Midlothian

Internal Audit Report

Tyne Esk LEADER

Issued: 24 October 2016

Final

Level of Assurance	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.

Executive Summary

1.0 Introduction

This report has been prepared following an internal audit of the Tyne Esk LEADER (Liaison Entre Actions de Developpement de l'Economie Rurale) Programme. This report covers the work of the Tyne Esk LEADER programme from the signing of the Service Level Agreement (SLA) between Midlothian Council and the Scottish Government on 30 December 2015 to the close out of this year's Internal Audit review in October 2016. The SLA requires that Internal Audit undertake an assessment annually of the extent of observance by the Accountable Body (Midlothian Council) of the requirements of the SLA.

The Tyne Esk LEADER Programme is part of the Scottish Rural Development Programme (SRDP) aimed at promoting economic and Community development within rural areas in Midlothian and East Lothian. The SRDP is part of the EU Common Agricultural Policy and is funded by the European Commission and the Scottish Government. LEADER is a bottom-up method of delivering support to communities for rural development. Grants are awarded by Local Action Groups (LAGs) to projects that support delivery of a Local Development Strategy. For each LAG there is an Accountable Body to support the administration of the programme.

At the close of the 2007-2013 LEADER Programme it was proposed that Midlothian Council would pursue the role as lead Accountable Body for the new 2014-2020 Programme. This decision was supported by the previous LAG and Midlothian and East Lothian Council. As the Accountable Body, Midlothian Council has delegated responsibility for a range of processing, payment, and administration functions as set out in the SLA. This includes all aspects associated with the implementation of the approved Local Development Strategy, such as the presentation, assessment and clearance of applications through the LAGs, and the subsequent approval and post approval case management functions.

There are a total of 21 LEADER programmes established throughout Scotland, and each of these is governed by a separate Local Action Group. The Tyne Esk Local Action Group for the new 2014-2020 programme has 15 individual members (maximum size of 16) and these were selected through a competitive process. The LAG has a minimum 51-49% split between private and public sector in line with Scottish Government guidance. The chair and vice chair have been elected through a democratic process. In order for the LAG to be quorate there must be a minimum of 9 members, with at least 5 drawn from the private sector.

Midlothian Council has received an indicative funding allocation from the Scottish Government of £3,490,769 to administer a LEADER Programme throughout the rural areas of Midlothian and East Lothian. This programme will deliver the priorities set in the Tyne Esk LEADER Local Development Strategy (LDS).

The Scottish Government informed the Council on 14 September 2016 that due to the uncertainty following the vote to leave the EU, the LEADER Programme will be temporarily paused from 23 November until January 2017. This was so that the Scottish Government could take on board any developments arising from the UK Government's Autumn Statement on the 24 November and reassess all EU funding programmes. However, the Scottish Government has now informed the LEADER Programmes that they will honour any grant commitments made and the pause to the programme announced earlier will no longer apply. While the LEADER Programmes still do not know the exact end date of the programme, the Scottish Government has confirmed that they intend to honour grant commitments for the foreseeable future. The teams anticipate this to be at least until Spring 2019.

The LAG has met 5 times since its first meeting on 25 November 2015 with the chair of the LAG being elected on this date.

The application process for LEADER is as follows:
- the applicant will submit an Expression of Interest form through the Scottish Rural Network website. Through this website the applicant will select their LAG area (eg Tyne Esk);
- a member of the LEADER staff team will then meet with the applicant to discuss the project in more detail;
- a summary of the Expression of Interest will be sent to the LAG for initial evaluation;
- the LEADER team will provide further guidance to the applicant so the applicant can prepare to make a full application to the LAG;
- the LEADER team will provide a username and password to the applicant to the Local Actions in Rural Communities system (LARCs). LARCs is the grants management system provided by the Scottish Government which covers the process of applying for LEADER funding and for the completion of claim forms for the drawdown of funds;
- the applicant will then complete their application and provide to the LEADER team appropriate information as required by the guidance (eg financial accounts or planning permission where relevant);
- LEADER staff will work with applicant to develop the project before submitting to the LAG for an assessment and decision; then
- the project will be submitted to the LAG for approval.

As at 30 September 2016, a total of 52 Expression of Interests have been received for the Tyne Esk Leader Programme. It is anticipated that 4 applications will be presented to the October LAG, and a further 3 in November. A total of £16,362 has been claimed back from the Scottish Government for the program, but this figure is wholly made up of administration costs (mainly advertising and salaries) as no grants have yet been awarded.

No applications had been submitted to the LAG for approval at the time of the audit (September 2016), therefore this audit focussed on providing assurance that adequate processes and governance were in place in preparation for projects being funded.

2.0 Objectives of the Audit

The audit objective is to provide assurance on the adequacy of the internal controls in place for the administration of the Tyne Esk LEADER Programme.

A copy of the terms of reference for the review is attached on page **12.**

3.0 Conclusion

Our audit identified that management have made good progress in implementing systems, internal controls, and procedures for the Tyne Esk LEADER Programme. However, as noted above, as no grants have yet been awarded our testing was limited to reviewing the programme's governance and internal processes. No grant applications were reviewed as part of the audit.

During the course of the audit we noted the following strengths:
- adequate arrangements have been established to ensure that compliance with the SLA is monitored;
- clear governance arrangements have been established for the Council and the LAG;
- satisfactory arrangements are in place for reviewing funding applications, handling enquiries, and initial project application development,
- appropriate processes are in place for the processing of LEADER administration grant applications and claims, including information and evidence compilation, records management, separation of duties, compliance with grant claim regulations, and communication with the Scottish Government team.

Some areas were identified with scope for improvement. These were:
- the register of interests form has not been completed by employees and all LAG members;
- there is currently inadequate storage facilities within the Economic Development team to store all physical files and many are currently being held in employee's personal lockers. Storage of detailed physical files for each grant applicant is a mandatory requirement in the Scottish Government's guidance;
- Midlothian's LEADER team needs to seek further clarification from the Scottish Government on some aspects of the programme, including: whether the Key Performance Indicators (KPIs) for the Tyne Esk LEADER programme have been formally accepted; if further refinement is required on the Local Development Strategy (LDS); clarification on the Data Sharing Agreement between the Council and the Scottish Government; clarification if the LEADER team has any requirements in relation to ISO 27001 (an international standard that

describes best practice for an information security management system) as the standard is referenced to in an EU regulation included in the SLA, and the process to follow if a grant recipient is in financial difficulties;

- it was noted that although the website provides a range of useful information, more information could be provided including, for example, minutes of LAG meetings and names of LAG members. Also, the Tyne Esk LEADER website should limit access of LAG members to 'read-only' and ensure passwords are of adequate strength; and
- whilst the minutes are to a good standard, it was identified that they could be improved by making it clearer within the body of the minutes as to whether a policy or new procedure was approved on that day by the LAG.

Given that the control framework is of a good standard with only minor elements of risks identified we have rated the strength of the internal controls over the Tyne Esk LEADER Programme as **Good**. We have raised a number of recommendations which are detailed in the Management Action Plan to reduce risk further and these recommendations have been agreed by management.

4.0 Findings

4.1   Register of Interests

The SLA requires that an up to date register of interests must be held for LAG members. The Council has to ensure that:
- No close relative of an individual applicant or an employee or representative of an organisation applying for funding can:
  - participate in the LAG decision making process; or
  - score an application from that applicant (which, for the avoidance of doubt, may include the Council).
- Additionally, the Council must ensure that no close relative of an individual applicant be involved in any monitoring or inspection activities relating to the applicant.

A satisfactory register of interests form has been drafted and distributed to LAG members in order for the Council to create an up to date register of interests. However, not all LAG members have completed and returned this form. In addition employees associated with the administration and monitoring of applications have not been requested to complete a register of interests form.

Also, it was noted that the SLA provides clear guidance on Conflicts of Interest but the LAG Operating Protocol and Code of Conduct uses different guidance which could result in inconsistencies and the requirements of the SLA not being adhered to.

No	Recommendation	Priority	Manager	Target Date
1	As a matter of urgency all LAG members and LAG observers must complete and return their register of interests form. LAG members should be prevented from voting until this has been completed and returned. Additionally, LAG members who fail to keep their register of interest up to date should be barred from voting on applications until this is returned.	High	LEADER Programme Co-ordinator	30/11/2016
2	The register of interest form should be completed by relevant employees as they will be undertaking project development and monitoring duties.	High	LEADER Programme Co-ordinator	Complete
3	In order for the conflicts of interest register to remain up-to-date, members should be requested to complete a register of interest form on an annual basis. LAG members	High	LEADER Programme	30/11/2016

No	Recommendation	Priority	Manager	Target Date
	should be advised to inform the LEADER Programme Co-ordinator if there are changes in the interim.		Co-ordinator	
4	The Honesty & Integrity (and Conflicts of Interest) section within the LAG Operating Protocol and Code of Conduct should be updated to include the specific wording and conditions included within the SLA.	Medium	LEADER Programme Co-ordinator	31/12/2016

4.2   Records Management

The Scottish Government Animation and Administration Guidance notes that while grant applications and supporting documentation will be recorded and held on LARCS, any documents that are intended to create legal rights and obligations – such as grant award letters, contracts and undertakings etc – which are still physically signed, must be retained as hard copies.

The guidance requires that a detailed physical file must be kept for every application. The master file (hard copy) must contain the audit trail of all key original documents as described above. This includes all documents that were part of the decision-making process leading to funding approval, withdrawal or rejection of a LEADER case, and any decisions thereafter (e.g. change requests and inspections). An index must be kept in the front of the file that identifies key documents such as the LAG assessment and the signed copy of the contract.

Currently there are inadequate facilities in Economic Development for the storage of physical files. Files for applicants are being stored in employee's personal lockers instead of a secure cabinet.

No	Recommendation	Priority	Manager	Target Date
5	Steps must be taken immediately to ensure there is adequate storage for all LEADER files. Storage must be secure due to the sensitive nature of the information held.	High	Head of Communities and Economy	30/11/2016

4.3   Governance and Communication

A LAG protocol has been established setting out the role, management responsibilities, and functions of the group. Minutes are prepared for all LAG meetings and a check is carried out by the LEADER Programme Co-ordinator at the start of each meeting to ensure that the LAG is quorate. It was noted that although the minutes are of a good standard, more clarity could be added to the minutes of when specific policy items have been agreed (eg the group protocol and the scoring framework being approved).

A new website with a user-friendly design has been launched for the Tyne Esk LEADER programme. The website is being used as the primary means of communication with potential applicants. It includes the latest news on the programme, successful case studies, details on how to apply and relevant contact information.

It was agreed with the Tyne Esk Leader Co-ordinator that more relevant information could be provided on the website. To improve transparency of decision making, consideration should be given to including minutes of meetings, the LAG protocol (the document which states the purpose and terms of reference of the LAG) and names of LAG members in an effort to improve transparency and minimise potential Freedom of Information requests.

It would be helpful to applicants if the website detailed the types of funding LEADER cannot fund (a standard list has been included in the LEADER guidance). Also, as LEADER requires match funding for various types of projects (ie LEADER is only funding part of the project) it would be helpful if the website provided a list of potential match funders.

The website provides additional information to LAG members and Midlothian LEADER employees in the member's section of the website. It was noted that all users with access to the member's section could edit the website as they have been provided with 'update' access rather than 'read-only' access. Additionally, it was noted that the strength of the password provided to Internal Audit for access to the website was deemed to be weak.

No	Recommendation	Priority	Manager	Target Date
6	The LEADER Programme Co-ordinator should ensure that for all LAG minutes it is clearly noted when a specific decision has been made by the LAG (eg for the approval of a policy or any other decision made by the LAG).	Medium	LEADER Programme Co-ordinator	Complete
7	Consideration should be given to including minutes of meetings (provided they are not confidential eg individual LAG member decisions on grants), the LAG protocol (the document which states the purpose and terms of reference of the LAG) and names of LAG members on the website.

Additionally, the website should include sections on the types of projects LEADER can fund and a list of potential match funders to assist applicants | Medium | LEADER Programme Co-ordinator | 31/12/2016 |
| 8 | Amendments should be made to the website so the access provided to LAG members is read-only. Minimum password strength standards should be enforced for access to | High | LEADER Programme | 31/12/2016 |

No	Recommendation	Priority	Manager	Target Date
	the member's area of the website.		Co-ordinator	

4.4 Risk Register and Issues Log

A risk register has been drafted for the programme. The risk register accurately captures the key risks of the programme, but the following was noted:

- the risk register has not been uploaded to the Council's Performance Management and Risk Management system, Covalent;
- the risks have not yet been rated;
- the register has not yet been presented to the LAG; and
- an issue on the risk register requires feedback from the Scottish Government (the correct approach to take if a grant recipient is in financial difficulties).

Additionally, it is best practice that an issues log of the key issues the programme is currently working on is compiled and communicated to LAG members.

No	Recommendation	Priority	Manager	Target Date
9	The LEADER programme risks should be uploaded to Covalent, rated and the register presented to the LAG on a regular basis.	Medium	LEADER Programme Co-ordinator	31/12/2016
10	Feedback should be obtained from the Scottish Government on what to do if the grant recipient is in financial difficulties and appropriate internal guidance updated.	Medium	LEADER Programme Co-ordinator	31/12/2016
11	A project issues log should be drafted and communicated to LAG members.	Medium	LEADER Programme Co-ordinator	31/12/2016

4.5   Clarification on Aspects of the Programme

During the course of the audit some areas were identified where further clarification is needed on the correct approach for Midlothian's LEADER team to take. Clarification needs to be provided on the following:

- the Local Development Strategy (LDS) outlines the priorities of the Tyne Esk LEADER fund. The LDS is the strategic document for the utilisation of LEADER funds by the LAG and must be well understood by LEADER employees and LAGs. The application guidance notes that this is a live document and may evolve over the lifetime of the project and that formal changes must be notified to the Scottish Government. The LEADER team should clarify if that means that a formal review is required for the LDS during the lifetime of the programme;
- although a range of guidance has been received from the Scottish Government for the management of the programme, clarity needs to be provided from the Scottish Government that this is the full list of guidance and that these are the most up-to-date versions;
- the LARCS system has been updated with the Key Performance Indicators that the LEADER team and LAG have decided to proceed with for reviewing the success of projects. Formal confirmation should be obtained from the Scottish Government's LEADER contact that they are satisfied with the KPIs selected;
- at the most recent Accountable Bodies meeting on 9 June 2016 various queries were raised on the Data Sharing Agreement between the Councils involved in LEADER programmes and the Scottish Government. The LEADER team should keep up to date with developments on this and contribute where appropriate; and
- the SLA references an EU regulation which seems to place requirements in relation to ISO 27001 accreditation for information systems security (an international standard that describes best practice for an information security management system). The LEADER team should liaise with LEADER Scottish Government contacts to confirm if the Council has to review any aspects of compliance with this for the purpose of the LEADER programme as the Council does not have ISO27001 accreditation. This is an issue for most Scottish Local Authorities and was discussed at the 9 June 2016 Accountable Bodies Group Meeting.

No	Recommendation	Priority	Manager	Target Date
12	The LEADER team should clarify with the Scottish Government the queries raised by Internal Audit and take appropriate action if required.	Medium	LEADER Programme Co-ordinator	31/12/2016

APPENDIX 1

Definitions of Ratings

<u>Audit Opinion</u>

Level of Control	Reason for the level of Assurance given
Excellent	The control framework is of a high standard with no unacceptable risks identified.
Good	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.
Average	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
Weak	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.
Poor	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.

<u>Recommendation Rating</u>

Priority	Risk Definition
High	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
Medium	£5K - £49K and / or local press interest
Low	Under £5K and / or no press interest.

Distribution

- Members of the Audit Committee
- Kenneth Lawrie, Chief Executive
- Mary Smith, Director, Education, Communities and Economy
- Ian Johnson, Head of Communities and Economy
- John Beveridge, Economic Development Manager
- Neil Ramsay, LEADER Programme Co-ordinator

Audit Team

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APPENDIX 2

TERMS OF REFERENCE:

Audit Objective and Scope

Audit Background:

The LEADER (Liaison Entre Actions de Developpement de l'Economie Rurale) programme is one element of the Scotland Rural Development Programme 2014-2020 (SRDP) which aims to promote economic and community development within rural areas of Scotland.

On approval from the Scottish Government, Midlothian Council as the Accountable Body for the Tyne Esk LEADER programme has been issued with a Service Level Agreement (SLA). This details the relationship between the Council and the Scottish Government and also the requirements, responsibilities and accountabilities of each for the Programme period 2014-20.

The SLA between the Scottish Government and Midlothian Council requires an annual internal audit of the functions and services undertaken by the Council in fulfilment of its role as the Accountable Body. This internal audit assessment includes the extent of observance by the Accountable Body of the requirements of the SLA.

In the case of Tyne Esk LEADER, the SLA was signed on 30 December 2015. The annual reporting date for the SLA is 15 October. The funding allocation for the Tyne Esk Leader Programme is £3,490,768, with 25% of this budget being for administration of the programme.

Primary Activities Over Course of Year:

The primary focus of the LAG over the course of the year in relation to its role in LEADER has been:
- Contribution to national work in developing LEADER systems and processes;
- recruitment of administration staff to oversee the delivery of the Programme;
- development of internal governance procedures and administrative systems;
- establishment of the LAG and 3 subgroups looking at Communications, Governance and Farm Diversification and Rural Enterprise; and
- promotion of the Programme throughout the area and responding to Expressions of Interest by those interested in applying to the Tyne Esk LEADER Fund.

At the time of writing this specification, there has been no activity in terms of formal approval of LEADER projects and therefore no grant awards, nor claims submitted to the LAG's team, nor flow of finance to applicants. The closing date for the first round of grant applications is 5 September 2016. Grants will start being awarded after this date. The projects funded will be for a period of up to two years.

Midlothian Council, as the Accountable Body, has not yet submitted claims to the Scottish Government for the administration component of LEADER grants, but will submit two claims during the fieldwork stage of the audit.

Audit Objective:

The audit objective is to provide assurance on the adequacy of the internal controls in place for the administration of the Tyne Esk LEADER Programme.

In light of the stage of development of the LEADER programme nationally and within Tyne Esk, the internal audit for year 1 of the operation of the SLA will cover the following:

1. Review of the terms of the SLA and arrangements in place within Midlothian Council to cover these terms, and any associated European Union Regulations.
2. Review of the clarity of governance and management processes in place to establish the roles of the LAG and the Council.
3. Review of the administration processes implemented within the Tyne Esk LEADER team, including all aspects of records management and information sharing undertaken by the Accountable Body and the LAG / LEADER team.
4. Review of processes for consideration of project and funding applications: handling of enquires; consideration of expressions of interest; any initial project application development; scoring and decision making processes by the LAG; and the adequacy of the framework for monitoring the performance grant recipients.
5. Review of the LEADER administration grant claim processes, to include adequacy of:
   a. information and evidence compilation;
   b. records management systems;
   c. separation of duties;
   d. compliance with grant claim regulations;
   e. effectiveness of communications between the Accountable Body and the Scottish Government team.

Regulatory Framework

The areas for internal audit review set out here should, through delivery of requirements under the SLA, satisfy the requirements of the following European Union Regulations:

- The eligibility requirements of Common Provisions Regulation 1303/2013 and specifically article 34 sets out the design and implementation of the LAG, including the selection of the Accountable Body, quorate balance of the LAG and the receiving and assessing of applications.
- Admin and control compliance requirements of Regulation 809/2014: covers all the admin checks, including in situ visits, On the Spot and Ex Post checks and how penalties are applied (although these latter aspects are not relevant to the current phase of LEADER delivery).
- Accreditation Annex of supplementing regulation 907/2014: Sets out the control activities for payments and penalties, monitoring and control activities and the requirement to keep an audit trail. (This year 1 audit is likely to be limited to consideration of arrangements in place to support appropriate audit trails and planned control activities as there are unlikely to be any live project samples at the time of audit.)
- Eligibility requirements of Rural Development Regulation 1305/2013 and specifically articles 42, 43 and 44: details the additional tasks referred to in article 34 that can be carried out by the LAGs i.e. co-operation.
- The financing management and monitoring requirements of 1306/2013: Covers the management and control systems put in place by member states.

In making any audit recommendations arising from consideration of the regulatory framework, the audit report should specify whether the internal systems established by Midlothian Council and the Tyne Esk Local Action Group require action and / or whether changes are required to the SLA document itself.

Exclusions and Limitations

 No specific exclusions.

Potential Risks

Potential risks include:
- non-compliance with the EU monitoring requirements resulting in fines, non-payment of grant, or reputational damage;
- grants are awarded to organisations that fail to meet their planned objectives; and

- lack of effective controls may lead to errors or irregularities occurring.

Audit Approach

The audit approach consists of:
- fact finding interviews with key employees;
- review of appropriate documentation which includes any risk reviews that have been conducted and risk registers that are in place;
- 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 Midlothian Council's Audit Committee; and
- submission of the final report to the LAG and the Scottish Government.

The Internal Audit Report will be expected to inform:
- the LAG in its responsibility for delivering the Tyne Esk LEADER programme;
- Midlothian Council in its role as Accountable Body and in delivering the SLA; and
- the Scottish Government in their management of the SLA.

Timescales & Reporting

The Audit will commence in July 2016 and is anticipated to be reported to the September 2016 Audit Committee.

Information Requirements

Access to all relevant systems, documentation and employees.

Audit Resource

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