

# Notice of meeting and agenda



## Audit Committee

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

**Date:** Tuesday, 10 May 2016

**Time:** 11:00

**John Blair**  
Director, Resources

**Contact:**

Clerk Name: Janet Ritchie  
Clerk Telephone: 0131 271 3158  
Clerk Email: [janet.ritchie@midlothian.gov.uk](mailto:janet.ritchie@midlothian.gov.uk)

**Further Information:**

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

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

## **1 Welcome, Introductions and Apologies**

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## **2 Order of Business**

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

## **3 Declarations of Interest**

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

## **4 Minutes of Previous Meeting**

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| <b>4.1</b> | Minutes of Meeting 15 March 2016 submitted for approval | <b>5 - 12</b> |
|------------|---|---------------|

## **5 Public Reports**

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|------------|---|------------------|
| <b>5.1</b> | Audit Scotland Report An overview of Local Government in Scotland 2016 - Report by Chief Executive                                    | <b>13 - 64</b>   |
| <b>5.2</b> | Midlothian Council Audit Progress Report - Report by External Auditors  | <b>65 - 82</b>   |
| <b>5.3</b> | Annual Governance Statement - Report by Chief Executive   | <b>83 - 92</b>   |
| <b>5.4</b> | Devolved School Management Scheme - Report by the Internal Audit Manager  | <b>93 - 104</b>  |
| <b>5.5</b> | Internal Audit Report on Financial Assurance for money delegated to the Integrated Joint Board - Report by the Internal Audit Manager | <b>105 - 114</b> |
| <b>5.6</b> | Internal Audit Annual Assurance Report 2015/16 - Report by Internal Audit Managers  | <b>115 - 132</b> |
| <b>5.7</b> | Audit Charter - Report by the Internal Audit Manager  | <b>133 - 152</b> |
| <b>5.8</b> | Self Assessment of the Internal Audit Section against the Public Sector Internal Audit Standards - Report by Internal Audit Managers  | <b>153 - 158</b> |

THE COMMITTEE IS INVITED (A) TO CONSIDER RESOLVING TO DEAL WITH THE UNDERNOTED BUSINESS IN PRIVATE IN TERMS OF PARAGRAPH 1, 6 and 14 OF PART 1 OF SCHEDULE 7A TO THE LOCAL GOVERNMENT (SCOTLAND) ACT 1973 - THE RELEVANT REPORT IS THEREFORE NOT FOR PUBLICATION; AND (B) TO NOTE THAT NOTWITHSTANDING ANY SUCH RESOLUTION, INFORMATION MAY STILL REQUIRE TO BE RELEASED UNDER THE FREEDOM OF INFORMATION (SCOTLAND) ACT 2002 OR THE ENVIRONMENTAL INFORMATION REGULATIONS 2004.

- 6.1** Midlothian Council Correspondence Review - Report by External Auditors
- 6.2** Business Gateway Contractors - Report by the Internal Audit Manager



# Minute of Meeting

Audit Committee  
Tuesday 10 May 2016  
Item No. 4.1



## Audit Committee

Date	Time	Venue
Tuesday 15 March 2016	11.00 am	Council Chambers, Midlothian House, Dalkeith, EH22 1DN

### Present:

Peter Smaill (Independent Chair)	Michael Thomas (Independent Member)
Councillor Baxter	Councillor Bryant
Councillor de Vink	Councillor Muirhead
Councillor Parry	

### In attendance:

Kenneth Lawrie	Chief Executive
Graham Herbert	Internal Audit Manager
Claire Gardiner	External Auditor Grant Thornton
Paul Dossett	External Auditor Grant Thornton
John Blair	Director Resources
Mary Smith	Director Education, Communities and Economy
Eibhlin McHugh,	Joint Director of Health & Social Care
Gary Fairley	Head of Integrated Service Support
Ricky Moffat	Head of Commercial Operations
Ian Johnson	Head of Communities and Economy

## 1. Apologies

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- 1.1 Apologies were received from Councillor Milligan.

## 2. Order of Business

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The order of business was confirmed as outlined in the agenda that had been circulated.

## 3. Declarations of interest

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No declarations of interest were received.

## 4. Minutes of Previous Meetings

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- 4.1 The minutes of the Audit Committee meeting of 8 December were submitted and approved as a correct record.

## 5. Reports

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Report No.	Report Title	Presented by:
5.1	Draft Midlothian Council Annual External Audit Plan	External Auditors, Grant Thornton

### Outline of report and summary of discussion

There was submitted the Midlothian Council Annual External Audit Plan for the financial year ending 31 March 2016. Claire Gardiner, External Auditor presented to the Committee the External Audit Plan which covers the audit approach to the financial statements and the wider responsibility under the Audit Scotland code which includes a review of governance and performance. The report outlines the key areas and challenges in the current year including the financial pressures and the identification of significant audit risks. Also included within the report is a timetable on the key phases of the audit for 2015/16.

Paul Dossett, External Auditor presented an update to the Committee on the Audit Plan which included the following:

- An Interim Audit has been conducted and the progress is going well.
- A whistle blowing allegation has been made and a draft report is with management for comments and this will be presented to the next Audit Committee meeting with recommendations where appropriate.
- An explanation on the procurement process by Audit Scotland for External Audit for next 5 years, starting 2016/17 and the timescale in which this will be concluded.

Thereafter the External Auditors responded to questions raised by the Committee members which included:

- Audit Scotland following the public £and how this will be scrutinised for best

value within local authorities.

- Clarification on the process on the appointment of External Auditors and the reasons why the appointment is carried out by Audit Scotland.
- It was highlighted there was one red alert within this report regarding Property, Plant and Equipment. It was explained that this affected all Councils.
- An explanation on net cost of services operating expenditure and accounting expenditure and the savings requirement of 3%.

#### Decision

- To note the increase in 1% audit fees for this year.
- To otherwise note the report.

Report No.	Report Title	Presented by:
5.2	Risk Management Report	Risk Manager

#### Outline of report and summary of discussion

The Risk Management update dated 8 March 2016 was submitted for quarter 3. The purpose of the report is to provide the Audit Committee with an update of the Strategic Risks, Issues and Opportunities facing Midlothian Council. The Head of Commercial Operations presented this report to the Committee highlighting the main sections of the report, thereafter giving detailed responses to the Committee's questions which included:

- General Data Protection Regulation risk.
- How the Council monitors and addresses the risks of flooding.

#### Decision

- To note the Strategic Risk Profile update report and consider the current response to the risks and opportunities highlighted.

Report No.	Report Title	Presented by:
5.3	Financial Monitoring 2015/16 and Financial Strategy 2016/17 to 2020/21	Director Resources

#### Outline of report and summary of discussion

There was submitted a report dated 8 March 2016 by the Director, Resources, bringing to the Committee's attention reports by the Head of Finance and Integrated Service Support, which had been considered by the Council on 8 February 2016 and 8 March 2016.

The Head of Finance and Integrated Service Support updated the Committee on the Council's decisions of 9 February and 8 March 2016 in respect of the following reports:

The Council Meeting 9 February 2016:

- (i) The Financial Strategy 2016/17, the Council's decision was to freeze Council Tax 2016/17.

The Council's decision was to note the recommendations for the following three reports:

- (ii) Financial Monitoring 2015/16 – General Fund Revenue.
- (iii) General Services Capital Plan 2015/16 Quarter 3 Monitoring.
- (iv) Housing Revenue Account - Revenue Budget and Capital Plan 2015/16.

The Special Council meeting on 8 March 2016:

- (i) The main purpose of this meeting was for the Council to set a balance budget for 2016/17. Council agreed the recommendations with some changes: (i) in respect of the Members Environmental Projects to reinstate £180,000 per annum back into the General Services Capital Plan; (ii) not accept the increase in free school meals. Approve the utilisation of £2.663 million of reserves in 2016/17 to balance the budget.

The Council's decisions was to approve the following two reports:

- (ii) General Services Capital Plan 2015/16 to 2020/2.
- (iii) Treasury Management and Investment Strategy 2016/17 and Prudential Indicators (March 2016).

Thereafter the Head of Finance and Integrated Service Support gave detailed responses to questions from the Committee which included:

- National Living Wage and the Council Pay Grade in relation to this.
- Confirmation of the Council's Reserves.
- Transformation Savings and any update on the expenditure on the transformation activity.

Decision
<ul style="list-style-type: none"><li>To note the recommendations.</li></ul>



Report No.	Report Title	Presented by:
5.4	Internal Audit Plan 2016/17	Internal Audit Manager

Outline of report and summary of discussion

There was submitted a report by Internal Audit Manager dated 24 February 2016. The Internal Audit Manager explained the purpose of the report was to present the draft Internal Audit plan for 2016/17; an explanation on how the plan was developed and the priorities for the internal audit activity during the year. The Audit Committee was invited to review and comment on the draft plan. The manager highlighted that



it was proposed to hold a session in May 2016 for members as detailed in the recommendations. It was also highlighted that there is provision in the plan for up to 4 audits in the year for emerging risks and that the Plan is flexible and could be adjusted should any new risks arise.

#### Decision

The Audit Committee agreed the following recommendations:

- To note that 100 days has been set aside for Health and Social Care within the plan but that the proposed audits and time allocated may change following input from the Integrated Joint Board Audit and Risk Committee.
- To note that following a recommendation by Grant Thornton a session with members of the Audit Committee will be arranged to identify priorities for the coming year.
- To otherwise note the report.

Report No.	Report Title	Presented by:
5.5	Internal Audit Report – Review of Controls Operating Over Developer Contributions	Senior Internal Auditor

#### Outline of report and summary of discussion

The report submitted was presented to the Committee by the Senior Internal Auditor providing details on the controls in place over Developer Contributions and whether these were adequate. Also highlighted to the Committee were the strengths identified; the areas where improvement was required and the recommendations proposed by Internal Audit.

The Senior Internal Auditor provided clarity on the issue regarding the recording and monitoring of Developer Contributions and the responsibility of collection of amounts owed by the relevant due date.

Thereafter the Head of Communities and Economy gave a background on why this Audit was requested and gave assurances that the Council has not lost any Developer Contributions. The Head of Communities and Economy also explained that there is now a Section 75 Officer in post who is responsible for ensuring payments are received and appropriately accounted for and that a robust system is now in place.

The Head of Communities and Economy, Head of Finance and Integrated Service Support and the Internal Auditors responded to questions raised by the Committee.

#### Decision

- To review and follow up on the monitoring recommendations as part of Internal Audit's follow up review of issues raised and include these in the Report submitted to the Audit Committee in June 2016.
- To otherwise note the Report

**Note: Councillor Muirhead left the meeting at 12.17 pm**

Report No.	Report Title	Presented by:
5.6	Internal Audit Report – Pre-School Provision Partnership Providers	Internal Auditor

#### Outline of report and summary of discussion

The report submitted was presented to the Committee by the Internal Auditor providing details on the adequacy of the processes and controls for the Council's arrangements with Pre-School Provision Partnership Providers for three and four year olds. The audit included a review of guidance and procedures for staff, contracts, payment made to the nurseries, and performance monitoring. Detailed responses were provided to the questions raised by the Committee which included:

- Clarity on the 600 hours of free pre-school education and the provision for 2 year olds and an explanation on the timescales and work involved in implementing this.
- Additional resources received from the Scottish Government and how the finances are managed in relation to this.
- To note that Internal Audit would follow up on a sample of the recommendations raised.

#### Decision

- To review the contents of the audit report
- To endorse the Recommendations.

Report No.	Report Title	Presented by:
5.7	Integrated Joint Board Audit Plan and Service Level Agreement	Internal Audit Manager

#### Outline of report and summary of discussion

A report was submitted by the Internal Audit Manager dated March 2016. The Audit Manager presented the Report to the Committee highlighting the following:

- Under Legislation Local Authorities and Health Boards are required to set up an Integrated Joint Board and to delegate Health and Social Care functions to it.
- At a meeting of the Integrated Joint Board on 20 August 2015 it was agreed that the Internal Audit Manager of Midlothian Council would be the Chief Internal Auditor for this Board.
- The Scottish Government's guidance for Integrated Joint Board recommends that the arrangements for the internal audit service is documented as a service level agreement and that Operational Internal Audits by Midlothian Council and NHS Lothian should be shared with the Integrated Joint Board.
- The Internal Audit Plan for the Integrated Joint Board should also be shared

with Midlothian Council and NHS Lothian.

Thereafter the Internal Audit Manager responded to questions raised by the Committee.

#### Decision

- To recommend to Midlothian Council approval of the Service Level Agreement between the Internal Audit Services of Midlothian Council, NHS Lothian and the Integrated Joint Board.
- To recommend to Midlothian Council that operational Audits which may have relevance for the Integrated Joint Board are shared with the Integrated Joint Board Audit and Risk Committee.
- To otherwise note the 2015/16 Internal Audit plan approved by the Integration Joint Board.

## 6. Private Reports

In view of the nature of the business to be transacted, the Committee agreed that the public be excluded from the meeting during discussion of the undernoted item, as contained in the Addendum hereto, as there might be disclosed information as defined in paragraph 8 and 10 of Part I of Schedule 7A to the Local Government (Scotland) Act 1973:-

Report No.	Report Title	Presented by:
6.1	Internal Audit Report – Review of Controls Operating over Tendering of Contracts	Internal Auditor

#### Decision

- To note the report
- To endorse the Management Action Plan

The meeting terminated at 12:33



**Audit Scotland Report: An overview of local government in Scotland 2016  
(Audit Scotland, March 2016)****Report by: Kenneth Lawrie, Chief Executive****1. Purpose of the Report**

- 1.1. To provide Audit Committee with a summary of the Audit Scotland report, '*An overview of local government in Scotland 2016*' and the Council's position in relation to the report's findings.

**2. Background**

- 2.1. Each year the Accounts Commission produce an overview of issues that have arisen from their local authority audits. The overview assists councils in identifying and planning for pressures they may face in the coming year and the 2016 report explores council's financial and service performance and their journey of improving outcomes for service users and communities.
- 2.2. **An Overview of local government in Scotland 2016** was published by the Accounts Commission in March 2016. The report is based on local government audit work in 2015 and provides a high-level independent view of councils' management and performance.
- 2.3. The report should be seen as a source of information primarily for councillors and senior council officials and is in two parts. Part 1 considers the financial context in which councils operate and gives a national overview of councils' financial performance whilst Part 2 considers performance in delivering services and how councils are changing the way they operate in the context of increasing pressures, looking at the implications for councils' workforce and highlighting key aspects of governance.
- 2.4. The key messages identified in the 2016 report include:
  1. Councils need clear priorities and better long-term planning to support increasingly difficult spending decisions at a time of additional financial pressures and greater demands for services.
  2. Councils need to look beyond budget reductions which focus on incremental savings to existing services to options for more significant changes to delivering key services.
  3. Whilst performance measures show improvements across a number of areas, despite their reducing spend, this is not the case for customer satisfaction where performance has declined for some services.
  4. A key focus for savings has been, and continues to be, workforce reductions and as a result councils should ensure that they have people

with the knowledge, skills and time to design, develop and deliver effective services for the future.

5. In response to the Community Empowerment (Scotland) Act 2015, councils need to involve local people in decision making and service delivery options which are sustainable and meet local needs.
6. Councillors need to keep updating their skills and knowledge to fulfil their complex and demanding role, in particular their ability to challenge and scrutinise decisions and performance and to fully assess options for new and different ways delivering services.

### **3. Report Recommendations**

3.1. The recommendations made in the report are intended to support a range of existing sources available to help councillors understand and manage their council's financial and service performance and to support them in carrying out their role effectively, such as the support available from the Improvement Service.

3.2. The report noted the following recommendations stating what Councillors should do, Midlothian Council's current response covering each recommendation is shown in italics:

1. Satisfy themselves that their council has a longer-term financial strategy (five or more years) supported by an effective medium-term financial plan (three to five years). These should show how the council will prioritise spending to achieve its objectives, make any necessary savings and remain financially sustainable.

*Whilst the Financial Strategy presented to Council on the 8 March 2016, and the introduction of the 'Delivering Excellence' framework responds to the need for short to medium term financial planning, the Strategic Leadership Group, as part of their activities supporting the regular review and presentation of the Financial Strategy ensures that longer term planning is informed by the range of challenges and variables which potentially come into play over the longer period.*

2. Appraise all practical options for how to deliver the services their communities need within the resources available. This includes examining opportunities to work with and empower communities to deliver services in different ways, and learning lessons from others and from wider public service reform. They should ensure they get all necessary information and support from officers to help them fully assess the benefits and risks of each option.

*A key element of the 'Delivering Excellence' Framework presented to council on 22 September 2015 is that in reviewing services and budgets, officers should consider the full range of service delivery options, including, for example, co-production. A community engagement exercise 'Shaping Our Future' is taking place to support this work. This is to encourage residents, community groups, partner organisations and employees to tell us what the priorities are for them, their families and*

*their communities and to get their help to reshape our services to meet those priorities. The approach will also take account of the new draft guidance being produced in connection with the Community Empowerment Act, and officers will report on this to Council in the near future.*

3. Ensure their council continues to develop workforce strategies and plans that clarify the numbers and skills of staff needed in future. In assessing their council's workforce, councillors should consider whether they have people with the knowledge, skills and time to support them effectively in making the difficult decisions that lie ahead, and to design and implement new ways of delivering services.

*Work to create workforce plans, both at council and service levels, for Midlothian Council is well underway. Our HR business partners are working with Heads of Service to analyse their workforce profile and make recommendations and plans for the service level actions required to ensure that we have sufficient, appropriately skilled, employees to meet future service requirements.*

4. Make sure that decision-making processes and scrutiny arrangements remain appropriate for different ways of delivering services. This includes:
  - having clearly written and manageable information to help them make decisions and scrutinise performance
  - carrying out business openly and improving public reporting

*The ongoing review of scrutiny and the Planning and Performance Management Framework during the 2015/16 performance cycle includes a refresh of performance reporting and service planning and the planned introduction of the Balanced Scorecard for the pending annual report. Engagement with members, in a session focussing on 'Scrutiny and the importance of good quality performance information', as part of their development programme will also inform the ongoing review.*

*Further improvements to the council's approach to public performance reporting, identified in a report to Audit Committee on the 23 September 2015, have also been taken into account in the recently published Annual Performance Report 2014/15.*

5. Regularly review their personal training and development needs. They should work with council staff and others to create opportunities to update their knowledge and skills in increasingly important areas, such as financial planning and management, options appraisal, commissioning services, partnership working and scrutiny. These opportunities should also be available to any new members after the local elections in 2017.

*Elected members currently have access to a collective development programme and individual development discussions which cover a range of topics, including specific training for those members on scrutiny committees such as Audit. The approach and support for member*

*development is currently being refreshed with discussions with members informing development areas going forward.*

6. Use the questions in this report and the separate self-assessment tool (see Appendix 1) to help them assess their council's position.

*The assessment tool referred to in the report and attached as an appendix will be shared with all members as part of their development planning.*

## **4. Report Implications**

### **4.1. Resource**

There are no additional resource implications.

### **4.2. Risk**

Whilst there are no additional direct risks associated with this report, the Audit Scotland Report – An overview of local government in Scotland 2016, does ask members to consider the wider scrutiny and performance management and risk elements associated with their role.

### **4.3. Single Midlothian Plan**

Themes addressed in this report:

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

### **4.4. Key Priorities within Single Midlothian Plan**

Midlothian Council and its Community Planning Partners have made a commitment to treat the following areas as key priorities under the Single Midlothian Plan:-

- Early years and reducing child poverty
- Economic Growth and Business Support
- Positive destinations for young people

This report does not directly impact Midlothian Council's key priorities but a key message within the Audit Scotland Report does make reference to the need for clear priorities.

### **4.5. Impact on Performance and Outcomes**

The report does not directly impact Midlothian Council's and wider partners performance and outcomes but it does stress the need to ensure



consideration is given to the wider strategic planning and objectives as part of the council's response to Audit Scotland's finding noted in their report.

#### **4.6. Adopting a Preventative Approach**

This report does not directly impact actions and plans in place to adopt a preventative approach.

#### **4.7. Involving Communities and Other Stakeholders**

This report does not directly relate to involving communities but the Audit Scotland Report does emphasise the need to address the requirements in the Community Empowerment (Scotland) Act 2015.

#### **4.8. Ensuring Equalities**

This report does not recommend any change to policy or practice and therefore does not require an Equalities Impact Assessment.

#### **4.9. Supporting Sustainable Development**

The recommendations in this report support Midlothian Council's position in relation to Audit Scotland's findings for the wider overview of Local Government in Scotland 2016 and therefore support ongoing sustainable development.

#### **4.10. IT Issues**

There are no IT issues arising from this report at this time.

### **5. Recommendations**

The Committee is asked to:

- a) Note the Audit Scotland report and the position of Midlothian Council in relation to the report's recommendations.

**Appendix 1** – An overview of local government in Scotland 2016 – Self-assessment tool for councillors

**Date:** 20 April 2016  
**Report Contact:** Myra Forsyth, Quality & Scrutiny Manager  
**Tel No:** 0131 271 3445  
**E-Mail:** [Myra.forsyth@midlothian.gov.uk](mailto:Myra.forsyth@midlothian.gov.uk)

#### **Background Papers:**

An overview of local government in Scotland 2016; Accounts Commission, March 2016




# Local government overview 2016

Self-assessment tool for councillors



ACCOUNTS COMMISSION 

This self-assessment brings together a number of potential questions for councillors related to [An overview of local government in Scotland 2016 \[PDF\]](#) . It is designed to help councillors identify how well informed they are about each area and to highlight areas where they may wish to ask further questions.

How well informed am I?		
Questions for councillors to consider	What do I know?	Do I need to ask any further questions?
<b>Reserves (paragraphs 18 to 20)</b>		
What level of reserves do we need, both allocated and unallocated?		
How effectively are we using the reserves we hold?		
<b>Borrowing and financing (paragraphs 21 to 24)</b>		
What implications do different borrowing and financing options have for our future revenue budgets?		

## How well informed am I?

Questions for councillors to consider	What do I know?	Do I need to ask any further questions?
<b>Pension costs (paragraphs 30 to 35)</b>		
What are the implications of workforce reductions on our pension costs?		
How will these affect our pension liabilities and pension administration costs?		
<b>Funding gaps (paragraphs 39 to 42)</b>		
How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?		
What options do we have to address this budget shortfall for example, redesign services, use reserves?		
How big is the remaining funding gap after we implement our selected options?		
What actions are we taking to close any remaining funding gap?		
<b>Long-term planning (paragraphs 43 to 46)</b>		
Do we have a long-term financial strategy covering at least five years that accounts for future pressures?		
Is our five-year strategy supported by detailed financial plans covering a minimum period of three years?		
How well do our financial plans set out the implications of different levels of income spending and activity?		

## How well informed am I?

Questions for councillors to consider	What do I know?	Do I need to ask any further questions?
How does our financial strategy link to our vision for the future?		
<b>Public Performance Reporting (paragraph 50)</b>		
How clearly do we report our plans and performance to the public?		
<b>Service redesign (paragraphs 56 to 65)</b>		
How will our savings plans help us achieve our corporate objectives and commitments made to our Single Outcome Agreement?		
How open are we to considering all possible options to reduce the cost, and improve the quality and effectiveness of the services we provide?		
How fully have we appraised the options for sharing services with similar or neighbouring authorities or other public sector bodies?		
What options do we have for collaborating or sharing services?		
How are we involving and empowering local communities to design and deliver services to suit local needs?		
How do we learn from other changes we have made and the experiences of other organisations when identifying and considering all the options?		

## How well informed am I?

Questions for councillors to consider	What do I know?	Do I need to ask any further questions?
<b>Workforce planning (paragraphs 66 to 75)</b>		
How do we ensure our senior officers have the knowledge, skills and time to support us in making difficult decisions?		
What do we need the workforce to look like in terms of numbers, skills and knowledge?		
How do we ensure the council's future pay structures do not discriminate against any groups of staff?		
How effectively is the council working to improve sickness absence among employees?		
<b>Openness and scrutiny (paragraphs 76 to 87)</b>		
How do we ensure that the information we receive is clearly written, jargon-free and manageable?		
How can we consider more of our business in public?		
How can we involve our communities more in local decisions?		
How well do we scrutinise decisions on financial and service performance?		
How do we ensure we have the knowledge and expertise we need to scrutinise effectively?		

# An overview of local government in Scotland 2016



ACCOUNTS COMMISSION 

Prepared by Audit Scotland  
March 2016


# The Accounts Commission

The Accounts Commission is the public spending watchdog for local government. We hold councils in Scotland to account and help them improve. We operate impartially and independently of councils and of the Scottish Government, and we meet and report in public.

We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

Our work includes:

- securing and acting upon the external audit of Scotland's councils and various joint boards and committees
- assessing the performance of councils in relation to Best Value and community planning
- carrying out national performance audits to help councils improve their services
- requiring councils to publish information to help the public assess their performance.

You can find out more about the work of the Accounts Commission on our website: [www.audit-scotland.gov.uk/about/ac](http://www.audit-scotland.gov.uk/about/ac) 

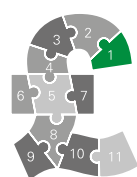
Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.



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These pound sign icons appear throughout this report and represent key facts.



These question mark icons appear throughout this report and represent questions for councillors.



## Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

# Chair's introduction



In our 2015 overview report we said, 'Councils tell us that they should manage budgetary pressures in 2015/16 but the years beyond pose a level of challenge not previously experienced.' The Commission recognises the achievement of councils – both councillors and officers – in meeting these challenges to date.

But the scale of the challenge in 2016/17 and beyond has significantly increased because of the local government funding settlement. The settlement has substantial implications for services to the public, councillors and the local government workforce.

Next year councils and health boards, through health and social care partnerships, jointly have the responsibility to make a significant start in the shift from hospital care to care at home and care in the community. This is the most far-reaching public service reform since the establishment of the Scottish Parliament.

And these challenges are compounded by: a one-year financial settlement, cost pressures, increasing demands on services from an ageing and growing population, the ambitions of the Community Empowerment (Scotland) Act 2015, and the political pressures created by elections in both 2016 and 2017.

The majority of our recent Best Value audits have highlighted a dependency on incremental changes to services, increasing charges and reducing employee numbers in order to make savings. But these are neither sufficient nor sustainable solutions set against the scale of the challenge facing councils. Cuts can only be part of the solution. What is required is a more strategic approach, longer-term planning and a greater openness to alternative forms of service delivery.

It is challenging for councillors and officers to fundamentally change the way a council has provided a service over a lengthy period of time. But there are significant consequences to not conducting comprehensive option appraisals: services may not be as efficient or effective as they could be and may not be achieving value for money, resources may not be directed to priority areas such as preventative services, and councils may not be able to demonstrate that they are achieving best value.

In considering all viable options, it will be essential that councillors are provided with comprehensive and objective information on the cost, benefits and risks of each option. This will help them make considered decisions in partnership with service users and communities.

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**the scale  
of the  
challenge has  
significantly  
increased –  
cuts can only  
be part of the  
solution**

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As the landscape of service delivery becomes ever more complex, councils will need to ensure they have people with the necessary knowledge and skills to manage that complexity. This is important for councillors and council officers, as both must have, for example, skills in options appraisal, programme management, commissioning, finance and scrutiny.

And in a climate of reducing resources the importance of scrutiny has never been greater. Scrutiny arrangements must add demonstrable value in monitoring the planning, execution and follow-up of key decisions. The public needs to have confidence that their council's arrangements are transparent, independent and effective. If they are not, the public interest is not being met.

The Commission hopes that this overview report will be a helpful tool for councillors and officers to stand back and assess their progress in the journey of improving outcomes for service users and communities. As always, the Commission welcomes feedback on its overview report.

**Douglas Sinclair**

Chair of the Accounts Commission

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# Summary



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## Key messages

- 1** Councils' revenue funding from the Scottish Government will reduce by five per cent in 2016/17, bringing the real terms reduction in revenue funding since 2010/11 to 11 per cent. At the same time, they face additional financial pressures and greater demands on services. Councils have been effective in balancing their annual budgets until now but councillors face increasingly difficult decisions about how best to spend their reducing budgets. This requires clear priorities and better long-term planning.
  - 2** Councils' responses to budget reductions have mainly focused on incremental savings to existing services. In the face of further funding reductions, councils should be evaluating options for more significant changes to delivering key services, beyond health and social care integration.
  - 3** Despite reducing their spending, performance measures show that councils improved in areas such as educational attainment, the quality of council housing and waste recycling, in 2014/15. However, customer satisfaction with some services declined and there are more significant funding reductions to come in 2016/17 and beyond.
  - 4** Most councils have reduced their workforces to save money, and many are planning further staff reductions. In doing so, they need to ensure they have people with the knowledge, skills and time to design, develop and deliver effective services in the future.
  - 5** Councils and their partners also need to respond to the Community Empowerment (Scotland) Act 2015, by involving local people more in making decisions about services, and empowering local communities to deliver services that are sustainable and meet local needs.
  - 6** Councillors need to keep updating their skills and knowledge to fulfil their complex and demanding role. In particular, it is increasingly important that they are able to challenge and scrutinise decisions and performance, and fully assess options for new and different ways of delivering services within their reducing budgets.
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## Recommendations

Councillors are now leading complex organisations in increasingly challenging circumstances. There are a range of sources to help them understand and manage their council's financial and service performance, for example the Improvement Service. Our recommendations are intended to complement other sources of support and help councillors in carrying out their role effectively.

### Councillors should:

- satisfy themselves that their council has a longer-term financial strategy (five or more years) supported by an effective medium-term financial plan (three to five years). These should show how the council will prioritise spending to achieve its objectives, make any necessary savings and remain financially sustainable
- appraise all practical options for how to deliver the services their communities need within the resources available. This includes examining opportunities to work with and empower communities to deliver services in different ways, and learning lessons from others and from wider public service reform. They should ensure they get all necessary information and support from officers to help them fully assess the benefits and risks of each option
- ensure their council continues to develop workforce strategies and plans that clarify the numbers and skills of staff needed in future. In assessing their council's workforce, councillors should consider whether they have people with the knowledge, skills and time to support them effectively in making the difficult decisions that lie ahead, and to design and implement new ways of delivering services
- make sure that decision-making processes and scrutiny arrangements remain appropriate for different ways of delivering services. This includes:
  - having clearly written and manageable information to help them make decisions and scrutinise performance
  - carrying out business openly and improving public reporting
- regularly review their personal training and development needs. They should work with council staff and others to create opportunities to update their knowledge and skills in increasingly important areas, such as financial planning and management, options appraisal, commissioning services, partnership working and scrutiny. These opportunities should also be available to any new members after the local elections in 2017
- use the questions in this report and the separate self-assessment tool to help them assess their council's position.

## About this report

**1.** This report provides a high-level, independent view of councils' management and performance. It draws on the findings from local government audit work in 2015, including audits of 2014/15 financial statements, Best Value, Community Planning and performance. All reports are available on Audit Scotland's website.

**2.** The report is primarily for councillors and senior council officers as a source of information and to support them in their complex and demanding roles:

- **Part 1** reviews the financial context in which councils are operating and gives a national overview of councils' financial performance. Information that compares one year with another is shown in real terms (taking inflation into account, based on 2014/15 prices) unless otherwise stated.
- **Part 2** considers how councils are performing in delivering services and how they are changing the way they operate in the context of increasing pressures. It looks at the implications for councils' workforces and highlights key aspects of governance.

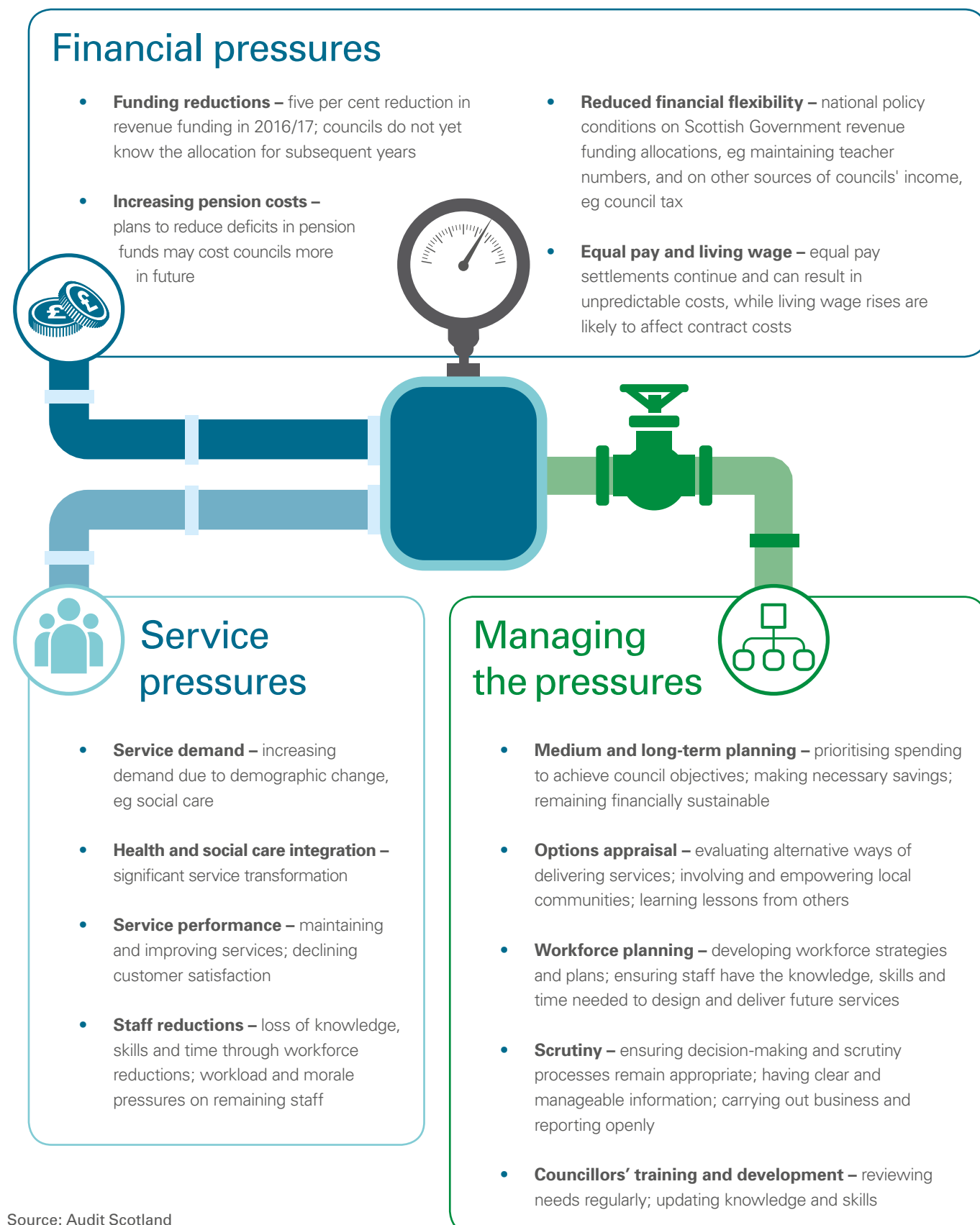
**3. [Exhibit 1 \(page 9\)](#)** provides a summary of the main pressures that councils face.

**4.** Throughout the report we identify questions that councillors could ask to help them understand their council's financial position, scrutinise performance and make good decisions. Councillors should satisfy themselves that they understand, and are comfortable with, the answers to the questions most relevant to them in their role within the council. These questions are also in a [separate self-assessment tool](#) on [Audit Scotland's website](#), where we have also provided selected financial facts about each council to help comparisons and benchmarking.

## Exhibit 1

### Local government pressures

In the face of financial and service pressures, councils should be planning for the longer term and evaluating options for more significant service redesign.



Source: Audit Scotland

# Part 1

## Managing financial performance



### Key messages

- 1** Councils received £10.76 billion of funding from the Scottish Government in 2014/15. This included £9.92 billion for revenue funding, which helps pay for day-to-day running costs, including staff. This was almost the same as the previous year and 6.5 per cent less in real terms than in 2010/11. While revenue funding in 2015/16 also remained largely unchanged in real terms, major challenges lie ahead for councils. The Scottish Government has reduced revenue funding in 2016/17 by five per cent in real terms. This equates to an 11 per cent reduction in revenue funding between 2010/11 and 2016/17. Councils also received capital funding in 2014/15 of £0.84 billion.
- 2** Councils have continued to balance their budgets each year by reducing their spending. The majority underspent their 2014/15 budgets and increased their reserves in anticipation of future funding reductions.
- 3** Local Government Pension Scheme (LGPS) funds report shortfalls between the value of funds and the future pension commitments to be paid. This does not create immediate problems. Pension funds have plans in place to reduce any deficits within a 20-year period.
- 4** Councils' debt has been increasing since 2011/12, although it decreased slightly in 2014/15. In addition, many councils predict gaps between their income and spending in future years. This may threaten their financial sustainability if risks are not well managed.
- 5** The challenging financial environment, together with changing demographics and rising demands on services, means that effective medium-term (three to five years) and longer-term (five or more years) financial planning is critical for councils. This is more challenging for councils when they do not know what their future funding and income will be, meaning that they need to plan for a range of possibilities.

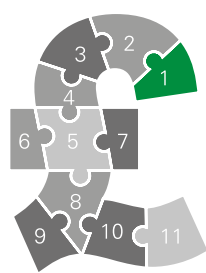
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**councils have effectively balanced their budgets but long-term planning is critical in this challenging financial environment**

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**In 2016/17, Scottish Government revenue funding for councils is 11 per cent lower (in real terms) than in 2010/11**



**5.1 per cent:** reduction in Scottish Government revenue funding for councils in 2016/17



**6.5 per cent:** reduction in Scottish Government revenue funding between 2010/11 and 2014/15

**£0.4 billion:** increase in non-domestic rates (NDR) income between 2010/11 and 2014/15

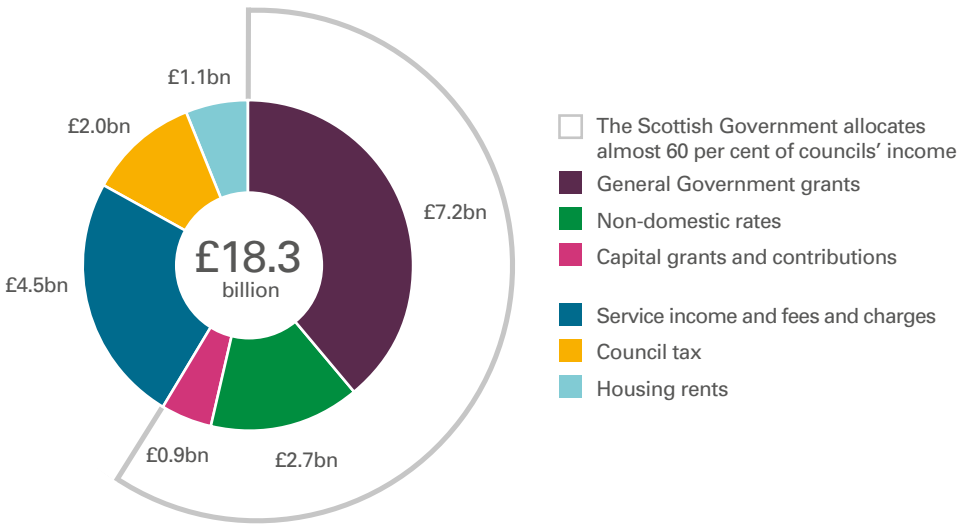
**£18.3 billion:** councils' total income in 2014/15

**5.** Councils' 2014/15 accounts showed that their total income was £18.3 billion. In line with previous years, the Scottish Government allocated almost 60 per cent of this (£10.76 billion) ([Exhibit 2](#)). This included revenue funding of £9.92 billion for day-to-day running costs, including staff; and capital funding of £0.84 billion to invest in buildings, roads and equipment. In real terms, the £10.76 billion is six per cent lower than in 2010/11, when total funding was at its highest.

**Exhibit 2**

**Sources of councils' £18.3 billion of income in 2014/15**

Almost 60 per cent of councils' income is allocated by the Scottish Government.



**Notes:**

1. Service income, fees and charges may include specific, service-related grants and income such as payments from the Scottish Government, NHS or other councils. They exclude housing rents which are shown separately as housing income.
2. Capital grants and contributions include income from the Scottish Government and others such as central government bodies, National Lottery and the European Union.
3. Figures sum to £18.4bn due to rounding.

Source: Councils' annual accounts, 2014/15

**6.** Scottish Government revenue funding remained almost unchanged (in real terms) in 2014/15 and 2015/16. In 2016/17, it will be five per cent lower than in 2015/16. This represents a reduction of 11 per cent in real terms since 2010/11.

**7.** In 2014/15, Scottish Government revenue funding included £343 million as part of the council tax reduction scheme, replacing council tax benefit that until 2013/14 came from the UK Government. It also included £490 million for freezing council tax at 2007/08 levels. The Scottish Government has added £70 million each year since 2008/09 to make up for income councils would have received if they had increased council tax in line with inflation each year. As part of the funding agreement for 2014/15, councils committed to implementing national policies to freeze council tax, and maintain teacher numbers and pupil to teacher ratios.

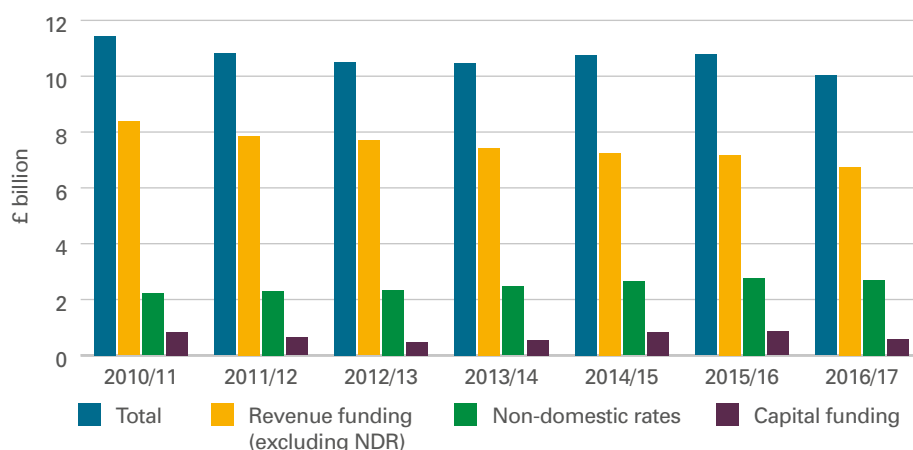
### NDR makes up an increasing share of the revenue funding allocated by the Scottish Government

**8.** Non-domestic rates (NDR) are a tax on business property to help pay for local services. The Scottish Government sets the rate of tax, councils collect the money, and the Scottish Government redistributes it as part of its funding allocation to councils. NDR income has risen in recent years due to annual increases in the rate of tax and rises in the number of business properties on which the tax is paid ([Exhibit 3](#)). This increase, alongside total revenue funding decreases, has led to NDR making up 25 per cent of allocated revenue funding in 2014/15 compared with 19 per cent in 2010/11.

## Exhibit 3

### Scottish Government funding to councils from 2010/11 to 2016/17, at 2014/15 prices

NDR income has been rising while total revenue funding has reduced.

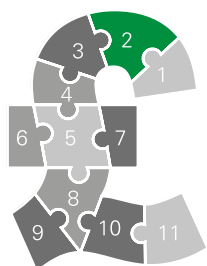


#### Notes:

1. Funding allocations up to 2012/13 have been adjusted to remove funding for police and fire. Responsibility for these services transferred from local to central government in April 2013.
2. The Scottish Government has not yet set out its plans for local government funding beyond 2016/17.
3. From 2013/14, revenue funding includes payments for council tax reduction, replacing council tax benefit which previously came from the UK Government. This was £356 million in 2013/14 and £343 million in 2014/15, at 2014/15 prices.
4. The 2016/17 figures do not include £250 million that the Scottish Government allocated to health and social care integration authorities. This is an allocation from the Scottish Government health budget to NHS boards, rather than councils. The NHS boards will direct the funding to the integration authorities.

Source: Local Government Finance Circulars, Scottish Government, 2011-2016

## Capital funding from the Scottish Government increased significantly in 2014/15 as part of a phased plan



**£37.1 billion:** value of physical assets owned by councils, for example buildings, schools, roads and equipment





**£2.2 billion:** amount councils invested in capital projects in 2014/15

**£498 million:** revenue and capital payments for Private Finance Initiatives (PFI) and Non-Profit Distributing (NPD) contracts in 2014/15

**9.** As part of its 2011/12 Spending Review, the Scottish Government rescheduled payments of some planned capital grant funding for councils for 2012/13 and 2013/14 by two years. This was to provide more capital funding for government bodies that are not allowed to borrow money. The Scottish Government then increased capital allocations to councils by £120 million in 2014/15 and £94.2 million in 2015/16. Similar shifts in capital funding are planned between 2016/17 and 2019/20, with lower funding in the first two years and higher in the last two years.

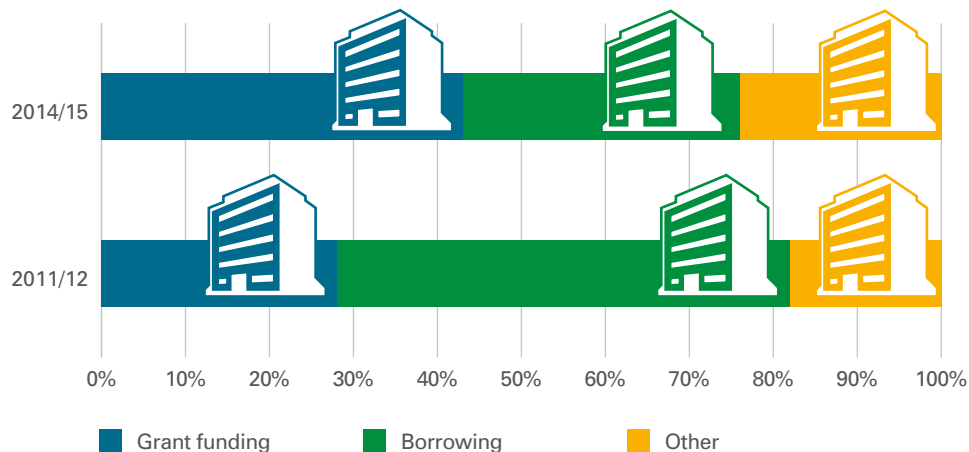
**10.** Between 2011/12 and 2014/15, capital grant funding increased from £720 million to £925 million (at 2014/15 prices). The Scottish Government provided about 80 per cent of grants in this period. Councils' total capital spending has decreased over the same period, from £2.5 billion to £2.2 billion (at 2014/15 prices). Councils are now using more capital grants than borrowing to fund their capital programmes ([Exhibit 4, page 14](#)). In 2016/17, councils face a decision about whether to increase their borrowing or decrease their capital programmes due to planned capital funding reductions by the Scottish Government.

**11.** Twenty-eight councils underspent their capital budgets in 2014/15. Capital underspends can have significant effects on a council's financial position, including cash flows from year to year, and how well it achieves its objectives. They may also have an effect on current and future borrowing. It is therefore important that capital spending plans are realistic. Councils should closely monitor capital spending and make sure there is effective communication between their capital investment and treasury management functions (the latter of which manages cash flow, borrowing and investments). Councils' treasury management strategies should set out for councillors how the borrowing strategy is informed by corporate priorities and capital investment needs ([Borrowing and treasury management in councils \[PDF\]](#) <sup>1</sup>). Councils should also demonstrate to elected members and service users how planned capital investment will help achieve their long-term strategic priorities ([Major capital investment in councils: follow-up \[PDF\]](#) <sup>2</sup>).

## Exhibit 4

### Sources of funding for capital spending

From 2011/12 to 2014/15, funding from capital grants increased and funding through borrowing decreased.



Note: Other sources of capital finance include money from the sale of assets, revenue funding used for capital spending and contributions from specific capital funds.

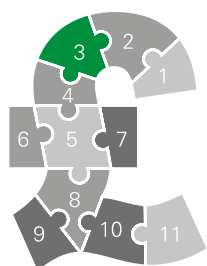
Source: Audit Scotland

**12.** As councils make decisions on how to manage reducing budgets, they must consider both the short and long-term implications of capital financing. This includes considering innovative funding options available for capital programmes, such as City Deals which attract additional funding from both the UK and Scottish Governments, as well as borrowing in traditional ways.

**13.** Councils are making significant revenue payments for Private Finance Initiatives (PFI) and Non-Profit Distributing (NPD) contracts, mostly for new and refurbished schools. In future, they will also face revenue charges associated with new projects financed through similar contracts or through newer funding models. It is important that both capital investment plans and treasury management strategies take into account the future revenue costs of capital financing options. Being aware of these costs allows councillors to fully scrutinise the long-term implications and affordability of funding decisions and to assess the sustainability of capital investment plans.

**14.** Councils have long-term assets worth nearly £40 billion, including physical assets, such as buildings, roads, vehicles and equipment, and long-term investments. The value increased by 1.7 per cent during 2014/15. The reported value of existing assets, shown in councils' annual accounts, is expected to increase greatly from 1 April 2016 when council-owned roads are to be valued on a different basis.

## Councils have balanced their budgets by reducing their spending but face additional pressures on top of funding reductions



**£18.7 billion:** spending on day-to-day running of services (including interest costs and accounting adjustments)



**23 councils** spent less than their income on providing services in 2014/15

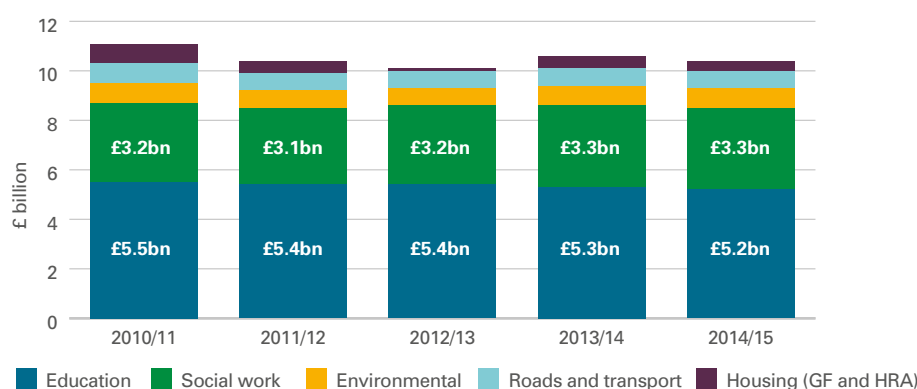
**15.** Councils have managed financial pressures by reducing spending across many of their main services and activities, except in social work ([Exhibit 5](#)). Councils' 2014/15 accounts showed expenditure of £18.7 billion. This looks like councils overspent by £0.4 billion but is actually due to adjustments that councils must make in their annual accounts, under local government accounting rules, for things like the accounting treatment of fixed assets and pension costs. In fact, the majority of councils underspent against their overall budgets in 2014/15. The one notable exception to this was Falkirk Council, which overspent by £2.9 million (0.8 per cent of its General Fund revenue budget). The most significant overspend of £3.3 million occurred in social work services and was partially offset by underspends in other areas.

**16.** The large number of underspends suggests that councils have successfully controlled their spending on services in preparation for the anticipated further funding reductions from 2016/17 onwards. Preparations for planned reductions in future years can also contribute to underspends if opportunities arise to

### Exhibit 5

#### Council spending on main services 2010/11 to 2014/15, at 2014/15 prices

Councils have reduced their real terms net spending in service areas except in social work.



#### Notes:

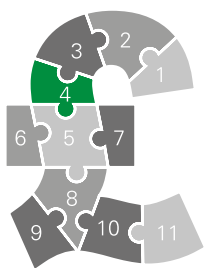
1. The figures show net spending, which is the total amount spent less any income from fees, charges or other service-related income.
2. Housing figures include spending from the General Fund (GF) and Housing Revenue Account (HRA).

Source: Councils' annual accounts, 2010/11-2014/15

make savings ahead of schedule. Councils will find it increasingly challenging to underspend or balance their budgets from 2016/17 onwards because many incremental savings have already been made.

**17.** Even where councils underspent against their overall budgets, about a third of councils reported overspending their social work or social care budgets. The highest overspend in 2014/15 was in City of Edinburgh Council's health and social care service, which overspent its budget by £5.9 million due to demand pressures. The council has commissioned an external review to identify the main reasons for this and to help manage the budget in future. With demand rising because people are living longer, combined with further funding reductions, social care budgets will come under increasing pressure for many councils and for the new health and social care integration authorities. In 2016, we will publish a report, *Social work in Scotland*, which will look at the scale and impact of the financial and demand pressures facing social work and how councils and their partners are addressing these challenges.

### Councils increased their usable reserves during 2014/15 in anticipation of further funding reductions



**£1.9 billion:** councils' usable reserves (excluding Orkney and Shetland Islands councils)



**£375 million:** unallocated General Funds (excluding Orkney and Shetland Islands councils)

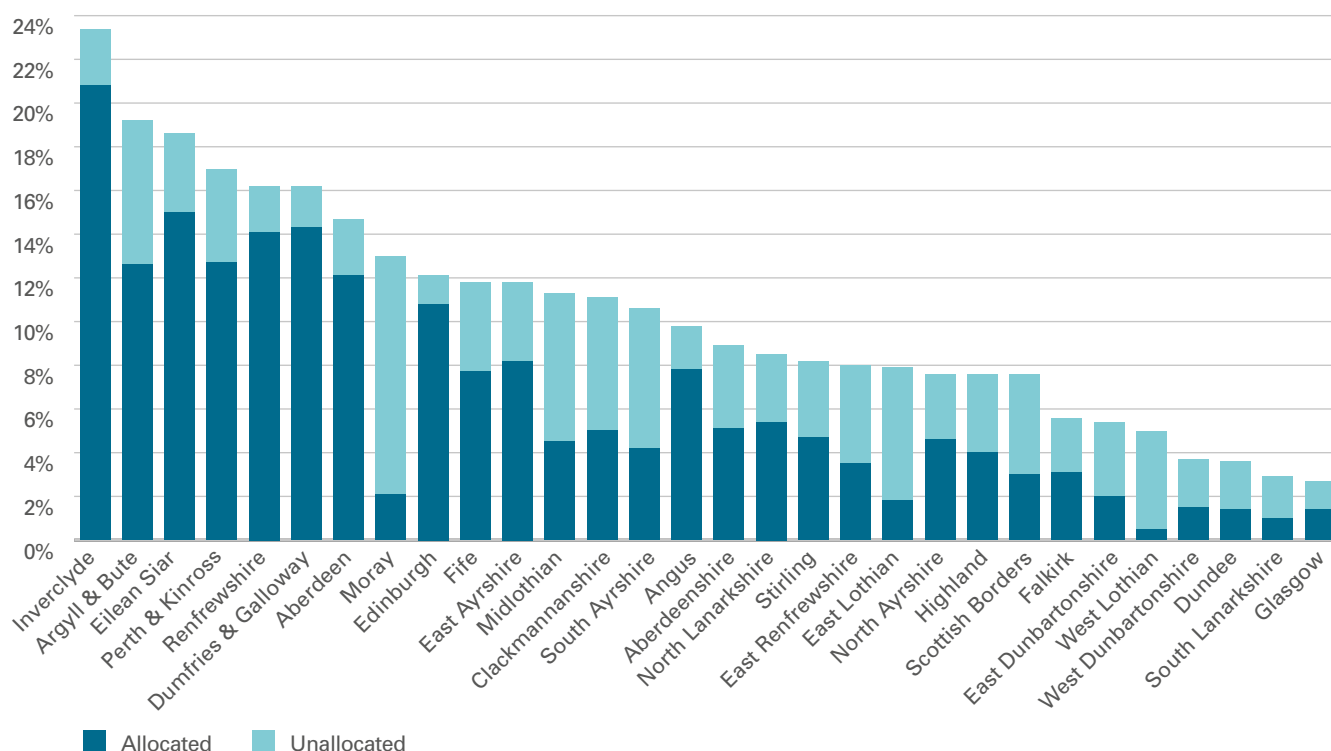
**13 councils** planned to use reserves for day-to-day spending in 2015/16

**18.** By the end of 2014/15, councils (excluding Orkney and Shetland Islands councils) had usable reserves of £1.9 billion, which is £31.4 million more than at the beginning of the year. £1.1 billion of this was in General Funds, available for councils to spend as required. £375 million of the £1.1 billion of General Funds were unallocated, meaning they were not earmarked for a specific purpose and therefore available as a contingency for unforeseen spending, such as making up shortfalls in income or savings, or for possible future commitments. Unallocated General Funds rose by 18.5 per cent during 2014/15. They are now 39 per cent higher than they were in 2010/11. Council finance directors tell us this is largely because they are being careful to save whenever opportunities arise, in anticipation of further funding reductions. Across Scotland, there is wide variation in the level of reserves councils hold and the levels of unallocated General Funds, with eighteen of the 30 councils having allocated more than half of their General Funds ([Exhibit 6, page 17](#)).

## Exhibit 6

### General Fund reserves held as a percentage of service costs, 2014/15

There is wide variation in the amount of General Fund reserves that councils hold compared to the cost of providing services.



#### Notes:

- Figures exclude Orkney and Shetland Islands councils, which hold large reserves and balances arising mainly from harbour and oil-related activities, which affect what is included in their General Funds.
- Service costs in this context are taken as the General Fund net cost of services, as reported in councils' annual accounts.

Source: Councils' annual accounts and data returns from auditors, 2014/15

**19.** Eighteen out of the 30 councils allocated more than half of their General Fund. Thirteen of Scotland's 32 councils planned to use reserves to bridge a gap between their income and spending in 2015/16 or beyond. Using reserves to support day-to-day spending on services is unsustainable. Financial plans and reserves policies must strike a balance between the planned use of reserves and being prepared for any unforeseen changes in circumstances to ensure councils can manage external pressures. For example, there have recently been multi-million pound compensation payments for multiple equal pay claims. Such events can significantly affect councils' reserves and their plans for using them.

**20.** The level of reserves that a council holds is a local decision, but should be clearly informed by an annually reviewed reserves policy. Thirty-one councils had a reserves policy in 2014/15, the exception being The Moray Council which plans to finalise a policy in March 2016. It is important that officers advise councillors of the rationale for holding specific levels of reserves. Councillors need to be satisfied that their council's reserve level is both appropriate and necessary. Reserves policies set a minimum or target level of reserves to be held but half of councils ended 2014/15 with unplanned increases or decreases in their General Fund ([Exhibit 7, page 18](#)). This underlines the importance of ensuring reserve levels are adequate and policies are regularly reviewed.



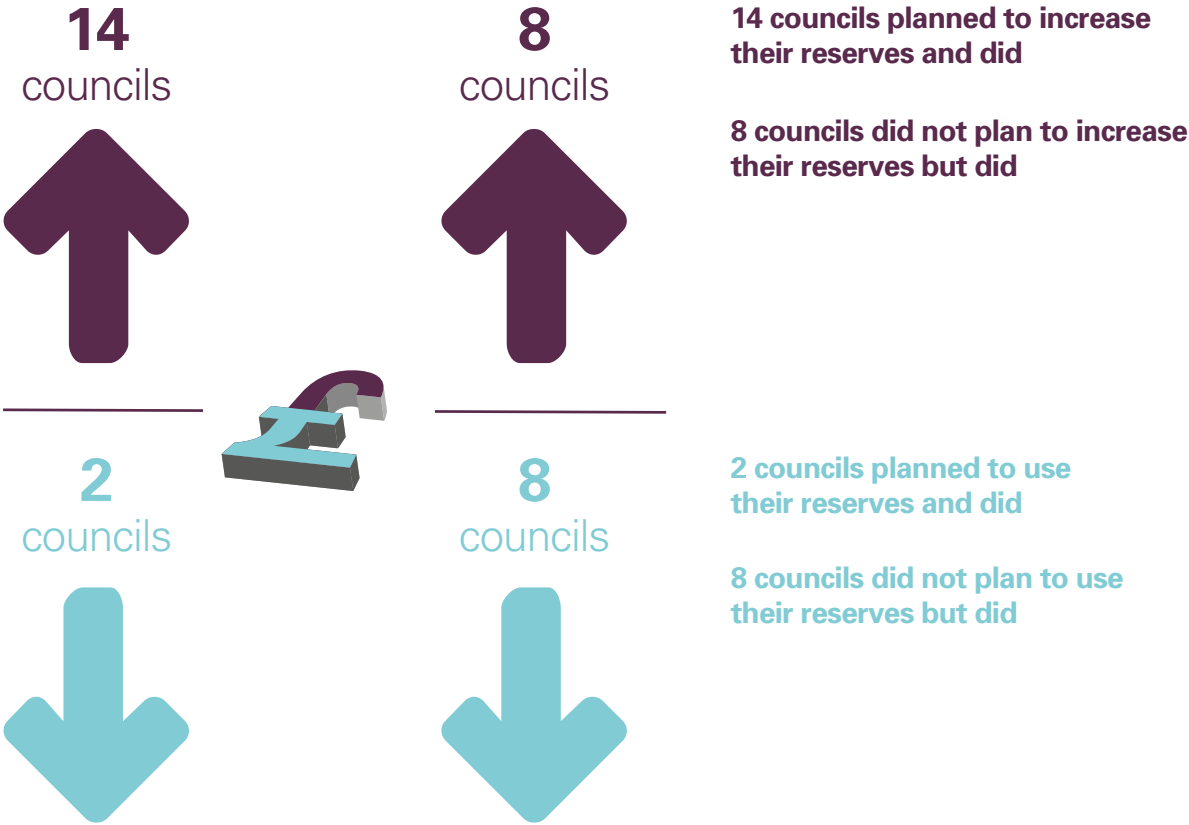
**What level of reserves do we need, both allocated and unallocated?**

**How effectively are we using the reserves we hold?**

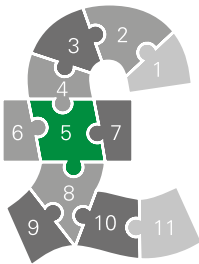
Exhibit 7

Increases and decreases in General Fund reserves

Total General Fund reserves increased overall but half of councils did not increase or decrease their reserves as planned.



Source: Councils' annual accounts and data returns from auditors, 2014/15



**£39.9 billion:** value of councils' long-term assets including their physical assets (£37.1 billion) and other assets such as long-term investments and money they are owed



**£13.8 billion:** councils' net debt – the difference between what is borrowed and owed (£15.2 billion) and the value of short-term investments (£1.4 billion)

**£12.5 billion:** councils' total short and long-term borrowing, which is the majority of their debt

**£0.5 billion:** increase in borrowing during 2014/15



### Councils' net debt has increased since 2010/11, but decreased slightly in 2014/15.

**21.** Councils' debt includes money they have borrowed as well as commitments made under PFI, NPD and finance leases. Councils paid interest and repayment charges of about £1.5 billion in 2014/15, similar to the amount they paid in 2013/14. Most of councils' borrowing is for capital projects and helps them spread the cost of building, refurbishing and replacing their assets over a number of years.

**22.** Councils' net debt (total debt minus investments and cash) decreased by £44 million during 2014/15. At £13.8 billion (excluding Orkney and Shetland Islands councils), it remains £1.3 billion more than in 2010/11 ([Exhibit 8](#)).

**23.** Councils need to assess the affordability of borrowing and other forms of debt. In the short term, they do this using a number of 'prudential indicators', which show the effects on revenue budgets, in compliance with The Prudential Code.<sup>3</sup> We recommended in [Borrowing and treasury management in councils](#) [\[PDF\]](#) that councils should do more to assess the long-term affordability of borrowing and other forms of debt.

## Exhibit 8

### Councils' net debt, 2010/11 to 2014/15

Councils' net debt has increased since 2010/11, but decreased slightly in the last year.



#### Notes:

1. Net debt is calculated as total debt (long-term borrowing, short-term borrowing, bank overdrafts and other long-term liabilities) minus external investments (short-term investments and cash, and cash equivalents).
2. Figures exclude Orkney and Shetland Islands councils, which have large investments associated with harbour and oil activities.

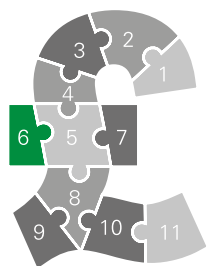
Source: Councils' audited accounts, 2010/11-2014/15

**24.** Borrowing levels are not an indication of financial problems or that a council may not be financially sustainable. As long as repayments are affordable and the council can finance its debts, then borrowing is a valuable means of financing longer-term capital costs. It is up to individual councils, taking into account their existing commitments, to determine how much they can afford to pay in annual repayments. Councils have reduced their borrowing in recent years, at the same time as there were changes in capital funding allocations from the Scottish Government and reductions in the overall size of capital programmes. Their overall level of outstanding borrowing has increased to £12.5 billion.



**What implications do different borrowing and financing options have for our future revenue budgets?**

## Local Government Pension Scheme fund deficits can vary from year to year and long-term plans are in place to finance them



**£33.8 billion:** assets managed by the 11 separate LGPS funds in Scotland

**£44.5 billion:** total liabilities of the 11 LGPS funds

**£10 billion:** councils' share of the £10.7 billion long-term LGPS fund deficits



**25.** Pension contributions are a significant cost for councils. Most council staff pay into either the Scottish Teachers' Superannuation Scheme (STSS) or the Local Government Pension Scheme (LGPS). The Scottish Government is responsible for the STSS while councils are responsible for the LGPS. Staff in other related organisations, such as colleges, can also be members of these schemes.

**26.** The LGPS has 11 separate investment funds. These vary in size from Strathclyde Pension Fund, which manages about £16 billion (over 45 per cent) of the £33.8 billion LGPS assets, to a number of smaller funds each managing less than five per cent of total assets.

**27.** The value of the pension funds is fully assessed every three years to set contribution rates, most recently in 2014. Annual estimates are also made in between assessments. A range of factors are taken into account each time, for example inflation and life expectancy, and so annual estimates of fund values and future pension payments can vary from year to year.

**28.** At the end of 2014/15, there was an estimated £10 billion shortfall, or deficit, between the value of councils' pension funds and the future pension payments that will be made. This has increased by around £2.5 billion since 2011. During 2014/15, there were significant deficit increases in Glasgow City (£234m, 18 per cent), City of Edinburgh (£191m, 36 per cent), South Lanarkshire (£140m, 28 per cent), Falkirk (£128m, 51 per cent) and North Lanarkshire (£111m, 26 per cent) councils.

**29.** Pension deficits do not create immediate problems because staff and employer contributions and future payments will be made over a long period. There are long-term plans in place for funds to address current estimated deficits within 20 years.

### The LGPS costs for councils are increasing

**30.** There are three main factors that determine variation in costs associated with the LGPS, and may result in increased pension costs for councils:

- Employer contribution rates: these range from around 17 to 22 per cent of employees' pay in 2014/15. They are not directly comparable between funds, or between councils within the same fund, because some councils make separate payments specifically to reduce deficits. But rates are set to increase. For example, by 2017/18 contribution rates will increase for five of the 11 councils that manage and administer the funds.

- **Administration costs:** these include the investment management fees for each fund, and other administration costs, and have been increasing. These are not comparable between funds, but the way the fees are reported has been changed to improve transparency and comparability between funds.
- **Investment performance:** the investment strategy for a fund takes into account the size of the fund's assets compared to its future liabilities, as well as other external market factors, when setting performance targets. Expected returns on investments are used to set employer contribution rates. In 2014/15, eight of the 11 LGPS funds reported above-expected returns and three reported returns below the targets they set for themselves (Highland, North East and Shetland).

**31.** Most LGPS funds have a growing number of pensioners within their schemes. The number of contributing members has also been increasing, despite staff reductions. Auto-enrolment into pension schemes is expected to result in more people joining. However, increases in the number of contributing members alone are not expected to offset the growing number of pensioners.

**32.** Councils face rising pension costs due to increases in pension scheme membership, raising the number of employees for whom they must contribute. Voluntary severance agreements can also increase the costs of paying pensions early and adding years to relevant employees' pensions. These agreements also result in councils having to make separate redundancy payments, although these are not pension costs.

**33.** Future employer contributions are part of a cost-sharing arrangement which may limit future increases. Employee contributions may however increase. Also, from 2016/17, employees and employers will no longer benefit from a reduction in National Insurance contributions, leading to increased costs for both.

**34.** There have been several recent developments to strengthen the governance and reporting of LGPS funds. In compliance with The Public Sector Pensions Act 2013, a local pension board was established for each LGPS fund before 1 April 2015. The board's role is to assist the fund manager to comply with rules relating to governance and administration of the fund.

**35.** A new Scottish Local Government Pension Scheme Advisory Board has also been set up as part of these reforms. Its role includes advising ministers on how the LGPS is operating and on any changes that may be desirable. It is likely to consider whether the structure of the LGPS in Scotland, with 11 separately administered funds, is efficient. That might include considering the value of the approach taken in England, of combining LGPS fund assets to allow collective investments to be made. The Accounts Commission welcomes this review of the LGPS.

#### **Equal pay remains a significant cost pressure**

**36.** By March 2015, councils had paid out £605 million to employees in equal pay compensation. During 2014/15, 24 councils settled nearly 4,000 equal pay claims, worth a total of £24.9 million. Councils currently estimate that about 30,000 cases remain outstanding. Councils had put aside £117 million in anticipation of further payments in 2015/16 and beyond. This includes £78 million by North Lanarkshire Council to compensate employees whose claims were brought to tribunal and agreed in 2014/15.



**What are the implications of workforce reductions on our pension costs?**

**How will these affect our pension liabilities and pension administration costs?**

**37.** Some councils do not expect many more significant equal pay claims and have reduced the money set aside for this purpose. However, recent cases highlight that councils' provisions can be significantly lower than the final costs. For example, Fife Council made a provision for equal pay claims of about £7 million in its 2014/15 accounts, based on the number of existing cases it had. However, in 2015/16 the council agreed to settle a large number of claims brought against it on the basis that the council's application of its job evaluation, pay protection and job assimilation arrangements under single status were unfair. The council's previous estimates of equal pay liability did not anticipate the application of its job evaluation scheme as being at risk. Therefore, the cost to the council of settling these cases is predicted to be many times greater than the financial provision it had made. This will significantly affect the council's financial position, including its planned spending on services and other projects or programmes. It is unclear how many other councils could potentially be in a similar position to Fife. The Accounts Commission plans to look at equal pay issues across local government in more detail during 2016/17.

#### **Minimum and living wage rises have cost implications for councils**

**38.** The living wage in Scotland is £8.25 per hour.<sup>4</sup> Councils have a collective agreement with Scottish Joint Council trade unions on pay for the period 2015/16 to 2016/17. As part of this agreement, councils committed to a pay settlement which set the living wage at a level of £8.33 per hour. In addition, the UK Government is aiming for a minimum wage of £9 per hour by 2020, which would mean significant pay rises for those currently on or near the current minimum wage (£7.20 per hour for those aged 25 and over from April 2016). While there are clearly benefits to low-paid workers through the living wage commitment, the increases in employee costs and contract costs – when contractors pay their staff the living wage – will put additional pressure on councils' finances. It will also require councils to review their grading structures where the living wage moves jobs out of existing pay scales.

#### **Good financial planning and management is required to manage future pressures and ensure financial sustainability**

**39.** At March 2015, all councils had balanced their budgets and were not planning to spend more in 2015/16 than they could afford. External auditors reported that councils had adequate reserves and could afford to repay their current debts. However, audit work has highlighted concerns about some aspects of financial planning, management and sustainability in a small number of councils.

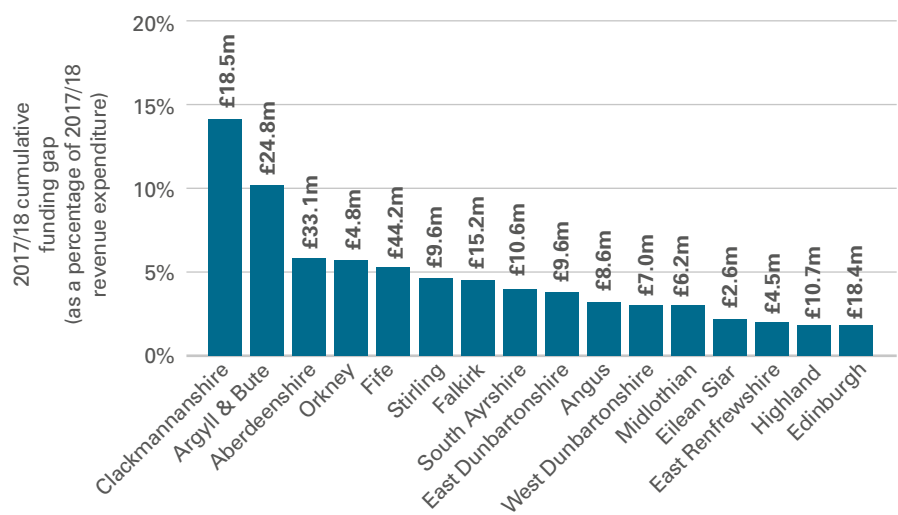
**40.** Auditors are most concerned about those councils that have been spending, or plan to spend, a significant amount of their reserves but still face a large gap between their expected income and spending. At March 2015, more than half of councils that had prepared indicative budgets for both 2016/17 and 2017/18 were reporting a funding gap between income and expenditure, even after they had identified savings and planned whether to use some of their reserves. At that point, five councils were predicting cumulative funding gaps of more than five per cent of their service costs by 2017/18. These were Clackmannanshire (14 per cent), Argyll and Bute (ten per cent), and Aberdeenshire, Orkney and Fife (five to six per cent) ([Exhibit 9, page 23](#)).



**How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?**

**Exhibit 9**  
**Predicted funding gaps at March 2015**

At March 2015, five councils were predicting cumulative funding gaps of more than five per cent in 2017/18.



- Notes:
- 1. Figures are the 2017/18 cumulative funding gaps. Ten councils predict a balanced budget in 2017/18. Six councils had not prepared a budget for 2017/18 by March 2015.
  - 2. Many councils have updated their estimates of funding gaps since this data was collected in March 2015 but we have not collected this updated information.

Source: Audit Scotland



**41.** The extent of the Scottish Government’s funding reduction for 2016/17 is likely to result in councils identifying even larger funding gaps between the cost of delivering current services and their income, after taking account of planned savings or additional sources of income. Addressing this will require councils to go beyond incremental cost-saving measures to existing services and to fundamentally rethink their models of service delivery.

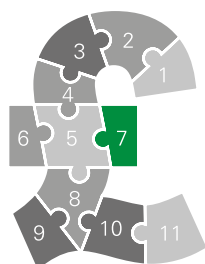
**42.** Councils’ financial sustainability continues to be at risk as they face the combined challenges of reduced funding, increasing cost pressures (such as pensions, the living wage and equal pay) and rising demand for services from an ageing and growing population. Auditors will continue to assess councils’ financial health and how well they are planning and managing their finances. Councils with good medium and longer-term financial plans and strategies are better equipped to manage these risks effectively.

**What options do we have to address this budget shortfall for example, redesign services, use reserves?**

**How big is the remaining funding gap after we implement our selected options?**

**What actions are we taking to close any remaining funding gap?**

## Financial planning is crucial as councils face significant pressures in 2016/17 and beyond



**15 councils** have long-term financial strategies covering five or more years

**29 councils** have medium-term financial plans covering three to five years

**43.** A good financial strategy sets out a council's financial objectives and how it will achieve them. It shows clearly how the council will use the money it has to help achieve its Single Outcome Agreement (SOA) and strategic objectives. A financial strategy should cover at least five years and should set out the risks and liabilities, any assumptions made about income and the implications for affordability. Councils should also have in place detailed financial plans that set out fully-costed annual spending plans over at least the medium term (three to five years). When future Scottish Government funding is not known, councils should plan for a range of possible scenarios so they are prepared for different levels of funding and income.

**44.** Almost all councils have financial strategies that are accompanied by detailed financial plans covering at least three years. About a third of councils have financial plans covering five or more years. In a small number of councils, auditors reported that plans and strategies were still being developed.

**45.** Effective financial strategies and plans must take into account future financial pressures and how the council intends to respond to these. For example, councils need to assess how affordable the different options are for changing the way they deliver services. It is therefore important that financial plans support councils' priorities, savings and service change programmes, and asset management and workforce plans.

**46.** Shetland Islands Council, for example, has a five-year financial plan based on forecasts of future income, cost pressures, managing spending within the budget and financial risks. The council also intends to develop a 35-year asset investment plan to help it maintain the assets needed to deliver its priorities without reducing the money left for day-to-day running of services.



**Do we have a long-term financial strategy covering at least five years that accounts for future pressures?**

**Is our five-year strategy supported by detailed financial plans covering a minimum period of three years?**

**How well do our financial plans set out the implications of different levels of income spending and activity?**

**How does our financial strategy link to our vision for the future?**

# Part 2

## Delivering services



### Key messages

- 1** Councils' performance in 2014/15 continued to improve across many of the performance measures in the Local Government Benchmarking Framework (LGBF). Councils have well-established systems to manage their performance and are improving how they report to the public.
- 2** Health and social care integration is the most significant aspect of public sector reform for councils. New integration authorities may not be in a position to make an impact in 2016/17. Significant risks need to be addressed if integration is to fundamentally improve the way health and care services are delivered.
- 3** The Accounts Commission continues to be concerned about councils' slow progress in delivering services differently, rather than relying on incremental savings to existing models of service delivery. There are some examples of councils achieving savings and community benefits through increasing online access to services, sharing services, collaborating on procurement and using arm's-length external organisations (ALEOs). Councils, however, need to be more ambitious in their plans, better at longer-term planning, and willing to appraise all practical options for delivering services more efficiently and effectively. This includes empowering and supporting local communities in delivering local services.
- 4** Most councils continue to reduce staff numbers. It is essential that they have comprehensive workforce strategies and plans, which must take into account not only workforce-related cost pressures, but the staff knowledge, skills and time they will need to plan and deliver services differently in future.
- 5** There is a need for councillors to continuously review and develop their skills and knowledge to help them carry out their increasingly complex and challenging role effectively. They need to have the skills and the necessary information to allow them to carry out effective scrutiny of performance. This becomes ever more important as councils develop new and different ways of delivering services within their reducing budgets.

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**councils need to be more ambitious and consider all the practical options for delivering services differently in future**

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## Councils' performance improved in many service areas in 2014/15





47. Within the resources they had available in 2014/15 (for example money, people and buildings), councils continued to improve several key service performance measures, such as secondary school educational attainment, the balance between care at home and in care homes, the quality of council housing and waste recycling ([Exhibit 10](#)). Whatever their performance, the LGBF provides the starting point for councils to compare themselves with others to understand differences and learn lessons that will help them to improve performance.

48. The LGBF shows that public satisfaction with services has generally declined in recent years. This suggests a need for councils to work more closely with their communities and service users to establish service priorities.

### Exhibit 10

#### Councils' service performance at a national level






There have been improvements across many of the performance indicators in the LGBF.






LGBF indicator		2010/11	2011/12	2012/13	2013/14	2014/15
 Education and Children's service	% of pupils gaining 5+ awards at Higher (Level 6)	23.0	25.0	25.7	28.1	29.3
	% pupils from deprived areas gaining 5+ awards at Higher (Level 6) <sup>1</sup>	8.0	9.0	10.1	12.6	12.8
	% of children being looked after in the community <sup>2</sup>	91.0	91.2	91.0	91.0	–
	% of adults satisfied with local schools	83.1	–	83.0	81.0	79.0
	% of pupils entering positive destinations	88.9	89.9	91.4	92.3	92.9
 Corporate services	% of the highest paid 5% of employees who are women	46.3	48.5	48.7	50.7	51.7
	Domestic noise – average time (hours) to respond	47.8	31.6	43.2	80.7	58.9
	Sickness absence days per teacher	6.6	6.2	6.6	6.1	6.3
	Sickness absence days per employee (non-teacher)	10.8	10.4	10.9	10.3	10.8
	% of income due from council tax received by the end of the year	94.7	95.1	95.2	95.2	95.5
 Adult social care	% of invoices sampled that were paid within 30 days	89.5	90.2	90.5	91.9	92.5
	SDS <sup>3</sup> spend on adults 18+ as a % of total social work spend on adults 18+	1.6	3.1	5.9	6.4	6.9
	% of people aged 65+ with intensive needs receiving care at home	32.2	33.0	34.1	34.3	35.6
	% of adults satisfied with social care or social work services	62.1	–	57.0	55.0	51.0
 Culture and leisure	% of adults satisfied with libraries	83.5	–	83.0	81.0	77.0
	% of adults satisfied with parks and open spaces	83.1	–	86.0	86.0	86.0
	% of adults satisfied with museums and galleries	75.5	–	78.0	76.0	75.0
	% of adults satisfied with leisure facilities	74.6	–	80.0	78.0	76.0

Cont



## Exhibit 10 continued

LGBF indicator		2010/11	2011/12	2012/13	2013/14	2014/15
 Environmental services	Street cleanliness score (% acceptable)	95.4	96.1	95.8	96.1	93.9
	% of total household waste that is recycled	38.7	41.0	41.7	42.2	42.8
	% of adults satisfied with refuse collection	80.9	–	83.0	83.0	84.0
	% of adults satisfied with street cleaning	73.3	–	75.0	74.0	74.0
 Housing	Gross rent arrears (all tenants) as a % of rent due for the reporting year	–	–	–	5.6	5.9
	% of rent due in the year that was lost due to empty properties	1.3	1.3	1.2	1.3	1.2
	% of dwellings meeting Scottish Housing Quality Standards	53.6	66.1	76.6	83.7	90.4
	Average time taken to complete non-emergency repairs (days)	–	–	–	10.2	9.9
	% of council dwellings that are energy efficient	74.9	81.2	88.8	94.0	96.5
 Corporate assets	% of operational buildings that are suitable for their current use	73.7	74.8	75.9	78.2	79.0
	% of internal floor area of operational buildings in satisfactory condition	81.3	82.7	82.6	80.9	82.9
 Economic development	% unemployed people assisted into work from council operated / funded employability programmes	–	–	9.6	12.5	14.2
		2009/11	2010/12	2011/13	2012/14	2013/15
 Roads maintenance	% of A class roads that should be considered for maintenance treatment	30.3	30.5	29.4	28.7	29.0
	% of B class roads that should be considered for maintenance treatment	35.8	36.3	35.0	35.2	36.1
	% of C class roads that should be considered for maintenance treatment	35.0	36.0	34.8	36.6	37.3

	Decline in performance from previous year		Improvement from previous year		No change in performance
	Baseline year		No data available		

## Notes:

1. This data is calculated from the Scottish Index of Multiple Deprivation (SIMD).
2. Balance of care for looked after children: percentage of children being looked after in the community.
3. Self-directed support.
4. We have not included unit cost measures in this exhibit. Additional performance information is available at [www.improvementservice.org.uk](http://www.improvementservice.org.uk)

Source: Local Government Benchmarking Framework, Improvement Service, 2016

### **Councils have well-established systems to help manage their performance and are improving how they report to the public**

**49.** Councils have well-established systems for monitoring performance and continue to develop them. For example, in conjunction with the Scottish Public Services Ombudsman's (SPSO's) Complaints Standards Authority, councils are improving complaints monitoring as a means of better understanding public satisfaction with their services. Local government scrutiny bodies (Audit Scotland, the Care Inspectorate, Education Scotland, Scottish Housing Regulator and Healthcare Improvement Scotland), working collectively through the annual Shared Risk Assessment (SRA) process, have highlighted scope in some councils to use information more effectively in order to manage performance. This includes comparing performance with other councils and using self-evaluation.

**50.** Public performance reporting (PPR) is an important way for councils to demonstrate their performance to the public. Many councils have improved how they report their performance in public but there is a significant gap between top-performing councils and those that still need to improve their PPR.

**51.** The Accounts Commission will use LGBF data, complaints information and public performance reports as important sources of intelligence to inform future audits of Best Value.




**How clearly  
do we report  
our plans and  
performance to  
the public?**

### **Health and social care integration is intended to transform services across Scotland, but councils and their partners still need to address significant risks**


**52.** The most significant transformation to council services taking place is the integration of health and social care services. The Public Bodies (Joint Working) (Scotland) Act 2014 sets out an ambitious programme of reform for the Scottish public sector to improve support for people who need health and social care services. It creates a number of new public organisations and aims to encourage more effective joint working between NHS boards and councils.

**53.** Councils and NHS boards are required to establish integration authorities by 1 April 2016. There are now 31 integration authorities, including a joint arrangement in Stirling and Clackmannanshire. All integration authorities are required to integrate adult health and social care services, but they can also choose to integrate other services. The scope of services being integrated varies widely across Scotland. Most notably, in Argyll and Bute, and Dumfries and Galloway, the integrated services will include all NHS acute services, including planned and unplanned hospital services. The integration authorities are now establishing management and governance arrangements, including organisational structures and internal processes.

**54.** Our [Health and social care integration \[PDF\]](#)  report found that integration authorities may not be in a position to make an impact in 2016/17.<sup>5</sup> We reported on the significant risks that need to be addressed if integration is to fundamentally change the delivery of health and care services. These include:

- difficulties in agreeing budgets and finalising comprehensive strategic plans, due to councils having to set their budgets before NHS boards, and uncertainty about longer-term funding

- uncertainty about how complex governance arrangements will work in practice
- significant long-term workforce issues, such as different terms and conditions for NHS and council staff, and difficulties in recruiting and retaining GPs and care staff.


**55.** The issues around budgeting, strategic planning and governance need to be addressed quickly in order to improve local health and social care services in the next few years. In the longer term, joint action by councils and NHS boards will be needed to address workforce issues. Our [Changing models of health and social care \[PDF\]](#)  report highlighted that, to transform services and successfully deliver better outcomes for users, NHS boards, councils and integration authorities will have to adopt innovative models of care and ways of working that are quite different from traditional services.<sup>6</sup>

## The quality and ambition of councils' savings and service change programmes vary greatly

**56.** Most of the savings councils have made over the last four years have relied on incremental reductions to a wide range of services and relatively small increases in income from fees and charges. Many savings have come from staff voluntary redundancies. There is a limit to how many staff can be lost before there is a major impact on the quality or quantity of services. Councils need to consider options for more fundamental changes to the way they deliver services.

**57.** Councils have been developing savings plans and service change programmes in response to current and future reductions in their income. However, auditors have highlighted variation in the ability of councils' programmes to make the savings required. Some are making good progress towards tangible savings and improvements to services for communities. For example, East Ayrshire Council's transformation strategy is designed to achieve sustainable savings of £34.7 million over the five-year period up to 2016/17. Planned savings in the first three years have already been achieved and, at the time of approving its 2015/16 budget, the council reported no funding gap up to 2016/17. The council reviews its transformation strategy annually and consults local communities and stakeholders on its priorities as part of the review.

**58.** Auditors have expressed concerns about the extent to which planned changes in some councils are enough to make required savings, whether these changes are being implemented quickly enough, and how any changes reflect a council's priorities. For example, in Aberdeenshire Council, the auditor has reported that there is little evidence of robust plans with clear links to outcomes.

**59.** The Accounts Commission is concerned about councils' slow progress in delivering services differently, rather than relying on incremental savings and staff reductions. Recent Best Value audits on East Dunbartonshire, Falkirk, and Argyll and Bute councils highlight that, regardless of the ambition of savings plans and service change programmes, only relatively small-scale changes have been delivered so far.<sup>7,8,9</sup> Larger-scale changes that make a bigger impact on budget shortfalls have proved more difficult to achieve. Our [East Dunbartonshire Council: the Audit of Best Value and Community Planning – a follow-up report \[PDF\]](#)  found a clear commitment to improvement but expressed concerns about the pace of delivering the improvements in practice. We recommended the council take urgent action to identify clearer priorities for its transformation programme.



**How will our savings plans help us achieve our corporate objectives and commitments made to our Single Outcome Agreement?**



**How open are we to considering all possible options to reduce the cost, and improve the quality and effectiveness of the services we provide?**

**60.** One area where councils are changing the way they work is in providing services online. This allows councils to provide services that better meet the needs of users, as set out in the Scottish Government's and COSLA's 2012 vision *Scotland's Digital Future – Delivery of Public Services*.<sup>10</sup> It also allows councils to deliver greater efficiency, reducing the number of staff required to deliver these services ([Case study 1](#)). However, it is important that councils continue to provide services for those who do not have access to, or simply do not want to use, online services.

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## Case study 1

### Examples of online services in councils



#### City of Edinburgh Council

The council is currently redesigning many of its customer care services and moving services online where possible. The council plans to deliver annual savings of £5.9 million, through reducing the number of support staff. There are early signs that this initiative is making an impact: 40 transactions, such as school placing requests, are already available online and savings of £355,000 over the past year have been made. The council now aims to roll out a further 153 new types of online transaction in 2016/17.

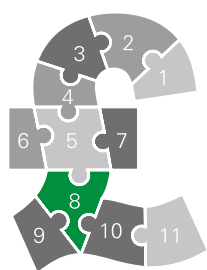
#### The Highland Council

The council aims to reduce the equivalent of 54.2 full-time employees and save £1.3 million by 2018/19 through its Digital First programme. In 2014, 82,000 transactions took place online with a corresponding ten per cent decrease in face-to-face transactions. The council currently offers 87 services online, such as paying rent online, and is aiming to have 40 per cent of customer transactions online by April 2017. The council has implemented the Improvement Service's customer portal 'myaccount'. This reduces the requirement for customers to prove their identity every time they apply, and gives customers the ability to upload scanned and photographed evidence.

Source: Audit Scotland

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## There is limited evidence of councils collaborating or sharing services




**£43 million:** saved by councils in 2012/13 by using collaborative procurement contracts



**61.** Collaborating or sharing services can help meet financial challenges. For example, East Ayrshire and South Ayrshire councils have a shared roads maintenance service, which has been operating since April 2014. It aims to maintain and improve the service while saving £8.6 million over the next ten years. Stirling and Clackmannanshire councils are jointly delivering social work and education services. However, they decided in late 2015 to withdraw from this arrangement, and they will revert to single-council services by April 2017. These shared services involved a lot of preparatory work. They highlight the need for sustained commitment if councils are to deliver shared services successfully and realise any planned longer-term benefits.

**62.** Our [Procurement in councils \[PDF\]](#)  report found that councils had saved £43 million in 2012/13 through using Scotland Excel or Scottish Government collaborative procurement contracts, and councils' use of collaborative contracts has been increasing since then.<sup>11</sup> Savings were not the only benefit to this collaborative working. Councils had been systematically using procurement spending to support local economic development, and they had begun to achieve community benefits, such as apprenticeships and environmental improvements, into procurement contracts.

**63.** Whatever the means of delivering services, a crucial element of achieving best value is using options appraisal effectively to evaluate current and alternative ways to deliver services. Our [How councils work: Options appraisal – are you getting it right? \[PDF\]](#)  report recommends rigorous and challenging appraisal of all the options.<sup>12</sup> It is important that councils consider a wide range of alternatives, including fundamentally different approaches, to help find the most effective and efficient way to achieve the council's priorities for its local communities ([Exhibit 11, page 32](#)).

**64.** In looking at possible options for delivering services, councils and their partners need to consider the opportunities presented by the Community Empowerment (Scotland) Act 2015. The Act aims to empower community bodies through ownership or control of land and buildings, and by giving them more say in decisions about public services.



**How fully have we appraised the options for sharing services with similar or neighbouring authorities or other public sector bodies?**

**What options do we have for collaborating or sharing services?**

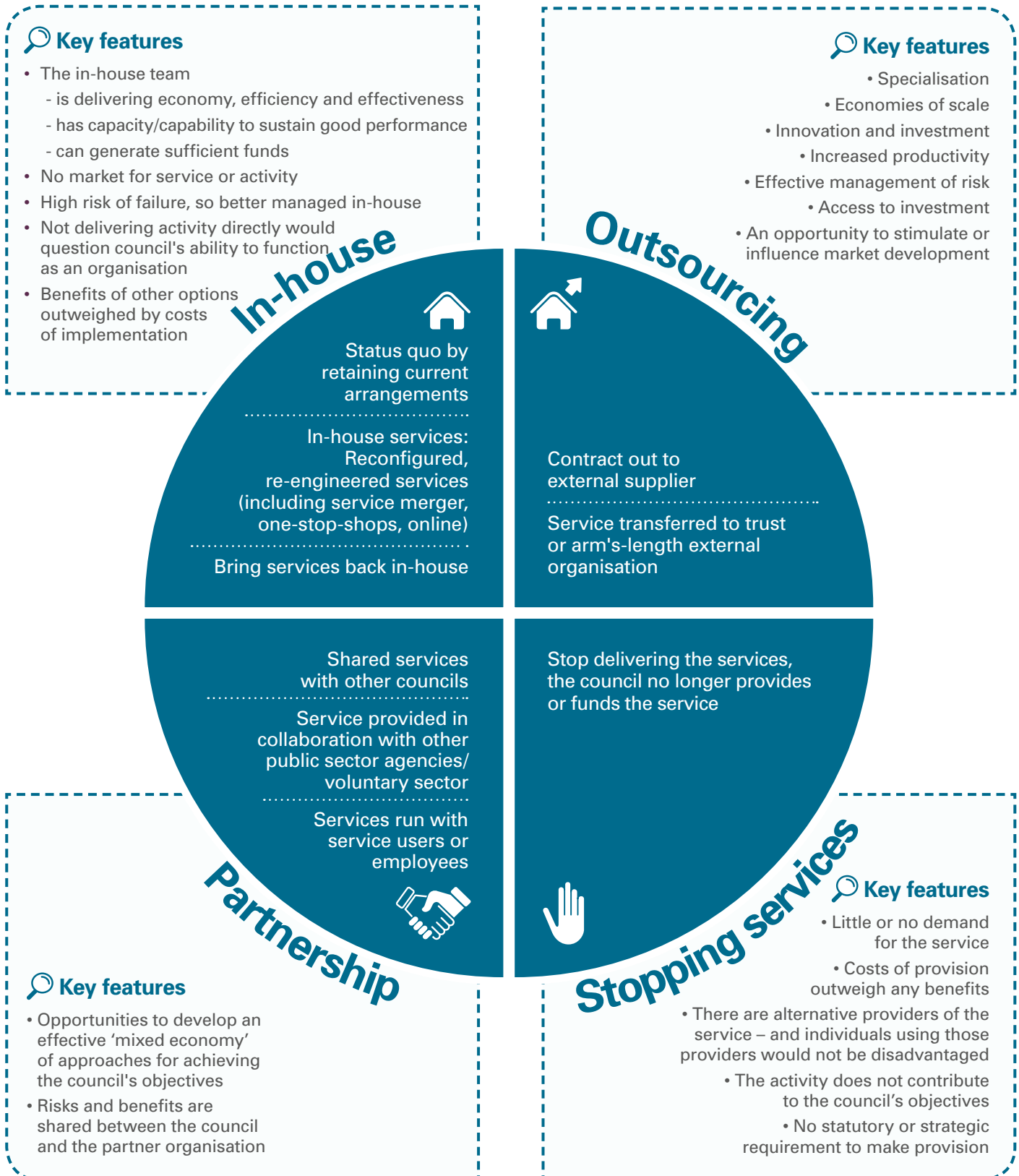


**How are we involving and empowering local communities to design and deliver services to suit local needs?**

## Exhibit 11

### Options for delivering services

Councils should use options appraisal to consider alternative ways of delivering services.



Source: Audit Scotland

### Councils are planning to increase the number of ALEOs to deliver services

**65.** Councils use ALEOs to deliver services differently and more efficiently, as they offer different opportunities for generating income and making tax savings. ALEOs are typically used to provide more commercial activities, including leisure, property development, car parking, energy generation, and conference facilities such as the Edinburgh International Conference Centre. They are also used across a diverse range of services including social care and waste recycling. Auditors have identified approximately 140 ALEOs operated by Scotland's councils, with around three-quarters of these providing cultural, leisure, housing or economic development services. Councils are planning to deliver more services through ALEOs by establishing new ALEOs or expanding the remit of existing ALEOs ([Case study 2](#)).



**How do we learn from other changes we have made and the experiences of other organisations when identifying and considering all the options?**

## Case study 2

### Examples of new and expanded ALEOs



#### SB Cares

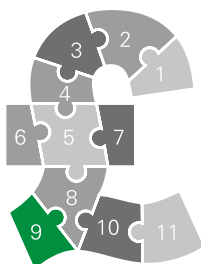
Scottish Borders Council established SB Cares to deliver most of the council's adult social care provision. Around 800 staff transferred to SB Cares on 1 April 2015. The new ALEO aims to make more efficient and flexible use of staff and generate additional income. The council expects to deliver £0.5 million savings in the first year.

#### Renfrewshire Leisure Limited

Renfrewshire Council expanded Renfrewshire Leisure Limited by transferring the management and staffing of cultural and leisure services, such as town halls, libraries and playing fields. It estimates £0.6 million of annual savings from the transferred services being eligible to pay reduced NDR.

Source: Audit Scotland

**As councils continue to reduce staff numbers, it is essential that they plan to have the staff knowledge, skills and time to deliver services differently in future**



**24 councils**, in September 2015, were planning to further reduce staff numbers during 2015/16 and beyond

**31 councils** have reduced and/or restructured their senior management in recent years, and 11 councils, in September 2015, were planning to make further changes






**66.** The majority of councils have reduced their workforces over the last few years to save money and establish more efficient ways of working. At 31 March 2015, there were approximately 200,800 people (full-time equivalent or FTE) employed by councils. This was around 800 fewer people (FTE) working in councils compared with the previous year. The net reduction in employment may be lower than 800 as it includes jobs transferring into ALEOs, although we do not have data on this. We have highlighted in previous reports that relying on reducing staff numbers to save money without changing the way councils deliver services is not sustainable.

**67.** With their income falling further, and as they identify funding gaps in the next two years or longer term, councils are planning further staff reductions. Some councils are now making compulsory redundancies to reduce costs and better manage their workforces. For example, over half of councils have policies that allow them to make compulsory redundancies if necessary, and seven have already made a very small number of compulsory redundancies in 2014/15. At the same time, councils feel that their ability to fully manage their workforce in line with local priorities is affected by other factors outwith their control, such as the Scottish Government's requirement for councils to maintain teacher numbers.

**68.** A key area of savings has been in reducing and restructuring senior management. Councils need to ensure that they manage the risks of relying on smaller numbers of individual officers with an increasingly wide range of responsibilities. There is also the risk that they may not have the management skills and time they need to plan and implement new ways of delivering services. In contrast, some councils have difficulties in recruiting and retaining people in some key roles. For example, Aberdeen City Council had difficulty filling the position of Director of Corporate Governance. More widely, there is a recognised shortage of qualified procurement professionals. Councils may therefore have to develop the skills of their existing staff or find new ways to attract people with the specialist skills they need. This highlights the importance of succession plans as part of workforce planning to avoid losing essential skills and knowledge, particularly when considering further staff reductions.

#### Further workforce reductions must reflect councils' priorities

**69.** A number of councils have been developing their workforce strategies and plans. An effective workforce strategy takes account of the skills needed for the future, not just the numbers and grades of staff. This means tying it in with the council's identified priorities and its plans for changing how services are delivered. For example, with councils expected to involve local communities more in planning, managing and delivering services, in response to the Community Empowerment (Scotland) Act 2015, they may need to retain or develop further their skills in this area.

**70.** Some councils have still to fully, or further, develop their workforce planning. We have raised concerns about workforce planning in recent Best Value reports. For example, East Dunbartonshire Council has a workforce strategy in place but it does not contain clear targets or timescales for meeting objectives, and so it is difficult to assess its impact. Our [Health and social care integration \[PDF\]](#)  report also identifies the need for long-term workforce strategies in the new integration authorities. Developing a suitably skilled workforce is particularly challenging in health and social care integration, given the wide range of people involved and the size of the workforce.



**How do we ensure our senior officers have the knowledge, skills and time to support us in making difficult decisions?**



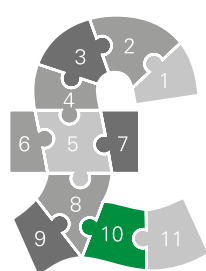
**What do we need the workforce to look like in terms of numbers, skills and knowledge?**

**How do we ensure the council's future pay structures do not discriminate against any groups of staff?**



**71.** We have also identified a risk that staff in some support services may be under severe pressure after significant staff reductions. For example, information collected by auditors shows that most councils have reduced finance staff. This has not had a negative impact on service delivery to date, with all councils submitting their unaudited accounts on time and all council audits being completed by the due date of 30 September 2015. Some councils are planning to reduce finance staffing further. This can pose risks for councils in being able to carry out good long-term financial planning, effective monitoring of budgets and savings, and responding to the additional work involved in budgeting for the new health and social care arrangements. However, it can also indicate better use of technology and therefore a need for fewer finance staff.

### There is potential to reduce staff time lost due to sickness absence



**10.8 days:** the average number of sickness days per employee (excluding teachers) in 2014/15

**6.3 days:** the average number of sickness days per teacher in 2014/15



**72.** In 2014/15, sickness absence across councils increased by almost half a day per employee, excluding teachers. Sickness absence per employee varied across councils from an average of 8.8 days per year in Orkney to 14.5 days per year in West Dunbartonshire ([Exhibit 12, page 36](#)). If councils with high absence levels could lower this to match the top eight performing councils (lower than 9.9 days), that would gain the equivalent staff time of close to 700 full-time employees (excluding teachers) across Scotland.

**73.** Sickness absence also varied in 2014/15 among teachers from an average of 3.6 days per year in North Ayrshire to 10.1 days per year in Clackmannanshire. Similarly, if councils with high teacher absences could match the top eight performing councils (lower than 5.7 days), that would gain the equivalent staff time of close to 200 full-time teachers across Scotland.

**74.** With councils' workforces reducing, this potentially increases the workload for remaining staff, which in turn can negatively affect morale and sickness absence. It can also impact on the ability of managers to deal with absence issues.

**75.** Reasons for sickness absence are complex and varied and therefore reducing absence is not easy. East Dunbartonshire Council has taken steps to reduce sickness absence, for example, by introducing better monitoring of short and long-term absences, identifying departments with high absence rates, and providing further support and guidance for managers. This has led to a decrease in staff absence levels, although they are still above the Scottish average. To try to reduce the cost of absence, the Improvement Service is helping councils to learn from each other, using the LGBF as a starting point.

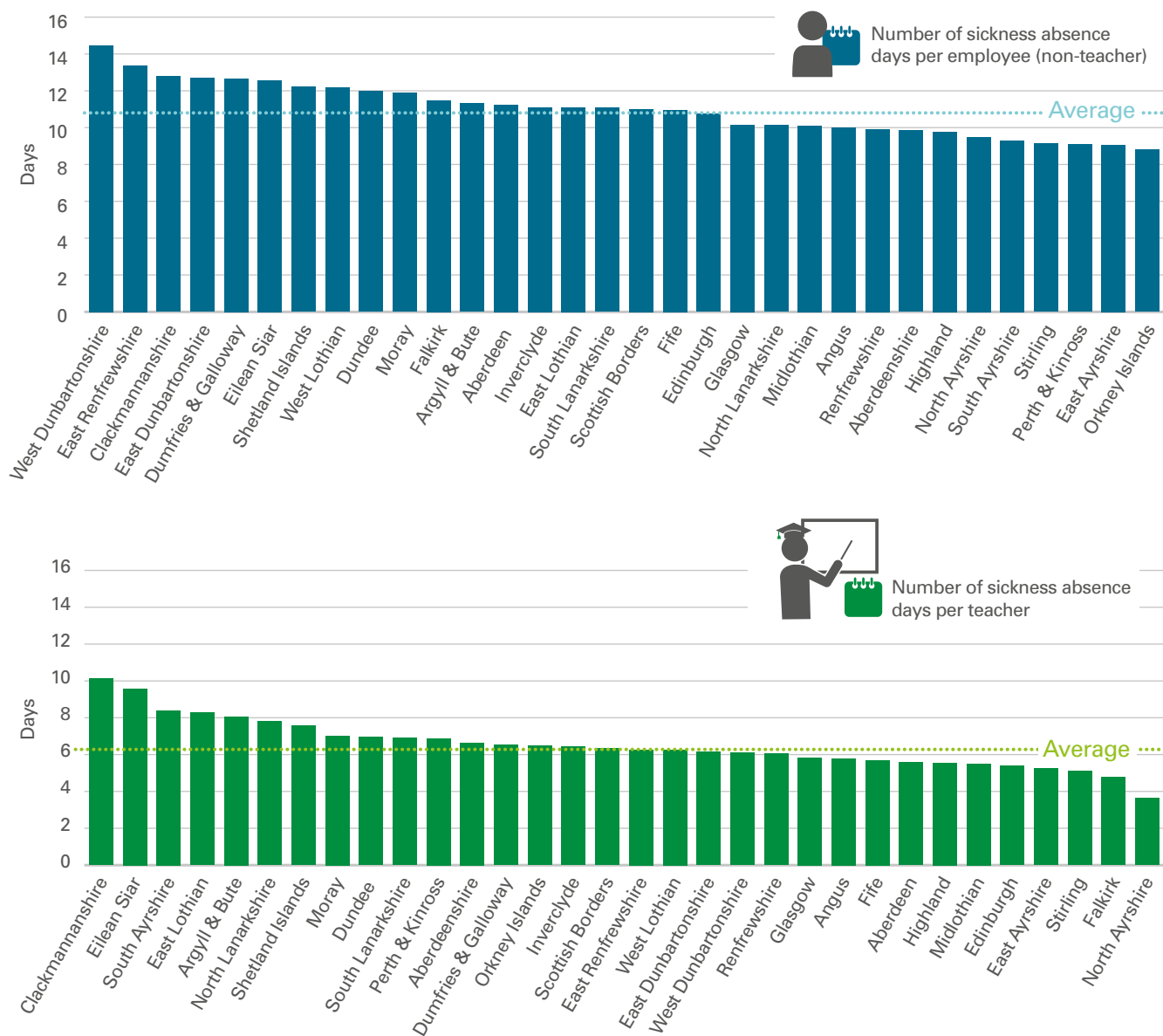


**How effectively is the council working to improve sickness absence among employees?**

## Exhibit 12

### Sickness absence for council employees in 2014/15

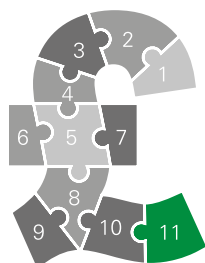
Clackmannanshire and West Dunbartonshire councils have the highest average number of sickness days for teachers and other employees respectively.



Note: Sickness absence varies from year to year. When councils use this LGBF information, they will want to consider the data for more than one year.

Source: Local Government Benchmarking Framework, Improvement Service, 2016

## Councillors need good quality information to make decisions and the appropriate skills to carry out their scrutiny role




**1,223:** the number of councillors in Scotland

**32:** all councils' audited accounts were unqualified in 2014/15



**76.** It is important that councillors have clear, understandable and manageable information to help them make decisions and scrutinise effectively. We have seen meeting papers where councillors were expected to read over 700 pages of information. Committee reports can be long, complex and written in very bureaucratic language, making them difficult to understand. This places significant demands on councillors and makes it difficult for them to focus on the most important issues, such as the council's underlying financial position.

**77.** Councils were required to add a management commentary to their annual financial reports for the first time in 2014/15. It replaces the previous explanatory foreword, as part of the move to make the accounts more accessible to readers. This should enable councillors and others to scrutinise the annual financial reports more effectively. We have prepared guidance for councils about financial reporting and scrutiny, with suggested questions for councillors to ask. This is available on our [website](#). We will review these in more detail next year.

**78.** As well as making the accounts more understandable, officers need to provide councillors with information, support and advice to help them scrutinise the accounts and other financial and service performance information. For example, there are gaps between the technical information, such as prudential indicators, and the straightforward explanations that many councillors need to fully understand the consequences of their decisions. Our [Borrowing and treasury management in councils \[PDF\]](#)  report found that councils need to improve their scrutiny in this area.

### Councils need to conduct their business openly in the interests of local accountability

**79.** Good governance requires councils to conduct their business in a transparent manner. In some of the Best Value audits we carried out in 2015, for example in East Dunbartonshire and Argyll and Bute councils, we highlighted that they are carrying out a relatively high proportion of business in private. A wider analysis of the number of reports that councils consider in private, rather than in public, has highlighted variation in approach. For example, around a quarter of councils discuss less than two per cent of reports in private at meetings of the full council or at a policy and resources committee (or equivalent). In contrast, a few councils consider over 15 per cent of items in private.



**How do we ensure that the information we receive is clearly written, jargon-free and manageable?**




**How can we consider more of our business in public?**

**80.** Decisions on considering items publicly or privately are influenced by a range of factors. In particular, they may be affected by local schemes of delegation to senior officers, allowing them to make certain operational decisions. They may also be influenced by the local culture developed over time in councils. In our recent Best Value report on Argyll and Bute Council, we recommended that the council establishes a more open and transparent culture and style of working, which includes minimising the amount of business it carries out in private. Councils should be looking to identify and adopt best practice to strengthen local accountability.

**81.** Every year, the Accounts Commission emphasises in its overview report the importance of good governance. This includes procedures for authorising spending decisions, systems for managing risks, processes for reporting and scrutinising financial and service performance, and the way councillors and staff behave. All of these are increasingly important as councils continue to adapt to changing circumstances and develop more creative and ambitious ways of achieving positive outcomes for communities. In doing this, they are working more with partners in the public, private and third sectors, and in partnership with their communities. It is therefore even more important for councils to review and update governance arrangements to ensure that they are fit for purpose. The principles of good governance are:

- creating and implementing a vision and focusing on outcomes
- councillors and officers working together to achieve a common purpose, with clearly defined functions and roles
- promoting the council's values and upholding high standards of conduct and behaviour
- taking informed and transparent decisions which are subject to effective scrutiny and managing risk
- developing the capacity and capabilities of councillors and officers
- engaging with local people and other stakeholders to ensure robust public accountability.<sup>13</sup>

**82.** Councils should have appropriate arrangements in place to approve, monitor and hold ALEOs to account for the public funding that is provided to them. This includes complying with the Following the Public Pound Code. The Code is designed to ensure that openness, integrity and accountability are applied to all council decisions when public money is being spent, for example when establishing funding relationships with ALEOs. The importance of good governance was highlighted in Audit Scotland's [\*Conclusions on issues relating to the Lennoxtown Initiative\* \[PDF\]](#)  in November 2015.<sup>14</sup> The report found that more robust processes should have been put in place to demonstrate that the public funds provided were used for the charitable purposes intended, and that using resources in this way represented best value.

**83.** In 2015, the chair of the Accounts Commission wrote to all chief executives and council leaders highlighting the importance of good governance and to encourage councils to apply good practice more consistently across all ALEOs. Local Area Networks will continue to monitor how effectively councils are overseeing ALEOs, with audit work looking at the role of ALEOs in service delivery being considered for 2017/18.




**How can we involve our communities more in local decisions?**

### Councillors must develop their skills and knowledge as their role becomes more complex and demanding

**84.** Councillors face taking increasingly difficult decisions, often needing to consider new and more complex ways of delivering services. They need to be confident in their ability to appraise new ways of working and to scrutinise operational and financial performance. This will help them carry out their role effectively in the current demanding environment. Their continuing professional development should identify the skills and knowledge they need to develop.

**85.** Training on scrutiny tends to be provided at the start of a political term, as part of the induction scheme for new councillors, or targeted towards councillors who sit on scrutiny committees. However, scrutiny training needs to be provided more widely. Perth and Kinross Council, for example, developed an action plan after identifying a risk in councillors appointed to ALEOs not having the appropriate skills and training.

**86.** Our [Borrowing and treasury management in councils \[PDF\]](#)  report found that councillors said it was often difficult to attend training due to other commitments. This was said to be particularly difficult where training courses were scheduled to last for a full day. To keep knowledge and skills up to date, councils could consider providing more training in a variety of ways to suit councillors' needs, including short briefings and online training.

**87.** Following local elections in 2017, the induction and training for new and re-elected councillors will be very important in helping them fulfil their role and responsibilities in an increasingly complex and challenging environment. To contribute to this, the Accounts Commission is doing more work on roles and responsibilities in 2016/17.




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**How well do we scrutinise decisions on financial and service performance?**

**How do we ensure we have the knowledge and expertise we need to scrutinise effectively?**

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# Endnotes



- ◀ 1 [\*Borrowing and treasury management in councils\* \[PDF\]](#) , Audit Scotland, March 2015.
- ◀ 2 [\*Major capital investment in councils: follow-up\* \[PDF\]](#) , Audit Scotland, January 2015.
- ◀ 3 *The Prudential Code for Capital Finance in Local Authorities*, CIPFA.
- ◀ 4 Living Wage Foundation.
- ◀ 5 [\*Health and social care integration\* \[PDF\]](#) , Audit Scotland, December 2015.
- ◀ 6 [\*Changing models of health and social care\* \[PDF\]](#) , Audit Scotland, March 2016.
- ◀ 7 [\*East Dunbartonshire Council: the Audit of Best Value and Community Planning – a follow-up report\* \[PDF\]](#) , Audit Scotland, June 2015.
- ◀ 8 [\*Falkirk Council: the Audit of Best Value and Community Planning\* \[PDF\]](#) , Audit Scotland, August 2015.
- ◀ 9 [\*Argyll and Bute Council: Best Value audit 2015\* \[PDF\]](#) , Audit Scotland, December 2015.
- ◀ 10 *Scotland's Digital Future – Delivery of Public Services*, November 2012.
- ◀ 11 [\*Procurement in councils\* \[PDF\]](#) , Audit Scotland, April 2014.
- ◀ 12 [\*How councils work: Options appraisal – are you getting it right?\* \[PDF\]](#) , Audit Scotland, March 2014.
- ◀ 13 *Delivering good governance in local government, Guidance note for Scottish authorities*, SOLACE/CIPFA, 2008.
- ◀ 14 [\*Conclusions on issues relating to the Lennoxtown initiative\* \[PDF\]](#) , Audit Scotland, November 2015.



# An overview of local government in Scotland 2016

This report is available in PDF and RTF formats, along with a podcast summary at:  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) 

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# Audit Committee External Audit Update Paper

## Midlothian Council

Year ended 31 March 2016  
May 2016

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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

# Introduction

This paper provides the Audit Committee with a report on progress in delivering our responsibilities as your external auditors. The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you; and
- a number of challenge questions in respect of these emerging issues which the Committee may wish to consider.

Members of the Audit Committee can find further useful material on our website [www.grant-thornton.co.uk](http://www.grant-thornton.co.uk), where we have a section dedicated to our work in the public sector (<http://www.grant-thornton.co.uk/en/Services/Public-Sector/>). Here you can download copies of our relevant local government publications including:

- Reforging local government: Summary findings of financial health checks and governance reviews
- Making devolution work: A practical guide for local leaders
- Spreading their wings: Building a successful local authority trading company
- Easing the burden: the impact of welfare reform on local government and the social housing sector
- All aboard? Local government governance review 2015
- Growing healthy communities: the health and wellbeing index
- Partnership working in mental health
- Better together: Building a successful joint venture company

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either Paul Dossett or Claire Gardiner.

# External audit progress compared to plan at May 2016

Activity	Planned date	Progress	Comments
<b>Governance and transparency</b> We have obtained an understanding of the overall control environment relevant to the preparation of the financial statements including standards of conduct and the approach to fraud.	January 2016	Complete	Our review found the governance structures and processes in place are designed effectively.  <b>Further work planned:</b> We will review the Annual Governance Statement included in the Abstract of Accounts and assess compliance with the principles from the Delivering Good Governance in Local Government framework.
<b>Journal entry controls</b> We have reviewed the Council's journal entry policies and procedures as part of determining our journal entry testing strategy.	February-August 2016	On track	Our review of the journal entry controls did not identify any material weaknesses, however we did note that the system allows the manual input of the journal creator and authoriser and the journal number. This increases the risk of fraud and error, therefore our testing procedures have been extended.  <b>Further work planned:</b> <ul style="list-style-type: none"> <li>Review of control environment at the year end to ensure no changes</li> <li>We will update our understanding of 'unusual' entries based on the findings from our review of the control environment and client knowledge</li> <li>Substantive testing of the journal transactions occurring in the financial year.</li> </ul>
<b>Walkthrough testing</b> In our Annual Audit Plan we have identified two areas where we consider there is an increased risk of material misstatement to the financial statements: <ul style="list-style-type: none"> <li>Valuation of property, plant and equipment is not correct</li> <li>Operating expenses are understated or not recorded in the correct period</li> <li>Employee remuneration expenses are understated</li> <li>Welfare benefit expenditure improperly computed.</li> </ul> For all the above systems we have gained an understanding of the key controls and completed walkthrough tests to ensure the controls were operating in line with our understanding.	February 2016	Complete	We conducted a review of the controls over the systems we identified as having an increased risk of material misstatement. For all the systems subject to walkthrough testing we have concluded that the system is designed effectively.  <b>Further work planned:</b> In line with our audit plan we will undertake substantive tests of detail on each system as part of our final audit.

# External audit progress compared to plan at May 2016 (continued)

Activity	Planned date	Progress	Comments
<b>Early substantive work</b> Over the past two years we have been working with the Council to create efficiencies in the audit process. As part of this we have conducted substantive work at the interim stage of our audit using the information available for the first nine months of the financial year. We have conducted early substantive work in the following areas: <ul style="list-style-type: none"> <li>• Property, plant and equipment</li> <li>• Operating expenses</li> <li>• Fees, charges and other income</li> <li>• Employee remuneration</li> </ul>	February 2016	Broadly on track	Our work included sample testing across all areas listed opposite. We have encountered some issues in obtaining the supporting documentation for our samples as follows: <ul style="list-style-type: none"> <li>• We selected a sample of 19 transactions relating to fees, charges and other income to be traced to supporting documentation and the bank. Of the sample we are still awaiting supporting documentation for 9 transactions</li> <li>• We selected a sample of 37 payroll transactions to be traced to contract and recalculate employer contributions for superannuation and National Insurance. From this sample there were 8 instances where the superannuation contributions did not appear to be at the expected rate. The payroll team are now investigating this further.</li> <li>• We selected 30 operating expenses transactions and supporting documentation could not be retrieved for 1 of the sample. This is being looked into further by the finance team.</li> <li>• We selected a sample of 20 title deeds to verify the rights of the Council and from this 2 sets of title deeds were not obtained. The legal team are taking action to provide the title deeds</li> </ul> <b>Further work planned:</b> In line with our audit approach we will conduct further testing across all areas at the year end. If the issues above remain unresolved we will be required to increase the level of testing conducted at the year end.
<b>National Fraud Initiative Questionnaire</b> A member of the audit team discussed and verified progress with the National Fraud Initiative and completed the required questionnaire.	February 2016	Complete	There were no issues arising from this work and we have submitted the required information to Audit Scotland, by the required deadline.
<b>Local Scrutiny Plan</b> Each year, we participate in the shared risk assessment and publication of Local Scrutiny Plan as part of our work on the Local Area Network (LAN) with other scrutiny partners.	March 2016	Complete	The Local Scrutiny Plan 2016-17 was finalised in March 2016. The update reflects recent work carried out by local scrutiny partners, including Grant Thornton, Education Scotland, the Scottish Housing Regulator and the Care Inspectorate, and national work carried out by Audit Scotland.  The LAN considered evidence from key management documents and performance indicators and concluded that no new scrutiny risks have been identified that require additional scrutiny work.

# External audit progress compared to plan at May 2016 (continued)

Activity	Planned date	Progress	Comments
<b>Local Government Technical Update</b> Each year we provide a training session with the finance team to update for any key changes to the financial reporting requirements, regulations and legislation.	17 March 2016	Complete	A session was held on 17 <sup>th</sup> March which provided the opportunity for discussion on any key changes to financial reporting requirements and the Council's planned approach to complex areas. As part of this session we received queries on the Council's Private Finance Initiatives, bad debt provision and capital accounting. We will be following up on the issues with the Council in due course.
<b>Review of information technology controls</b> Our information systems specialist, will perform a high level review of the general IT control environment as part of the overall review of the internal controls system.  We identified a number of issues as part of the 2014-15 audit process, which will be followed up as part of the review of the IT control environment.	April 2016	On track	Our information systems specialist has been in touch with the Council IT department to arrange dates for the work to be conducted. This work provides assurance over the IT controls on the general ledger systems and contributes to the efficiency of our year end testing.
<b>Final accounts audit</b> Including: <ul style="list-style-type: none"> <li>• audit of the 2015-16 financial statements</li> <li>• proposed opinion on the Council's accounts</li> </ul>	July – August 2016	On track	The Council is planning to prepare the draft financial statements in June 2016, which is in line with the timetable in outlined in our Annual Audit Plan.  Throughout the audit process we review guidance issued by Audit Scotland, Scottish Ministers and CIPFA and discuss with the finance team at the Council. In advance of the year end we will review any new guidance and discuss with officers to reach an agreed approach.  We plan to complete our audit of the financial statements by 31 August 2016 and as part of this we will be working with the Council to re-evaluate our approach to testing. We will issue a draft program of work to the Council for discussion.
<b>Our wider Code responsibilities</b> Under the Audit Scotland Code of Audit Practice we are required to review and report on: <ul style="list-style-type: none"> <li>• financial management</li> <li>• financial sustainability</li> <li>• Best Value and performance.</li> </ul>	June – August 2016	On track	As part of our planning we identified a number of areas where we would conduct work as part of our wider responsibilities including: <ul style="list-style-type: none"> <li>• Continuing financial pressures</li> <li>• A review of the Council's approach to improving collection of debt</li> <li>• The impact of the potential changes to the political landscape</li> <li>• Following the public pound</li> <li>• Fraud and irregularity</li> <li>• Performance management.</li> </ul> Across the year we have been monitoring the Council position in line with the above and we plan to schedule meetings with the relevant officers in order to inform our year end reporting.

# External audit progress compared to plan at May 2016 (continued)

Activity	Planned date	Progress	Comments
<p><b>Workforce planning follow up</b> Each year, Audit Scotland ask us to review the local impact of a selected national study. In 2015-16 auditors are expected to conduct a targeted follow-up review of Scotland's Public Sector Workforce report.</p> <p>The Audit Scotland report highlighted that there had been a significant reduction in the Scottish Public Sector workforce across the four year period to March 2013 and noted that there were further challenges ahead. They encouraged public bodies to think differently about how they deliver services and work better together. A key recommendation was to improve the strategic planning of the workforce to improve future skills needs, gaps and challenges.</p>	May 2016	On track	<p>We are aware the Council have developed a People Strategy covering 2015 – 2017 outlining the actions to be taken to enable and support their employees to deliver excellent, innovative and cost effective services to communities.</p> <p>The Audit Scotland follow-up aims to obtain a national picture of the movement in workforce planning since the report in November 2013. The work will require the audit team to complete a pro-forma questionnaire provided by Audit Scotland.</p> <p>We will conduct the work based on Council papers on workforce planning and discussions with officers as appropriate.</p>
<p><b>Audit Scotland's Best Value programme</b> Audit Scotland are currently working on a revised approach to auditing Best Value across the sector. As this is the final year of our appointment of the Council, we have been asked to collate our knowledge of council activities and provide this to Audit Scotland for consideration with regards to their approach to Best Value going forward.</p>	May 2016	On track	<p>We will focus on ensuring a smooth handover with the incoming auditor, a key element to this will be a baseline survey in line with Audit Scotland requirements.</p> <p>We will use our accumulated auditor knowledge of the Council to populate the baseline survey and work with officers to ensure this reflects the most up to date position.</p>
<p><b>Recent Audit Scotland Reports</b> Audit Scotland publish have published a number of key national reports in 2016 to date, including:</p> <ul style="list-style-type: none"> <li>• Changing models of health and social care</li> <li>• Community planning: an update</li> <li>• Major capital investment in councils: follow-up</li> <li>• Local Government Overview report</li> </ul>	March – July 2016	On track	<p>It is important the Council considers the national findings, from Audit Scotland, within a local context and develops actions as appropriate.</p> <p>We will monitor the Council's approach to the scrutinising national reports and developing actions in line with recommendations.</p>

# IFRS 13 'Fair value measurement'

## Accounting and audit issues

The 2015-16 Accounting Code applies IFRS 13 'Fair Value Measurement' for the first time. The standard sets out in a single framework for measuring fair value and defines fair value as the price that would be received to sell an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date.

There is no public sector adaptation to IFRS13 but the Treasury and therefore the Code has adapted IAS 16 Property, Plant and Equipment so that operational assets (providing service potential) are no longer held at fair value but current value. As such IFRS 13 does not apply to operational assets. This new definition of current value means that the measurement requirements for operational property, plant and equipment providing service potential have not changed from the prior year.

However, surplus assets will need to be measured under the new definition of fair value, reflecting the highest and best use from the market participant perspective.

Other areas affected by the new standard include investment property, available for sale financial assets and those items where fair values are disclosed - for example, long term loans and PFI liabilities. IFRS 13 also introduces extensive disclosure requirements.

Local authorities need to:

- identify/ review their classification of surplus assets and investment properties
- discuss IFRS 13 with their property valuers and treasury advisers to ensure that fair values provided are produced in line with the new standard
- update accounting policies and disclosures to reflect the new standard.

## Challenge question

- Has your Chief Finance Officer reviewed the surplus assets and investment property categories to ensure what is included is correctly classified?
- Has your Chief Finance Officer ensured property valuers and treasury advisers are aware of the fair value definitions under IFRS 13?
- Have the accounting policies and disclosures in your accounts been updated to reflect the IFRS 13 requirements?



# Highways Network Asset

## Accounting and audit issues

CIPFA announced at the recent Local Government Accounting Conferences some key messages with regards to changes in accounting for the Highways Network Asset from 2016-17. These included:

- Transport Infrastructure Assets will now be referred to as single asset, the Highways Network Asset (HNA)
- this will be measured at Depreciated Replacement Cost (DRC) using the Modern Equivalent Asset (MEA) basis of valuation from 1 April 2016 and will be applied prospectively rather than requiring a full retrospective restatement
- the new requirements only apply to authorities with assets meeting the definition of a single HNA asset

The 2016-17 Accounting Code which will include further details on these announcements is expected to be published in Spring 2016. Grant Thornton has produced a short briefing on these announcements which is available from your Engagement Lead and Engagement Manager and will provide further briefings as further details become available.

The finance team has been working with the Roads and Transport department to collate the data required. The Roads and Transport department are in the process of conducting condition surveys and gathering data on inventory for population in to the valuation model.

Across Scotland local authorities are using the SCOTs finance model to generate the valuation figures required to comply with the CIPFA Code in 2016-17. It is likely that a national exercise will be undertaken to assess the validity of the model and provide audit assurance on its use. The key challenge for the Council will be demonstrating that the information provided by Roads and Transport is complete and accurate.

## Challenge question

- Has the Audit Committee been briefed on progress against the Council's plan for implementing the change in accounting?

# Reforging local government: Summary findings of financial health checks and governance reviews

## Grant Thornton market insight

The recent autumn statement represents the biggest change in local government finance in 35 years. The Chancellor announced that in 2019-20 councils will spend the same in cash terms as they do today and that "better financial management and further efficiency" will be required to achieve the projected 29% savings. Based on our latest review of financial resilience at English local authorities, this presents a serious challenge to many councils that have already become lean.

Our research suggests that:

- the majority of councils will continue to weather the financial storm, but to do so will now require difficult decisions to be made about services
- most councils project significant funding gaps over the next three to five years, but the lack of detailed plans to address these deficits in the medium-term represents a key risk
- Whitehall needs to go further and faster in allowing localities to drive growth and public service reform including proper fiscal devolution that supports businesses and communities
- local government needs a deeper understanding of their local partners to deliver the transformational changes that are needed and do more to break down silos
- elected members have an increasingly important role in ensuring good governance is not just about compliance with regulations, but also about effective management of change and risk
- councils need to improve the level of consultation with the public when prioritising services and make sure that their views help shape council development plans.



In Scotland the recent Local Government Settlement announced that the total funding allocation from the Scottish Government will fall by 1.7% from £10.76bn in 2015-16 to £10.15bn in 2016-17. This represents a significant challenge for Councils as government grants are their main source of funding. Local authorities can generate income locally through council tax and income from fees and charges. However, with council tax remaining frozen in 2016-17 and capped at 3% from 2017, the focus for most local authorities is on generating expenditure savings rather than increasing local income.

Our report is available at <http://www.grantthornton.co.uk/en/insights/reforging-local-government/>

# Making devolution work: A practical guide for local leaders

## Grant Thornton market insight

Our latest report on English devolution is intended as a practical guide for areas and partnerships making a case for devolved powers or budgets.

The recent round of devolution proposals has generated a huge amount of interest and discussion and much progress has been made in a short period of time. However, it is very unlikely that all proposals will be accepted and we believe that this the start of an iterative process extending across the current Parliament and potentially beyond.

With research partner Localis we have spent recent months speaking to senior figures across local and central government to get under the bonnet of devolution negotiations and understand best practice from both local and national perspectives. We have also directly supported the development of devolution proposals. In our view there are some clear lessons to learn about how local leaders can pitch successfully in the future.

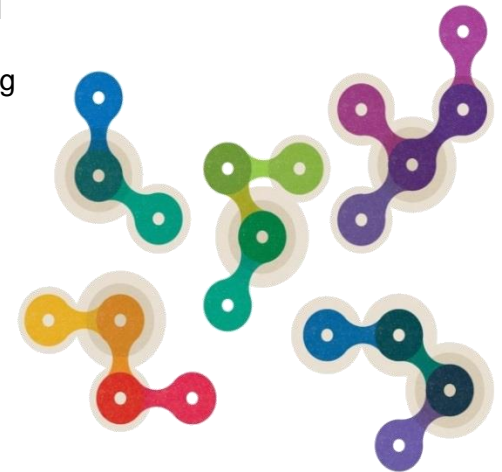
Devolution in England is building on the precedent set by city deals negotiated between individual localities and central government. The Scottish Government have been encouraging regional city deals through their Agenda for Cities which was refreshed in March 2016. The refresh sets out the vision for a Scotland where cities and their regions power Scotland's economy for the benefit of all. The Scottish Government highlights that City Region Deals offer the potential for new collaborative regional partnerships focused on long term strategic approach to improving regional economies.

We would encourage local leaders think through the fundamental questions involved:

- what can we do differently and better?
- what precise powers are needed and what economic geography will be most effective?
- what governance do we need to give confidence to central government

The report 'Making devolution work: A practical guide for local leaders' can be downloaded from our website:

<http://www.grantthornton.co.uk/en/insights/making-devolution-work/>



# CFO Insights– driving performance improvement

## Grant Thornton and CIPFA Market insight

CFO insights is an online analysis tool that gives those aspiring to improve the financial position of their local authority instant access to insight on the financial performance, socio- economy context and service outcomes of every council in England, Scotland and Wales.

The tool provides a three-dimensional lens through which to understand council income and spend by category, the outcomes for that spend and the socio-economic context within which a council operates. This enables comparison against others, not only nationally, but in the context of their geographical and statistical neighbours. CFO Insights is an invaluable tool providing focused insight to develop, and the evidence to support, financial decisions.

We are happy to organise a demonstration of the tool if you want to know more.



# Knowing the Ropes – Audit Committee Effectiveness Review

## Grant Thornton

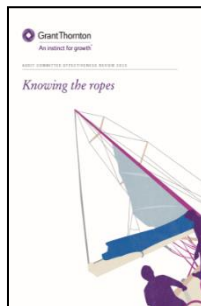
This is our first cross-sector review of audit committee effectiveness encompassing the corporate, not for profit and public sectors. It provides insight into the ways in which audit committees can create an effective role within an organisation's governance structure and understand how they are perceived more widely. It is available at <http://www.grantthornton.co.uk/en/insights/knowning-the-ropes--audit-committee-effectiveness-review-2015/>

The report is structured around four key issues:

- What is the status of the audit committee within the organisation?
- How should the audit committee be organised and operated?
- What skills and qualities are required in the audit committee members?
- How should the effectiveness of the audit committee be evaluated?

It raises key questions that audit committees, board members and senior management should ask themselves to challenge the effectiveness of their audit committee.

Our key messages are summarised opposite.



# Supporting members in governance

## Grant Thornton and the Centre for Public Scrutiny

We have teamed up with the Centre for Public Scrutiny to produce a member training programme on governance. Elected members are at the forefront of an era of unprecedented change, both within their own authority and increasingly as part of a wider local public sector agenda. The rising challenge of funding reductions, the increase of alternative delivery models, wider collaboration with other organisations and new devolution arrangements mean that there is a dramatic increase in the complexity of the governance landscape.

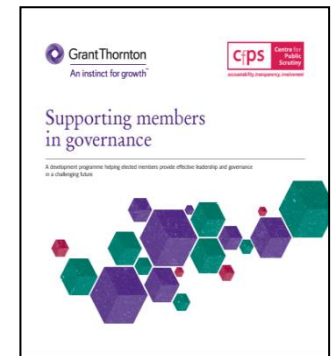
Members at local authorities – whether long-serving or newly elected – need the necessary support to develop their knowledge so that they achieve the right balance in their dual role of providing good governance while reflecting the needs and concerns of constituents.

To create an effective and on-going learning environment, our development programme is based around workshops and on-going coaching. The exact format and content is developed with you, by drawing from three broad modules to provide an affordable solution that matches the culture and the specific development requirements of your members.

- Module 1 – supporting members to meet future challenges
- Module 2 – supporting members in governance roles
- Module 3 – supporting leaders, committee chairs and portfolio holders

The composition of the Council may change following local elections in May 2017. The development programme can begin with a baseline needs assessment, or could be built around the needs of the newly elected members.

Further details are available from your Engagement Lead and Audit Manager





# Scotland Ltd 2015

## Grant Thornton market insight

The country's leading sector- Oil and Gas- faced daunting challenges and was forced to confront difficult questions about its long term future. But, despite the large cloud hanging over the industry, there remains many reasons to be optimistic and positive about the Scottish economy.

This is the second year Grant Thornton have produced a Scotland Ltd report. This report offers a detailed analysis of the top 100 limited companies north of the border, exploring the trends behind their success and what challenges or growth opportunities we can expect in the coming months and years.

The last twelve months have been some of the most testing in the oil and gas industry's history, but it's not all bad news. Recent multi-million pound funding support announcements from the government and major players in the sector suggest that the industry does have a future.

Our research suggests that Food and Drink is now clearly the top sector in Scotland Ltd 2015, with Property and Construction also performing well. The country's economy is becoming increasingly diverse, driven by pioneering businesses focused on sustainable long-term growth, innovation and greater collaboration.

Despite the extensive economic diversification and a growing private sector, Scotland's Public Sector continues to be a key employer as well as a promoter and facilitator of economic growth. The future public spending forecasts mean that local authorities are increasingly under pressure to deliver services in efficient and innovative ways. The need to find alternative ways of working will see local authorities reach out to private businesses and the third sector to provide essential community services.

There is no doubt that there are some significant challenges coming in the years ahead. However, our report demonstrates that there are many reasons to be optimistic and to celebrate our country's increasingly vibrant economy.

Our report is available at <http://www.grantthornton.co.uk/en/insights/powering-scotlands-vibrant-economy/>

### TOP 100 BY SECTOR



# Scottish Local Government Benchmarking Framework

## Local Government Issues

The fourth annual report for the Scottish Local Government Benchmarking Framework (LGBF) has been issued. The Overview Report outlines how much councils spend on particular services, service performance and how satisfied people are with the major services provided by councils.

The headline findings for Scotland as a whole are that over the last 4 years councils have achieved substantial improvements in efficiency and productivity while service output and outcomes have been maintained and improved.

The findings for the last 12 months show that the trend of improvement has continued across the majority of services, however, there is evidence that the on going budget constraints are beginning to impact upon some service areas. The data collected under the LGBF shows that councils have protected priority areas such as education and social care, and have actively shifted resources to accommodate the care and support needs of the aging population. Some of the areas that have had the most significant reductions have mitigated the impact through self generated income and alternative delivery models.

With further challenging budgets anticipated from 2016-17 onwards, the report highlights that it should not be assumed that the improvements will simply continue. Many efficiency and productivity gains have been taken already and further gains will be much harder to achieve.

### Challenge question

- Have Members considered the results for Midlothian Council in this recent benchmarking exercise?





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## **Annual Governance Statement**

**Report by: Kenneth Lawrie, Chief Executive**

### **1 Purpose of Report**

This report provides an assessment of the Council's compliance with its Code of Corporate Governance and invites the Audit Committee to note the attached draft statement which is proposed to be included in the Financial Statements.

### **2 Background**

- 2.1** Midlothian Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards. This is to allow public funds and the assets at its disposal to be safeguarded and used efficiently and effectively in pursuit of best value.
- 2.2** Elected Members and senior management are responsible for the governance of the business affairs of Midlothian Council and have therefore developed a Code of Corporate Governance based on the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives' (SOLACE) framework.
- 2.3** This framework includes a requirement that an Annual Governance Statement (AGS) should be prepared; that this be included as part of the Financial Statements; and that the AGS be authorised by the Leader of the Council and Chief Executive.
- 2.4** Each year, the level of compliance with the Code of Corporate Governance is monitored by requiring Heads of Service (including the statutory post of Section 95 Officer) to complete a self-assessment against the key elements of the Code. Input from the Monitoring Officer is also sought. Internal Audit independently reviews a sample of control elements from the Code, as well as using evidence from its own reviews of Council performance undertaken during the year. The conclusions of any external inspections are also used to help inform the AGS.

- 2.5** A copy of the proposed AGS for 2015/16 is shown at Appendix 1.

### **3 Report Implications**

#### **3.1 Resource**

There are no direct resource implications arising from this report.

#### **3.2 Risk**

The AGS highlights where progress has been made in reducing risks within the Council over the period 2015/16 and also highlights where further work is planned in 2016/17 to reduce risk further.

#### **3.3 Single Midlothian Plan and Business Transformation**

Themes addressed in this report:

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

#### **3.4 Key Priorities within the Single Midlothian Plan**

By ensuring that the Council has proper governance arrangements in place, this provides a suitable framework when seeking to achieve the key priorities of the Single Midlothian Plan.

#### **3.5 Impact on Performance and Outcomes**

Without good governance arrangements, performance and outcomes may be adversely affected.

#### **3.6 Adopting a Preventative Approach**

This report addresses the Council's policy to have a robust internal control environment, management of risk and effective governance.

#### **3.7 Involving Communities and Other Stakeholders**

The AGS has been prepared following consultation with Chief Officers, Heads of Service, the Monitoring Officer and Internal Audit.

#### **3.8 Ensuring Equalities**

An Equalities Impact Assessment (EQIA) is not required at this stage and there are no equalities issues arising from the report.

### **3.9 Supporting Sustainable Development**

There are no sustainable development issues raised in this report.

### **3.10 IT Issues**

There are no IT issues raised in this report.

## **4 Recommendations**

The Audit Committee is invited to consider and comment on the proposed Annual Governance Statement prior to its finalisation.

**Date:** 14 April 2016

**Report Contact:**

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## Annual Governance Statement

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

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

In order to achieve this, the Council has developed a Code of Corporate Governance based on the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives' (SOLACE) framework and guidance on Delivering Good Governance in Local Government. The Code was reviewed and updated in 2013. The Council also has a number of officials in statutory posts who monitor governance and the supporting processes during the year. These are the Head of the Paid Service, the Monitoring Officer, the Chief Finance Officer and the Chief Social Work Officer.

The Code of Corporate Governance details 6 Principles and 18 elements of good Governance. A copy of the Local Code of Corporate Governance is on our website at [www.midlothian.gov.uk](http://www.midlothian.gov.uk). Elements included are:

- allocating responsibility for maintenance of proper financial records and accounts and for maintaining effective systems of internal control;
- appointing a Monitoring Officer with responsibility to ensure that the Council, its officers and Elected Members, maintain the highest standards of conduct;
- establishing a scheme of delegated powers;
- establishing and enforcing a code of conduct for officers;
- having effective scrutiny and challenge arrangements in place over officer and Council decisions;
- open and effective recording of Council decisions;
- risk management processes;
- whistle blowing and fraud prevention procedures and processes;
- providing induction and training for Elected Members and Council officers;
- encouraging individuals from all sections of the community to engage with the Council;
- undertaking equality impact assessments where required; and
- obtaining professional advice on matters that have legal or financial implications.

Midlothian Council's financial management arrangements conform to the requirements of the CIPFA Statement on the role of the Chief Financial Officer in Local Government. The Chief Financial Officer has overall responsibility for the Council's financial arrangements and is professionally qualified and suitably experienced to lead the Council's finance function.

The Council is responsible for conducting each financial year, a review of the effectiveness of its governance framework, including risk management and the systems for internal control and financial control. The review of the effectiveness of the Council's governance framework is informed by:

- The work of the Corporate Management Team;
- The work of Council managers and Financial Services staff;
- The annual assurance questionnaires that are provided by all 8 Heads of Service;
- An annual review, by Internal Audit, of compliance with the Council's Local Code of Corporate Governance;
- The Audit Manager's annual report which is based on internal audit reports from across the range of Council services;
- Reports from the Council's external auditor; and
- Reports from other external review bodies, agencies and inspectorates.

The key governance arrangements and controls are set out in the local Code of Corporate Governance. Each year, using an assurance template, Internal Audit samples elements in the code to determine whether these are working effectively and that therefore the governance framework is working effectively.

In addition each Head of Service is required to undertake an annual self assessment of their area of responsibility using an assurance template where key elements of governance are examined.

Neither of these assessments highlighted any issues that would impact on the level of effectiveness of the Council's governance framework. A small number of improvements were identified and these are noted below in the action plan.

The statement has also been informed by the work undertaken by Internal Audit who, following the requirements of the Local Authority Accounts (Scotland) Regulations 2014, conducted an annual review of the effectiveness of the Council's system of internal control. The Internal Audit Manager concluded that based on the work undertaken in 2015/16 by the Internal Audit Section that overall, internal controls had been implemented and were being monitored by management in line with Financial Directives, Council Policies and the other key essentials of a robust Internal Control Environment.

The results from these reviews were presented to the May 2016 Audit Committee of the Council along with the Annual Governance Statement for approval.

The Head of Audit (the Audit Manager) has responsibility for the Council's Internal Audit function and reports functionally to the Audit Committee and operationally to the Chief Executive to allow appropriate independence. The Audit Manager is professionally qualified and suitably experienced to lead and direct the Internal Audit team.

The Public Sector Internal Audit Standards (PSIAS) require that an external assessment be conducted at least once every 5 years by a qualified, independent



assessor from outside the organisation over the level of compliance against PSIAS by the Internal Audit Section. An external assessment was not undertaken in 2015/16 but will be undertaken in late 2016/17 as part of the reciprocal assessments by the Scottish Local Authority Chief Internal Auditors' Group (SLACIAG). However a self evaluation of compliance with the Public Sector Internal Audit Standards by Midlothian Council's Internal Audit Section was undertaken by the Internal Audit Manager. This evaluation demonstrated that the key elements of the Standards were complied with during the year. The Council's external auditor conducts an annual review of the effectiveness of the Council's Internal Audit Service and arrangements and reports its findings to the Council within its Annual Audit Report. The latest available assessment (2014/15) was satisfactory.

A number of risks were well managed in 2015/16 and this is demonstrated by the work undertaken in setting up the Integrated Joint Board and the launch of the Scottish Borders Rail Line.

A number of governance improvements were highlighted in the 2014/15 self assessment and progress has been made in 2015/16 on the following:

- having a positive impact on the key priorities of economic recovery and business growth; positive destinations for young people; and early years – getting it right for every Midlothian child;

This action has continued to be part of performance monitoring throughout the 2015/16 performance management and scrutiny cycle and reported to Cabinet and Performance Review and Scrutiny Committee with the end year update due as part of the quarterly reporting in late May, early June 2016. The Community Planning Partnership priorities for 2015/16 have shown steady improvement across Early Years, Positive Destinations and Economic Development and these areas will be further developed in 2016-19. The Community Planning Partnership have recently reviewed key priorities and whilst they continue to build on the work previously undertaken, the key priorities for the period 2016-19 are: reducing the gap in learning outcomes; reducing the gap in health outcomes; and reducing the gap in economic circumstances.

- the continued delivery of the approved financial strategy in what continues to be a challenging financial environment for Local Government. Ensuring that measures are developed and implemented to secure the necessary financial savings to balance future years' budgets;

This action is ongoing and updates are provided through regular reports to Council. The Council has already taken decisions in respect of its 2016/17 budget to address a budget shortfall of £7.6 million. Balancing future year's budgets will continue to be a focus of action over coming years.

□ continued development of risk management processes by aligning risk assessments with service planning and mitigation of risks associated with delivering the Council's outcomes;

In 2015/16, work has been undertaken on the Corporate Risk Register through a bench marking exercise with other local authorities and public sector organisations and the revised Corporate Risk Register has had input from the Corporate Management Team and Directors. A strategic risk profile approach has been used to identify current issues, emerging risks and opportunities. The Risk Manager is now reviewing operational risk registers with service managers, with support from Performance Officers, to assess current and emerging risks which will inform the Strategic Risk Profile. An assessment as to whether Risk Registers should be provided to Cabinet and Council, in addition to the Audit and Risk Committees is being undertaken, given that risk management can be used to help inform decision making and shaping strategy.

□ procurement reform arising from the Procurement Reform Bill and new EU Directives;

All procedures and processes are currently being updated to comply with the new procurement legislation, some elements of which are not due to be implemented until 2017.

□ continued compliance with the Public Services Network code of connection requirements;

The 2016/17 PSN Code of Connection was submitted to the Cabinet Office on 10 March 2016 for approval. It is likely that the Council will maintain ongoing PSN compliance.

□ responding to the impact of further Welfare Reform changes;

Action has been taken to mitigate the impact on households affected and also in the income to the Council but there are further changes with Universal Credit migration and Personal Independence Payments. There is no change in the strategic approaches guiding Midlothian Council's response to Welfare Reform, which is to mitigate against the impact of the effects within the capability and resources of the Council and its partners.

□ the Health and Social Care Integration agenda with the continued establishment of joint services;

The Midlothian Integration Scheme was approved by the Scottish Government on 27 June 2015 and has now been legally constituted with the first Board meeting of the Integrated Joint Board held on 20 August 2015. From 2016/17, the Integrated Joint Board takes on responsibility for delivery of the services delegated to it by Midlothian Council and NHS Lothian. The Integrated Joint Board at its meeting on 10 December 2015 approved its Strategic Plan and directions have now been issued to Midlothian Council and NHS Lothian on how these delegated funds should be used. A process

of financial assurance has been undertaken by the Section 95 Officer on amounts transferred to the Integrated Joint Board by Midlothian Council and a report on this process is also to be submitted to the Midlothian Audit Committee by the Internal Audit function of the Council.

□ The Midlothian Police and Fire and Rescue Board provides the local scrutiny and accountability for Police and Fire and Rescue services as outlined in the Police and Fire Reform (Scotland) Act 2012. This Board was newly established in February 2016 and training opportunities are currently being developed;

During 2015/16, a training workshop was held with the previous Safer Communities Board, Elected Members and partnership representatives from across the Community Safety and Community Planning Partnership who attended on the topic of Community Justice and proposals to change the remit of the Community Safety Partnership to incorporate Community Justice. The Board also received regular update reports on the new national model for Community Justice. A programme of training opportunities will be provided to members of the Police and Fire and Rescue Board, as the Police and Fire and Rescue Board provides the local scrutiny and accountability for Police and Fire and Rescue services as outlined in the Police and Fire Reform (Scotland) Act 2012.

Those actions which are underway but which have not yet been fully concluded (ie the Business Transformation Programme; Welfare Reform; Procurement and Risk Management) will continue to be progressed in 2016/17.

The following table sets out improvements to the governance framework which are to be progressed in 2016/17:

Area for Improvement	Proposed Action in 2016/17
Key priorities and Financial Strategy	To continue to progress the Council's key priorities and deliver the Financial Strategy
Procurement	To update all procedures and processes to comply with the new procurement legislation
Compliance with new Code of Corporate Governance	Updating the Code of Corporate Governance to allow full compliance with the new International Framework of Good Governance in the Public Sector
Compliance against the new CIPFA code of practice on Fraud and Corruption	Review the current Counter Fraud Policy and Strategy, Whistle-blowing Policy and create a separate Anti-bribery and Corruption Policy to allow full compliance against the new CIPFA code of practice on "Managing the Risk of Fraud and Corruption"
Adoption of audit recommendations	To adopt the recommendations made by Internal Audit on the areas where significant weaknesses in control have been identified during the year (including Developer Contributions and Business Gateway)
Serious Organised Crime and Corruption	Undertake a high level assessment of the Council's readiness in relation to the risks posed by Serious

	Organised Crime and Corruption. An improvement plan for recording, managing, and addressing areas of potential risk exposure has been developed and an Integrity Board will be convened to take this forward.
Disaster recovery plans	Ensure that disaster recovery plans have been adequately tested and to monitor the on-going testing of these.
Standing Orders	Updates are required to Standing Orders and the associated documents (Scheme of Administration and Scheme of Delegation) caused by the recent management review and subsequent changes to the Council Directorates

On the basis of the Council's assurance system, and the elements of governance at its disposal, we are satisfied that overall, Midlothian Council's systems of internal control, risk management and governance arrangements are of a satisfactory standard. We are aware of areas where improvements are required and steps will be taken in the forthcoming year to address these areas, allowing the Council to advance its corporate governance arrangements and seek continuous improvement.

**Signed:**

**Catherine Johnstone, Leader of the Council / Kenneth Lawrie, Chief Executive**

**Date:**



## Internal Audit Report

### Devolved School Management Scheme

Issued: May 2016

<b>Level of Assurance</b>	<b>Good</b>	The controls in place to allow budgets to be calculated and allocated in a consistent and equitable way;
	<b>Good</b>	The controls designed to monitor actual to budgeted spend at a school and Council level
	<b>Weak</b>	The processes and controls designed to allow the principles laid down in the 2012 Devolved School Management Scheme to be embedded in the Midlothian Council scheme

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## Executive Summary

### 1.0 Introduction

Devolved budgets were introduced by the Scottish Education Authority in April 1993 and required councils to devolve 80% of school budgets to head teachers. The aim of devolving budgets was to improve local decision making by schools and provide more flexibility to head teachers in responding to the needs of individual schools. In 2006 revised Scottish Executive guidance recommended devolving 90% of budgets.

Further guidance was published in 2012 and the updated guidance reflects the considerable change in the economic and financial climate for local government and the wider public sector in Scotland and which removed the percentage targets. The aims of the revised guidance were to empower head teachers to meet local needs and deliver the best possible outcomes for young learners, in line with the objectives of the Curriculum for Excellence, Getting it Right for Every Child and the Early Years Framework. They are also intended to ensure that the existing best practice in relation to the operational aspects of Devolved School Management Schemes will become standard practice across the county based on the core values of subsidiarity (the principle that decisions should be taken at a level closest to where they will have their effect), openness, transparency and local accountability.

In order to assist establishments implement the new guidance, a Devolved School Management Self-Evaluation toolkit was developed by the Scottish Government to allow councils to obtain assurance that their local schemes were compliant with the principles laid down in the new guidelines.

Midlothian Council, for the financial year 2015/16, devolved a total of approximately £50M which comprised £27M for primary and nursery schools and £23M for secondary and community schools.

For the financial year ending 2014/15, all Midlothian Schools under spent against their budget and were permitted, under the scheme rules, to carry forward £995K of the accumulated under spend into 2015/16. An additional £13K was also carried forward to allow for IT equipment that could not be installed in time for the year end.

Responsibility for the calculation of budgets and monitoring financial spend for the devolved budgets transferred from the Education Resources Section to Finance and Integrated Service Support in January 2015.

### 2.0 Objectives of the Audit

To provide assurance to Senior Management and the Audit Committee over the effectiveness of the processes and controls designed to allow the locally Devolved School Management Scheme to be consistent with the principles laid out in national guidelines.

A copy of the terms of reference for the review is attached at Appendix 2.

### 3.0 Conclusion

It is audit's opinion that Midlothian Council has in place a mature process for the calculation and monitoring of devolved school budgets and that the schools themselves have a good record of managing their expenditure within the budgets set.

However we have identified the following:

- although the current scheme has been regularly updated, it has not been revised to take account of the latest Scottish Government guidelines on devolved School budgets published in 2012 or the changing financial climate and settlement conditions on teacher numbers;
- a number of requirements from the revised guidelines are not reflected in the current DSM scheme;
- risk registers do not currently reflect the fact that the current scheme is not compliant with the new guides and therefore does not accurately reflect the level of risk; and
- all budgeted amounts are not included in the current guidelines or where they are do not always reflect the way the budget is actually calculated.

We have on this occasion rated the individual controls objectives for the review rather than applying an overall assessment as follows:

- Good - the controls in place to allow budgets to be calculated and allocated in a consistent and equitable way;
- Good - the controls designed to monitor actual to budgeted spend at a school and Council level; and
- Weak - the processes and controls designed to allow the principles laid down in the 2012 Devolved School Management Scheme to be embedded in the Midlothian Council scheme.

We have rated the strength of the internal controls in accordance with the table in Appendix 1.

### 4.0 Findings

#### 4.1 Update of Devolved School Management Scheme (DSM) to reflect the latest Scottish Government Guidance

Although the current scheme has been regularly updated it has not been revised to take account of the latest Scottish Government guidelines on devolved school budgets published in 2012. Furthermore there has been no self assessment against the Devolved School Management Toolkit which was designed to allow local authorities to gain assurance that their DSM schemes follow all the principles laid down in the new guidelines.

Internal Audit undertook a sample check against the new guidelines and noted a number of areas where the existing scheme was not compliant or did not make specific reference to the area detailed within the new guidelines. Examples include:

- there is a requirement to involve Elected Members, in consultation with all appropriate stakeholders (including schools, parents and parent councils) in establishing the criteria to be used to create budget formula (including school role, deprivation factors, the number of young people at each stage in the school and rurality issues);
- the current scheme refers to three year budgeting based on the Scottish Government providing firm revenue grant allocations. The current scheme does not therefore highlight uncertainty over grant settlements and the impact this may have on devolved school budgets;
- the current scheme does not demonstrate a link between corporate and departmental plans to reflect national and local strategic priorities;
- there is no detail in the current scheme over how consultation should be conducted between the establishment and the local authority; and
- there is no reference to training, for Elected Members or Parent Councils, on the DSM scheme.

No	Recommendation	Priority	Manager	Target Date
1	A self assessment of the Devolved School Management Scheme should be undertaken against the Devolved School Management Self-Evaluation Toolkit.	High	Resources Manager	30/11/16
2	A group should be established comprising of: Elected Members, Director of Education Communities and Economy, Head of Education, heads of establishments (primary, secondary, nursery and special schools), parent representatives and other teaching staff to undertake this assessment.	High	Resources Manager	30/11/16



## Midlothian Council - Internal Audit

No	Recommendation	Priority	Manager	Target Date
3	An action plan should be developed following the assessment where any deficiencies are identified and acted upon.	High	Resources Manager	30/11/16
4	Benchmarking should be undertaken with other councils in terms of the DSM with any improvements added to the action plan in 3 above.	High	Resources Manager	30/11/16
5	As part of developing an updated scheme, Elected Members, schools, parents and parent councils should be involved in approving the scheme criteria.	High	Resources Manager	30/11/16

### 4.2 Risk Registers

The risk register for Education does not specifically mention the national DSM scheme or compliance against it (although it does mention the legislation that the DSM scheme falls under- Standards in Scotland's Schools (2000)). This audit has identified that the published scheme is out of date, and there has not been an assessment against the Scottish Government Toolkit.

In addition, although there was a risk on budgetary control the following was identified:

- although budgetary control rests within Education there is a dependency on Financial Services in relation to reporting and any actions that may arise for overspends (for example enhanced training);
- the budgetary risk has not been updated since June 2015; and
- one action on providing training on petty cash to schools has gone past the action date.

No	Recommendation	Priority	Manager	Target Date
6	Risk Registers should be updated to reflect the requirements of the 2012 guidelines on DSM and actions recorded against the risk to allow the Council to become compliant.	Medium	Resources Manager	30/06/16
7	Risk registers should be reviewed on a regular basis with actions addressed in a timely manner.	Medium	Resources Manager	30/06/16
8	Officers within Education and Financial Services should review the current Education Risk Registers for any areas where Education require input from Financial Services to support the mitigation of financial risks.	Medium	Resources Manager	30/06/16

## Midlothian Council - Internal Audit

No	Recommendation	Priority	Manager	Target Date
	<u>Management comment</u> This is currently being addressed by the Resources Manager, Education and Senior Accountant, Financial Services.		Senior Accountant	

### 4.3 Training and Communication on the DSM Scheme and other related policies

Although it has been reported to Internal Audit that all budget holders have received training on the operation of the DSM scheme, there is a lack of audit trail to evidence this. This could cause difficulty where there is a dispute as to whether the Council has provided the training or not, where, for example, a requirement has not been followed. There is also a lack of standardised training material available to budget holders.

In addition it was noted that although the DSM scheme has been published through the 'Staffroom.Net' site this publication did not provide detail of how individual budgets are calculated, was loaded in 2010 and has not been refreshed, and is not generally available on the Midlothian Council Website.

We also noted that currently Head Teachers do not have to provide signed evidence that they have received and reviewed key Council policies, including Financial Directives, Petty Cash and Subsistence for Internally Arranged Events. In addition, updates to policies and procedures are issued to schools using a "secondary-schools" email address rather than the individual email address of senior school staff and therefore it is not always clear that these individuals have received these updates.

No	Recommendation	Priority	Manager	Target Date
9	A standard training course and training pack over the operation of school budgets including the DSM allocations should be provided to head teachers and support staff when they take on budgetary responsibilities. A formal record of this training should be maintained.	Medium	Senior Accountant	30/09/16
10	The DSM scheme should, when updated, be placed on the Council's Web site so that teachers, parents and pupils have access to the scheme.	Medium	Resource Manager	30/06/16
11	Head Teachers should be required to sign a standard template to evidence that they have been provided with and will disseminate to relevant staff key Council policies and procedures (including the DSM).	High	Head of Education	30/06/16 (and on-going)
12	Important, new or updates to policies should be distributed to the individual email accounts	High	Head of	Implemented

## Midlothian Council - Internal Audit

No	Recommendation	Priority	Manager	Target Date
	of head teachers within the school as well as using the shared email accounts.		Education	

### 4.4 Current Scheme

A small number of issues were identified with the current DSM scheme:

- there is an annual historic 1.5% savings target applied to the gross devolved budget, less additional support need costs. This is not currently referenced in the current scheme and a re-performance of the calculated reduction identified minor differences in the way this had been calculated between primary and secondary schools;
- the allowance provided within the scheme for repairs does not equate back to the figures calculated; and
- the scheme rules do not detail certain allowances or how these are calculated including: Newly Qualified Teaching Cover and Mentoring.

It was noted that the current scheme allows 2.5% of the final approved budget to be carried forward to the following year where there is an under spend on the budget for the previous year. As at the end of 2014/15, there was a cumulative under spend of £1.008m (£995K of the accumulated under spend from 2014/15 and an additional £13K carried forward to allow for IT equipment that could not be installed in time for the year end) which establishments could carry forward into 2015/16. The Devolved School Management Self Evaluation toolkit details that Education service plans should be linked to national and local strategies and priorities. Whilst there is a balance to be achieved by allowing schools to determine how this surplus is spent, given the financial climate and settlement conditions on teacher numbers, the revision to the existing scheme should review the level of carry forward and provide guidance within the scheme to require that any material spend is directly related to help achievement of the Council's objectives and priorities.

No	Recommendation	Priority	Manager	Target Date
13	The updated scheme should cover all budgeted amounts with checks introduced to ensure that these are consistently applied.	Medium	Resources Manager	30/11/16
14	As part of the review of the current scheme, Education should include a review of financing including the level of carried forwards given the financial climate and settlement conditions on teacher numbers and consider building into the current scheme rules that under spends may only be used where the expenditure can be directly linked to assisting	High	Resources Manager	30/11/16

## Midlothian Council - Internal Audit

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No	Recommendation	Priority	Manager	Target Date
	<p>the Council meet its objectives and priorities.</p> <p><b>Management Comment</b></p> <p>Review of the current scheme to be completed by November 2016 and applied to 2017/18 budget setting process.</p>			

## APPENDIX 1

### Definitions of Ratings

#### Audit Opinion

Level of Control	Reason for the level of Assurance given
<b>Excellent</b>	The control framework is of a high standard with no unacceptable risks identified.
<b>Good</b>	The control framework is of a good standard with only minor elements of risk identified which are either accepted or being dealt with by management.
<b>Average</b>	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
<b>Weak</b>	The control framework is weak and requires improvement as significant issues exist with the adequacy and effectiveness of the Internal Control arrangements. These control deficiencies could result in delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.
<b>Poor</b>	The control framework is inadequate or ineffective and the issues identified require immediate attention to prevent the delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.

#### Recommendation Rating

Priority	Risk Definition
<b>High</b>	Legal / regulatory issues would normally be regarded as high risks.  Strategic risks would normally be regarded as high risks.  Financial impact - £50K plus and / or national press interest
<b>Medium</b>	£5K - £49K and / or local press interest
<b>Low</b>	Under £5K and / or no press interest.

### **Distribution**

- Members of the Audit Committee
- Kenneth Lawrie, Chief Executive
- Other members of the Corporate Management Team
- Grace Vickers, Head of Education, Communities & Economy
- Sandra Banks, Resource Manager, Education Communities & Economy
- David Gladwin, Financial Services Manager, Finance and Integrated Service Support: Financial Services
- Callum Alsmeyer, Senior Accountant, Finance and Integrated Service Support: Financial Services
- Grant Thornton, External Audit

### **Audit Team**

Author: J G Herbert  
Reviewer: H Mohieddeen

### APPENDIX 2

#### TERMS OF REFERENCE

##### Audit Objective and Scope

###### Audit Objective

To provide assurance to Senior Management and the Audit Committee over the effectiveness of the processes and controls designed to allow the locally Devolved School Management Scheme to be consistent with the principles laid out in national guidelines.

###### Scope of Audit

The audit will focus on:

- the processes and controls designed to allow the principles laid down in the 2012 Devolved School Management Scheme to be embedded in the Midlothian Council scheme;
- the controls in place to allow budgets to be calculated and allocated in a consistent and equitable way; and
- the controls designed to monitor actual to budgeted spend at a school and Council level.

##### Potential Risks

During the planning stage of the review Internal Audit consider what the theoretical risks that could exist if controls are absent (for example the lack of a DSM scheme which Midlothian is known to have):

- Midlothian young people disadvantaged through not following national guides;
- financial loss through mismanagement of Council funds; and
- failing to provide best value.

## Midlothian Council - Internal Audit

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<b>Audit Approach</b>
<p>The audit approach consists of:</p> <ul style="list-style-type: none"><li>• fact finding interviews with key employees;</li><li>• review of appropriate documentation which includes any risk reviews that have been conducted and risk registers that are in place;</li><li>• interrogation of any relevant systems and sample testing as required;</li><li>• closure meeting with local management to discuss the findings and any recommendations from the review;</li><li>• draft and final reporting; and</li><li>• presentation of the final report to the Audit Committee.</li></ul>
<b>Timescales &amp; Reporting</b>
<p>The audit will commence in August 2015 and is expected to be complete and reported to the Audit Committee in December 2015.</p> <p>Any issues arising will be communicated directly to local management as they are identified. A formal audit report will be produced summarising the findings and any recommendations identified during the review.</p>
<b>Information Requirements</b>
<p>Access to all relevant systems, documentation and employees.</p>
<b>Audit Resource</b>
<p>Audit team: Graham Herbert</p>



**Internal Audit Report on Financial Assurance for money delegated to the Integrated Joint Board****Report by Internal Audit Manager****1. Purpose of the Report**

The purpose of this report is to provide the Midlothian Council Audit Committee with an opinion on the assurance work that has been carried out on the funds to be delegated to the Integrated Joint Board (IJB) by Midlothian Council for the provision of Health and Social Care for the financial year 2016/17. A similar report is being prepared by the NHS Lothian Audit team over the financial assurance process undertaken by NHS Lothian on the funds that they are also transferring to the IJB.

**2. Background**

Under the Public Bodies (Joint Working) (Scotland) Act 2014, and associated regulations, Local Authorities and Health Boards are required to set up an integration authority and to delegate health and social care functions to it. In June 2015, the Midlothian Integration Scheme was given approval by the Scottish Government and the Midlothian Integrated Joint Board was formed in August 2015.

The Scottish Government's guidance on Integrated Joint Boards recommends that partners to the integration schemes conduct a process of financial assurance on the amounts to be delegated to the Integrated Joint Board and that the internal auditors of each partner give an opinion on the assurance process that has been undertaken.

The financial assurance process is intended to ensure the budgets for delegated functions are calculated on a reasonable and consistent basis and that the process used is in accordance with Scottish Government guidelines.

**3. Approach**

The Terms of Reference for this audit had 8 control objectives and we have examined each of these individually reviewing for evidence and concluding where there is sufficient evidence to do so.

**3.1** To determine whether the proposed allocated budget from Midlothian Council to the Integrated Joint Board (IJB) is aligned to those service budgets which are to be delegated.

- All services within Adult and Social Care are identifiable and all functions in that service have been transferred to the IJB.

### Conclusion

Budgets were found to be aligned to the service budgets delegated.

- 3.2** To determine whether the methods and assumptions in calculating the budgets to be transferred are consistent with previous years and were subject to appropriate challenge.
- standard procedures for preparing budgets are in place and were being followed;
  - prior years budgets and projected outturn figures are used in the preparation of budgets;
  - demographic pressures are assessed through comparison of actual spend, using judgement and experience to inform future expectations;
  - budgets are developed with input from service management and are reviewed by Financial Services management, and the Head of Finance and Integrated Service Support, before being approved by Council.

### Conclusion

The methods and assumptions used in the calculated budget transferred were found to be consistent with previous years and have been appropriately challenged.

- 3.3** To determine whether material non-recurrent funding and expenditure budgets for delegated services and the associated risks are identified and assessed.
- Non recurrent funding is not a material feature of Midlothian Council's budget, but one off funding for specific purposes is identified and monitored individually.

### Conclusion

One off funding for specific purposes is identified and monitored.

- 3.4** To determine whether savings and efficiency targets and any associated schemes have been clearly identified and the assumptions and risks tested and validated.
- Savings of £414,000 in respect of Health and Social Care have been approved by Midlothian Council on 8 March 2016.
  - These savings have been detailed in budget reports, and assumptions and risks challenged during the budget approval process.
  - During testing, we have considered the historic performance of savings delivery and the factors that have led to overspends.

### Conclusion

Savings and efficiency targets have been clearly identified and the assumptions and risks tested and validated. There is also evidence that the Council has delivered on past savings targets.

- 3.5** To determine whether the medium term financial forecasts for the delegated services and associated assumptions and risks have been reviewed.
- The Scottish Government adopted a one year budget and grant settlement for 2016/17 and published details of both on 16 December 2015. It is also currently anticipated that a three year budget and grant settlement will be adopted for 2017/18 to 2019/20, with details emerging in the autumn of 2016.
  - In January 2016, the Scottish Government clarified an additional £250m of funding for Social Care which would be paid to IJBs via the Health Service. This funding equates to £3.6m for the Midlothian IJB and is being directed towards new social care initiatives, support for the Scottish Living Wage and revision of charging thresholds.
  - As a consequence, and in anticipation of future budget settlements being equally challenging, it was not considered prudent to prepare medium term financial forecasts beyond 2016/17.
  - However, the Council's budget model does include forecasts of material budget elements such as contractual inflation, pay inflation, etc.

### Conclusion

It has not been possible for Midlothian Council to prepare medium term financial forecasts for future years given the one year grant settlement.

We note however the Head of Finance and Integrated Service Support's intention to provide the IJB with medium term forecasts for the Strategic Plan once a medium term settlement is published by the Scottish Government.

- 3.6** To determine whether Scottish Government Guidance has been used and followed in relation to financial governance, financial assurance and risk assessments (including the Integrated Resource Advisory Group's guidance).
- The Midlothian Integration Joint Board has appointed a Chief Officer, Chief Finance Officer and Chief Internal Auditor in accordance with Scottish Government guidance. The membership of the Board itself and the Board's Risk and Audit Committee are in accordance with the guidance. It is planned to implement quarterly financial monitoring, and produce annual audited accounts. The external auditor has also been appointed.
  - The reports on financial assurance issued to Council in June 2015, December 2015, and March 2016 follow the methods

outlined in the guidance issued by the Scottish Government, in considering existing Council Budgets, actual spend and plans for the initial year.

- Risks are being managed at a corporate and service level. The financial assurance reports delivered to Council to date have identified a number of risks that may affect Midlothian Council.
- Council reports make clear that financial assurance would be a process which will continue into 2016/17.

### Conclusion

The process of financial assurance has followed the guidance published by the Scottish Government. We did identify however that although the risks to Midlothian Council have been identified in submitted reports, these have not been recorded on the Council's risk management system (Covalent) and thus do not clearly record the mitigating controls and actions required to bring the risk to an acceptable level within the Council.

- (1) Recommendation – the Head of Finance and Integrated Service Support should ensure that Covalent is updated to record and monitor the risks identified in the financial assurance reports (i.e. loss of flexibility in controlling budgets for delegated functions, financial and demographic pressures and the disparity of sizes between Lothian IJBs) along with details of mitigating controls and actions to bring these risks within Midlothian Council's risk appetite. This has a target completion date of 30 June 2016.

### **3.7** To determine whether risk sharing agreements are in place between the parties which clearly define responsibilities in the event of the IJB exceeding the established budgets.

- The Integration Scheme outlines the process for dealing with the risk of overspends. In the first instance, when monitoring indicates that an overspend is arising, the relevant party should develop recovery plans to address the overspend.
- If an overspend cannot be avoided, and there are no reserves available to cover the overspend, the partners may make additional payments to the IJB, or as an alternative, consider making additional payments based on agreed percentages with repayment in future years .
- The IJB has made proposals that in the first year there would be a principle of no cross-subsidisation established, with each partner retaining responsibility for their own overspends. However, this is not stated in the Integration scheme or in a Risk Sharing Agreement. There has been correspondence between the Chair of the IJB and the Finance Director of NHS Lothian seeking to clarify this point.

### Conclusion

The Integration Scheme details the process that would be undertaken should there be a dispute over funding or other matters. In addition it is reported that partners have discussed, and there is general acceptance, that there should be no cross-subsidisation between the partners in 2016/17. This is intended to assist in mitigating financial risks to the Council. This approach is in line with Integrated Resource Advisory Group (IRAG) Guidance, which recommended that the first year/period is treated as a transitional period, and that partners agree to a risk sharing arrangement with adjustments being made through subsequent year's allocations. However there is a risk associated with the lack of a formal agreement in relation to cross-subsidisation in the event of overspends and each partners' financial liability in the first year of operation.

(2) Recommendation – the Head of Finance and Integrated Service Support should continue to work with the Chief Finance Officer of the IJB and the Director of Finance of NHS Lothian towards a common understanding of responsibility for overspends in the first year of operation, and record this in a written Risk Management Agreement. This is expected to be completed by 30 June 2016.

**3.8** To determine whether regular reports on financial assurance have been presented to Midlothian Council and the IJB.

- There have been three reports to Midlothian Council on Financial Assurance in June 2015, December 2015, and in March 2016. Copies of the Financial Assurance reports to the Finance and Resources Committee of NHS Lothian were attached to each of the 2015 reports.
- A further Financial Assurance report is planned to be presented to Midlothian Council in June 2016.
- The risks identified in these reports include: financial pressures, particularly those affecting health, risks related to the sharing of pan-Lothian services, risks relating to the disparity in sizes of the Lothian IJBs and the loss of flexibility in controlling the budgets transferred to the IJB.

A Financial Assurance update report has been presented to each of the meetings of the shadow IJB and the IJB.

### Conclusion

Regular reports on Financial Assurance are being presented to Midlothian Council and the IJB.

## **4. Audit Opinion**

It is our opinion that the process of Financial Assurance carried out by Midlothian Council has followed the guidelines laid out by the Scottish Government and therefore has followed an adequate assurance process.

We have made 2 recommendations in paragraphs 3.6 and 3.7 relating to the management of risk.

## **5. Report Implications**

### **5.1 Resource**

There are no direct resource implications arising from this report.

### **5.2 Risk**

There is a potential risk of a lack of compliance with Scottish Government Guidelines.

### **5.3 Single Midlothian Plan**

Themes addressed in this report:

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

### **5.4 Key Priorities within the Single Midlothian Plan**

This Report does not directly impact on the key priorities within the Single Midlothian Plan.

### **5.5 Impact on Performance and Outcomes**

The financial assurance process is central to the way the Council has delegated its limited financial resources to the IJB for the delivery of delegated responsibilities.

### **5.6 Adopting a Preventative Approach**

Delivering Health and Social Care through a joint board is intended to strengthen the delivery of preventative approach.

### **5.7 Involving Communities and Other Stakeholders**

This report has been discussed with senior management from Midlothian Council.

### **5.8 Ensuring Equalities**

There are no equalities issues with regard to this report.

### **5.9 Supporting Sustainable Development**

There are no sustainability issues with regard to this report.

#### **5.10 IT Issues**

There are no IT issues with regard to this report.

### **6. Recommendations**

The Audit Committee is therefore asked to:

- a) note the contents of this report;
- b) to approve the recommendations made in the report.

### **7. Appendices**

- 1. Terms of Reference

**6 April 2016**

**Report Author: Heather Mohieddeen, Senior Auditor**  
**Reviewer: Graham Herbert, Audit Manager**  
**Tel: 0131 271 3517**  
**E-Mail: [Graham.herbert@midlothian.gov.uk](mailto:Graham.herbert@midlothian.gov.uk)**

**TERMS OF REFERENCE**  
**Financial Assurance**

**Audit Objective and Scope**Audit Objective

To review the financial assurance process undertaken by Midlothian Council on the preparation for amounts to be delegated to the Integrated Joint Board for the provision of Health and Social Care for the financial year 2016/17.

Scope of Audit

The following areas are included within the scope of the Audit:

- the proposed allocated budget from Midlothian Council to the IJB is aligned to those services budgets which are to be delegated;
- the method and assumptions in calculating the budgets to be transferred are consistent with previous years and is subject to appropriate challenge;
- material non-recurrent funding and expenditure budgets for delegated services and the associated risks are identified and assessed;
- savings and efficiency targets and any associated schemes have been clearly identified and the assumptions and risks tested and validated;
- the medium term financial forecasts for the delegated services and associated assumptions and risks have been reviewed;
- Scottish Government Guidance has been used and followed in relation to financial governance, financial assurance and risk assessments (including the Integrated Resource Advisory Group guidance);
- Risk sharing agreements are in place between the parties which clearly define responsibilities in the event of the IJB exceeding the established budgets; and
- Regular reports on financial assurance have been presented to the Council and IJB.

Exclusions and Limitations

This audit excludes performance monitoring against budget which will be reviewed in 2016/17 Internal Audit Plan.

**Potential Risks**

Potential risks include:

- insufficient budget available for delivery of the Strategic Plan leading to potential overspends on the allocated budget;
- demographic pressures are not accurately assessed; and
- savings and efficiencies used in calculating the budget are not realistic, accurately calculated and clearly communicated to the Integration Joint Board.

**Audit Approach**

The audit approach consists of:

- fact finding interviews with key employees;
- review of appropriate documentation which includes any reports to Council and Integration Board;
- interrogation of any relevant systems and sample testing as required;
- closure meeting with local management to discuss the findings and any recommendations from the review;



- draft and final reporting; and
- presentation of the final report to the Audit Committee.

### **Timescales & Reporting**

The audit will commence in January 2016 and will be reported to the Audit Committee of Midlothian Council in March 2016. A copy of the report will be shared with the Audit Committee of the Midlothian Integration Joint Board.

### **Information Requirements**

Access to all relevant systems, documentation and employees.

### **Audit Resource**

<b>Lead Auditor</b>	<b>Heather Mohieddeen</b>	<b>0131 271 3126</b>
<b>Reviewer</b>	<b>Graham Herbert</b>	<b>0131 271 3517</b>



**Internal Audit: Annual Assurance Report 2015/16****Report by Graham Herbert and Elaine Greaves, Internal Audit Managers****1. Purpose of Report**

The purpose of this paper is to report on the work undertaken by Internal Audit during the financial year 2015/16 and to provide an overall assessment of the adequacy and effectiveness of the Council's framework of governance, risk management and control based on that work.

**2. Background****2.1 Public Sector Internal Audit Standards (PSIAS)**

From 1 April 2013, all audit work has been undertaken in accordance with the new Public Sector Internal Audit Standards (PSIAS). A paper on these standards was reported to the Audit Committee on 18 June 2013. One of the requirements of these standards is that the Internal Audit Manager is required to prepare an annual internal audit opinion and report that can be used to inform the Council's overall Annual Governance Statement which is included in the published financial statements. The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control and must incorporate:

- the opinion;
- a summary of the work that supports the opinion;
- a statement on conformance with the Public Sector Internal Audit Standards; and
- the results of the quality assurance and improvement programme over the level of compliance by the Internal Audit Section with the requirements of PSIAS.

The Standards require that an external assessment be conducted at least once every 5 years by a qualified, independent assessor from outside the organisation over the level of compliance against PSIAS. An external assessment was not undertaken in 2015/16 but will be undertaken in late 2016/17 as part of the reciprocal assessments by the Scottish Local Authority Chief Internal Auditors' Group (SLACIAG). However, an assessment of Internal Audit's work is undertaken each year by the Council's external auditor (Grant Thornton) as part of their annual audit. Their report in 2014/15 found this to be satisfactory.

**2.2 Self Assessment of Internal Audit against the Standards**

A self evaluation of compliance with the Public Sector Internal Audit Standards by Midlothian Council's Internal Audit Section was undertaken by the Internal Audit Manager. This evaluation demonstrated that the key elements of the Standards were complied

with during the year, but identified a small number of areas where performance could be improved. An action plan has been developed to address these issues and the majority have already been acted upon. A report on this assessment is to be presented to the Audit Committee on 10 May 2016.

### **2.3 Balanced Scorecard**

Internal Audit has based its performance indicators on those developed by SLACIAG. These include the number of face to face meetings with the Chair of the Audit Committee and Chief Executive, the level of coverage of corporate risks in the audit plan, the follow up of recommendations raised by Internal Audit and training and qualifications of Internal Audit employees. Appendix 5 provides a summary against these targets. Internal Audit introduced a pilot stakeholder feedback process in 2015/16 and this is to be further developed in 2016/17.

### **2.4 Organisational Independence**

The Standards state that the Internal Audit Manager is required to report to the Audit Committee and have free and unfettered access to the Chief Executive and the Chair of the Audit Committee. He/she must report to a level within the organisation that allows the Internal Audit activity to fulfil its responsibilities and the Internal Audit Manager must confirm to the Audit Committee, at least annually, the organisational independence of the Internal Audit activity.

The reporting line for Internal Audit functionally is to the Audit Committee and structurally to the Chief Executive.

The Internal Audit Manager met regularly throughout the year with the Chief Executive, the Director, Resources and the Section 95 Officer to discuss governance, risk management and internal control matters. The Internal Audit Manager has met the Chair of the Audit Committee on a one to one basis, on six separate occasions during the year and, in addition, before each Audit Committee meeting.

There have been no threats to the independence of the internal audit activity during the period.

### **2.5 Proficiency and Due Professional Care**

The Standards state that internal auditors must possess the knowledge, skills and competencies needed to perform their individual responsibilities and are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications. The Internal Audit Manager must hold a relevant professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced. Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor.

For the majority of the year (April 2015 to early March 2016) the Internal Audit Section has had a resource of 4 FTE. The role of Internal Audit Manager during this period was undertaken by a CIMA (Chartered Institute of Management Accounts) qualified accountant who has both public sector and financial services experience. The senior auditor and auditor are both members of the Association of Chartered Certified Accountants (ACCA). Also, the trainee auditor is now exam qualified with ACCA and is awaiting acceptance to full membership. The job share Internal Audit Manager returned from maternity leave in March and is CMIIA qualified (Chartered Member of the Institute of Internal Auditors) with both public sector and financial services experience.

The Internal Audit Section also took over responsibility for the two Accredited Counter Fraud Specialist officers who, from October 2015, have been used to review and identify the threats of Corporate Fraud and to provide support to the Internal Audit team and assist with the National Fraud Initiative.

## **2.6 Internal Audit Resource**

The Internal Audit resource has been sufficient to undertake a challenging and value adding Internal Audit Plan and this in turn has provided management, external audit, the Audit Committee and other interested parties with a significant level of assurance.

During 2015/16, the Midlothian Internal Audit Manager was appointed as the Chief Auditor of the Health and Social Care Integrated Joint Board (IJB). This has necessitated the development and delivery of an IJB Audit Plan for 2015/16.

## **2.7 Internal Audit Plan**

The Internal Audit Plan for 2015/16 was approved by the Audit Committee on 17 March 2015. The audit plan is risk based and concentrates on governance, risk and internal control matters affecting the Council.

For the financial year 2015/16, the risk assessment approach was consistent with the Internal Audit Strategy and focused Internal Audit resource towards:

- the Council's main IT and financial systems;
- high risk exposures as identified through the risk management system, particularly the corporate risk register;
- consultancy exercises requested by management;
- investigations, where required; and
- the provision of an Internal Control Help Desk service.

There have been no areas reviewed which had inappropriate scope. Progress with the Internal Audit Plan was presented to the Audit Committee in December 2015. Internal Audit is on course to achieve a very challenging Audit Plan by the end of June 2016, with only minor

adjustments, required through taking on additional work for the Integrated Joint Board (as detailed in Appendices 2 and 3).

## **2.8 Internal Audit Opinion**

I am content that the breadth and depth of coverage is sufficient to allow me to provide a balanced opinion on the overall adequacy of the Council's framework of governance, risk management and control over the period 2015/16. No direct reliance has been placed on the work of other assurance providers in providing this opinion.

It is my view that overall the Council's framework of governance, risk management and control over the period 2015/16 are of a satisfactory standard and have been implemented and are monitored by management in line with Financial Directives, Council Policy and the other key essentials of a robust Internal Control Environment.

In arriving at this overall opinion I have considered:

- the ratings applied to each individual audit undertaken in the period and their relative importance in relation to the control environment within Midlothian Council;
- management's performance in addressing issues raised by Internal Audit;
- the strength of governance arrangements including the Code of Corporate Governance and adherence to its requirements;
- the risk management system; and
- strategies designed to manage fraud risk.

### Internal Audit Reviews

In relation to the 2015/16 Audit Plan, we reviewed the internal controls, governance and management of risk within a number of Council systems, both financial and non financial. The Internal Audit activities undertaken during 2015/16 and the conclusions arising from that work are set out at Appendix 1.

Internal Audit use a set of assurance categories to provide an opinion on the level of assurance given over internal control, governance and the management of risk within audit assignments. This can be found in Appendix 4.

From the Audits undertaken in 2015/16, we have identified a number of areas that required improvement to the internal controls. While a small number of areas were rated as weak, these were confined to certain control objectives within specific audits (for example Developer Contributions). The majority of reviews have shown either average or good internal controls.

The results of our audits were reported to management and the Audit Committee and action plans for improvement over controls were agreed on the conclusion of each audit. The recommendations arising from the action plans were loaded into the Council's Covalent system

and progress with their implementation is recorded on the system by management.

### Implementation of Internal Audit Recommendations

Internal Audit periodically reviews whether recommendations have been implemented and reports the outcome of this to the Corporate Management Team and the Audit Committee. A review of overdue recommendations was undertaken in December 2015 and this highlighted that 96% of the recommendations were either 'completed' or 'on target' and only 4% were overdue. In June 2015, a sample of 40 recommendations recorded as 'completed' by management on the Covalent system were reviewed to confirm the adequacy of the actions taken. 36 were found to have been implemented satisfactorily, 4 were partially complete and none were found to be unsatisfactory. This exercise will be repeated in May 2016 and the results will be reported to the June 2016 Audit Committee.

We are pleased to note from this follow up work that management have acted on Internal Audit recommendations and therefore controls have been strengthened.

### Code of Corporate Governance

Each year, Internal Audit undertakes a review of the Code of Corporate Governance and tests a sample of the key elements listed as controls to determine whether they are working in practice. Our testing identified that the control elements were working effectively although we did identify the following:

- the need to update certain policies and procedures (including counter fraud and corruption and whistle blowing). Updated policies are planned to be presented to the June 2016 Audit Committee;
- updates are required to the Council's Standing Orders and associated documents (Scheme of Administration and Scheme of Delegation) caused by the recent management review and subsequent changes to the Council Directorates;
- the Adult and Social Care service have removed the risk of 'Fraud, Waste, and Error' from their risk register on the basis that they considered this risk low. Internal Audit intends to undertake work in this area in 2016/17 to test this opinion.

We are aware that CIPFA (Chartered Institute of Public Finance and Accountancy) and SOLACE (Society of Local Authority Chief Executives) have established a Joint Working Group on Good Governance in Local Government and is consulting on a revised Framework for Delivering Good Governance in Local Government. This is based on the new International Framework of Good Governance in the Public Sector developed jointly between CIPFA and the International Federation of Accountants. Work will be required in 2016/17 to ensure compliance against the new code.

## Risk Management

Internal Audit reviews management's perception of risk in all audits undertaken and reviews risk more generally as part of the planning cycle for each year's audit plan. From these assessments, it is noted that Midlothian Council has a mature risk management process with key risks monitored by management on operational, corporate and project risk registers.

We noted that in 2015/16:

- the Risk Management Group met quarterly and provided quarterly reports to the Corporate Management Team and the Audit Committee;
- work has been undertaken on the Corporate Risk Register in 2015/16 through a bench marking exercise with other local authorities and public sector organisations;
- the revisions to the Corporate Risk Register have had input from the Corporate Management Team and Directors; and
- a strategic risk profile approach has been used to identify current issues, emerging risks and opportunities.

The Risk Manager is now reviewing operational risk registers with service managers, with support from Performance Officers, to assess current and emerging risks which will inform the Strategic Risk Profile. He is also assessing whether Risk Registers should be provided to Cabinet and Council in addition to the Audit and Risk Committees, given that risk management can be used to help inform decision making and shaping strategy.

The Internal Audit Section has identified instances, through testing, where revisions to risk scores and listed controls were required and have also identified a small number of risks that are not being updated on a quarterly basis. Generally however we are of the opinion that the current process is working effectively.

## Fraud

Midlothian Council has a number of controls in place to limit the risk of fraud and to highlight where fraud may have occurred. These include:

- a Counter Fraud and Corruption Policy and Strategy;
- a Whistle-blowing Policy and reporting system
- an Anti-money Laundering policy;
- segregation of duties;
- operational risk registers contain a 'Fraud, Waste, and Error' risk which managers are required to review on a quarterly basis; and
- Heads of Service are required to assess fraud risk annually as part of the Annual Governance process.

A new CIPFA code of practice on 'Managing the Risk of Fraud and Corruption' was published in October 2014 and areas of improvement are noted arising out of a self assessment against this new code. The



Counter Fraud and Corruption Policy and Strategy and the Whistle-blowing Policy are currently being updated and a separate Anti-bribery and Corruption Policy is being created (this is currently embedded in the Counter Fraud and Corruption Policy).

As part of the Action Plan being progressed by the Deter Sub-Group of the Serious Organised Crime Taskforce, SOLACE has agreed that all 32 Scottish Local Authorities should undertake a high level assessment of their readiness in relation to the risks posed by Serious Organised Crime and Corruption. An improvement plan for recording, managing, and addressing areas of potential risk exposure has been developed and an Integrity Board will be convened to take this forward.

Since October 2015, the Corporate Fraud team have undertaken reviews of council tax discounts and exemptions and have worked with Housing to identify tenancy fraud. In addition, a National Fraud Initiative flexible data match of the Electoral Register against Single Person Discount was undertaken and reviews of matches identified were carried out.

The levels of reported fraud / theft within the Council continue to remain relatively low although there have been a number of reported incidents in 2015/16. These include an alleged theft of fundraising monies, alleged thefts of a mobile telephone (£350), a laptop (£500) and a TV (£1000), and suspected thefts of fuel. Investigations have been undertaken or are underway and controls implemented to help reduce future such incidents.

## **2.9 Annual Governance Statement**

The following issues from this report have been used within the annual Governance Statement. The need to:

- strengthen internal controls in a number of areas (including Developer Contributions and Business Gateway);
- update the existing Code of Corporate Governance following issue of the new International Framework of Good Governance in the Public Sector;
- review the current Counter Fraud Policy and Strategy, Whistle-blowing Policy and create a separate Anti-bribery and Corruption Policy to allow full compliance against the new CIPFA code of practice on “Managing the Risk of Fraud and Corruption”; and
- undertake a high level assessment of the Council’s readiness in relation to the risks posed by Serious Organised Crime and Corruption. An improvement plan for recording, managing, and addressing areas of potential risk exposure has been developed and an Integrity Board will be convened to take this forward.

## **2.10 Audit Committee Chair’s Report**

Each year the Internal Audit Section assists the Chair of the Audit Committee in completing the Chair’s annual report to the Audit

Committee and assists with the assessment of the Audit Committee against the CIPFA Practical Guidance for Local Authorities.

### **3. Report Implications**

#### **3.1 Resource**

There are no direct resource implications arising from this report.

#### **3.2 Risk**

In overall terms, our Internal Audit assignments, the risk management system, investigations, consultancy and help-desk advice provides a sufficient level of assurance over the governance, risk management and internal control compliance with the Financial Directives and key Council policies. However, the areas highlighted for improvement present residual risk which management are progressing.

#### **3.3 Single Midlothian Plan and Business Transformation**

Themes addressed in this report:

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

#### **3.4 Key Priorities within the Single Midlothian Plan**

This report does not relate directly to the key priorities within the Single Midlothian Plan.

#### **3.5 Impact on Performance and Outcomes**

None.

#### **3.6 Adopting a Preventative Approach**

This report addresses the Council's policy to have a robust internal control environment, management of risk and effective governance.

#### **3.7 Involving Communities and Other Stakeholders**

This statement on the Council's Internal Control Environment is as a result of consultation with management during audit assignments, the Corporate Management Team and the Chief Executive.

### **3.8 Ensuring Equalities**

We found no equalities issues to report on during the financial year. Internal Audit considers equalities issues as part of every audit assignment.

### **3.9 Supporting Sustainable Development**

Internal Audit provides an independent assurance function which assists the sustainability of the Council's internal control environment, governance and management of risk. During the year, we have found no sustainability issues.

### **3.10 IT Issues**

There are no IT issues with regard to this report.

## **4. Recommendations**

The Audit Committee is invited to:

- (1) note the Annual Assurance Report; and
- (2) note that the weaknesses identified with internal controls in 2015/16 will be followed up in 2016/17 and updates will be provided to the Corporate Management Team and the Audit Committee.

**Date:** 31 March 2016  
**Report Contact:** Graham Herbert / Elaine Greaves, Internal Audit Manager  
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### **Appendices:**

- Appendix 1 - Summary of work undertaken in 2015/16 and progress against the 2015/16 Internal Audit Plan
- Appendix 2 – Impact of Integrated Joint Board
- Appendix 3 – Changes to Audit Plan
- Appendix 4 - Definition of Internal Audit Assurance Categories
- Appendix 5 – Balanced Scorecard Measures

## SUMMARY OF WORK UNDERTAKEN IN 2015/16 AND PERFORMANCE AGAINST THE INTERNAL AUDIT PLAN

No	Audit Activity	Date reported to Audit Committee	Comment
1	A review of the Code of Corporate Governance	May 2016	An audit of a sample of controls listed in the Code of Corporate Governance was reviewed for operational effectiveness. Testing identified that the key elements were in place and operating effectively. Issues raised are recorded within the Internal Audit Manager's statement.
2	Annual Assurance Report	May 2016	A high level summary of the control environment of the Council by the Internal Audit Manager. The statement is also used to inform the Annual Governance Statement.
3	Review of the Internal Audit Charter	May 2016	The Charter is required to allow the Internal Audit Section to be compliant with the Public Sector Internal Audit Standards.
4	Internal Audit Recommendations follow up	June 2015	A follow up review was undertaken of a sample of previously raised recommendations made by Internal Audit. A sample of 40 recommendations recorded as 'completed' by management on the Covalent system were reviewed to confirm the adequacy of the actions taken. 36 were found to have been implemented satisfactorily, 4 were partially complete and none were found to be unsatisfactory.
5	Construction Industry Scheme	September 2015	The objective of the audit was to review the controls operating over the Construction Industry Scheme following an inspection by HM Revenue and Customs. Controls were generally found to be satisfactory with 3 minor issues raised.
6	Payroll	September 2015	The objective of the audit was to assess the adequacy of the control environment of the Council's payroll arrangements. The audit was rated as average and identified issues around segregation of duties, exception reporting and audit trails.
7	House Rents	December 2015	This audit reviewed the billing and charging of house rents. The audit was given a good rating with minor issues raised in relation to credit balances and rental performance of garage sites.
8	Commercial Rents	December 2015	This audit reviewed controls surrounding the renting of council owned commercial property. The audit was rated as average and identified improvements in the use of the application system, arrears control and tenant vetting.
9	National Fraud Initiative	December 2015	The purpose of this report was to update the Audit Committee on the completion of the National Fraud Initiative data matching exercises for 2014/15, and the outcomes of this exercise. The report identified £16,153 in overpaid benefits and discounts and 24 blue badges that were cancelled.

No	Audit Activity	Date reported to Audit Committee	Comment
10	Internal Audit Recommendation Performance Report	December 2015	A review of overdue recommendations was undertaken and this highlighted that 96% of recommendations raised were either 'complete' or 'on target to be completed' and 4% had gone passed their expected due date.
11	Developer Contributions	March 2016	This audit reviewed the controls operating over receipt and use of Developer Contributions. A number of weaknesses were identified in relation to monitoring the collection of contributions and matching these contributions to agreed infrastructures. The monitoring element of the review was given a weak rating while other control objectives were rated as either good or average.
12	Pre –school provision partnerships providers	March 2016	The objective of the audit was to review the adequacy of the processes and controls for the Council's arrangements with Pre-School Partnership Providers for three and four year olds. The audit was rated as average, with recommendations raised in relation to procedures, appropriate checks on commissioning, monitoring, and ensuring signed copies are available of all contracts.
13	Tendering of contracts	March 2016	The objective of the audit was to review the adequacy of Midlothian Council's process and controls over the tendering of supplier contracts and, for a sample of contracts, to review the level of compliance against the established processes. The Audit was rated as good, although some issues were raised in relation to segregations, retention of full audit trails, and improvements to the contract register database.
14	Business Transformation Follow up Review (see note 1)	Estimated for June 2016 Audit Committee  Field work underway	To follow up on the recommendations made in the 2014/15 Business Transformation Internal Audit Review.
15	Welfare Reform	Estimated for June 2016 Audit Committee  Planning underway	To review the processes and controls in place to deliver the new Universal Credit payments.
16	Internal Quality Assurance process over Care At Come Providers.	Estimated for June 2016 Audit Committee  At reporting stage	To review the Council's quality control routines for the monitoring of care provision by third party providers.
17	A review of Self-Directed Support	Estimated for June 2016 Audit Committee  At reporting stage	To provide assurance to senior management and the Audit Committee that the Council has adequate controls in place regarding the implementation of Self-Directed Support
18	Devolved School Budgets	Estimated for May 2016 Audit Committee  At reporting stage	To review the control of budgets delegated to schools and the level of compliance against Scottish Government guides.
19	Petty Cash Follow up	Estimated for June 2016 Audit Committee  At end of fieldwork stage	To follow up on the recommendations raised as part of the Petty Cash Audit review.
20	4 Consultancy	Estimated for May 2016	Where consultancy reviews highlight control

No	Audit Activity	Date reported to Audit Committee	Comment
	engagements have been undertaken in the year (Business Gateway, Expense Procedure Review, support for the Integrated Joint Board on Governance and support for a Freedom Of Information Request).	Audit Committee	issues these are reported to the Audit Committee.
21	Progress Report Against the Internal Audit Plan	December 2015	Noted progress and possible implications of Integrated Health and Social Care work on the plan.
22	Private Public Partnerships	Estimated for June 2016 Audit Committee  Field work underway	A review of the current utilisation of buildings to ensure best value is being achieved.
23	Corporate Fraud	Estimated for May 2016 Audit Committee with inclusions in the Internal Audit Manager's report	Up until October 2015 the Corporate Fraud team were undertaking work on behalf of the Department of Work and Pensions in relation to benefit investigations. Since then they have reviewed and updated fraud related policies and procedures, undertaken reviews of council tax discounts and exemptions and have worked with Housing Services to identify tenancy fraud. They have also supported the Audit team with compliance based audit reviews.
24	Help Desk Facility	N/A	54 individual enquires were raised with Internal Audit over the year. The nature of the enquires vary considerably but have included: concerns raised by members of the public which were either managed by the Internal Audit team or were referred for resolution to the appropriate Council area; and the provision of advice on internal controls.
25	Self assessment against the public sector internal audit standards	Estimated for May 2016 Audit Committee	No material exceptions to the standards were noted through undertaking the assessment.
26	Co-ordinating the submission of Audit Scotland Reports to the Audit Committee.	Various dates	A total of 4 Audit Scotland Reports have been submitted to the Audit Committee over the period.

## IMPACT OF THE INTEGRATED JOINT BOARD (IJB)

On 20 August 2015, the Internal Audit Manager of Midlothian Council was appointed as the Chief Auditor of the Integrated Joint Board. This necessitated the development of an Audit Plan, Service Level Agreement and the delivery of that plan for the Integrated Joint Board. No resource had been allocated for this responsibility in the 2015/16 plan other than delivery of the two Adult and Social Care Audits (and a 10 day support budget). The following were therefore additions to our agreed plan:

No	Audit Activity	Date reported to Audit Committee	Comment
1	Governance including Financial Assurance Process	Presented to March IJB Audit and Risk Committee	A further report will be required on financial assurance when the process is complete for 2016/17.
2	Financial Assurance over amounts delegated to the Integrated Joint Board by Midlothian Council.	Estimated for May 2016 Midlothian Council Audit Committee	Testing identified a high level of compliance against the Scottish Government Guidance.
3	Strategic plan	To be presented to June / July IJB Audit and Risk Committee	Terms of Reference issued and some high level work undertaken in relation to the financing of the strategic plan.
4	Manager's Annual Report	To be timed to support the Annual Governance Statement	Assessment of Code of Corporate Governance already undertaken.
5	Assessment against PSIAS / Assessment of Audit and Risk Committee	To be timed to support the Annual Governance Statement	

Internal Audit has also provided support in relation to the development of the IJB Financial Directives, Standing Orders and the Code of Corporate Governance.

**PROPOSED CHANGES TO THE MIDLOTHIAN COUNCIL AUDIT PLAN FOR 2015/16**

Because of the additional work (detailed above) and operational changes, the following amendments have been made to the Audit Plan approved by the Audit Committee in March 2015:

No	Audit	Change
1	Business Contingency and Civil Contingencies	<p>The 2015/16 Internal Audit plan contained a review of Business Continuity and Civil Contingencies. The Risk Manager (who manages the section) has advised that (as from 1 April 2016) this section merged with East Lothian Council. As part of this process, the practices of East and Midlothian will be reviewed and the best practices from each will be used going forward. It is considered therefore that this is not the best time to undertake a review of this area.</p> <p>We have however identified from the Heads of Service Questionnaires, sent out as part of the preparation for the 2015/16 Annual Governance Statement, that a number of concerns have been raised in this area (for example, failure of IT systems as all information is now held electronically). We have therefore noted this as an action in the Annual Governance Statement and will monitor progress in the resolution of these issues.</p>
2	Stores	There was an initial request from Management to delay this Audit and it is now to be included within the 2016/17 Internal Audit Plan.
3	Financial Strategy / Business Transformation follow up	This has been restricted to a follow-up review only. However an audit of the Delivering Excellence model is included in the 2016/17 Audit Plan.
4	Purchasing Cards / Petty Cash	This review was restricted to following up the recommendations raised in the 2014/15 Audit as the purchasing cards were not sufficiently rolled out at the time of the review.



**DEFINITION OF INTERNAL AUDIT ASSURANCE CATEGORIES**

<b>Level of Control</b>	<b>Reason for the level of Assurance given</b>
<b>Excellent</b>	The control framework is of a high standard with no unacceptable risks identified.
<b>Good</b>	The control framework is of a good standard with only minor elements of risk identified which are either accepted or being dealt with by management.
<b>Average</b>	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
<b>Weak</b>	The control framework is weak and requires improvement as significant issues exist with the adequacy and effectiveness of the Internal Control arrangements. These control deficiencies could result in delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.
<b>Poor</b>	The control framework is inadequate or ineffective and the issues identified require immediate attention to prevent the delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.

**Summary of Balanced Scorecard Measures**

Target / Measure	Performance
To hold at least quarterly one to one meetings with the Chair of the Audit Committee	6 meetings held. Met.
To hold at least quarterly one to one meetings with the Chief Executive	15 meetings held. Met.
To Audit all Corporate Risks on a three year cycle	<p>The following corporate risks have been subject to review in 2015/16:</p> <ul style="list-style-type: none"> <li>• People risk (included in Transformation follow up review).</li> <li>• Governance and Standards in Public Life (included in review of Code of Corporate Governance)</li> <li>• Internal control environment (covered in all internal audit reviews).</li> <li>• Balancing budgets (audit on Transformation).</li> <li>• Corporate change and transition (Included in Transformation follow up review).</li> <li>• Legal and regulatory (Early Years and compliance with Scottish Guide on Devolved School Budgets).</li> <li>• Corporate policies and strategies (included in all audits).</li> <li>• Emergency Planning and Business Continuity (included in all audit reviews).</li> <li>• Welfare Reform (audit on 2015/16 plan).</li> </ul> <p>Asset condition has been included on the 2016/17 plan.</p> <p>The inability to meet demand for alternative accommodation was not audited, but this was removed as a corporate risk in 2015/16.</p> <p>Met.</p>
The follow up of recommendations. Two reports per year and specific follow up reviews.	Met.
Adoption of PSIAS	<p>Self assessments show a good level of overall compliance. This will be subject to external scrutiny in 2016/17.</p> <p>Met.</p>
Percentage of qualified staff	<p>All internal auditors hold a relevant professional qualification with one member of the team awaiting final confirmation of acceptance as a member of ACCA.</p> <p>The two fraud officers hold accredited fraud qualifications.</p> <p>Met</p>
Training provided to Internal Audit Staff	Budget available / training needs identified as part of development plans / training logs

Target / Measure	Performance
	maintained.  Met.
Satisfaction rates from client surveys	This has been subject to a pilot in 2015/16. For the surveys returned to date the audits have been rated as good or excellent. This is an area that will however be further developed in 2016/17.
Involvement of Internal Auditors in major change initiatives	Transformation reviews and new legislation reviewed as part of current audit plan.  Met.
Compliance with Internal Audit strategy	Audit strategy is to review corporate risks, key processes and systems, and to have time set aside for investigations and consultancy. This approach has been followed in 2015/16.  Met.



**Audit Charter**  
**Report by the Internal Audit Manager****1 Purpose of Report**

The Public Sector Internal Audit Standards require the Internal Audit Manager to present the Internal Audit Charter to the Corporate Management Team and Audit Committee following any updates made to the Charter.

**2 Background**

**2.1** The Public Sector Internal Audit Standards (PSIAS) apply across the whole of the public sector. The PSIAS are based on the Institute of Internal Auditors Standards, with a limited number of additional requirements and interpretations, that allow the PSIAS to be adapted for the public sector.

**2.2** Midlothian Council Internal Audit section has developed an Audit Charter based upon the new standards and this was originally submitted and approved by the Audit Committee on 18 June 2013.

**2.3** A small number of adjustments have been made to the Charter following the annual assessment of the Charter by the Internal Audit Manager.

**3 Report Implications**

The following alterations have been made to the existing Charter:

- to record the Fraud Officer role within the Internal Audit Section;
- to record Midlothian Council Internal Audit section responsibilities in relation to the Integrated Joint Board; and
- to add a new section in relation to the Mission Statement and Core Principles following a recommendation from the Internal Audit Standards Advisory Board. (This has not as yet been formally adopted into the PSIAS but is expected to be).

**3.1 Resource**

There are resource implications for the Internal Audit Section with taking on the audit responsibilities for the Integrated Joint Board.

**3.2 Risk**

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process.

### **3.3 Single Midlothian Plan and Business Transformation**

Themes addressed in this report:

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

### **3.4 Key Priorities within the Single Midlothian Plan**

This report does not relate directly to the key priorities within the Single Midlothian Plan.

### **3.5 Impact on Performance and Outcomes**

Applying the framework of the PSIAS will give the Audit Committee assurance that the Internal Audit Service is keeping up to date with legislative requirements and current best practice.

### **3.6 Adopting a Preventative Approach**

The PSIAS are applicable from 1 April 2013 which means the Internal Audit Service has taken steps to be fully compliant.

### **3.7 Involving Communities and Other Stakeholders**

There are no communities or other stakeholder issues with regard to this report.

### **3.8 Ensuring Equalities**

There are no equalities issues with regard to this report.

### **3.9 Supporting Sustainable Development**

There are no sustainability issues with regard to this report.

### **3.10 IT Issues**

There are no IT issues with regard to this report.

## **4 Summary**

The Audit Charter has been updated to reflect a small number of changes following an assessment.

## 5 Recommendations

The Audit Committee is invited to:

- note the changes outlined in this report;
- note that Internal Audit will re-submit the Charter should the additional Mission Statement and Core Principles not be included within the PSIAS; and
- approve the revised Internal Audit Charter shown at Appendix 1.

**Date 04 April 2015**

**Report Contacts:**

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**Background Papers:**

Appendix 1 – Midlothian Council Internal Audit Charter





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## **MIDLOTHIAN COUNCIL – INTERNAL AUDIT CHARTER**

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### **INTRODUCTION**

The Public Sector Internal Audit Standards (PSIAS) requires that the purpose, authority and responsibility of the Internal Audit activity must be formally defined in an Internal Audit Charter, consistent with the *Definition of Internal Auditing*, the *Code of Ethics* and the *International Standards for the Professional Practice of Internal Auditing* (Standards) detailed in the PSIAS. The Internal Audit Manager will periodically review the Internal Audit Charter and present it to senior officers within the Council and the Audit Committee for approval.

Compliance with the PSIAS is mandatory.

The authority for Internal Audit to operate in Midlothian Council is contained in the Local Code of Corporate Governance, the Council's Standing Orders and in the Financial Regulations. This Internal Audit Charter expands upon that framework, defines the detailed arrangements and sets out the Internal Audit Manager's strategy for discharging his / her role and providing the necessary annual assurance opinion.

Midlothian Council's Internal Audit service will comply with the PSIAS and will apply these standards to all Internal Audit service providers, whether in house, shared services or outsourced.

### **DEFINITIONS (standards 1000, 1010)**

Midlothian Council has adopted the definition of Internal Auditing as given in the PSIAS (**standard 1010**):

*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.<sup>1</sup>*

Midlothian Council has adopted the Mission Statement and Core Principles for the Professional Practice of Internal Audit set out in the PSIAS.

#### **Mission:**

*To enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.*

#### **Core Principles:**

1. Demonstrates integrity.
2. Demonstrates competence and due professional care.
3. Is objective and free from undue influence (independent).

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<sup>1</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Section 3

4. Aligns with the strategies, objectives, and risks of the organisation.
5. Is appropriately positioned and adequately resourced.
6. Demonstrates quality and continuous improvement.
7. Communicates effectively.
8. Provides risk-based assurance.
9. Is insightful, proactive, and future-focused.
10. Promotes organisational improvement.

The Public Sector Internal Audit Standards require that the Internal Audit Charter defines the terms 'board', 'senior management' and 'Chief Audit Executive' in relation to the work of Internal Audit. For the purposes of Internal Audit work at Midlothian Council:

- the 'board' refers to the Council's Audit Committee which has delegated responsibility for overseeing the work of Internal Audit;
- 'senior management' is defined as the Chief Executive and members of the Council's Corporate Management Team; and
- 'Chief Audit Executive' refers to the Internal Audit Manager.

## **CODE OF ETHICS AND CONFIDENTIALITY**

Internal auditors will conform to the Code of Ethics as set out in the PSIAS (**standard 1010**).<sup>2</sup> This includes the principles of:

- integrity;
- objectivity;
- confidentiality; and
- competency.

Disciplinary procedures of professional bodies and the Council may apply to breaches of this Code of Ethics. Additionally, internal auditors are bound by the rules of confidentiality set out in their local conditions of service and job description. If individual internal auditors have membership of another professional body then he or she must also comply with the relevant requirements of that organisation.

Internal auditors must also have regard to the Committee on Standards of Public Life's Seven Principles, information on which can be found at [www.public-standards.gov.uk](http://www.public-standards.gov.uk).

## **RIGHTS OF ACCESS AND AUTHORITY (standards 1000, 1010)**

The Council has given the Internal Audit Service, for the purpose of its audit work, full, free and unrestricted access at any reasonable time to all the Council's records and other documentation (electronic and manual), personnel, Elected Members, premises, assets, and operations of the Council and partner organisations. It also has authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities. All employees, including senior management, are required to assist the Internal Audit activity in fulfilling its roles and responsibilities.

Internal Audit has permission to be provided with a separate log-in to any computer system within the Council and have full access to any system, personal computer or other device in the ownership of the Council. Internal Audit can require any employee of the Council to produce cash, stores, or any other Council property under the employee's control.

Internal Audit will safeguard all information obtained in the carrying out of its duties and will only use it for the purposes of an audit, investigation, or consultancy work. Internal Audit will make no

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<sup>2</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Section 4

disclosure of any information held unless this is authorised or there is a legal or professional requirement to do so.

## **POSITION OF INTERNAL AUDIT WITHIN MIDLOTHIAN COUNCIL AND REPORTING LINES (standards 1000, 1010, 1110)**

Structurally, Internal Audit reports directly to the Chief Executive. At least eight times a year, the Internal Audit Manager meets the Chief Executive to discuss progress with the audit plan, audit findings, the internal control environment, levels of residual risk and governance matters. Reporting at this level helps ensure the independence of Internal Audit, for example in terms of audit selection, scope, audit procedures, frequency of reporting, the content of reports, and that issues raised in reports receive a sufficiently high profile. Additionally, this reporting structure enhances the perception of independence from the perspective of auditees (ie that Internal Audit is free from the influence of Council services).

The Internal Audit Manager has unrestricted access to the Independent Chair of the Audit Committee, and the Committee Members, and discusses before each Audit Committee, the agenda with the Chair (**standard 1111**). Additionally, Internal Audit has unrestricted access to all Chief Officers and employees of the Council.

The reporting relationship described above along with access to Audit Committee Members and senior management ensures that *“the Internal Audit activity is reporting to a level within the organisation that allows the internal audit activity to fulfil its responsibilities.”*<sup>3</sup>

Functionally, Internal Audit reports to the Audit Committee (the Board). The Internal Audit Service reports 5 times a year to the Audit Committee, whose membership consists of 6 Elected Members, an independent chair and an independent member.

The Audit Committee will:

- approve the Internal Audit Charter;
- approve the Risk Based Internal Audit Plan;
- approve the Internal Audit budget and resource plan;
- receive communications from the Internal Audit Manager on Internal Audit’s performance relative to its plan and other matters;
- approve decisions regarding the appointment and removal of the Internal Audit Manager; and
- make appropriate enquiries of management and the Internal Audit Manager to determine whether there are inappropriate scope or resource limitations.

In addition, the Audit Committee reviews all Internal Audit reports including the Annual Assurance Statement.

The Audit Committee has delegated to the Chief Executive the responsibility of setting the remuneration and performance assessment of the Internal Audit Manager and feedback is also sought from the chair of the Audit Committee. Decisions in relation to the appointment or removal of the Internal Audit Manager have likewise been delegated to the Chief Executive.

This will all be managed within the Council’s existing Human Resource policies and procedures.

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<sup>3</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Standard 1110

## **INDEPENDENCE AND OBJECTIVITY (standards 1000, 1010, 1110, 1111)**

In Midlothian Council, Internal Audit is an independent review activity. It is not an extension of, or a substitute for, the functions of line management and will remain free from any undue influence or other pressure affecting its actions and reporting.

At all times, management's responsibilities include:

- maintaining proper internal controls in all processes for which they have responsibility;
- the prevention, detection and resolution of fraud and irregularities;
- providing Internal Audit with full support and co-operation, including complete access to all records, data, property and personnel relevant to the performance of their responsibilities at all levels of operations, without unreasonable delay;
- agreeing Terms of Reference for individual audit assignments no later than the agreed deadline, to include agreements on duration, scope, reporting and response;
- sponsoring of each audit by a Head of Service;
- considering and acting upon Internal Audit findings and recommendations or accepting responsibility for any resultant risk from not doing so;
- implementing audit recommendations in accordance with the agreed timescales; and
- updating Internal Audit with progress made on audit recommendations, informing Internal Audit of proposed changes and developments in processes and systems, newly identified significant risks and cases of fraud.

In addition, (**standard 1110.A1**) Internal Audit:

- has no executive responsibility, thus protecting its independence of reporting and action;
- has the authority to report in its own name;
- reserves to itself the right to determine its own work plans and priorities, which it will do in full compliance with recognised professional standards. Whilst Internal Audit will respond to requests for specially commissioned assistance, this is always subject to its existing commitments and the respective levels of identified risk; and
- will prepare annually, for the endorsement and agreement of the Audit Committee, a risk based audit plan of the activities and areas that are to be covered by its work. This will be based on an audit risk assessment and prioritisation of key business, operational, management and financial risks.

Given the safeguards in place outlined above and the access Internal Audit has to senior management, the Internal Audit service is free to act independently and objectively. The Internal Audit Manager will confirm to the Audit Committee, at least annually, the organisational independence of the Internal Audit activity.

## **PURPOSE (standards 1000, 1010, 2000, 2100)**

Internal Audit is an independent appraisal function and is part of Midlothian Council's system of Corporate Governance.

The Internal Audit Service's purpose is to support the Council in achieving its objectives by:

- supporting the Council in continuing to improve its governance arrangements;
- contributing to the Council's management of risk;
- supporting the Council in raising the standard of internal control;
- supporting the Director, Resources, Head of Finance & Integrated Service Support (s95 officer), Legal Services Manager (Monitoring Officer) and the Audit Committee in the discharge of their duties;

- contributing to the development and implementation of the Council's policies and procedures;
- supporting the Council with governance, risk and internal control advice in the development of new systems and improvement of existing systems;
- supporting the Council with governance, risk and internal control advice on projects;
- acting as an aid to ensure that the Council and its Members, managers and officers are operating within the law and relevant regulations;
- contributing towards the accuracy and reliability of financial statements and other published information;
- supporting of the Council in its management of human, financial and other resources in an efficient and effective manner;
- supporting the Council in meeting its social, environmental and community priorities;
- promoting and raising the standards of an anti-fraud and corruption culture; and
- contributing towards establishing and maintaining a culture of honesty, integrity, openness, accountability and transparency throughout the Council in all its activities and transactions.

These objectives will be achieved via the delivery of a high quality Internal Audit service that meets the needs of the Council.

The Internal Audit Manager will effectively manage the Internal Audit activity to ensure it adds value to the Council. The Internal Audit Service is effectively managed by:

- the results of the Internal Audit service's work achieving the purpose and responsibilities outlined in this Internal Audit Charter;
- the Internal Audit activity conforming with the *Definition of Internal Auditing* and the *Standards*;
- the individuals who are part of the Internal Audit activity demonstrating conformance with the *Code of Ethics* and the *Standards*; and
- performance against the Internal Audit balanced scorecard reported annually to the Audit Committee.

The Council's Internal Audit Service adds value to the Council by providing objective and relevant assurance, and contributing to the effectiveness and efficiency of governance, risk management and control processes.

### **Assurance Provided to Other Entities**

The Public Bodies (Joint Working) (Scotland) Act 2014 was passed by the Scottish Parliament on 25 February 2014 and received Royal assent in April 2014. It establishes the framework for the integration of health and social care in Scotland.

In order to take this legislation forward, NHS Lothian and Midlothian Council have established the Integrated Joint Board (IJB). The IJB is a legal entity in its own right, created by Parliamentary Order, following Ministerial approval of the Integration Scheme and is to operate under public sector good practice governance arrangements which are proportionate to its transactions and responsibilities.

The Scottish Government Guidelines produced by the Integration Resource Advisory Group recommends that the Internal Audit Service should be provided by one of the Internal Audit teams from the Health Board or Local Authority. On 20 August 2015 the Board approved the appointment of the Midlothian Council Internal Audit Manager as the Chief Internal Auditor for the IJB.

The detailed arrangements and reporting requirements for the IJB's Internal Audit Service have been set out in a Service Level Agreement. This Service Level Agreement was approved by the Council's Audit Committee on 15 March 2016.

The Internal Audit Section applies the same standards as defined in this Charter to any work undertaken for the Integrated Board.

In addition, during 2017/18 Midlothian Council will undertake an assessment of another local authority Internal Audit Section in terms of its compliance against the Public Sector Internal Standards.

Midlothian Council's Internal Audit Service does not provide assurance services to any other parties external to the organisation other than as noted above.

### **SCOPE OF INTERNAL AUDIT ACTIVITY (standards 1000, 1010, 2100, 2110, 2120, 2130)**

The scope of the work carried out by Internal Audit is designed to evaluate and recommend improvements to the Council's governance, risk management, and control processes using a systematic and disciplined approach (**standard 2100**).

Internal Audit shall review, appraise, make appropriate recommendations for improvement, and report upon:

- the Council's governance arrangements and processes;
- the design, implementation and effectiveness of the Council's ethics-related objectives, programmes and activities;
- the information technology governance of the Council in support of the Council's strategies and objectives;
- the systems and processes in place to ensure effective organisational performance management and accountability;
- the coordination of activities and communication among the Audit Committee, external and internal auditors and management;
- the identification and assessment of risk by management;
- the effectiveness and appropriateness of controls and other arrangements put in place to manage risk;
- the risk appetite of the part of the Council under review and the residual risk;
- the communication of risk and control information in a timely manner across the Council, enabling staff, management and the Audit Committee to carry out their responsibilities;
- the potential for the occurrence of fraud and how the organisation manages fraud risk;
- the completeness, reliability, integrity and timeliness of information, both financial and operational;
- the systems and processes established to ensure compliance with policies, plans, procedures, laws, and regulations, whether established by the Council or externally, and that employees' actions are in compliance;
- the action(s) taken to address significant legislative or regulatory issues;
- the economic acquisition of resources;
- the effectiveness of arrangements for safeguarding the Council's assets and interests;
- the economy, efficiency and effectiveness with which resources are deployed;
- the effectiveness and efficiency of operations and programmes; and
- the extent to which operations are being carried out as planned and strategic objectives and goals are met.



Internal Audit's work covers:

- all Council activities, systems, processes, controls, policies, and protocols;
- all Council departments, cost centres and other business units and establishments; and
- all services and other activities for which the Council is responsible or accountable, whether delivered directly or by third parties through contracts, partnerships or other arrangements.

Where other assurance providers (such as Grant Thornton or Audit Scotland) have undertaken relevant assurance work, Internal Audit will seek to rely on the work of these other assurance providers where professional standards and the nature and quality of the work they have undertaken would make it appropriate to do so.

#### **DUE PROFESSIONAL CARE (standard 1220, 1220.A1, 1220.A2, 1220.A3, 1220.C1)**

Internal auditors will apply the care and skill expected of a reasonably prudent and competent internal auditor. This means Internal Auditors will be alert to the significant risks that might affect objectives, operations or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified (**standard 1220.A3**). Due professional care does not imply infallibility.

Internal auditors will exercise due professional care by considering (**standard 1220.A1**):

- the extent of work needed to achieve the engagement's objectives;
- relative complexity, materiality or significance of matters to which assurance procedures are applied;
- adequacy and effectiveness of governance, risk management and control processes;
- probability of significant errors, fraud, or non-compliance; and
- cost of assurance in relation to potential benefits.

In exercising due professional care, internal auditors should consider the use of technology-based audit and other data analysis techniques and significant risks that might affect objectives (**standard 1220.A2**).

Specifically for consulting engagements, internal auditors should consider (**standard 1220.C1**) the:

- needs and expectations of clients including the nature, timing and communication of engagement results;
- relative complexity and extent of work needed to achieve the engagement's objectives; and
- cost of the consulting engagement in relation to the potential benefits.

#### **RESPONSIBILITIES AND REPORTING REQUIREMENTS OF INTERNAL AUDIT (standards 1000, 1010, 2010, 2020 2050, 2060, 2200, 2201, 2210, 2220, 2230, 2240, 2300, 2310, 2320, 2330, 2400, 2410, 2420, 2421, 2440, 2500, 2600)**

Internal Audit's responsibility is to report to the Council on its assessment of the adequacy of the entire control environment, delivering opinions through the Audit Committee.

The Internal Audit Manager will establish risk-based plans to determine the priorities of the Internal Audit activity, consistent with the Council's goals. The plan will be flexible in nature, can be updated to reflect the changing risks and priorities of the Council, and will take into account (**standards 2010, 2010.A1**):

- Midlothian Council's risk registers and risk management framework, including risk appetite levels set by management for the different activities and parts of the Council;

- the balance of coverage required so External Audit can place reliance on Internal Audit's work;
- the Internal Audit Manager's experience from previous Internal Audit reports;
- establishing whether previous audit recommendations have been implemented satisfactorily;
- the impact of national issues (e.g. economic factors or the introduction of new legislation);
- the impact of local issues (e.g. corporate or service action plans and issues raised by external assurance bodies);
- input from senior management and Members of the Audit Committee;
- the periodic review of core financial and operational systems in line with Internal Audit's three year strategy;
- the available audit resource and skills;
- the need for specialist skills, where they are not available already;
- staff development and training;
- time needed for the management of the Internal Audit service e.g. audit planning, development of the annual opinion, attendance at meetings, the appraisal process, the updating of relevant audit policies and procedures;
- contingency set aside for consultancy, ad hoc reviews or fraud investigations; and
- liaison with other assurance providers, to share information and audit plans, such as the External Auditor.

The risk-based plan and resource requirements, including significant interim changes, are reported to the Chief Executive, the Corporate Management Team which includes the Head of Finance and Integrated Service Support (s95 officer), and the Audit Committee. The Audit Committee will approve, but does not direct the risk-based audit plan (**standard 2020**).

Internal auditors will develop and document a Terms of Reference (i.e. an audit brief) for each engagement, including the engagement's objectives, scope, timing, resource allocations, management expectations and reporting format required (**standards 2200, 2201**). The Terms of Reference will be discussed and agreed with relevant managers and be approved at Head of Service level and by the Internal Audit Manager. Audits are carried out using a risk based approach, and will consider the objectives of the activity being reviewed, the significant risks to the activity, the adequacy of the governance, risk management and control processes and the opportunities to make significant improvements to the activity's processes.

Internal auditors will conduct a preliminary assessment of the risks relevant to the activity under review and document these in the Terms of Reference and engagement objectives will reflect the results of this risk assessment. Adequate criteria are needed to evaluate an activity's governance, risk management and controls. In the public sector, criteria may include value for money (e.g. the effective use of money, people or assets). Audit work will also consider the probability of significant errors, fraud, non-compliance and other exposures when developing the engagement objectives (**standard 2210**).

The established scope will be sufficient to satisfy the objectives of the engagement. The scope of the engagement will include consideration of relevant systems, records, personnel and physical properties, including those under the control of third parties. Internal Auditors will determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints and available resources (**standards 2220, 2230**).

Internal auditors will develop and document work programmes that achieve the engagement objectives. Work programmes will include the procedures for identifying, analysing, evaluating and documenting information during the engagement. The work programme will be approved by



the Internal Audit Manager or Lead Auditor prior to its implementation and any adjustments approved promptly (**standard 2240**).

Internal auditors will identify sufficient, reliable, relevant and useful information to achieve the engagement's objectives. Also, internal auditors will document relevant information to support the conclusions and engagement results and base their conclusion on appropriate analysis and evaluation. Records for audit and consultancy engagements are compliant with the Council's retention policies. The Internal Audit Manager will control access to engagement records. The Internal Audit Manager will obtain the approval of senior management and/or Legal Services prior to releasing such records to external parties, as appropriate (**standards 2300, 2310, 2320, 2330**).

Internal auditors will communicate the results of engagements. All audit reports will be communicated to the Audit Committee. Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client. Draft reports will be agreed with relevant management for factual accuracy prior to submission to the Audit Committee. If a final communication contains a significant error or omission, the Internal Audit Manager will communicate corrected information to all parties who received the original communication. Engagement results will specify the engagement's objectives and scope as well as applicable conclusions, recommendations and action plans. The Internal Audit service will strive to ensure that communications are accurate, objective, clear, concise, constructive, complete and timely. Additionally, internal auditors are encouraged to acknowledge satisfactory performance in engagement communications (**standards 2400, 2410, 2420, 2421**).

The following table describes the different assurance opinions that are provided by Internal Audit:

Level of Control	Reason for the level of Assurance given
<b>Excellent</b>	The control framework is of a high standard with no unacceptable risks identified.
<b>Good</b>	The control framework is of a good standard with only minor elements of risk identified which are either accepted or being dealt with by management.
<b>Average</b>	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
<b>Weak</b>	The control framework is weak and requires improvement as significant issues exist with the adequacy and effectiveness of the Internal Control arrangements. These control deficiencies could result in delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.
<b>Poor</b>	The control framework is inadequate or ineffective and the issues identified require immediate attention to prevent the delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.

Each Internal Audit report, except possibly a report rated with an excellent level of assurance, is likely to result in Internal Audit recommendations (Management Action Plan). The Head of Service in charge of the service/operation/system/process/risk which has been audited will be in charge of the Management Action Plan. If the audit assignment examined a corporate matter (impacting on more than one services, or all services), then a Head of Service will be designated by the Corporate Management Team to take charge of the Action Plan, across services.

At the conclusion of an audit assignment, the Internal Audit Manager and Head of Service will agree recommendations and timescales for these, along with priority ratings (High, Medium or Low). These recommendations will then be input by the Internal Audit Service into Covalent (the Council's performance management system) and will be subject to quarterly performance reporting and Audit Committee scrutiny. If appropriate actions to mitigate an identified risk cannot

be agreed with management, this is recorded in the Management Action Plan section of the audit report and the residual risk will be explained and highlighted. If this risk is deemed to be high, then the risk will be reported to the Corporate Management Team and Audit Committee and the Council's risk registers can be updated where appropriate (**standard 2600**).

The Internal Audit Manager is responsible for reviewing and approving the final engagement communication before issue and deciding to whom and how it will be disseminated. When the Internal Audit Manager delegates these duties, he or she retains overall responsibility. The Internal Audit Service follows Midlothian Council's policy on exempt information in the decision of making reports publically available. In compliance with the Data Protection Act 1998 and other relevant statutory and professional standards, no personal data is included in final Internal Audit reports (**standard 2440**).

The following table describes the three priority levels given to audit recommendations:

Priority	Reason for level of priority
<b>High</b>	The following would be regarded as high risk issues: <ul style="list-style-type: none"> <li>• Non compliance with Legal / regulatory requirements;</li> <li>• Strategic risks; and</li> <li>• Financial impact of £50K or more and / or national press interest.</li> </ul>
<b>Medium</b>	Financial impact of between £5K to £49K and / or local press interest
<b>Low</b>	Financial impact of under £5K and / or no press interest.

The Internal Audit Manager accepts that the responsibility of Internal Audit does not end when the Audit Report is issued, and that there will be a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action. This will be achieved by undertaking regular reviews of closed issues to confirm that these have been adequately addressed. Additionally, Internal Audit activity will monitor recommendations arising out of consulting engagements to the extent agreed upon with the client (**standard 2500**).

During the Management Action Plan period for **Poor** and **Weak** rated reports, Heads of Service are expected to discuss progress with **Weak** reports at Divisional Management Team level. For **Poor** rated reports, it is expected that Corporate Management Team will receive progress reports from Heads of Service.

The Internal Audit Manager, in the discharge of his /her duties, shall be accountable to the Audit Committee and the Chief Executive for:

- providing, at least annually, an opinion on the overall adequacy and effectiveness of Midlothian Council's framework for governance, risk management and control (the entire control environment).
- periodically providing information on the results of the annual audit plan and the sufficiency of the Internal Audit Service's resources;
- periodically reporting to the Audit Committee on the Internal Audit Activity's purpose, authority, responsibility and performance relative to its plan (**standard 2060**);
- reporting on significant risk exposures and control issues, including fraud risks, governance issues and other matters needed or requested by senior management and the Audit Committee;
- periodically reporting on the status of audit recommendations; and
- co-ordinating with other significant assurance functions (**standard 2050**).

The opinion will incorporate a summary of work that supports the opinion, a statement of conformance with the PSIAS and the results of the quality assurance and improvement programme. Additionally, the opinion will include details on the scope and time period of the opinion, scope limitations, reliance on other assurance providers, risk management framework used when forming the opinion and the overall opinion reached. The reasons for an unfavourable overall opinion will be stated (**standard 2450**).

Where other assurance providers (such as Grant Thornton or Audit Scotland) have undertaken relevant assurance and audit work, Internal Audit will seek to rely on the work of these other assurance providers where professional standards would make it appropriate to do so.

## **CONSULTANCY WORK**

Internal Audit may undertake non-assurance, consultative or fraud- related work at the request of senior management and the Audit Committee approved a protocol for this at its meeting on 23 October 2013. Provided that the independence of the service is not compromised, the request does not impact on core assurance work, sufficient resource is available and there are sufficient skills, knowledge or other competencies needed to perform the engagement (**standard 1210.C1**), then these requests will be considered for acceptance by the Internal Audit Manager. The Internal Audit Manager will consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value and improve the Council's operations (**standard 2010.C1**). Accepted engagements will be included in the audit plan.

When performing consultancy work the auditor will remain objective and not take on management responsibility (**standard 2120.C3**). Internal auditors will establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities and other client expectations and this must be agreed with the relevant senior manager. For significant engagements, this understanding will be documented in a Terms of Reference (**2201.C1**).

During consulting engagements, internal auditors will address risk consistent with the engagement's objectives and be alert to the existence of other significant risks. Internal auditors will incorporate knowledge of risks gained from consulting engagements into their evaluation of the organisation's risk management processes (**standards 2120.C1/C3**).

Consulting engagement objectives will address governance, risk management and control processes to the extent agreed upon with the client and will be consistent with the Council's values, strategies and objectives (**standards 2210.C1/C2**). If significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards. In performing consulting engagements, internal auditors will ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations will be discussed with the client to determine whether to continue with the engagement (**standards 2220.A2/C1**).

During consulting engagements, governance, risk management and control issues may be identified. Whenever these issues are significant to the organisation, they will be communicated to senior management and the Audit Committee (**standard 2440.C2**).

This work could take many forms, but will typically include special reviews or assignments which fall outside the approved work plan and for which a contingency is included in the audit plan. Work programmes for consulting engagements may vary in form and content depending upon the nature of the engagement.

Examples of such work include, but are not limited to:

- advice on controls for systems and activities to reduce risk;
- advice on opportunities to reduce costs through greater economy and efficiency within systems and activities;
- provision of quality assurance on projects involving major change and systems development; and
- provision of an independent and objective assessment of the evidence on progress in implementing action plans.

Approval will be sought from the Audit Committee if there is to be a significant variation in consultancy work above the contingency included in the audit plan (**standard 1130**).

The role of Internal Audit in a consultancy assignment is to provide advice, facilitation and support to management who retain the responsibility for the ultimate decisions taken within the area under review. The Internal Audit Manager is responsible for communicating the final results of consulting engagements to clients (**standard 2440.C1**). Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.

Where Internal Audit provides advice on the setting up of controls, it does so as a consultant and the provision of such advice does not prejudice the right of Internal Audit subsequently to review, comment on and make recommendations on the relevant systems or controls in appropriate circumstances.

## **ARRANGEMENTS FOR AVOIDING CONFLICTS OF INTEREST (standards 1000, 1120, 1010, 1130)**

Internal auditors will have an impartial, unbiased attitude and avoid any conflict of interest. The Internal Audit service will preserve objectivity by ensuring that all internal auditors are free from any conflicts of interest and that the undertaking of non-audit duties does not impair independence. Internal auditors are required within the PSIAS to refrain from participating *“in any activity or relationship which may impair or be presumed to impair their unbiased assessment.”*<sup>4</sup>

A conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfil his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor, the Internal Audit activity and the profession. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively.

Internal auditors will:

- not accept any gifts, hospitality, inducements or other benefits from employees, clients, suppliers or other third parties (other than as may be allowed by the Council's own policies);
- not use information obtained during the course of duties for personal gain;
- disclose all material facts known to them which, if not disclosed, could distort their reports of cones (not disclosing known information), unlawful practice, subject to any confidentiality agreements; and
- comply with the Bribery Act 2010.

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<sup>4</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Section 4 - 2.1

Non-compliance with the above will be considered an offence for disciplinary purposes.

Where Internal Audit employees are required to undertake non-audit duties, the Internal Audit Manager will make it clear that those audit staff are not fulfilling those duties as internal auditors. The Internal Audit Manager will ensure that within the service there remains sufficient impartiality to enable the actions and activities of those Internal Audit employees to be subject to audit by those independent from the activity. This could be achieved, for example, by using employees from a partner authority in the case that all internal auditors at Midlothian Council are impaired in terms of their independence.

Internal auditors will refrain from assessing specific operations for which they were previously responsible. Objectivity, for the purpose of audit work, is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year (**standard 1130.A1**). The Internal Audit Manager does not have executive responsibility for any Council functions other than the Internal Audit Service (**standard 1130.A2**).

Internal auditors may provide consulting services relating to operations for which they had previous responsibilities (**standard 1130.C1**). If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure will be made to the Internal Audit Manager and the engagement client prior to accepting the engagement (**standard 1130.C2**).

Where the Internal Audit Manager is engaged in a non-audit role and has been in a position of management responsibility, for example in response to an emergency, the subsequent audit of any such activity will be delegated to an appropriate independent 'deputy' from Internal Audit or a party outside the Internal Audit service to undertake any work that may be necessary and to report independently to those charged with governance.

If any member of the Internal Audit Service, or any individual or organisation engaged to act on its behalf, considers that there is or is perceived to be a conflict of interest, this will be declared to the Internal Audit Manager who will then consider the validity of the claim. If the claim is found to be accurate and reasonable, then the Internal Audit Manager will direct alternative and independent resources to the audit. If the Internal Audit Manager's own independence is impaired, the Internal Audit Manager will declare this in writing to the Chief Executive and another independent person or body will be appointed to fulfil this role.

## **FRAUD**

As outlined in the Council's *Fraud and Corruption Policy*, the responsibility for the prevention and detection of fraud and corruption rests with management.

Audit procedures alone, even when performed with due professional care, cannot guarantee that fraud or corruption will be detected. Internal Audit does not have responsibility for the prevention or detection of fraud and corruption. Internal auditors will, however, be alert in all their work to risks and exposures that could allow fraud or corruption. The Internal Audit Section also has two qualified fraud specialists who support the Council by managing a fraud hotline and whistle blowing facility and are available to support management with investigations and to identify internal or external fraud.

Where any matter arises which involves, or is thought to involve, a fraud, corruption or financial irregularity, the relevant Head of Service / Divisional Director will immediately notify the Internal



Audit Manager for consideration of appropriate action. Managers will only establish the basic facts of the suspicion and should not attempt to carry out any detailed investigation themselves.

Where Internal Audit is satisfied that a matter will be investigated appropriately, the responsibility can be discharged to the Service.

Further information on Internal Audit's role and responsibilities in relation to fraud, are detailed within the Council's Counter *Fraud and Corruption and Whistleblowing Policies*.

The Internal Audit Section also manages the National Fraud Initiative on behalf of the Council.

## **AUDIT RESOURCES AND WORK PRIORITISATION (standards 1000, 1010, 1210, 1230, 2030)**

Work is directed according to the assessed level of risk, the judgement of the Internal Audit Manager, with direction from the Audit Committee. The annual risk based audit plan agreed by the Audit Committee will be the main determinant of the relative priority to be placed on each Internal Audit assignment. The risk-based plan will explain how Internal Audit's resource requirements have been assessed. The Internal Audit Manager will determine the actual deployment of available resources based on the risk assessment described above.

The plan will have within it the provision of resources to address unplanned work. This contingency will be directed towards unplanned work including consultancy engagements and covering other unforeseen variations in the level of resources available to Internal Audit, such as staff vacancies.

The Internal Audit Manager will ensure that Internal Audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan. Appropriate refers to the mix of knowledge, skills and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimises the achievement of the approved plan.

The Internal Audit Manager will hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced (**standard 1210**). Each job post within the Internal Audit structure details the skills and competencies within the approved job description and person specification. In line with the Council's competency appraisal framework and the PSIAS, each member of the team will be assessed against these skills, competencies and appropriate work related objectives. Any development and training plans will be regularly reviewed, monitored and agreed with the Internal Audit Manager and the Chief Executive. There will be ongoing assessment of training needs through the competency appraisal framework. Employment of new staff will be in line with the Council's HR policies. External resources will be procured in line with the Council's Financial Regulations, Standing Orders and Procurement Policy.

Additionally, Auditors are also required to maintain a record of their continual professional development in line with their professional body (**standard 1230**).

The Internal Audit Manager will obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement (**standard 1210.C1**). Internal auditors will have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. Following a recent restructure however, Internal Auditors do now have the ability to seek advice and refer to the in-house Corporate Fraud Officers. Internal auditors will have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise

of an internal auditor whose primary responsibility is information technology auditing (**standards 1210.A1/.A2/.A3**).

In the event that the audit risk assessment identifies a need for a greater degree of audit work than there are resources available, the Internal Audit Manager will identify the shortfall in the annual Internal Audit Plan and initially advise the Chief Executive. Where the Internal Audit Manager believes that the level of agreed resources will impact adversely on the provision of the annual Internal Audit opinion, the consequences will be brought to the attention of the Audit Committee (**standard 2030**). It shall be for the Audit Committee and the Chief Executive to decide whether to accept the risks associated with the non-delivery of such audit work or to recommend to the Council that it requires the Chief Executive to identify additional resources.

Fraud Officers will carry out internal audit work in the course of their duties and this internal audit work will be assigned and reviewed by the Internal Audit Manager to ensure compliance with the PSIAS. Additionally, all relevant signed declarations of independence made by Internal Auditors are also required to be made by the Fraud Officers. The Internal Audit Manager will ensure that the Fraud Officer's access to Council systems and records is appropriate for the scope of the assigned audit work.

#### **QUALITY ASSURANCE (standards 1300, 1310, 1311, 1312, 1320, 1321, 1322, 2040, 2430, 2431)**

Public Sector Internal Audit Standards require that the Internal Audit service is subject to a quality assurance and improvement programme that will include both internal and external assessments. This will be developed by the Internal Audit Manager and cover all aspects of Internal Audit. These assessments aid the Internal Audit Manager in the annual assessment of Internal Audit's efficiency and effectiveness and in identifying opportunities for improvement.

The Internal Audit Manager is responsible for informing the Audit Committee and Senior Management whether the Internal Audit Service is compliant with the PSIAS and achieves its objectives. An assessment against the requirements of the PSIAS will be completed on an annual basis and, along with the results of the quality assurance program, will be reported to the Audit Committee as part of the Internal Audit Annual Assurance Report. The Internal Audit Manager may only state that the Internal Audit service conforms with *the International Standards for the Professional Practice of Internal Auditing* if the results of the quality assurance programme support this statement. Instances of non-conformance will be reported to the Audit Committee and significant deviations will be considered for inclusion in the annual governance statement (**standards 2430, 2431**).

#### Internal assessments

All of the Internal Audit engagements are subjected to a thorough internal peer review of quality, to ensure that its work meets the standards expected from its staff. For example, the internal quality reviews are undertaken by the Internal Audit service to ensure that:

- all work undertaken is in accordance with PSIAS;
- supervision is provided to all levels of staff ;
- work is allocated to staff with appropriate skills, competence and experience;
- work is monitored for progress, assessed for quality and to allow for coaching;
- the work is planned and undertaken in accordance with risks associated with areas under review; and
- the conclusions are fully supported by the detailed work undertaken and with sufficient and appropriate evidence held on file.

All Auditors have access to an up to date electronic audit manual, the Internal Audit Charter, Midlothian Council Policies and Procedures and the Public Sector Internal Audit Standards (**standard 2040**). Internal auditors are regularly reminded to become familiar with these documents. The Internal Audit service uses resources from CIPFA, IIA, ACCA, and SLACIAG (Scottish Local Authorities Chief Internal Auditors' Group). Additionally, Midlothian Council's Internal Audit service shares audit reports and test plans/strategies with East Lothian Council's Internal Audit service.

#### External assessments

An external assessment will be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the Council. In order to fulfil this requirement, Midlothian Council's Internal Audit Service has elected to be part of SLACIAG's validated self-assessment framework. Full details of this scheme were presented to the Audit Committee on 18 March 2014.

This fulfilled the PSIAS requirement to discuss with the Audit Committee:

- the form of external assessments;
- the qualifications and independence of the external assessor or assessment team, including any potential conflicts of interest; and
- the frequency of the external assessments.

#### **APPROVAL OF CHARTER**

Original Charter	Approved by the Audit Committee 18 June 2013
First revision to Charter	Approved by the Audit Committee 28 October 2014
Second revision to Charter	Approved by the Audit Committee 5 May 2015
Third revision to Charter	Proposed approval date 10 May 2016

The Charter will be subject to continuous review by the Chief Executive, the Internal Audit Manager and the Audit Committee.



**Self Assessment of the Internal Audit Section against the Public Sector Internal Audit Standards****Report by Graham Herbert / Elaine Greaves, Internal Audit Managers****1 Purpose of Report**

The purpose of this Report is to provide to the Audit Committee the results of a self evaluation by the Internal Audit Manager on the level of compliance by Midlothian Council's Internal Audit Section against the Public Sector Internal Audit Standards.

**2 Background**

- 2.1 The Public Sector Internal Audit Standards require ongoing monitoring of the performance of the Internal Audit activity and periodic self-assessments to evaluate conformance with the Definition of Internal Auditing, the Code of Ethics and the Standards.
- 2.2 External assessments must be conducted every five years by a qualified, independent assessor or assessment team from outside the organisation. Midlothian is to participate in the Scottish Local Authority Chief Internal Audit Group (SLACIAG) inspection arrangements with the first external assessment due to take place in 2016/17.
- 2.3 SLACIAG has prepared a detailed checklist to allow Council Audit teams to self assess their performance against the new standard and the results of this assessment are shown at Appendix 1 (this document has been placed in the Members' Library due to its size).

**3 Findings**

- 3.1 Our assessment found that the key elements of the Standards were complied with by Internal Audit during the year. We have identified a small number of areas where performance could be improved and these are noted in Appendix 2. We do not however believe that these are significantly material to require comment in the Annual Governance Statement (AGS).

**4 Report Implications****4.1 Resource**

There are no direct resource issues arising out of this report.

**4.2 Risk**

There are no significant risks identified as part of this report as the Internal Audit Section was found to be compliant with the main elements of the Standards.

### **4.3 Single Midlothian Plan and Business Transformation**

Themes addressed in this report:

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

### **4.4 Key Priorities within the Single Midlothian Plan**

This report does not relate directly to the key priorities within the Single Midlothian Plan.

### **4.5 Impact on Performance and Outcomes**

This report provides assurance that the Internal Audit Section is complying with the major requirements of the Standards.

### **4.6 Adopting a Preventative Approach**

The self assessment reduces the risk of non compliance against the Standards and allows the Internal Audit Section to provide a more effective service to the Council and Council Service users.

### **4.7 Involving Communities and Other Stakeholders**

There are no communities or other stakeholder issues with regard to this report.

### **4.8 Ensuring Equalities**

There are no equalities issues with regard to this report.

### **4.9 Supporting Sustainable Development**

There are no sustainability issues with regard to this report.

### **4.10 IT Issues**

There are no IT issues with regard to this report.

## **5 Summary**

The Internal Audit Managers have concluded that there is an adequate level of compliance against the Public Sector Internal Audit Standards. This will be subject to external validation in 2016/17.

## 6 Recommendations

The Audit Committee is invited to note:

- the results of the self assessment;
- the areas for development; and
- that the Internal Audit Section will be subject to an external assessment in 2016/17.

**Date 31/03/2016**

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**Appendices:**

Appendix 1 – SLACIAG Checklist (see Members' Library)

Appendix 2 – Action plan



## Appendix 2

### Internal Audit Action Plan Developed From an Assessment against the Public Sector Internal Audit Standards

No	Issue	Action	Due Date
1	1100.4 / 1300.1 A pilot process of receiving client feedback was introduced in 2015/16. Internal Audit have received positive feedback so far but there is scope to develop this process further through for example obtaining annual feedback from Heads of Service and the Chair of the Audit Committee.	Obtain feedback on Internal Audit Performance from Heads of Service at the annual planning meetings.  Obtain feedback on Internal Audit performance from the Chair of the Audit Committee.	31/03/17  30/06/16
2	1200.1 The job description of the Internal Audit Manager needs to be updated to reflect the additional responsibilities in relation to the Integrated Joint Board and additional responsibilities for fraud and NFI. The senior audit role and fraud officers' descriptions also need to be updated. This is not seen as a material issue since all members of the internal audit team have objectives set at the start of the financial year which clearly detail expectations.	Update relevant job descriptions.	30/09/16
3	2300.5/ 2300.7 The Internal Audit Section retains current year files within the section and then sends these for archiving where they are securely destroyed after 6 years retention rather than the five currently detailed within the Records Management system. For system related data, information is held in secure folders to which only Internal Audit have access with restrictions on certain files to the Audit Managers only. There is however no fixed annual review of these system files to determine which records should be deleted.	Introduce an annual review of system files.  Clarify with Records Democratic Document Team Leader retention policy for Finance related Audit records.	30/06/16 and then on-going.  31/05/16
4	1200.6 The audit team use EXCEL for extracting data for testing. The team also have access to IDEA software for data matching and exception reporting and although three members of the team are trained in its use more use could be made of this software in particular for the Corporate Fraud Team.	Train all members of the Internal Audit team in the use of IDEA and assess its use for Corporate Fraud work in 2016/17.	30/08/16
5	2100 The Risk and control Matrix includes a requirement to review (where relevant) information technology, fraud, legislation and regulation (including data protection /	Expand the current risk and control matrix.	Closed

No	Issue	Action	Due Date
	<p>business continuity), policies and procedures and risks that impact on the Council's strategic objectives.</p> <p>The current template used to record work undertaken on these areas does not however have a specific checklist against these areas. A further section on the risk and Control Matrix could be developed to record conclusions on each of these specifically.</p>		