

## **Chief Internal Auditor's Annual Assurance Report and Opinion 2017/18 for Midlothian Council**

### **1 Introduction**

- 1.1 It is Management's responsibility to design and maintain proper risk management, governance and internal control processes and systems to ensure probity in systems and operations, including the prevention, detection and resolution of fraud and irregularities. Management is also responsible for checking that the arrangements and controls are operating effectively. These are known as the first and second lines of defence which are not fixed but evolve as the Council changes.
- 1.2 Internal Audit, as the third line of defence, is an independent appraisal function established for the review of the internal control system as a service to Midlothian Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk.
- 1.3 The Internal Audit activity adds value to the organisation (and its stakeholders) when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management and control processes; and objectively provides relevant assurance.
- 1.4 The Objectives of Internal Audit are set out in its Charter: "As part of Midlothian Council's system of corporate governance, Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives and to do so:
- In support of the Council's vision, values and priorities.
  - As a contribution to the Council's corporate management of risk, including assisting Management to improve the risk identification and management process in particular where there is exposure to significant financial, strategic, reputational and operational risk to the achievement of the Council's objectives.
  - As an aid to ensuring that the Council and its elected members, employees and contracted third parties are operating within the law and relevant regulations, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.
  - As a contribution towards establishing and maintaining a culture of honesty, integrity, openness, accountability and transparency throughout the Council in all its activities and transactions.
  - As a contribution towards ensuring that financial statements and other published information are accurate and reliable."
- 1.5 The Public Sector Internal Audit Standards (PSIAS) (2017) requires that:  
"The chief audit executive [MLC's Chief Internal Auditor] must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.  
The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.  
The annual report must incorporate:
- the opinion;
  - a summary of the work that supports the opinion; and
  - a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme."

- 1.6 This Annual Assurance Report provides the annual internal audit opinion and summarises the work carried out by Internal Audit during the year to 31 March 2018 that underpins the opinion in accordance with the Internal Audit Charter, Strategy and Annual Plan. The report also states the outcomes of assessments of the Internal Audit service against the PSIAS.

## **2 Opinion on the systems of Internal Control, Risk Management and Governance**

- 2.1 My opinion is that, based on our reviews, risk assessments and knowledge, the systems of internal control and governance are generally adequate though there are indications in some areas of non-compliance and a lack of evidence of Management monitoring that they are operating satisfactorily; therefore improvements are required to the second line of defence consistently across the Council to ensure probity in systems and operations, including the prevention, detection and resolution of fraud and irregularities.
- 2.2 The Council's Local Code of Corporate Governance has been updated as part of the 2016/17 annual review process and was approved by Council in December 2017, following consideration by the Audit Committee. This is to ensure this key document continues to be relevant and complete to reflect the appropriate framework for effective governance of the Council's affairs and facilitate the exercise of its functions to deliver best value.
- 2.3 The Council recognises that risk management is an integral part of all activities and has Corporate and Service Risk Registers in place which are subject to regular review by those Managers who are allocated the responsibilities for managing individual risks. The Audit Committee received periodic reports from the Risk Manager on corporate risks and mitigations to fulfil its oversight role to monitor the effective development and operation of risk management in the Council.
- 2.4 Further improvements in internal control, risk management and governance have been agreed by Management as highlighted in Internal Audit reports and recommendations made during the year or outstanding from previous years.

## **3 Internal Audit Annual Plan 2017/18 Delivery**

- 3.1 Staff resources have been adversely affected during the year, mostly notably due to the Service Review that was undertaken on the Internal Audit function, the introduction of Shared Services arrangement from December 2017 (Chief Internal Auditor 0.5 FTE – shared with Scottish Borders Council), and the deployment of Internal Audit and Counter Fraud resources to the Roads Contract Management Investigation. This has had an impact on the delivery of the Internal Audit planned work.
- 3.2 The following Audit Reviews from 2017/18 Audit Plan have not been carried out for a variety of reasons with explanation provided:
- Children and Young People's Act – Named Person (Strategic Risk Based Audit - In agreement with relevant Senior Management this audit review was deleted from the programme as new legislation is not yet in place and audit work would therefore not be value added).
  - Highways Network Assets (Strategic Risk Based Audit – This audit review was deleted from the programme as the planned accounting change did not materialise therefore no requirement to review compliance).
  - Follow up of the 2016/17 Audit of Financial Strategy and Delivering Excellence (Strategic Risk Based Audit – Deferred to 2018/19 Audit Plan due to impact on staff resources of Roads Contract Investigation; Audit work is being incorporated in Delivering Excellence Programme review within 2018/19 Audit Plan).
  - Social Care Budget Planning Project (Strategic Risk Based Audit - Audit work to be incorporated in Revenue Financial Budget Monitoring review within 2018/19 Plan).

- Pupil Equity Funding (Strategic Risk Based Audit – Deferred to 2018/19 Audit Plan in agreement with Senior Management as awaiting guidance and templates from Scottish Government relating to the ring-fenced funding Return).
- Bank and Cash (Core Process / System Audit – Delayed due to a new till system being implemented in leisure centres to be launched in April 2018; Audit work to be incorporated in Sales to Cash review within 2018/19 Audit Plan).
- Council Owned Care Homes (Deferred in light of Monitoring of External Care Homes review carried out in 2017/18).
- Payroll (Core Process / System Audit – Deferred to 2018/19 Audit Plan due to impact on staff resources).

3.3 In contrast the following Audits that were deferred from 2016/17 Audit Plan have been carried out: Health and Safety; Monitoring of External Care Homes (Strategic and Risk Based Audits); and Accounts Payable (Core Process / System Audit).

3.4 The range and breadth of Internal Audit work that has been performed during the year, which is listed below, is sufficient to inform the Internal Audit assurance on the systems of internal control, governance arrangements and risk management:

#### **Strategic and Risk Based Audits**

3.5 To provide assurance on the internal controls and governance in place to ensure efficient and effective use of assets and resources and perform substantive testing of transactions to ensure completeness and accuracy of data in core systems, reviews included:

- Climate Change Reporting (Review the reporting arrangements to the Scottish Government).
- Waste (Review the systems and controls in place for the charging, collection, and disposal of Trade Waste and related performance reporting).
- Complaints (Performance reports highlight that performance indicators are off target for all Services. To include a review of controls operating over FOI requests).
- Health and Safety (Deferred from 2016/17 Audit Plan - Review the adequacy of the control framework designed by Management to allow compliance with Health and Safety legislation).
- Monitoring of External Care Homes (Deferred from 2016/17 Audit Plan – Assess the adequacy of the Council’s internal quality control over third party care home providers).

#### **Core Process / System Audits**

3.6 To provide assurance on the internal financial controls in place and perform substantive testing of transactions to ensure completeness and accuracy of data in core financial systems, reviews included:

- Accounts Payable (Deferred from 2016/17 Audit Plan - Assess controls operating for the main systems used by the Council to pay suppliers for goods and services).
- Purchasing Cards (Deferred from 2016/17 Audit Plan – Assess the adequacy of the internal controls in place for the Council’s use of purchasing cards the roll-out of which was part of the Council’s plan in reducing Petty Cash spend).
- Treasury Management (Test controls over policies and practices, strategies and reporting and compliance with the Treasury Management Code of Practice).

## **Legislative and Other Compliance Audits**

- 3.7 To test compliance with the terms of the funders' service level agreements or other requirements as part of the wider assurance framework, reviews included:
- Tyne Esk LEADER Grant Fund (Annual requirement to review the controls in place to deliver the Tyne Esk LEADER Grant Fund and to undertake compliance related work as defined by the Service Level Agreement).
  - Construction Industry Scheme (Annual requirement to undertake review in this area to test that the scheme rules are being complied with as required by HMRC) - The Findings, which were reported internally, indicate that monthly reporting to HMRC is satisfactory, and no errors were found in the invoice samples reviewed; During the course of the Audit we have informed relevant Service Areas about a minor matter to improve internal control; It is proposed to reduce the frequency of this Compliance activity from Annual to 3-Yearly within the Internal Audit Plan which has been agreed by relevant Management.

## **Annual Audit Work**

- 3.8 During the year resources were deployed in undertaking the following work relating to the whole Council:
- Recommendation Follow-Up Reviews (Two reviews were undertaken. The first noted performance against closing issues by the agreed due date while the second included a sample check on the adequacy of actions taken against issues which are flagged as closed, to check that recommendations have been implemented and to ensure that the new controls had the desired effect on improving internal controls, risk management and governance).
  - Review of Corporate Governance (Test a sample of the key elements in the Local Code of Corporate Governance to determine whether these are operating as described. The results from this testing are included in the Annual Governance Statement).
  - Annual Assessment of Internal Controls (Prepare an annual report for the Audit Committee summarising the work undertaken by the Internal Audit section and forming an opinion on the adequacy of the control environment within the Council).
  - Assessment of Internal Audit against PSIAS (Each year the Internal Audit section undertakes a self-assessment against the Public Sector Internal Audit Standards and reports its findings to the Audit Committee. In addition during 2017/18 there was an External Quality Assessment (EQA) peer review carried out by Highland Council to validate the self-assessment – see below).
  - Assessment of the Audit Committee against the CIPFA Code (Assistance provided to the Chair of the Audit Committee in undertaking an assessment of the Audit Committee against the CIPFA Audit Committees Practical Guidance for Local Authorities and Police 2013 Edition).
  - Help Desk Enquiry System (Internal Audit has a help desk facility where guidance and advice is given Management and Staff on internal controls. The help desk is also used to manage any enquiries received through the whistle blowing facilities offered by the Council).
  - Administration of Audit Scotland Reports (Internal Audit coordinates submission of Audit Scotland Reports to the Audit Committee by relevant Management).
  - Support for the Risk Management and Integrity Groups (Internal Audit attends and provides support to the Risk Management Group and the Integrity Group).
  - Planning for 2018/19 (Development of the Internal Audit Charter, Strategy and Annual Plan for 2018/19)

## **Investigations**

- 3.9 The most significant investigation during the year related to Roads Contract Management which had a significant impact on staff resources in the second half of the year. The findings and recommendations arising from Phase 1 of the Investigation have been used to inform the Internal Audit opinion. Further work is planned in Phase 2 and within other planned Internal Audit and Counter Fraud work in 2018/19 to provide further assurance.

## **Non MLC Work**

- 3.10 MLC Internal Audit section carries out three Audit reviews and provides support for the Midlothian Integration Joint Board (MIJB) based on a plan approved by MIJB and results are reported to MIJB's Audit and Risk Committee then to MIJB.

## **4 Public Sector Internal Audit Standards and Quality Assurance & Improvement Plan**

- 4.1 The professional standards as set out in Public Sector Internal Audit Standards (PSIAS) effective 1 April 2013 (updated 2017) include:

- Definition of Internal Auditing;
- Code of Ethics;
- Attribute Standards (Purpose, Authority and Responsibility; Independence and Objectivity; Proficiency and Due Professional Care; Quality Assurance and Improvement Programme);
- Performance Standards (Managing the Internal Audit Activity; Nature of Work; Engagement Planning; Performing the Engagement; Communicating Results; Monitoring Progress).

- 4.2 The Quality Assurance and Improvement Plan (QAIP) is designed to enable evaluation of Internal Audit's conformance with the Definition of Internal Auditing and the Standards, along with an evaluation of whether Internal Auditors apply the Code of Ethics, and an action plan to implement identified improvements.

- 4.3 An internal self-assessment of Internal Audit practices against the Standards was carried out in 2017/18, as required by the PSIAS, which has indicated Internal Audit conforms with the Definition of Internal Auditing, Code of Ethics, Attribute Standards and Performance Standards.

- 4.4 The PSIAS requires the self-assessment to be subject to an External Quality Assessment (EQA) each five years, by appropriately qualified and independent reviewers. To this end the Scottish Local Authorities Chief Internal Auditors Group (SLACIAG) developed its "Peer Review" framework in which MLC took part. An External Quality Assessment (EQA) Peer Review by Highland Council was carried out in March 2018. The full report is awaited though verbal feedback indicates conformance with the PSIAS against the 13 Assessment Areas and has highlighted a few areas where improvements can be made. An action plan will be developed to implement identified improvements.

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**31 May 2018**