

MIDLOTHIAN COUNCIL

Audit Committee

Annual Report from the Chairman Year ended 31 March 2014

Introduction

This Annual report has been prepared to inform Midlothian Council of the work carried out by the Audit Committee during the financial year. The content and presentation of this report meets the requirements of the Audit Committee Combined Code (2008) and the 2013 Chartered Institute of Public Finance Accountancy (CIPFA) document "Practical Guidance for Local Authorities-Audit Committees".

Meetings

The Committee met formally six times in the year; in addition a Training Day was held on 7 June 2013. Prior to each meeting a briefing session is held between the Chairman and the Internal Audit team, and additional meetings are held regularly by the Chairman with senior officers and informally with the External Auditor.

Members of the Committee have independent access to both Internal and External Audit.

Compared to the maximum possible 47 aggregate attendances of the permanent members of the Committee, 7 apologies for absence were received, representing an 85% attendance record.

Membership

Apart from the independent Chairman there has been (up to February 2014) an independent voluntary Member and six Councillors represented on the Committee. Four of the members of the Committee have private sector financial experience and related qualifications The Chief Executive, the Director Resources, and the Section 95 Officer (Head of Finance and Integrated Service Support) are regularly in attendance. The internal and external audit teams attend at every meeting and other officers are present as and when required according to subject matter.

Governance

The Committee operates under the Council's Standing Orders and its policy is to conform to the CIPFA's guidance and recommendations for Best Practice. In the light of updated CIPFA guidance "Practical Guidance for Local Authorities and Police" (issued in December 2013) there will require to be alterations to the Council's Standing orders in respect of the Audit Committee

so as to continue in conformity with the CIPFA position. These proposed changes are set out in Appendix 1 and the full assessment against the new CIPFA guidance is attached at Appendix 2.

The Committee is also conversant with Audit Scotland's reports on Midlothian and its publications regarding local government in Scotland.

The Chairman and Committee Members have access to, and consult when appropriate, relevant publications of Audit Scotland, CIPFA, National Fraud Initiative, and relevant Accounting Standards.

The members also review the Council's Annual Governance Statement.

Assurance Framework

The Annual Governance Statement is set out at Appendix 3. Other than the proposed CIPFA conformity changes referred to there have been no changes arising or proposed in respect of the Assurance Framework in the year. The Committee has, however, noted the Council's revised Code of Corporate Governance as of December 2013.

Internal Audit

The internal Audit team has had a complement of 3.7 FTE employees in the year (2012/13: 4.7 FTE). An internal assessment against the Public Sector Internal Audit Standards (PSIAS) was reported to the Committee on 06 May 2014 and showed compliance against the code. Going forward there will be a system of reciprocal assessments within local governments and this will be introduced over the next three years. This will be in addition to the external report forming part of Grant Thornton's annual audit which found the function to be satisfactory in 2012/13.

In December 2013, the Committee noted the output position of the Internal Audit function. There had been 378 recommendations in the prior three years, with 96% of the recommendations reported as implemented or "on target". The outlying 4% are the subject of continuing follow-up. The position compares with that reported to the March 2012 committee where 14% of recommendations remained outstanding.

In December 2013 Internal Audit proposed to the Committee a new protocol aimed at prioritising the work of the team, in consultation with senior executives and members of the Committee and this has now been adopted. In March 2014 a schedule of internal audit topics was evolved so as to create an overall taxonomy of subjects which should all be covered over time. In the longer term it is intended to conform the captions for Internal Audit review with the Risk Register descriptions, where these constitute accounting or output risks suited to the Committee's review.

In total, in year 2013/14, 114 recommendations have been made by Internal Audit all of which have been reviewed and endorsed by the Audit Committee.

Risk Management

The Committee has reviewed Risk Management reports which have highlighted a number of high risk areas in the period. These include corporate change and transformation, balancing budgets in future years, legal and regulatory compliance and Welfare Reform risks.

These areas have all been subject to Internal Audit reviews in 2013/14 and will remain a focus for the section in 2014/15.

Reports are to be submitted to the June 2014 Audit Committee which make recommendations on a number of proposed improvements to Risk Management including reporting on risk and an annual review of service and corporate risk registers as part of the service planning process.

Value for Money

Although there is no specific caption in the Standing Orders at present which specifies this goal, in practice the concept has determined the content of debates within the Audit Committee. The following examples show the approach:

Accounts Receivable - the Committee considered the profile of debtors, with particular concern regarding the level exceeding 12 months outstanding. Recommendations were accepted as to faster invoicing, service withdrawal for non-payers, use of third party agencies and improved dispute resolution.

Direct Labour - the Committee reviewed the adverse variances in direct labour costs which followed upon the implementation of equalisation, associated with moving to a salaried rather than hourly rates basis for employees.

Progress Monitoring

Internal Audit as stated above, follow-up on recommendations made. The initiatives of the Committee in this respect are demonstrated from the Minutes. Specific matters can be, and are, requested for follow-up discussions at the point of initial discussion. Under the proposed changes to Standing Orders the obligation to follow up is emphasised further.

Effectiveness of Internal Controls

The Committee has made several recommendations in 2013/14 in respect of internal controls and these are monitored for implementation by the Internal Audit team. Additionally the External Auditor reviews the effectiveness of the resultant controls and systems. Apart from primarily financial matters the Committee has considered operational risks, including IT resilience and

Disaster Recovery policy. The Committee specifically examined Data Protection controls so as to reduce the risk of failing to conform to legal standards and operational best practice.

The outturn of the Lasswade Hub project, a new asset constructed on time and within budget, was reviewed and controls were found to be effective.

Other operational matters reviewed include Frameworki, electronic payments, Dalkeith car parking and environmental policy implementation.

External audit

The Committee reviewed and discussed Grant Thornton's Annual Audit Report.

We specifically considered financial resilience in light of utilisation of £2M from capital funds to pay principal loan repayment originally budgeted to be met from general funds for year ending 31 March 2013 and through a revenue overspend to budget of £1.25M in the same period. While the Audit Committee is not responsible for the Council's Budget, it monitors variances and has requested a review of the Business Transformation programme which is a key element of the Council's Financial Strategy to balance future years' budgets.

The Committee has also discussed the impact of the Public Private Partnership (PPP) model used for a number of the Council's school building programmes, and whose rising servicing burden also contributes to possible financial stress in the future in the absence of effective countervailing measures. The Scottish Futures Trust are undertaking a review of the Council's PPP contracts to ensure the contracts are operating effectively and the Council is receiving value for money. A report on the outcome of this exercise will be submitted to the Committee in due course.

Individual members of the Committee have raised questions about the capitalisation of equal pay settlements made to employees. Explanations were received from the Section 95 Officer and the External auditors that in 2009-10, the Scottish Government provided a scheme to local authorities to allow councils to settle equal pay claims where the need to borrow was supported by a strong business case. The Committee noted and accepted this explanation.

There have also been discussions on the new accounting requirements in relation to asset valuation effective for 2013-14 where it is recommended that each class of asset is valued during the same period to improve comparability year on year with assets of the same class.

Financial Management

The Committee also considered on 18 June 2013 and 18 March 2014 the funding position of the Council.

In general, the Council's cost of capital appears to reflect a positive market position, enjoying a marginally lower coupon on third party debt compared to other Scottish local authorities. In addition, it has access to Public Works Loan Board finance over long repayment profiles and has pre-funded capital expenditures to ensure matching at perceived attractive rates. The Committee is aware that professional advice is taken on the strategy regarding debt commitments.

On questioning, it has been explained that the Council's cash headroom appears adequate on all likely scenarios, including the known downward trends in rent and council tax collection. These issues will also be the subject of a further report in 2014/15.

Counter Fraud and Corruption

The Committee approved an Anti-Money Laundering policy in March 2014.

An interim report on the outcome of the data matching exercise, undertaken as part of the National Fraud Initiative, was presented to the Committee in March 2014. This identified a number of potential matches which are being investigated and a report on these is to be submitted to the June 2014 Audit Committee.

Midlothian has an established whistle blowing policy and various channels for reporting concerns confidentially which includes a reporting facility on the Council's website.

Conclusion

The Committee is functioning actively and within the terms of its remit. The Members are conscious that its deliberations do not determine budgets or the associated policies. Its role is thus to ensure the adequacy of governance and risk management arrangements, tackle financial irregularities and strengthen procedures where the available data suggest better processes are required.

In a small number of instances it is apparent that the enforceability of the Council's legal rights, is the central challenge to preserve full financial integrity. Recoverability issues will be an increasing concern going forward. However, the values are not critical to the operation of the Council compared to the challenge of deficits arising due to the overall financial position relative to the cost of outputs.

The Committee in 2014/15 will continue to review any perceived weaknesses in financial management but additionally will focus on the forward-looking strategies to manage the expected budget deficits over the coming years. In

this, a continuing emphasis on Value for Money will harmonise the aims of balancing the Council's financial position while generating optimal public benefit from the services provided by the Council.

Recommendation

The Audit Committee is invited to:

- approve and endorse the Chairman's report to Council; and
- consider and, if appropriate, recommend to Council amendments to the Standing Orders of the Audit Committee, as shown as shown in Appendix 1(attached).