Midlothian

Auditor: James Polanski, Ext 5646

Final Internal Audit Report

to

**Chief Executive
All Directors
All Heads of Service
Community Planning Manager
Procurement Manager**

on

Following the Public Pound

21 November 2018

1   Introduction

1.1   The purpose of this audit was to review the controls in place to ensure compliance with the Code of Guidance on Funding External Bodies and Following the Public Pound (FTPP) 1996, published by COSLA (Convention of Scottish and Local Authorities) and best practice guidance.

2   Audit Scope

2.1   The scope of this audit was to examine and evaluate the following areas:

- to assess the Council's governance arrangements and to ensure the Council has adequate policies and procedures in place for complying with the Code and controlling payments to external organisations (including local procedures);

- that any awards of funding comply with the Council's policies and procedures and contributes to the Council's high level strategic objectives; and

- the adequacy of the risk assessments, written agreements, and monitoring arrangements with external organisations (proportionate to the level of resource/funding provided and risks to the Council).

3   Management Summary

3.1   Guidance from COSLA and the Accounts Commission (Code of Guidance on Funding External Bodies and Following the Public Pound, 1996, hereafter referred to in the report as 'the Code') was published in response to concerns regarding councils' increasing use of arm's-length bodies (such as companies, trusts, and voluntary bodies) and the need to maintain control and accountability over public funds. Subsequent reports on this topic have been published by Audit Scotland providing further guidance to Councils. The Direction under section 51 of the Local Government in Scotland Act 2003 outlines the legal requirement for every local authority to comply with the Code.

3.2   In common with other local authorities, Midlothian Council has increasingly engaged with the voluntary sector to assist in the delivery of services and achievement of the Council's aims. Therefore, compliance with the Code and related best practice guidance is important for the Council, and will further increase in importance due to the Community Empowerment (Scotland) Act 2015.

3.3   The Council's engagement includes the Council's voluntary sector grants programme, financial assistance and management support provided to voluntary organisations for the development of community hubs/centres, and contracts / service level agreements (SLAs) with voluntary sector organisations for delivery of the Council's strategic aims, particularly in the areas of Adult Services, Children's Services, and Early Years, where there are long standing engagements with voluntary organisations that have not been subject to formal competitive tendering.

3.4 Our review identified that adequate governance arrangements are in place and policies and procedures have been developed to allow for compliance with the Code, and relevant risks have been logged and are periodically reported to Senior Management. However, awareness in some areas could be improved, as could access to the FTPP policy. We have raised 1 recommendation for this control objective (recommendation 5.1).

3.5 From the sample of organisations reviewed during the audit, we note that the organisations contribute to the Council's strategic objectives. It was noted that non-competitive action (NCA) forms were not completed for all contracts with voluntary organisations reviewed during the audit, and the rent grants stream should be aligned with the Asset Transfer Guidance and reviewed to ensure best fit with the Council's strategic objectives. We have raised 2 recommendations for this control objective (recommendations 5.2 and 5.3).

3.6 Up to date authorised written agreements were in place for all organisations reviewed other than where the written agreement was still under negotiation with the external organisation, and an officer, in charge of monitoring performance of the organisation on behalf of the Council in relation to the grant or contract/SLA, was in place for all agreements reviewed as part of the audit. However, some areas were identified where monitoring could be improved over financial information (e.g. review of insurance and financial accounts) and evidence of review of performance information by the relevant officer. We have raised 4 recommendations for this control objective (recommendations 5.4 to 5.7).

3.7 Internal Audit considers that the level of assurance we are able to give is Substantial Assurance.

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

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

4 Findings

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
4.1 Fraudulent payments made to organisations, financial loss, reputational damage to the Council	Adequate policies and procedures are in place for complying with the Code and controlling payments to external organisations (including local procedures).	There is an overarching FTPP policy in place for the Council and the requirement to follow the Code is detailed in the Council's Financial Regulations. The policy adequately sets out the requirements of the Code and principles to follow. It was noted that although the revised FTPP policy was approved during 2017, the policy had not been added to the intranet. At the next update of the Financial Regulations, the current procedures and new legislation (e.g. The Community Empowerment Act) should be included.	Satisfactory	5.1
		Although there is no specific 'FTPP' risk register, there are related risk registers that touch on the risks related to this, and these risks are periodically reported to CMT and the Audit Committee.	Satisfactory	
		As part of the annual governance statement process, Heads of Service are asked to confirm compliance with the Code as part of the governance checklist. However, it was noted that the question within the checklist focuses on grants, but the Code's scope is wider than this.	Good	
		Recent reports to Council relating to the funding to specific voluntary organisations, and review of the Council's voluntary grants programme, were reviewed as part of the audit. It was noted that these reports referred to the requirement to follow the Code.	Good	
		The governance arrangements and control processes around the grant funding contribution towards the build of a community centre were reviewed and good practice was noted. It was identified that although the agreement specifies particular insurances the organisation should have in place, these should be confirmed annually.	Good – finding discussed with Management	
		It was noted that although there is a grants register for the Voluntary Sector Grants Programme maintained by Communities Team, and a Contract Registers maintained by Procurement, there is no separate register for additional grants provided to organisations through Council reports (e.g. contribution towards funding a Community Centre). However, the report to Council and Minutes do provide an audit trail of the reasoning and approval for the funding provided.	Satisfactory	5.1

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
4.2 Funding is provided to organisations that do not contribute to the Council's strategic objectives. Financial loss, reputational damage, and the Council failing to provide a valuable service to the community.	Awards of funding comply with the Council's policies and procedures and contributes to the Council's high level strategic objectives.	**Voluntary Sector Grants Programme** As a result of the Council's grants review in 2014, it is mainly the Communities Team that distributes revenue grants to voluntary sector organisations, and this centralisation has allowed there to be a standardisation of procedures. The majority of the grants programme was refocussed to give alignment with the priorities of the Single Midlothian Plan. Exceptions were put in place through Council approval for the funding of Galas to continue outside these categories.	Good	
		Communications plans have been developed and put in place to promote the grants programme. Application packs and procedures have been designed to allow the organisation to demonstrate how their activities contribute to one or more of the 4 themes, and these are reviewed by the officer scoring panel. Officers involved in the scoring panel are required to complete a vested interests form, and are not permitted to participate in the application scoring for any grants they have an interest in. Recommended grant awards are then submitted to Council for approval.	Good	
		The 2014 review of grants established a new rents stream. The basis for funding these organisations are letters submitted to the Council by the organisations in 2014 requesting that the annual contribution to their rent continue. In 2018/19 there are 17 organisations who receive rents of between £1,500 and £17,249. The rents stream aspect of the voluntary sector grants programme has not recently been reviewed to ensure best alignment with the Council's strategic objectives. A report submitted to Council in August 2018 on the Voluntary Sector Grants Programme, recommended and agreed that these arrangements should be reviewed and aligned with the Asset Transfer guidance to ensure the organisations are making best use of the premises they occupy. During the audit some anomalies were identified with the rents stream and these should be included in the review of rents grants stream.	Satisfactory – subject to the action that has been agreed to review this area in the August 2018 Council report on the Voluntary Sector Grants Programme	5.2
		Contracts with Voluntary Organisations The Contracts/SLAs for each organisation are authorised at Director level, signed by a witness, and signed by a senior manager from the voluntary organisation with a witness. The specification of the service is developed by Management and included in the signed written agreement.	Good	

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
4.2 Funding is provided to organisations that do not contribute to the Council's strategic objectives. Financial loss, reputational damage, and the Council failing to provide a valuable service to the community. (cont'd)	Awards of funding comply with the Council's policies and procedures and contributes to the Council's high level strategic objectives. (cont'd)	Many of the organisations have been funded by the Council for years, and in some cases the Council provides the majority, or a significant percentage, of these organisations' incomes through the contracts/SLAs. Consequently, many of these contracts/SLAs have never been competitively tendered. The Council's procedures stipulate that contracts that have not been competitively tendered should have an authorised NCA form. From a sample of 10 Contracts/SLAs reviewed, it was noted that a NCA form was not completed for 7. Additionally, it is noted that whilst there is a process in place for Directors and certain senior officials to formally declare any conflicts of interest (recorded in a central register held by Legal Services), there is no process to require the requesters of a NCA to declare if they have any vested interests.	Satisfactory - subject to completion of NCA where applicable	5.3
4.3 There is no certainty or consensus on services to be delivered, costs of service, or expected outcomes. The Council is unaware if the organisation is meeting the satisfactory performance required or if value for money has been met.	Adequate risk assessments, written agreements, and monitoring arrangements with external organisations are in place (proportionate to the level of resource / funding provided and risks to the Council).	**Voluntary Sector Grants Programme** For small grants (<£3,000), applicants agree to a basic set of conditions that are appropriate to the level of award. For grants greater than £3,000 the applicant has to agree to further conditions in terms of monitoring and reporting requirements, including allowing provisions for audit access. A Service Level Agreement (SLA) is established with the organisation if the grant is greater than £30,000 per annum. The SLA includes an agreed detailed description of the service/project, monitoring requirements, cost, payment arrangements, and further terms and conditions. From 6 large grant acceptance forms reviewed, 3 were above £50,000 per annum, and this exceeded the authorising manager's authority limit. Although there is a process in place for grant recommendations to be submitted to Council, the authority limits for approving the award of grants and contracts should be observed. For all grants, the application has been designed to demonstrate how the applicant is contributing towards one of the 4 category themes of the grants programme, and monitoring reports are based around these objectives. Additionally, applicants are required to submit copies of financial accounts, insurances, and articles of association as part of their application pack. The Communities Team highlighted the challenge of receiving monitoring information from applicants in a timely manner. From a sample of 12 small grants reviewed, monitoring documentation was received for 11 grants.	Good Satisfactory – compliance issue discussed with Management. Good	N/A

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4.3 There is no certainty or consensus on services to be delivered, costs of service, or expected outcomes. The Council is unaware if the organisation is meeting the satisfactory performance required or if value for money has been met. (cont'd)	Adequate risk assessments, written agreements, and monitoring arrangements with external organisations are in place (proportionate to the level of resource / funding provided and risks to the Council). (cont'd)	For large multi-year grants, it was noted that accounts and insurances had not been confirmed annually and they were only requested at the outset. Additionally, although monitoring information was received for these organisations, there was limited written evidence of review or 'signing-off' of the monitoring information by the nominated grant lead, including periodic risk assessment subsequent to the application. It is understood that there has been periodic informal discussions with the grantees, however given that some of the larger grants are >£30k per annum, the audit trail of this should be improved.	Satisfactory with a few exceptions and subject to improved audit trails	5.4 & 5.6
		Contracts with Voluntary Organisations The contract used for Adult Services and Children's Services have a standard format that has been developed by Procurement and reviewed by Legal Services. No issues were noted with the quality of the written agreements in this area.	Good	
		The contract used by Early Years is not as comprehensive or robust as the contract pro-forma used in Children's Services and Adult Services. For example, the SLAs did not explicitly include clauses for allowing access to all records in relation to the contract, audit access, and the termination notice period in some cases was longer (6 months instead of 3 months). It has been advised that, Early Years will move on to the same contract type as is used for other parts of the Council, and the contracts did adequately detail the service to be provided.	Satisfactory – given that the more robust contract is planned to be used for future agreements.	N/A
		Contracts/SLAs within Health and Social Care Directorate, and Education, Communities and Economy Directorate are logged with a credit reference agency. When financial alerts are received, these are forwarded to relevant Management to review and take appropriate action. Accounts and insurances are confirmed for contracts/SLAs within Adult Services and Children's Services annually as part of the 'provider fitness check' process. Additionally, periodically other relevant policies and procedures are confirmed as part of this process. Accounts are reviewed by an accountant within Financial Services, and any findings of note are forwarded to relevant Management to review.	Good	

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
4.3 There is no certainty or consensus on services to be delivered, costs of service, or expected outcomes. The Council is unaware if the organisation is meeting the satisfactory performance required or if value for money has been met. (cont'd)	Adequate risk assessments, written agreements, and monitoring arrangements with external organisations are in place (proportionate to the level of resource / funding provided and risks to the Council). (cont'd)	It was noted that Early Years contracts/SLAs were at the time not included as part of the 'provider fitness check' process, and although Managers are aware of periodically getting copies of accounts, the same rigour as described above was not in place. This issue was highlighted immediately by Internal Audit and plans were put in place to address this by Officers.	Satisfactory – due to immediate action taken.	5.5
		From the sample of 10 Contracts/SLAs reviewed for both Education, Communities and Economy and Health and Social Care, it was identified that in some cases that not all information outlined as being required in the contract was included in the information received by the officer. Additionally, in some cases there was not a direct audit trail of evidence of sign-off and review of the information received by the officer. However, it was noted that in all areas reviewed, the process of receiving and reviewing monitoring information was under review by the relevant team, with plans in place to make further improvements. There is contract monitoring guidance for the Health and Social Care Directorate, but it was last updated in 2012. In addition there is no similar guidance in place for Education, Communities and Economy. It is understood that this issue will be addressed with the development of Council-wide guidance.	Satisfactory with a few exceptions – plans underway to improve processes in the areas reviewed	5.6
		Procurement Contract Registers and Risk Assessments Contract registers are maintained by Procurement. The registers include relevant information for the contract such as value, contacts, start date, end date, etc. The Adult Services register also details the number of extensions and the type of procurement (e.g. direct purchase, NCA, OJEU open tender), and there is a risks section highlighting any emerging risks facing suppliers. This type of procurement information has not yet been fully input for Early Years and the risk section has not been completed for Children's Services. From the sample reviewed, 9 of the 10 organisations could be seen on the Contract Register. The organisation that was omitted was an Early Years contract, and the contract register for Early Years was not yet fully developed at the time of review.	Satisfactory – once all registers are brought to the same standard	5.7

5   Recommendations

Rec. Ref No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.1	Management should ensure that all relevant staff are aware of the requirements of the Following the Public Pound Code and that it is easily accessible (i.e. available on the Intranet) to facilitate compliance. Management should review if the grants register could also capture payments to voluntary organisations agreed through Council.	Medium	Agreed.	Alasdair Mathers, Community Planning Manager by 31 March 2019
5.2	Management should ensure, within the review of the rents grant stream that any anomalies are resolved to mitigate against the risk of allegations of unfairness in the process.	Medium	Agreed.	Alasdair Mathers, Community Planning Manager by 31 December 2019
5.3	Management should ensure that a NCA is completed for contracts with voluntary organisations that have not been competitively tendered. Additionally, procurement procedures should be enhanced to require the requester of the NCA to declare if they have any vested interests.	Medium	Agreed.	Heads of Service from Education, Communities & Economy and Health & Social Care Directorates with support from Iain Johnston, Procurement Manager by 31 March 2019
5.4	For large multi-year grants, insurances and financial accounts should be requested and reviewed annually, and evidence of this retained.	Medium	Agreed.	Alasdair Mathers, Community Planning Manager by 31 December 2018
5.5	The 'Provider Fitness Check' process should be rolled out to all relevant contracts with outside bodies within the Education, Communities and Economy Directorate.	Medium	Agreed.	Iain Johnston, Procurement Manager by 31 March 2019
5.6	Officers should adequately evidence their review of contracts / large grants that the monitoring information received is adequate for the purpose of measuring performance and outcomes.	Medium	Agreed.	Heads of Service from Education, Communities & Economy and Health & Social Care Directorates by 31 March 2019
5.7	Contract registers for Children's Services and Early Years should detail the number of extensions and the type of procurement (e.g. direct purchase, NCA, OJEU open tender), and highlight any emerging risks facing suppliers.	Low	Agreed.	Iain Johnston, Procurement Manager by 31 March 2019

Overall Audit Opinion level and definition

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

Recommendation Ratings

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

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

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

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

Jill Stacey
Chief Internal Auditor