

## **MIDLOTHIAN COUNCIL**

### **Audit Committee**

#### **Annual Report from the Chairman Year ended 31 March 2016**

#### **Introduction**

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

#### **Meetings**

The Committee met formally five times in the year. A briefing session is held between the Chairman and the Internal Audit Manager before each Audit Committee meeting. In addition the Chairman also meets with the Chief Executive, Director Resources, Head of Finance and Integrated Service Support (Section 95 Officer) and Internal Audit Manager before each Committee. The Chairman has also met Elected Members, Senior Officers and the External Auditors outside of these formal meetings.

Compared to the maximum possible 35 aggregate attendances at the Audit Committee of the permanent members of the Committee during 2015/16, 6 apologies for absence were received, representing an 81% attendance record.

#### **Membership**

The Audit Committee has a total of 8 members. There is an Independent Chair and from 22 September 2015 an Independent Voluntary Member was also appointed to the Committee. There are six Elected Members represented on the Committee (voting members). The quorum for meetings of the Committee of 3 Councillors was achieved at all meetings during the year. Five members of the Committee have private sector financial experience and related qualifications. The Chief Executive, the Director, Resources, Director, Education Communities and Economy, Director of Health and Social Care, and Head of Finance and Integrated Service Support are regularly in attendance; and other officers as appropriate. The Internal Audit team attended every meeting as did Grant Thornton, the Council's External Auditors.

#### **Governance**

The Committee operates under the Council's Standing Orders and its policy is to conform to the relevant CIPFA and Convention of Scottish Local Authorities

(COSLA) Codes and Position Statements, and recommendations for Best Practice. An assessment against these codes is shown at Appendix 1. In light of the CIPFA position statement, (issued in December 2013) alterations have been agreed to the Council's Standing orders in respect of the Audit Committee so as to continue in conformity with the CIPFA position (for example the need to assess value for money and approve the Audit Charter). These proposed changes, previously reported, require to be authorised, along with other changes to Standing Orders, by the full Council and this process is underway. The draft revised standing orders were presented to the Corporate Management Team on 22 March 2016 and they will be presented to Council in due course (including the revised Terms of Reference for the Audit Committee).

The Audit Committee Members were asked to complete a Core Knowledge Self Assessment in the prior year so that any training needs can be identified (Appendix 3). A training session will be held on 20 September 2016 with Grant Thornton, the External Auditors, to address any training needs.

The Committee is also conversant with Audit Scotland's reports on Midlothian and its publications generally regarding local government in Scotland. The Audit Committee receives regular reports from Council officers presenting the actions taken against these reports.

The Chairman and Committee Members have access to, and consult when appropriate, relevant publications of Audit Scotland, CIPFA, National Fraud Initiative (NFI), and relevant Accounting Standards. They also review the Council's Risk Management processes and Risk Registers, and monitor Internal Audit performance in terms of delivery of the Internal Audit Plan and the level of compliance against the Public Sector Internal Audit Standards.

The Members also review and have input to the Council's Annual Governance Statement (Appendix 2).

### **Assurance Framework**

The Annual Governance Statement is set out at Appendix 2. The table on page 5 of Appendix 2 sets out the actions proposed for 2016/17 to further improve the Council's assurance framework. These include: updating the procurement processes to comply with the new procurement legislation, updating the Code of Corporate Governance to comply with the new International Framework of Good Governance in the Public Sector, reviewing the Counter Fraud Policy and 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", undertake a high level assessment of the Council's readiness in relation to the risks posed by Serious Organised Crime and Corruption, and ensure that disaster recovery plans have been adequately tested and to monitor the on-going testing for this.

## **Internal Audit**

The Internal Audit team has had a complement of 4 FTE employees for the majority of 2015/16. An internal assessment against the Public Sector Internal Audit Standards (PSIAS) was reported to the Audit Committee on 10 May 2016 and this showed compliance against the code. A comprehensive checklist accompanied the report which was based on the agreed Scottish Local Authority Chief Internal Audit Group format. Going forward there will be a system of reciprocal assessments within local government with the first external assessment of Midlothian to be undertaken in 2016/17.

Grant Thornton's external audit report, published in September 2015, found the Internal Audit function to be operating satisfactorily. Grant Thornton noted that "overall Internal Audit have completed their plan for 2014/15 as agreed with the Audit Committee and have provided detailed updates to Committee".

In December 2015, the Committee noted the output position of the Internal Audit function. There had been 474 recommendations made in the prior three years, with 90% of the recommendations reported by management as implemented or "on target" to be implemented by the agreed date. The outlying 10% are the subject of continuing follow-up. This reflects a similar position to the previous year's performance (reported in December 2014) where 636 recommendations had been raised and 92% of these were reported as complete by management. The Internal Audit section is to sample a number of issues that have been reported as closed during the year and aims to report this to the June 2016 Audit Committee.

The Audit Committee considered and approved an Annual Assurance Report on the Internal Audit function submitted by the Internal Audit Manager for the financial year 2015/16. This report provided a summary of the work undertaken by the section in comparison to its plan and provided an overall opinion on the Council's system of control based on that work. This opinion was that overall the Council's framework of governance, risk management and control over the period 2015/16 was 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.

## **National Fraud Initiative**

Midlothian participate in the National Fraud Initiative led by Audit Scotland using data-matching techniques to identify potentially fraudulent activity involving social security payments and other entitlements, such as the Blue Badge disabled parking scheme. The work is ongoing but results so far identified a small number of overpaid benefits and discounts which suggest that the Council is not subject to widespread abuse.

## **Newbyres Housing**

The Audit Committee retain interest in the progress of potential litigation aimed at recovery of losses incurred by the Housing Revenue Account relating to advice given in the construction of 66 council residential properties, which have now been demolished in consequence of CO2 emissions and the absence of foundation membranes.

## **Newbyres Village Care Home**

The Audit Committee have noted an overspend position in 2015/16 of this Council-run care home. A material adverse variance against the staffing budget suggests that the cost base for the level of staffing required to provide care may have been underestimated. We are aware that the Council is focussed on achieving operational improvement and the Audit Committee will continue to monitor the situation to gain assurance that a normalised performance is occurring against appropriate measures.

## **Financial Monitoring and Financial Strategy**

The Committee has reviewed in 2015/16 regular reports submitted by the Head of Finance and Integrated Service Support in relation to Financial Monitoring, the General Services Capital Plan, Housing Revenue Account and the Financial Strategy.

The Committee has discussed (latest 15 March at quarter 3) the projected net overspend of £1.058m in relation to the General Fund Revenue Account for 2015/16 and has also reviewed the Financial Strategy for 2016/17 and the programmes to manage the projected financial gap (including approved savings, transformational programme, asset management and operational and financial discipline).

In 2014/15, the Council achieved Business Transformation savings of £0.9m compared to a revised target savings figure of £1.8m. Officers have assured us that savings involving early retirement for staff are achieving paybacks against cost which meet the requirements of the Voluntary Severance Early Release policy, and the programme as a whole is forecast to have further savings across a number of strands of work. The effectiveness of Business Transformation relative to cost remains under periodic review by the Audit Committee.

## **Progress Monitoring**

Internal Audit annually reviews whether a sample of recommendations has been implemented satisfactorily. In addition, a report is also prepared annually which details management's performance in closing issues by the agreed due date (as noted above). Both of these reports are presented to and discussed by the Audit Committee. In addition, specific matters are requested for follow-

up discussions at the point of initial discussion, as is required by the Standing Orders and evidenced through the Audit Committee minutes.

### **Effectiveness of Internal Controls**

The Committee has made several recommendations in 2015/16 and endorsed the recommendations made by the Internal and External Auditors. Recommendations made in respect of internal controls are monitored by the Internal Audit team. Additionally, the External Auditor reviews the effectiveness of the controls and systems.

Internal Audit reports directly to the Chief Executive, which strengthens the independence of the function. The External Auditor also noted in their September 2015 report that the Committee “is also well supported by Internal Audit, and by the Independent Chair, who provides additional perspective and financial expertise to the Committee”. The External Auditor’s review of IT controls in the 2014/15 audit report produced low-priority recommendations and identified that the controls operating were generally satisfactory. The issues identified in the review of IT controls are being followed up in the current year.

Although there is no specific caption in the Standing orders ([www.midlothian.gov.uk/download/downloads/id/61/standingorders](http://www.midlothian.gov.uk/download/downloads/id/61/standingorders)) at present which specifies that the Audit Committee should review best value (which is included in the revised version which still awaits Council approval), in practice this concept continues to determine the content of debates within the Audit Committee. In addition specific areas where unanticipated risks had been, or might be, encountered were discussed.

During the year, Internal Audit reports have identified weaknesses in the systems of internal control. Examples include: Developer Contributions where it was identified that there were monitoring weaknesses by the Council on when staged payments fall due and on the dates that contributions needed to be used by; the need to strengthen contractual relationships with third parties for specific programmes; and that some payments to subcontractors which fall under the Construction Industry Scheme were not treated appropriately.

Other reports submitted by Internal Audit have included: Commercial Lets, Payroll, Tendering of Contracts, House Rents, Early Years Partnership, Cashless Catering and Devolved School Management Budgets. These reports have been discussed by the Audit Committee and the recommendations made in the management actions plans have been endorsed. The Audit Committee has also requested follow up reports, to measure progress against the recommendations, on certain reviews including Following the Public Pound and Developer Contributions.

### **Financial Management and External Audit**

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

The principal discussion arose from a materially better-than-expected outturn. For the year ended 31 March 2015, when a £3.9m utilisation of reserves had been projected, the result was an improvement of £0.8m. This comprises an underspend of £3.2m and a positive income variance of £1.5m. On analysis, the spending variance is supported by a series of variances due to non-predictable favourable conditions (especially in Social Work and Adult Care).

There does not appear to be a systemic overconservative approach, but the Chairman of the Audit Committee has made himself available for further examination of forecasting methodology should there be subsequent significant variances ( whether positive or negative).

Uncommitted Reserves on the general fund account at 31 March 2015 were £12.84m, which is over 5% of net cost of services and above the level set out in the Council current reserves strategy. In real terms, the Council continues to face increases in demand and with restricted Scottish Government support, it continues to be the case that both efficiency gains and service reductions will be needed to ensure balancing of the revenue account in future years.

The Committee also reviewed favourably the Treasury management function. While the Council's cash deposit strategy for its reserves is supported by external professional advisors, caution was advised by the Committee as to the selection of overseas deposit-taking institutions.

## **Conclusion**

The Committee, in tandem with the Internal Audit function, has taken steps to streamline its workload by way of a more planned approach to subject scrutiny. It retains the flexibility to probe specific unanticipated problems, and increasingly views its work as related to assessing risks and not just enforcing good housekeeping as deficiencies become apparent, important though that function remains.

The Committee in 2016/17 will thus continue to question any perceived weaknesses in internal controls and will also focus on the Council's forward-looking strategy for stabilising the Consolidated Income and Expenditure account. In this a continuing emphasis on Value for Money harmonises the aims of balancing the Council's financial position while generating optimal public benefit from the Council's operations.

The Audit Committee has also been monitoring progress with the role out of the new Health and Social Care Integration Joint Board and has received an Internal Audit report on the financial assurance process undertaken over amounts delegated by the Council to the new Board. The Audit Committee will be involved in scrutinising the outturns from this in future years.