interest costs.

Whilst interest rates have been at a historical low over the past years, inevitably these will increase. Increases to interest rates will only affect new borrowing or variable rate loans, instead of existing fixed rate loans which accounts for a significant proportion of the Council's borrowing portfolio.

The Council is forecasting a slower increase in debt repayments over the next two years. In 2016-17 debt repayments will increase faster than in prior years. These will be paid from the general services and housing revenue account budgets and have been included in the next three years' budgets. The Council's level of debt places pressure on future available revenue funding as debt and associated interest is repaid. There are further risks is capital expenditure is deferred and associated borrowing is taken out at higher interest rates, potentially leading to larger debt charges.

In benchmarking undertaken by Audit Scotland from analysis of the 2013-14 unaudited financial statements of Scotland's 32 local authorities, the Council continues to have the highest level of net external debt when taken as a proportion of revenue expenditure (166%; 2012-13:171%) and second highest per head of population (£3,930 per head; 2012-13: £3,700). However it is recognised that this benchmarking does not differentiate between demographic differences or the split between general services and housing related borrowing.

The Council has the eighth (2012-13: fifth) highest level of debt as a proportion of fixed assets, with a ratio of 0.6 (2012-13: 0.5). Borrowing continues to rise to fund the Council's capital programme, although the active reduction in capital expenditure limits to support no new borrowing from 2014-15 should support a longer term decrease in borrowing levels.

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Financial planning

The 2014-15 budget forecasts a breakeven position, incorporating a further £0.2 million utilisation of reserves.

Lower staff costs as a result of VERS will facilitate achievement of the budget.

Background

Local government finance settlements have been agreed for 2014-15 and 2015-16. The table below shows the profile of revenue and capital grants over this period.

£m	Revenue allocation	Capital grant funding
2013-14	166.4	7.5
2014-15	163.6	10.8
2015-16	164.3	11.6

Source: Scottish Government website

Revenue budget

A three year revenue budget was approved by council in February 2014. This used the 2013-14 budget as a base and reflected changes for known items of income and expenditure in future years. The 2014-15 budget forecasts a breakeven position, incorporating a further £0.2 million utilisation of reserves.

This budget has been set on the assumption that council tax will remain frozen in 2014-15. The main changes over the period to 2016-17, by service, are summarised below. The changes are incorporated in the approved budgets and comprise of both known changes and agreed efficiency savings/measures.

In 2016-17 no utilisation of reserves is planned. The reallocation of savings from VERS represents the largest movement within corporate commitments in 2014-15 (£2 million reallocated to departments) and increased debt charges (£0.3 million increase). Corporate income is expected to increase in 2014-15 due to forecast increases in revenue support grant budgeted in 2014-15. The main expenditure savings will be in partnership and community services, with total savings of 5.3% required to achieve budget, with the majority of these savings in 2014-15 from the removal of costs relating to staff who left through VERS.

£000					
Department	**Budget 2013-14**	**Changes 2014-15**	**Changes 2015-16**	**Changes 2016-17**	**Cumulative 2017**
Resources and people services	102,520	124	346	1,944	104,934
Health and social care partnership	44,839	(444)	(1,069)	4	43,330
Partnership and community services	48,455	(1,775)	(220)	(572)	45,888
Net expenditure	**195,813**	**(2,095)**	**(943)**	**1,376**	**194,152**
Corporate income	(215,552)	(2,572)	(551)	(571)	(219,245)
Transfer to/(from) reserves	(2,236)	2,406	1,438	(1,608)	-
Corporate commitments	21,975	2,260	56	803	25,093
(Surplus)/deficit	**-**	**-**	**-**	**-**	**-**

Source: East Lothian Council budget.

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Financial planning (cont.)

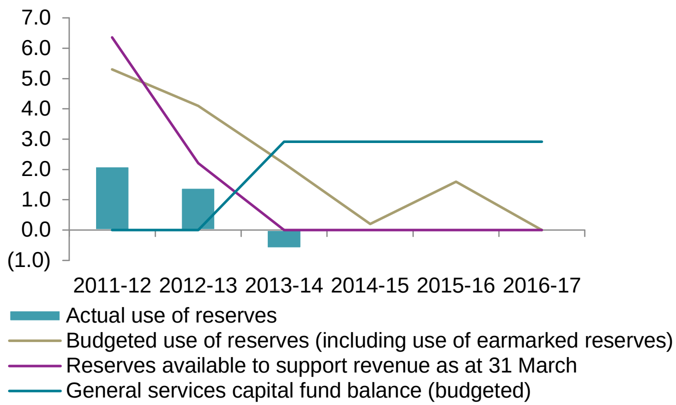
The Council is planning to utilise most useable un-earmarked general reserves by 31 March 2016. In 2016-17 the Council is budgeting a break-even position.

Capital expenditure limits have been set to limit additional borrowing after 2013-14. The capital programme will require ongoing monitoring and review to ensure it continues to meet the financial strategy.

Use of reserves

The Council is planning to utilise most usable un-earmarked general reserves by 31 March 2016. In 2016-17 the Council is budgeting a break-even position. While reserves are not planned to be required in 2016-17, there is risk for the Council in requiring it to achieve budget in each of the next two financial years to achieve a recurring financial balance from 2016-17.

The chart below illustrates the use of reserves over a six year period, in accordance with the approved council budget for 2014-15 to 2016-17, against reserves available.



Source: : East Lothian Council budget.

While, as at 31 March 2014, management confirmed that the Council remains on track with its financial strategy, continued monitoring will be required to ensure savings are achieved. Quarterly reports tracking progress with efficiency savings will help to support management in this task.

Cost reduction fund

The Council's cost reduction fund was £7.1 million as at 1 April 2013, being available to cover the cost of further service reviews and other potential efficiency savings. £3.6 million was utilised from this fund in 2013-14, primarily to fund the cost of VERS. As at 31 March 2014, £3.7 million remains earmarked as the cost reduction fund. A clear strategy and allocation of this fund will be needed to best utilise these reserves to support ongoing change projects.

Capital expenditure

Under statutory regulation the Council sets an annual limit on the maximum amount to allocate to capital expenditure. The financial strategy's capital limits, as set out below, seek to limit additional borrowing after 2013-14.

£m		
Year	**Capital expenditure limits**	**Capital projects budget**
2013-14 (actual)	33.0	24.8
2014-15	21.0	23.2
2015-16	21.0	21.1
2016-17	21.0	18.4
Totals	**96.0**	**87.5**

The cumulative budget over the four year period is within the cumulative capital limit. Management recognise the need for limits to be applied flexibly to incorporate project slippage, inter-year transfers and additional capital income. Elimination of additional borrowing, leading to reduced debt costs will support management's achievement of a sustainable financial position. Initial changes to the capital plan were presented to the Council in April 2014 which advised of changes to six projects.

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Financial statements and accounting

Our perspective on the preparation of the financial statements and key accounting judgements made by management

Audit conclusions and materiality

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

Audit conclusions

Our audit work is substantially complete pending receipt of management's representations and update of subsequent events. We have issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2014, and of the Council's deficit for the year then ended. An emphasis of matter paragraph is included within our audit opinion in respect of the facilities service significant trading operation not meeting the statutory target to break even over a three year rolling period as set out on page 22. There are no other matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit and governance committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Materiality

Planning materiality was provided in the audit strategy and plan 2013-14 dated 9 January 2014. We revised materiality prior to the commencement of the final audit, following updated internal sector guidance and receipt of the financial statements. Materiality has been set at £5.76 million (previously £9 million) which is approximately 2% of total expenditure in 2013-14. We have design our procedures to detect errors at a lower level of precision, i.e. £4.3 million. We report identified errors greater than £288,000 to the audit and governance committee.

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Significant risks and audit focus areas

The main audit focus areas are discussed on the following pages.

These were identified in the audit strategy and plan and are significant risks in respect of:

- **management override of controls;**
- **revenue recognition fraud risk;**
- **the Council's financial position; and**
- **valuation of council dwellings;**

and other focus areas of:

- **employee benefits;**

during the audit we also identified further focus areas of:

- **accounting for depreciation;**
- **significant trading operations; and**
- **provisions.**

Significant risks that ISAs require us to raise in all cases

Professional standards require us to consider two specific risks for all organisations:

- management override of controls; and
- fraudulent revenue recognition.

Our audit approach to address these was set out in our audit plan and strategy. We do not consider fraudulent revenue recognition to be a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised given the nature of grant funding. We therefore rebut this risk and did not incorporate specific work into our audit plan in this area over and above our standard fraud procedures. Although we do not consider the presumed risk of fraud from revenue recognition to be applicable, we remained alert to indications of fraud during the course of the audit.

As part of our work to address the significant risk of management override of controls we performed the following tests:

- testing of journals at the year end, and during the year;
- review of unusual transactions in the year;
- enquiries with employees outside the finance department;
- a test of unpredictability; and
- controls testing, including higher level controls.

We do not have any findings to bring to your attention in relation to these matters. No control overrides were identified.

Other areas of audit focus

Our audit strategy and plan included the following other significant risks:

- the Council's financial position, including revenue and capital and the impact on borrowing which we have considered in the strategic overview; and
- valuation of council dwellings;

and other areas of audit focus we have reported on other matters related to:

- accounting for the Council's participation in the Lothian Pension Fund;
- accounting for depreciation on enhancements to existing assets;
- significant trading operations; and
- provisions.

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Significant risks

We have considered key accounting issues, in relation to valuation of property, plant and equipment.

We concur with management's judgements regarding the valuation of property, plant and equipment.

Key accounting judgements	
Area	**KPMG comment**
Valuation of property, plant and equipment	■ Under the Council's rolling basis of revaluations, Council dwellings were revalued as at 31 March 2014, using the Beacon approach (adjusted vacant possession). The revaluation has increased the value of Council dwellings by £5.6 million. Our audit of the accounting for the revaluation includes evaluation of the valuer as a third party expert and consideration of the data underlying the valuation report. We found that the valuer as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the Council. Our testing included review of actual data against that used in the valuation report. No issues were identified. The valuer uses a number of assumptions in its calculations based on market conditions at the year end. Using our own internal valuation specialist reviewed the methodology and assumptions used. There were no issues identified from this review. We reviewed the revaluation adjustments processed in the financial statements and identified that these had been appropriately recognised and disclosed. ■ As in previous years Council dwellings are recognised as a single line item, by road or area, in the fixed asset register with total annual enhancements recognised as separate assets. It was not possible for management to specifically allocate the valuation based on this recognition in the fixed asset register. Additions and enhancements to council dwellings will be recognised on this one line, which does not enable componentisation of assets. Management are undertaking a review of the fixed asset register to ensure appropriate data is held on individual council dwelling assets. The current fixed asset register treatment also does not enable management to remove the relevant component on disposal or replacement in future years. There is a further risk to the depreciation calculation as individual assets and components useful lives cannot efficiently be applied to accurately calculate the depreciation amount for 2014-15. ***Recommendation one*** ■ Improvements were made to the annual impairment review process in 2012-13, with management putting in place an effective consultation procedure within the Council. Due to staffing changes in 2013-14 there were difficulties in receiving all manager reviews on a timely basis and the review was still on an informal basis. There is opportunity to further enhance the impairment review by tracking all manager reviews, potential impairments identified and conclusions in an overall document. We suggested to management that the review could be performed as at 28 February, thereby providing greater time for consideration and implementation of impairments. No impairments were identified in 2013-14. ***Recommendation two***

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Audit focus areas

In respect of employee benefits, each of the assumptions used to value the Council's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19.

Other accounting and audit matters	
Area	**KPMG comment**
Employee benefits valuation	The Council accounts for its participation in the Lothian Pension Fund in accordance with IAS 19: *Employee benefits* on a defined benefits basis using valuation information prepared by actuarial consultants. Our audit of the accounting for employee benefits includes evaluation of the actuarial consultants as a third party expert, consideration of the data underlying the actuarial report, including the level of contributions made during the year, the financial assumptions and membership data provided to the actuary by the Council, and estimates of the Council's share of the pension fund assets. We found that the actuarial consultants as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the Council. The level of contributions made in the year is estimated based on data prior to the year end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the period end. Our testing included review of actual data against that used in the actuarial calculations, no issues were identified. The actuaries use a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the period end date and assumptions on future salary increases. Using our own actuarial specialists, we reviewed the assumptions and concluded that the overall assumptions proposed represented a balanced position for the net deficit within our expected range. Further information is given in Appendix four. The Council has appropriately applied IAS 19 *(revised)* in the financial statements. If the standard had been adopted early in 2012-13, the estimated change to finance costs would be £2.9 million. We do not consider this to be a material amount and therefore agree with management's decision not to restate the prior year comparatives. There would be no impact on the prior year net assets position if the Council had restated the prior year comparatives. An audit adjustment of £5.1 million was processed to correct the accounting for the return on plan assets, which had been incorrectly recognised in other comprehensive income and expenditure instead of financing and investment income and expenditure.

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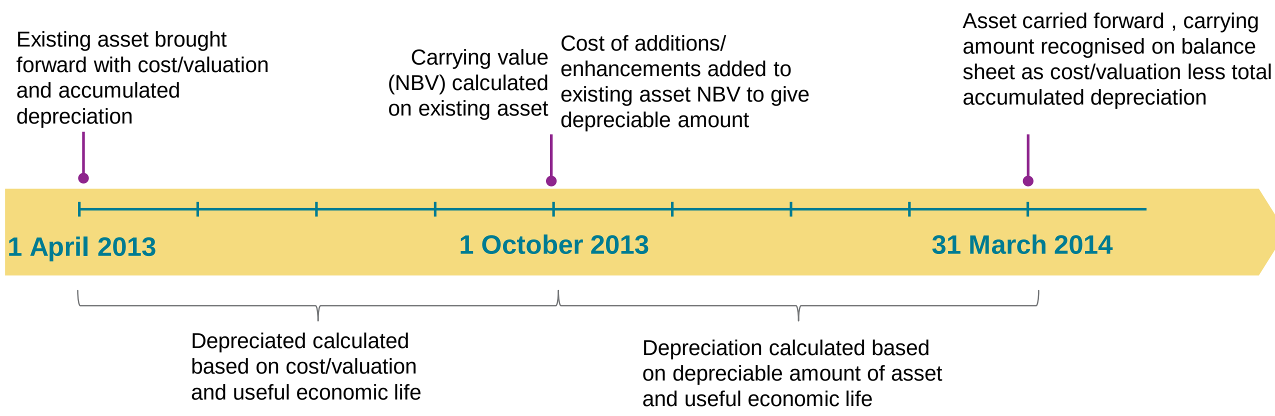
Audit focus areas (cont.)

We have considered key accounting issues, in relation to depreciation on additions to existing assets.

We have raised a recommendation to review the depreciation policy.

Other accounting and audit matters	
Area	**KPMG comment**
Depreciation	In a previous year, we reported that depreciation on additions to existing assets is calculated using the method set out below and illustrated in the diagram. This method gives rise to immaterial differences to a depreciation charge we would expect, although may give rise to larger errors in the future. 1. Depreciation on the cost or valuation of an existing asset is applied, based on its useful economic life and calculated on a daily basis from 1 April to 1 October. 2. The net book value ('NBV') of the existing asset is calculated as at 1 October, being the opening NBV less the depreciation calculated above. 3. The cost of any additions is added to this 'enhanced' carrying value, to provide a depreciable value of the asset. 4. The depreciable value of the asset is depreciated on a daily basis from 2 October to 31 March and added to the first six months of depreciation to give the depreciation charge for the year.



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Audit focus areas (cont.)

We identified further focus areas in relation to depreciation and significant trading operations.

We have raised a recommendation to review the depreciation policy.

An emphasis of matter paragraph is included within our audit opinion in relation to the facilities services significant trading operation not meeting the statutory three year breakeven target.

Other accounting and audit matters	
Area	**KPMG comment**
Depreciation (cont.)	This method of calculating depreciation is unique amongst our client base. We analysed the depreciation charge on those assets where capital expenditure has been incurred and accounted for as an enhancement. We consider that depreciation is understated on council dwellings by £1.6 million however, due to the revaluation at year end, this understatement does not impact on the carrying value of these assets, since if processed it would simply increase the revaluation journals. For other property, plant and equipment, we consider depreciation to be understated by £0.5 million. An unadjusted audit difference has been presented on page 36. This would result in a net decrease to net assets of £0.5 million if adjusted. We recommend management reviews the current depreciation policy, and considers revising the current methodology. This should take account of how enhancements to council dwellings are recognised in the fixed asset register as there is a risk that the audit adjustment could become material in value. ***Recommendation three***
Significant trading operations	■ The Council has three significant trading operations ('STOs'). The Local Government in Scotland Act 2003 requires that each STO breaks-even over a rolling three year period. The financial statements identify that facility services did not meet this statutory target and made a three year rolling deficit of £98,000 as at 31 March 2014. We reviewed the consistency of allocation of income and expenditure to each of the STOs, ensuring that no ineligible costs had been allocated to each STO. We recalculated the net surplus/deficit over the three year period. Property maintenance and roads services met this statutory target in 2013-14. ■ An emphasis of matter paragraph is included in our audit opinion in relation to this matter. Management has identified that in the first quarter of 2014-15 facilities services has met the rolling three year break even target. Furthermore, management is investigating options to perform a review of STOs to ensure they best meet the Council's requirements. ■ Non-material adjustments were required to the disclosed surplus for the year to ensure expenditure included was consistent with prior year disclosures. The narrative for facilities services was also updated to better reflect the three year cumulative position.

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Audit focus areas (cont.)

We identified further areas of audit focus in respect of provisions.

We have raised a recommendation to enhance the basis of the bad debt provision calculation.

Other accounting and audit matters	
Area	**KPMG comment**
Bad debt provision	■ The bad debt provision is calculated separately for council tax, housing rents, housing benefit and general bad debt. The council tax, housing rents and housing benefit provisions are calculated on a historic methodology, meaning they may not accurately reflect the bad debt the Council will face. ■ Overall, the Council provides for 73.5% (2012-13: 66.3%) of gross debtors. We have reviewed the provision policy and compared to other authorities, we consider that council tax, rents and housing benefit provisions are prudent, although recognise that a policy of writing-off debtors or retaining the gross debtor with provision impacts on benchmarking analysis. Our view is that the calculation methods used should be revised to more accurately reflect debtor payment trends. ***Recommendation four***
Provisions - other	■ In 2012-13 we discussed with management a potential provision for VERS. Management did not recognise a provision in the financial statements as they did not consider a constructive obligation to be present as at 31 March 2013 or that a reliable estimate was possible at that date. Management has recognised the cost of VERS as expenditure within the 2013-14 accounts. The difference of interpretation led to an unadjusted audit difference of £3.1 million in 2012-13. If this difference had been adjusted in 2012-13, the 2013-14 decrease in usable reserves balance would be £0.5 million (2013-14 accounts £3.6 million). ■ Following a European Court of Justice ruling in May 2014, employers are required to pay holiday pay to staff at a rate commensurate with any commission or over time that they regularly earn, instead of at their basic pay level. Following legal advice, management has implemented this process for holiday pay going forward. It is anticipated this will cost approximately £0.2 million per year. Management is reviewing any potential retrospective liability which is unlikely to be material. ■ Whilst the Council do not operate any landfill sites, coal mines or other sites which carry significant liabilities to restore, there is one Council owned former landfill site and one present private operation. Management monitors the environmental impact of the former landfill site and state that there are known issues with it. There is sector-wide consideration of operations with obligations to restore and potential financial stability of operators, following the liquidation of a coal mine operator in another area. Further analysis is required by management to identify any potential liability and ensure they have appropriate monitoring procedures in place. Management needs to review any site (including wind farms and quarries) with a decommissioning or rectification obligation. This is considered to be an area of limited risk for the Council and there are no known issues. ***Recommendation five***

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Accounting policies

There have been no substantive changes to the financial reporting framework as set out in the *Code of Practice on Local Authority Accounting in the United Kingdom 2013-14* ('the Code of Practice').

There have been no changes to accounting policies in 2013-14. All accounting policies have been applied consistently.

Disclosure has been included in respect of the impact of revisions to IAS 19 *Employee benefits.*

The financial statements have been prepared on a going concern basis.

Accounting framework and application of accounting policies	
Area	**KPMG comment**
Code of Practice on Local Authority Accounting in the United Kingdom 2013-14 ('the Code')	The 2013-14 financial statements have been prepared in accordance with the Code of Practice which is based upon International Financial Reporting Standards ('IFRS'). During the year there have been no substantive changes in financial reporting requirements, and consequently there are no material changes to the Council's accounting policies. We are satisfied that the accounting policies adopted remain appropriate to the business.
Impact of revised accounting standards	■ The Council has applied the revisions to IAS 19 *Employee Benefits,* opting not to restate the prior year comparatives on grounds of materiality. We concur with this approach as there were no changes to the balance sheet as a result of the retrospective application of IAS19R, and the impact on the comprehensive income and expenditure account are not material. The employee benefits accounting policy in the draft financial statements required updating to reflect IAS19R and disclose that no prior year restatement had occurred. Amendments to the pension disclosure notes were required to ensure the disclosures were in line with the changes in IAS19R.
Going concern	■ The Council had net assets at the balance sheet date, although reduced by £12.6 million in the year; due primarily to the movement in general fund and housing revenue account (£3.6 million) and increases in pension liability (£17.9 million), offset by the upwards revaluation (£6 million) and other smaller movements in debtors and cash balances. ■ Management has considered the funding available to the Council, which is approved for 2014-15, combined with longer-term funding expectations and the fact that the net liability obligations do not fall due within one year. Over the past few years there has been a reduction in the overall cost base and further efficiency savings are incorporated in budgets. There is tight financial control and this will be further supported by quarterly reporting on efficiency savings. Management considers it appropriate to adopt a going concern basis for the preparation of these financial statements, and disclosed these circumstances within the financial statements. We are satisfied that this disclosure remains appropriate, noting that the pension deficit and long term borrowing does not become due in the next 12 months.
Impact of revised accounting standards	■ There are no newly effective accounting standards that are considered to have a material impact on the Council's financial statements in the current year. Appropriate disclosure to this effect is included within the accounting policies note to the financial statements.

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Financial statements preparation

The financial statements and draft governance statement were made available on a timely basis.

There are further opportunities for continuous improvement in the financial statements preparation.

Financial statements preparation

- Management provided full draft financial statements on 26 June 2014, in line with the agreed timetable. This included the explanatory foreword, remuneration report and governance statement. A prepared by client audit file, was made available at the start of the final audit fieldwork on 7 July 2014. The finance team underwent change during the year, with the audit being performed during a period of a temporary finance manager.
- The majority of supporting documentation was received in a timely basis, and queries were answered promptly. We provided feedback to management on the content of the financial statements, annual report and governance statement, and we are pleased to report that these were consequently prepared appropriately. A number of presentational adjustments were needed to the draft financial statements, which would benefit from a more robust review prior to release. There is further opportunity for continuous improvement in the financial statement preparation. For example in the use and preparation of the CIPFA pro-forma financial statements in advance of the year end and in determining the approach to key judgements prior to the year end.
- The audit clearance meeting was held on 6 August 2014, in line with the prior year timetable. Management has indicated their desire to achieve a faster close of financial statements in 2014-15. We will meet with management to support an improvement in the financial statements close process.
- The Local Authority Accounts (Scotland) Regulations 2014 will come into force on 10 October 2014. The regulations contain provision for the unaudited annual financial statements as submitted to the auditor to be considered by the audit and governance committee no later than 31 August, and the audited financial statements to be presented to the audit and governance committee for consideration and approval prior to auditor signature before 30 September. Whilst the audit and governance committee already consider the unaudited financial statements, management will need to review the financial statements timetable to ensure the audited financial statements are also considered by the audit and governance committee.

Recommendation six

- All charitable trust funds registered with the Office of the Scottish Charity Regulator ('OSCR') require an audit. Management identified the Dr Bruce Fund as the only charity requiring an audit. We reviewed and agreed with OSCR confirmation that this is the only fund requiring an audit. Our audit work on the Dr Bruce Fund is complete. The charity financial statements are required to be approved and signed by 30 September 2014, in line with the timetable for the Council's accounts.
- In respect of the Council, there is one adjusted audit difference of £5.1 million in relation to the changes to IAS19 presentation and one unadjusted audit difference of £2.1 million in relation to the calculation of depreciation.
- There are no significant matters in respect of (i) auditor independence and non-audit fees and (ii) management representation letter content, as reported in appendix one.

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Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Corporate governance arrangements

Although there have been changes to the management structure and further staffing changes as a result of VERS, the corporate governance arrangements remain appropriate for the Council.

Risk management arrangements have been reviewed during the year, and a corporate risk management group is in place.

Corporate governance	The Council has overarching and supporting governance arrangements which provide a framework for organisational decision-making. The Council operates a cabinet structure, with a cabinet and two statutory committees; education and planning. The 2012 review of chief officers resulted in a reduction in the number of heads of service and a shift in this role to a more strategic position. A further change in the management structure occurred with effect from 1 April 2013, with three directors being reduced to two deputy chief executives. VERS also contributed to further staffing changes during 2013-14. Councillors are subject to a Code of Conduct instituted by the Ethical Standards in Public Life etc. (Scotland) Act 2000 and enforced by the Standards Commission for Scotland. A briefing session on the Code of Conduct was held during 2013-14 to ensure councillors are aware of their responsibilities. The Code of Conduct is documented within the Standing Orders, which are publically available. The Standing Orders were revised in June 2013 and updated in June 2014 to include a revised scheme of delegation and new procurement procedures. Commitment to the training and development of Councillors is evident through targets outlined in the 2014-15 improvement plan. As part of the Code of Corporate Good Governance a task group comprising senior officers of the Council was given responsibility for developing, monitoring and reviewing corporate governance. An annual corporate governance self evaluation has been implemented as a result of this. The results of the 2014 self evaluation were reported to the audit and governance committee in May 2014 and noted four improvement points, a decrease from the 13 points noted in 2013. This annual review of corporate governance demonstrates good practice and commitment to continuous improvement.
Risk management	Management is continuing to review risk management arrangements to provide assurance to elected members over the mitigation of identified risks. The risk management strategy and supporting documentation demonstrate a commitment to good practice and were initially implemented in December 2009. A corporate risk register is in place and is supported by departmental risk registers. The corporate risk register was updated in May 2014, following a review by the corporate risk management group. This was approved by cabinet in June 2014. Risk registers are currently maintained on spreadsheets, but are being transferred to the Aspireview system going forward. Risk appetite is referred to in the risk management strategy, although the Council’s overall risk appetite is not defined. The risk management strategy was last updated in 2012 and is due to be updated again in October 2014; it would be beneficial to users of the strategy to include further information on the Council’s risk appetite. The Council has a corporate risk management group, which is responsible for developing and monitoring the risk register, as well as identifying mitigating controls.

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Corporate governance arrangements (cont.)

Our reporting through the year identified improvements in the governance and controls framework from the prior year.

Annual governance statement	The annual governance statement provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. It describes a number of sources of assurance and identifies areas for improvements to be focussed on in the future. The statement also highlights the annual self-evaluation exercise carried out by the Council, which is based on the SOLACE/CIPFA good governance framework. Improvement points from this exercise are included within the statement and in the corporate improvement plan. The statement references the declarations of assurance completed by the Chief Officers to confirm that internal controls are operating effectively within their service or highlight any exceptions. Declarations of assurance were not completed by all officers in line with the Council's timetable. Due to long term absences, two of the declarations were signed by other people on behalf of the officers. The governance statement has been amended to reflect this.
Remuneration report	Since 2011-12, regulations place a requirement for local authority bodies to prepare a remuneration report. The Local Government Finance Circular number 8/2011, issued by the Scottish Government, provides guidance for the preparation of the remuneration report. The guidance states that the remuneration report is a statement in its own right and not a note to the financial statements. While there is no statutory prescription on its placement in the financial statements, it suggests a suitable placement would be after the governance statement. The remuneration report is included before the annual governance statement. There were initially incorrect figures stated in the draft remuneration report and presentational changes required to ensure that it complied with guidance. In addition to these errors, the guidance requires the disclosure of the Chief Executive or most senior officer of any subsidiary bodies. There was no such disclosure for the Council's subsidiary body, the Musselburgh Racecourse. This disclosure is required by the guidance, in a tabular format showing any remuneration received from the subsidiary body. Some employees were missing from the salary bandings disclosure, meaning these figures were incorrect. Furthermore, we identified an instance where an exit package was calculated incorrectly as the payroll department had not been made aware of a change in leaving date. The incorrect disclosures have been updated in the report; management should review the report more thoroughly prior to finalisation to identify any errors or inconsistencies. ***Recommendation seven*** The remuneration report is required to disclose details of any exit packages awarded during the year. Due to the VERS and other redundancies, 101 people received exit packages in 2013-14. We tested a sample of exit packages, verifying they were awarded in line with the Council's policy on early retirement and the correct amounts were disclosed. We reviewed exit package disclosures against Audit Scotland guidance. We did not identify any issues arising from this testing.

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Corporate governance arrangements (cont.)

While management have demonstrated a commitment to continuous improvement, the area of procurement would benefit from further attention.

Procurement	A new procurement policy and related procedures were drafted in 2013. The corporate procurement procedures were updated during the year and approved by Council on 24 June 2014. The procedures are included in the Standing Orders as an appendix and training has been provided to employees. As part of the update to procurement procedures, tendering limits were reduced and the approval process for new suppliers tightened. However, there is still a large volume of new suppliers and there has been limited progress in increasing the use of PECOS within the Council. We placed reliance on internal audit for review of procurement controls; internal audit identified weaknesses within procurement procedures; cases were identified where the procurement process had not been initiated by an officer with the appropriate delegated authority. The procedures for ensuring all documentation is completed and the guidance to officers on reporting procurement activity to members require review. Internal audit also noted that various versions of procurement procedures were made available to staff. The 2012-13 public performance report from Audit Scotland identified that the Council does not report fully on a range of information, sufficient to demonstrate that it is securing Best Value in relation to procurement. 10 Councils in Scotland also received a similar outcome in the analysis. Management is considering the improvements to be implemented. The 2012 procurement capabilities assessment rated the Council as ‘conformance’, with a score of 44% (2011: 28%), the increasing score demonstrates management focus on improving procurement. As part of organisational change, the procurement team now sits alongside the legal team, instead of previously within the finance function.
Prevention and detection of fraud	A key mechanism in the allocation of authority, accountability and responsibility and the prevention and detection of fraud is the existence and maintenance of strategic and financial documentation. The Council has appropriate policies and codes of conduct for staff and councillors including a whistle blowing policy. The whistle blowing policy was updated in June 2014, to reflect the staffing restructure. Management identified no significant fraud or irregularities, other than issues that were already brought to our attention by internal audit.
Maintaining standards of conduct and the prevention and detection of corruption	The Council has recently reviewed and updated its Standing Orders and supporting Schemes of Administration and Delegation and procurement procedures. Role descriptors for councillors were approved by Council in October 2013, in line with best practice guidance from The Scottish Local Authorities Remuneration Committee. New councillors and new employees are required to agree to their respective Codes of Conduct on commencement of office or employment, and management is required to communicate any changes in the Code of Conduct to employees. This reinforcement of values will contribute to the effective prevention and detection of corruption at the Council. Internal audit reviewed the updated procurement procedures, and highlighted some weaknesses which require addressing.

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Corporate governance arrangements (cont.)

National fraud initiative	The National Fraud Initiative ('NFI') is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. We prepared a short return to Audit Scotland in December 2013 assessing management’s participation in the NFI exercise. Management’s progress against a number of controls was graded on a traffic light basis, and an overall green rating was awarded. The Council has established a process for investigated cases of potential fraud highlighted by NFI, which is primarily undertaken by internal audit. Internal audit reported to the audit and governance committee in January 2014 on their findings from the recent NFI exercise. Internal audit show commitment to NFI and it is embedded within their annual plan, however some areas for improvement were identified.

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Corporate governance arrangements (cont.)

We noted improvements in the internal control environment, and the implementation of recommendations raised in the prior year.

In particular we welcome the timely completion of the year-end bank reconciliation.

We are able to place reliance, where relevant, on the work of internal audit.

Systems of internal control	We have noted considerable improvements in the governance and controls framework over the three years of our appointment. Changes to policies and procedures have been made against a backdrop of senior staff restructuring and ongoing efficiency rationalisation. While management has acted on a number of the recommendations made in previous audit reports, there are opportunities to further enhance the control environment, particularly in relation to journals processing. Our interim management report made five recommendations; three grade two (material) and two grade three (minor). Our substantive testing of bank reconciliations identified two bank accounts which were not being managed centrally, and therefore had not been included within the bank balances presented by management. These related to the social work department and held £52,000; we do not consider these to be material. Management has begun investigating these accounts, including looking at the position with regard homes for older people. ***Recommendation eight*** Overall, our testing of the design and operation of financial controls over significant risk points confirms that generally controls relating to financial systems and procedures are designed appropriately and operating effectively.
Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit. In 2013-14 we relied on: ▪ journals processing; ▪ procurement scheme of delegation; ▪ trading operations; ▪ creditors; ▪ housing revenue account; and ▪ national fraud initiative. We had also planned to use internal audit's work on statutory performance indicators, however this has not yet been completed. This is due to be completed in September 2014, working jointly with Midlothian Council. Internal audit reported that 'subject to the weaknesses outlined in the controls assurance statements, that reasonable assurance can be placed on the adequacy and effectiveness of the Council's internal control systems for the year to 31 March 2014.' The most significant areas where internal audit identified weaknesses in the design or operation of internal controls included procurement arrangements, journals processes, guidance for creditor payments, new suppliers, approval of payments, checking rent increases and homeless rent charges and retention of supporting documentation. The IASAB produced a common set of public sector internal audit standards ('PSIAS'), which were effective from 1 April 2013. Internal audit considered these standards when setting the 2013-14 and 2014-15 audit plans. Internal audit intend to complete an assessment against these new standards and implement an internal audit charter as part of the internal audit plan for 2014-15.

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Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

Performance management

Our work has identified that the Council's Best Value and performance management arrangements are good practice.

Best Value	Best Value places a statutory requirement on local authorities to ensure they have procedures in place for 'continuous improvement'. To achieve this, the Council developed an improvement framework, approved on 27 March 2012. Implementing an improvement framework demonstrates good practice in assessing whether the Council is achieving Best Value. The framework was reviewed in March 2014, and it was determined that no revision was required. That has not yet been reported to the Council. The Director of Performance and Best Value reported to the Accounts Commission on public performance reporting in June 2014, to consider whether councils reported on a range of information sufficient to demonstrate Best Value in a range of areas. East Lothian Council achieved a 'yes' score in 14 areas, a 'partial' score in six areas and a 'no' score in the area of procurement. This has prompted a review of KPIs in this area. The Council was highlighted as good practice in a range of areas, particularly around effective use of customer satisfaction information and a structured approach to public performance reporting. The performance website is well structured to the range of services and performance in each of these. The annual performance report is also well presented and contains information to show how customer feedback has been taken on board.
Performance management arrangements	A new Single Outcome Agreement ('SOA') has been developed by the Council and related partners. The SOA is an agreement between the East Lothian Partnership and the Scottish Government, setting out how each party will work to improve outcomes and reduce inequalities for East Lothian residents. The Council continues to use a well established approach to self-evaluation through the use of the How Good is our Council ('HGIOC') model, which is completed by all Council departments on an annual basis. The 2013-14 HGIOC process is substantially complete, but the results are yet to be compiled as some departments did not return their data on time. The results of the HGIOC exercise will be used to inform the service plans. Three year service plans are to be developed in order to align the plans with the three year budgets and provide continuity in each years' plan going forward. Together with the focus on self-evaluation, the main element of performance management takes place through monitoring service performance against agreed performance indicators. Performance indicators are listed on the Council website and progress is updated on a quarterly basis. Elected member scrutiny is primarily performed by the policy and performance review committee and the audit and governance committee. In addition, the corporate management team reviews performance on a continuous basis. A review of performance indicators is underway to ensure each single outcome agreement outcome, council plan objective and Audit Scotland indicator category is linked to a specific KPI. KPIs are reviewed on an annual basis to ensure they are still appropriate, demonstrating commitment to continuous improvement. A Council improvement plan is developed annually. This identifies actions from a range of sources, including the HGIOC reviews, corporate governance self-evaluation, audit reports, Audit Scotland's *Overview of Local Government in Scotland* and any outstanding actions carried over from the prior year improvement plan. Management reviews progress against the improvement plan during the year in order to identify any points which require carrying forward.

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Performance management (cont.)

The AIP states that overall the Council continues to perform well in most areas, and no areas have been selected for further scrutiny.

During 2013-14 we have prepared returns to Audit Scotland on health inequalities, ALEOs and major capital investment.

Shared risk assessment	The Council considered the updated assurance and improvement plan on 24 June 2014. This is used as a source of action points for the Council improvement plan, which was discussed and approved by members on the same date. The Local Area Network (LAN) recognises the Council's ongoing commitment to continuous improvement and self-evaluation. It recognises areas of strong performance, and a number of improvement activities. This plan contains no areas identified for further scrutiny, where two areas were selected in the previous year.
Local response to national studies	The Council's response to the following national reports was considered: ▪ Health inequalities in Scotland The report was published on 1 December 2012 and was considered by the audit and governance committee and senior management team together with an assessment of East Lothian Council's position. The report prompted the East Lothian Partnership to begin developing a health inequalities strategy. We prepared a short return to Audit Scotland in relation to the report.
Major capital investment in councils	The council management team considered the March 2013 Audit Scotland report '*Major capital investment in councils'* in May 2013. The audit and governance committee considered this report in June 2013. This provided background to the publication and the action plan prepared in response to this. The Council has made good progress against their action plan and has developed a comprehensive asset management strategy. However, the development of a formal capital investment strategy setting out a clear link between investment, performance and outcomes should be considered. We prepared a report to Audit Scotland on our findings from this review. These findings were documented in full in the 2013-14 interim management report.
Arms length external organisations (ALEO): Are you getting it right?	The Accounts Commission published a report in 2011, *'Arm's-Length External Organisations: Are you getting it right?',* as part of its 'How Councils Work' series of improvement reports. The aim of this was to provide the Accounts Commission a position statement on the councils' use of ALEOs. Management presented the report on ALEOs to the audit and governance committee on 27 September 2011. This was discussed by the audit and governance committee but no action plan was developed. The committee requested a clearer paper on ALEOs to be prepared, however this has not yet been completed. Our full findings from the targeted follow up are outlined in a separate report. These have been reported to Audit Scotland.

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Performance management (cont.)

Performance against statutory performance indicators and other local government bodies is measured by the Council and our responsibilities as external auditor extend to understanding the arrangements and systems.

Statutory performance indicators	As part of our review of performance management, Audit Scotland require specific consideration of SPIs. The aim of this work is to assess how authorities are compiling and reporting data and ensuring it is complete and accurate. Local authorities have a statutory duty to ensure appropriate arrangements are in place for collecting, recording and publishing performance information. Auditors have a statutory duty to be satisfied that the council has made adequate arrangements for collecting and recording information, and for publishing it, as are required for the performance of their duties. Consideration has been given to the Council's procedures for collecting and reporting information on SPIs, in line with Audit Scotland requirements. The audit of SPIs is a two stage process. Our results of the stage one assessment have been reported to Audit Scotland and our responses are outlined in a separate report. The results of the second stage, assessing the quality of PPR, will be reported to the Accounts Commission by May 2015. In 2013-14, Statutory Performance Indicators were not specified and were drafted by the Council based on categories provided by Audit Scotland. The specified indicators have been replaced by the Scottish Local Government Benchmarking Framework. The 2013-14 SPIs were developed in consultation with the policy and performance review committee, and are linked to the Audit Scotland categories as well as council plan and single outcome agreement objectives. The Council uses the Aspireview system to input, manage, interrogate and present data. For each indicator a performance indicator verification certificate is produced, requiring confirmation from two individuals. Management consider that there are adequate checks and controls to provide comfort over the completeness and accuracy of data. Internal audit are working jointly with Midlothian Council to perform sample testing on the SPI data at both councils. This is due to be performed in September 2014. Performance against the Council's performance indicators is reported in an annual performance report, publically available and discussed at the policy and performance review committee. The 2013-14 report is due to be published in October 2014.
Benchmarking	The Local Government Benchmarking Framework has been developed to help councils compare their performance using a standard set of indicators. The indicators in the framework replace the specified Statutory Performance Indicators ('SPI's') from 2013-14 onwards. Results are analysed in 'family groups' to ensure comparison is between authorities with similar characteristics. Management reviewed the available 2012-13 results, and reported these to the policy and performance review committee in April 2014. Indicators where there was a significant change from the prior period or a variance from the rest of the family group were analysed. Management has reviewed the five indicators where performance was poorest in the 2011-12 results, and has also reported the results of this. The Council is also participating in two pilot benchmarking exercises in road maintenance and school leaver destinations, the results of which will be reported to the policy and performance review committee later in the year. This shows commitment to continuous improvement. The framework also contains indicators based on customer satisfaction. These results show high levels of satisfaction for residents of East Lothian in a range of services, including a first place ranking for satisfaction with parks and open spaces across 32 councils.

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Appendices

Mandatory communications

There was one adjusted audit difference and one unadjusted audit difference.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There is one adjusted audit difference in relation to the changes to IAS19 which removed the £5.1 million return on plan assets from other comprehensive income and expenditure and correctly recognised this amount within financing and investment income and expenditure (net interest on the net defined benefit liability). The balance on general fund reserves is not effected.	Appendix 2
Unadjusted audit differences	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial. There is one unadjusted audit difference for the under recognition of depreciation on enhancements to existing assets. If recognised, net assets and total reserves would decrease by £0.6 million to £251.7 million.	Appendix 2
Confirmation of Independence Letter issued by KPMG LLP to the Audit Committee	We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of our Audit Director and audit staff. There are no non-audit fees for the year.	Appendix 3
Draft management representation letter Proposed draft of letter to be issued by the Company to KPMG prior to audit sign-off	There are no changes to the representations required for our audit from last year.	-

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Audit differences

There is one adjusted audited differences and one unadjusted audit difference to the financial statements.

Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There is one adjusted audit differences and one unadjusted audit difference.

Adjusted caption	Nature of difference	Deficit on provision of services (£'000)	Other comprehensive income and expenditure (£'000)
Comprehensive income and expenditure statement – financing and investment income and expenditure	The recognition of the net return on assets within the deficit on provision of services.	5,122	
Comprehensive income and expenditure statement – other comprehensive income and expenditure			5,122
Net impact		**5,122**	**5,122**

Unadjusted caption	Nature of difference	Net assets	Total reserves
Balance sheet – property, plant and equipment – Council dwellings	The recognition of depreciation on enhancements to existing assets council dwellings and other property, plant and equipment	(1,567)	
Balance sheet – property, plant and equipment revaluation		1,567	
Balance sheet – property, plant and equipment – other			
Balance sheet – unusable reserves		(551)	551
Net impact		**(551)**	**551**

A number of numerical and presentational adjustments were required to some of the financial statements notes, to add extra disclosures or to include additional information to aid the reader of the financial statements. The most significant of which were:

- remuneration report – inclusion of the most senior manager of the Council's subsidiaries and changes to the amounts disclosed to accurately reflect officer and councillor remuneration.
- pension note – correction of prior year comparatives, reordering the disclosure note and extra narrative disclosure.
- segmental and subjective analysis – represented disclosure note in line with the Code's guidance.

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Auditor independence and non-audit fees

Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with the Council.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the Council and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Council.

Confirmation of audit independence

We confirm that as of 1 September 2014, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the audit and governance committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

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Employee benefits

In respect of employee benefits, each of the assumptions used to value the Council's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19R.

Defined benefit pension liability

2014 £000	2013 £000	KPMG comment
(128,785)	(110,842)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19R pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	Council	KPMG central	Comment
Discount rate (duration dependent)	4.30%	4.30%	Acceptable. The actuarial assumption has been calculated using a different approach from the prior year. It is KPMG's view that this represents an enhancement in methodology.
CPI inflation	RPI - 0.8%	RPI – 1%	Acceptable – the Council's assumption is more prudent (higher liability) than KPMG's central rate, but is within the acceptable range.
Net discount rate (discount rate – CPI)	1.50%	1.65% - 1.75%	Acceptable – the Council's assumption is more prudent (higher liability) than KPMG's central rate, but is within the acceptable range.
Salary growth	1% pa until 31 March 2015. 1.5% above RPI	0% - 1.5% above RPI/CPI inflation	Acceptable – the Council's assumption reflects 1% salary increases until 31 March 2015.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of between 17 and 23 years. The closing deficit increased by £17.9 million compared to 2012-13, primarily due to the application of an updated discount rate. A reconciliation from opening to closing deficit is included in appendix four.

The Council has appropriately applied IAS 19 *(revised)* in the financial statements. If the standard had been adopted early in 2012-13, the estimated change to finance costs would be £2.9 million. We do not consider this to be a material amount and therefore agree with management's decision not to restate the prior year comparatives. There would be no impact on the prior year net assets position if the Council had restated the prior year comparatives. An audit adjustment of £5.1 million was processed to correct the accounting for the return on plan assets, which had been incorrectly recognised in other comprehensive income and expenditure instead of financing and investment income and expenditure.

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Employee benefits (cont.)

The table opposite shows the reconciliation of the movement in the statement of financial position.

Increases to the pension scheme deficit in the year have been driven by changes to the financial assumptions, particularly in respect of the discount rate.

	£000	Deficit/loss	Surplus/gain	Impact	Commentary
	Opening pension scheme deficit			**(110,842)**	The opening IAS 19 deficit for the Scheme at 1 April 2013 was £110.8 million, consisting of assets of £346.4 million and defined benefit obligation of £457.2 million.
I & E	**Service cost**			(13,899)	The scheme remains open to accrual. The employees' share of the cost of benefits accruing over the year is £13.9 million.
I & E	**Past service cost**			(1,165)	A past service cost of £1.2 million is recognised, relating to early retirement over the year.
I & E	**Net interest**			(4,993)	This is the interest on the opening deficit of £110.8 million adjusted for contributions paid during the period.
Cash	**Contributions**			14,834	The Council made contributions of £14.8 million, broadly in line with contributions made last year, allowing for salary increases.
OCI	**Actuarial gain/(loss) – demographic assumptions**			-	There was no change to the demographic assumptions since 31 March 2014, and so there is no gain or loss.
OCI	**Actuarial loss – financial assumptions**			(18,010)	There was an actuarial loss of £18.0 million, driven by a 0.2% decrease in the discount rate assumption. This is in line with the size and duration of the scheme.
OCI	**Other experience**			168	
OCI	**Return on assets**			5,122	The actual return on assets is lower than the interest on assets of £5.1 million.
	Closing pension scheme deficit			**(128,785)**	The closing IAS19 deficit on the scheme at 31 March 2014 is £128.8 million (consisting of assets of £370 million and defined benefit obligation of £498.8 million).

I&E – impacts on surplus /(deficit) within statement of comprehensive net expenditure

Cash – cash-flow impact

OCI – charged through other comprehensive income

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Action plan

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditor. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Fixed asset register		**Grade two**
As in previous years Council dwellings are recognised as a single line item by road or area in the fixed asset register with total annual enhancements recognised as separate assets. It was not possible for management to specifically allocate the valuation based on this recognition in the fixed asset register. As at 31 March 2014, management elected to recognise all council dwellings as a single line item in the fixed asset register, and all additions and enhancements to council dwellings will be recognised on this one line. This does not allow for componentisation of assets. There is a further risk to the depreciation calculation as individual assets and components useful lives cannot efficiently be applied to accurately calculate the depreciation amount for 2014-15.	Management should continue with its review of the fixed asset register to ensure appropriate data is held on individual council dwelling assets. This should cover methods to componentise council dwellings, the allocation useful lives and the calculation of depreciation of individual components.	Agreed. An initial review of the asset management database is scheduled to take place in November / December. This will take into consideration: information requirements, current practice and system capability, including the potential linkage with other Council asset management systems, and an assessment of current risks. The results from the review will consider any necessary actions to ensure that information retained within the fixed asset register is appropriate. **Responsible officer:** Service manager – business finance **Implementation date:** June 2015

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Action plan (cont.)

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Impairment review		**Grade three**
There is opportunity to further enhance the impairment review by tracking all manager reviews, potential impairments identified and conclusions in one document. We suggested to management that the review could be performed as at 28 February thereby providing greater time for consideration and implementation of impairments. There is a risk that the value of assets is overstated due to potential impairments conditions not being considered.	A stronger audit trail of impairment reviews tracking manager reviews, potential impairments identified and conclusions, summarised in one document, would help to support impairments recognised in the financial statements or consideration of impairment triggers. To support the formalisation of the impairment review, management could implement year end departmental surveys which would require managers to disclose pertinent information.	Agreed. In recent years a review of impairments has been carried out. No impairments were carried out in 2013-14, but we are happy to bring forward early consideration of management impairment reviews to allow details to be incorporated within the accounts. **Responsible officer:** Service manager – business finance **Implementation date:** February 2015
3 Depreciation		**Grade three**
We consider that management has an unique method of calculating depreciation on enhancements to existing assets, which gave rise to an immaterial depreciation error in the year. There is a risk that the audit adjustment could become material.	We recommend management reviews the current depreciation policy and considers revising the current methodology. This should take account of how enhancements to council dwellings are recognised in the fixed asset register as there is a risk that the audit adjustment could become material in value.	Agreed. Link to Action 1 - Fixed asset register **Responsible officer:** Service manager – business finance **Implementation date:** June 2015

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Action plan (cont.)

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
4 Bad debt provision		**Grade three**
The bad debt provision is calculated separately for council tax, housing rents, housing benefit and general bad debt. The council tax, housing rents and housing benefit provisions are calculated on a historic basis, meaning they may not accurately reflect the bad debt the Council will face. Overall, the Council provides for 73.5% (2012-13: 66.29%) of its debtors. We have reviewed this compared to other authorities and consider that council tax, rents and housing benefit provisions are prudent or that gross debtors can be written off.	We recommend that management reviews the calculation methods for bad debt provisions and write-offs. This should include analysis of debtor payment profiles to update and refresh the bad debt and write off policies.	Agreed. **Responsible officer:** Service manager – business finance / Service manager - revenues **Implementation date:** March 2015
5 Sites with rectification obligations		**Grade two**
Whilst the Council do not operate any landfill sites, coal mines or other sites which carry significant liabilities to restore, there is one Council owned former landfill site and one present private operation. Management monitors the environmental impact of the former landfill site. There is sector-wide consideration of operations with obligations to restore and potential financial stability of operators. There is a risk that there is a financial obligation on the Council or out-of-date knowledge of rectification, coupled with risks	We recommend management performs further analysis is required by management to identify any potential liability and ensure they have appropriate monitoring procedures in place. Management needs to review any site (including wind farms and quarries) with a decommissioning or rectification obligation.	Agreed. Review and identify ELC asset decommissioning obligations in line with Audit Scotland Guidance. Consider any associated financial liabilities for the Council, and review current monitoring arrangements to ensure that they remain appropriate to meet obligations. **Responsible officer:** Service manager – business finance / Service manager - waste **Implementation date:** March 2015

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Action plan (cont.)

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
6 Accounts timetable		**Grade three**
The Local Authority Accounts (Scotland) Regulations 2014 will come into force on 10 October 2014. The regulations contain provision for the unaudited annual accounts as submitted to the auditor to be considered by the audit and governance committee no later than 31 August, and the audited accounts to be presented to the audit and governance committee for consideration and approval prior to auditor signature before 30 September. There is further opportunity for continuous improvement in the financial statement preparation. For example in the use and preparation of the CIPFA pro-forma financial statements in advance of the year end and in determining the approach to key judgements prior to the year end.	Whilst the audit and governance committee already consider the unaudited accounts, management should review the accounts timetable to ensure the audited accounts are also considered by the audit and governance committee.	Agreed. Work has already commenced to review the 2013-14 year end statutory accounts, with a view to an accelerating the timetable for 2014-15 in order to meet with the revised regulations. This work is on-going, and will shape the timetable for the production of the 2014-15 statutory accounts. The accelerated timetable will also be considered in line with respective Council Committee dates. **Responsible officer:** Service manager – business finance / Service manager – licensing, admin and democratic services **Implementation date:** December 2014
7 Remuneration report		**Grade three**
A number of corrections and presentational adjustments were required to ensure that the remuneration report was accurate and complied with guidance. There is a risk that remuneration report is inaccurate or is not in line with guidance. We identified a miscalculation of an exit package, as the payroll department had not been made aware of a change in leaving date. There is a risk that exit packages are calculated incorrectly, and overpayments are made to employees leaving the council.	We recommend that the report should be reviewed more thoroughly prior to its inclusion in the financial statements to identify errors and inconsistencies. Furthermore, information for calculating and awarding exit packages should be passed to payroll in a timely manner to ensure overpayments are not made.	Agreed. Within the revised year end timetable, appropriate time will be built in to the process to allow review prior to submission of draft statements to audit. Processes are in place to ensure calculation of award packages is based on accurate information. Current processes will be reviewed to ensure that they remain appropriate, and information continues to be submitted to payroll in appropriate timescales. **Responsible officer:** Service manager – business finance / Service manager – HR and payroll **Implementation date:** June 2015

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Action plan (cont.)

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
8 Bank accounts		**Grade three**
Substantive testing of bank reconciliations identified two previously unidentified bank accounts held with the Bank of Scotland. These related to the social work department and held £52,000; we do not consider these to be material. Management has begun investigating these accounts, including looking at the position with regard homes for older people. There is a risk that other previously unidentified bank accounts exist that could hold significant bank balances or overdrafts.	We recommend that management should continue its investigation into other potential unidentified bank accounts. To ensure that the central finance team has all relevant information concerning bank accounts, management could implement year end departmental surveys which would require managers to disclose pertinent information.	Agreed. A review is currently being undertaken to identify any additional bank accounts in use. In addition, there has been on-going training with respective managers to ensure awareness of procedures relating to bank accounts. On an annual basis, managers will be asked to confirm that there remain no additional bank accounts in use within their respective service areas as part of the annual declaration of assurance. **Responsible officer:** Service manager – corporate finance **Implementation date:** Update on current review December 2014; Annual confirmation – June 2015

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