

Internal Audit Annual Assurance Report 2019/20

Report by Chief Internal Auditor

1. Purpose of the Report

- 1.1 The purpose of this report is to present to the Audit Committee the Internal Audit Annual Assurance Report for the year to 31 March 2020 which includes the Chief Internal Auditor's independent assurance opinion on the adequacy of Midlothian Council's overall control environment.

2. Background

- 2.1 The Local Authority Accounts (Scotland) Regulations 2014 that came into force on 10 October 2014 require a local authority to operate a professional and objective internal auditing service. This service must be provided in accordance with recognised standards and practices in relation to internal auditing. Recognised standards and practices are those set out in the *Public Sector Internal Audit Standards: Applying the IIA International Standards to the UK Public Sector* (PSIAS). The standards require internal audit to have suitable operational independence from the organisation.
- 2.2 The Public Sector Internal Audit Standards (PSIAS) 2017 require that: "The chief audit executive [MLC's Chief Internal Auditor] must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement. The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. The annual report must incorporate:
- the opinion;
 - a summary of the work that supports the opinion; and
 - a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme."
- 2.3 The Terms of Reference of the Midlothian Council Audit Committee states:
1. The Audit Committee is a key component of Midlothian Council's corporate governance. It provides an independent and high-level focus on the audit, assurance and reporting arrangements that underpin good governance and financial standards.
 2. The purpose of the Audit Committee is to provide independent assurance to Elected Members of the adequacy of the risk management framework and the internal control environment. It

provides independent review of Midlothian Council's governance, risk management and control frameworks, and oversees the financial reporting and annual governance processes. It oversees Internal and External Audit, helping to ensure efficient and effective assurance arrangements are in place.

3. Internal Audit Annual Assurance Report 2019/20

- 3.1 The Internal Audit Annual Assurance Report 2019/20, at Appendix 1, includes the Chief Internal Auditor's independent and objective opinion regarding the adequacy and effectiveness of internal control within Midlothian Council to fulfil the statutory role of Internal Audit, provides details of the Internal Audit activity that supports the opinion and of the performance during the year, and summarises the outcomes of assessments of the Internal Audit service against the Public Sector Internal Audit Standards.
- 3.2 The Internal Audit Annual Assurance Report 2019/20 provides assurances in relation to the Council's corporate governance framework that is a key component in underpinning delivery of the corporate priorities within the Single Midlothian Plan and has been used to inform the Annual Governance Statement 2019/20.

4. Report Implications

4.1 Resource

The Internal Audit function reports directly to the Chief Executive (operationally) and the Audit Committee (functionally). Staff resources have been adversely affected during the year, mostly notably due the continued deployment of Internal Audit and Counter Fraud resources to the ongoing counter fraud activity and in March 2020 due to the Council's emergency response associated with COVID-19. This has had an impact on the delivery of the Internal Audit planned work which is reflected in the Internal Audit Annual Assurance Report 2019/20 (Appendix 1).

There is a commitment by Midlothian Council to provide Internal Audit resources to the Midlothian Health and Social Care Integration Joint Board (MIJB) and audit work was undertaken during the year to meet that commitment. A separate annual assurance report will be presented to MIJB Audit and Risk Committee and MIJB to fulfil that role.

4.2 Risk

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process. Each Internal Audit engagement has been risk-based and, where appropriate, has tested the specific Service's management of risk.

Internal Audit provides assurance to the Corporate Management Team and the Audit Committee on the adequacy and effectiveness of internal controls and governance within the Council, including risk

management, and to highlight good practice and recommend improvements. Key components of the audit planning process include a clear understanding of the Council's functions, associated risks, and range and breadth of audit areas for inclusion within the Annual Plan.

Improvements in internal controls and governance arrangements can be demonstrated through Management-initiated actions complemented by the implementation of Audit recommendations.

It is anticipated that further improvements in the management and mitigation of risks will arise as a direct result of Management implementing the Internal Audit recommendations made during the year or outstanding from previous years which will enable Management to demonstrate further improvement in internal controls and governance arrangements.

Delivery of the Internal Audit services in conformance with the PSIAS will enable the Council to meet the requirements of the Local Authority Accounts (Scotland) Regulations 2014 to consider the findings of assessments as part of the consideration of the system of internal control required by regulation 5.

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 the Single Midlothian Plan

Midlothian Council and its Community Planning Partners include the following areas as key priorities under the Single Midlothian Plan:

- Reducing the gap in learning outcomes
- Reducing the gap in health outcomes
- Reducing the gap in economic circumstances

4.5 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year assists the Council in improving its performance and outcomes.

4.6 Adopting a Preventative Approach

Internal Audit assurance work includes assessments on when a preventative approach can be adopted.

4.7 Involving Communities and Other Stakeholders

The Internal Audit Annual Assurance Report 2019/20 has been presented to senior management at an SRG meeting on 3 June 2020 (comprising Chief Executive, Executive Directors, Chief Officers and Heads of Service) to outline the key messages of assurance and areas of improvement, and have been advised to take this into account when completing their annual self-evaluation and assurance process for the Council's Annual Governance Statement 2019/20.

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. Recommendations

The Audit Committee is therefore asked to consider the Internal Audit Annual Assurance Report 2019/20 (Appendix 1), and assurances contained therein, and to provide any commentary thereon.

Date: 14 May 2020
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Chief Internal Auditor's Annual Assurance Report and Opinion 2019/20 for Midlothian Council

1 Introduction

- 1.1 It is Management's responsibility to design and maintain proper risk management, governance and internal control processes and systems to ensure probity in systems and operations, including the prevention, detection and resolution of fraud and irregularities. Management is also responsible for checking that the arrangements and controls are operating effectively. These are known as the first and second lines of defence which are not fixed but evolve as the Council changes.
- 1.2 Internal Audit, as the third line of defence, is an independent appraisal function established for the review of the internal control system as a service to Midlothian Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk.
- 1.3 The Internal Audit activity adds value to the organisation (and its stakeholders) when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management and control processes; and objectively provides relevant assurance.
- 1.4 The Objectives of Internal Audit are set out in its Charter: "As part of Midlothian Council's system of corporate governance, Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives and to do so:
- In support of the Council's vision, values and priorities.
 - As a contribution to the Council's corporate management of risk.
 - As an aid to ensuring that the Council and its elected members, employees and contracted third parties are operating within the law and relevant regulations.
 - As a contribution towards establishing and maintaining a culture of honesty, integrity, openness, accountability and transparency throughout the Council in all its activities and transactions.
 - As a contribution towards ensuring that financial statements and other published information are accurate and reliable."
- 1.5 The Public Sector Internal Audit Standards (PSIAS) (2017) requires that:
- "The chief audit executive must deliver an annual internal audit opinion and report that can be used by the organisation to inform its governance statement.
- The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control.
- The annual report must incorporate:
- the opinion;
 - a summary of the work that supports the opinion; and
 - a statement on conformance with the Public Sector Internal Audit Standards and the results of the quality assurance and improvement programme."
- 1.6 This Annual Assurance Report provides the annual internal audit opinion to fulfil the statutory role of Internal Audit and summarises the work carried out by Internal Audit during the year to 31 March 2020 that underpins the opinion in accordance with the Internal Audit Charter, Strategy and Annual Plan. The report also states the outcomes of assessments of the Internal Audit service against the PSIAS.

2 Opinion on the systems of Internal Control, Risk Management and Governance

- 2.1 My opinion is that, based on our reviews, risk assessments and knowledge, the systems of internal control and governance are generally adequate with improvements having been made during the year. The implementation of further Audit recommendations as part of a culture of continuous improvement is of importance particularly relating to the strategic governance arrangements that underpin procurement and contract management, financial management, workforce development, and delivery of change and transformation.
- 2.2 The Council's Local Code of Corporate Governance (approved December 2017) complies with the CIPFA/SOLACE Framework 'Delivering Good Governance in Local Government' (2016). The Local Code has been updated as part of Internal Audit's assessment of internal control and governance to include comprehensive evidence against each of the seven principles of good governance and sub-principles. The updated Local Code will require approval by Council to ensure this key document continues to be relevant and complete to reflect the appropriate framework for effective governance of the Council's affairs and facilitate the exercise of its functions to deliver best value.
- 2.3 The Council recognises that Risk Management is an integral part of all activities and has Corporate and Service Risk Registers in place which are subject to regular review by those Managers who are allocated the responsibilities for managing individual risks. The Audit Committee received reports from the Risk Manager each quarter outlining corporate risks and mitigations to fulfil its oversight role to monitor the effective development and operation of risk management in the Council, though Members were not aware of when the Risk Management Policy and Strategy were most recently reviewed and scrutinised.
- 2.4 The Financial Regulations (approved July 2012), and associated policies, procedures and guidelines need to be reviewed, updated and developed, as appropriate, to reflect changes arising from organisation structures and systems and then be kept under regular review.
- 2.5 Improvements over the Council's capital planning arrangements are required to apply the Accounts Commission good practice guide 'Major capital investment in Councils'. A long term Capital Investment Strategy is in place. The Capital Plan and Asset Management Board (CPAMB) agreed to subject new Capital projects >£1M to a gateway review. The timeframes of the underlying Asset Strategies require aligning and Asset Management Plans require updating before projects can be effectively prioritised. The CPAMB should focus on its roles and responsibilities within its terms of reference to provide more effective scrutiny and challenge for capital planning, ensuring that projects included in the plan fit with strategic priorities and are affordable and realistically deliverable within stated timescales.
- 2.6 Further improvements in internal control, risk management and governance have been agreed by Management as highlighted in Internal Audit reports and recommendations made during the year or outstanding from previous years.
- 2.7 The significant incident which commenced in late March 2020 in response to the Covid-19 pandemic tested how well the risk management framework is operating. There were examples of innovations, new business processes and solutions, and new technology being embraced in order to deliver services to the community in the Council's role as Category 1 responder to carry out the following three essential functions: Caring for the Vulnerable; Liaising with Resilience Partners; and Supporting Economic Recovery. This was achieved using amended governance arrangements, new ways of decision-making, leadership and implementation including virtual meetings, conference calls, and systems remote access. Internal Audit were suitably informed of or engaged in changes in governance and internal controls. It will be important for the Council, at the appropriate time, to carry out a post-incident review and highlight any lessons learned.

3 Internal Audit Annual Plan 2019/20 Delivery

- 3.1 Internal Audit staff resources had been adversely affected during the first half of the year, mostly notably due the continued deployment, over and above the Plan Days, of Internal Audit resources to the ongoing corporate fraud investigations. This had reduced Internal Audit output during the first half of the year. The continuation of the Interim Internal Auditor to offset the full deployment of the two Fraud and Audit Officers on investigations and other corporate fraud work (non-Internal Audit work) in the second half of the year has enabled the completion of delayed work at the half year and the remaining planned audit work with one exception. In March 2020, due to the Council's emergency response associated with COVID-19 pandemic and adherence to national guidelines, the whole team were working from home. This has had a minor impact on the delivery of the Internal Audit planned work mainly due to the time of year.
- 3.2 The following Audit from the 2019/20 Audit Plan has not been carried out as a result of a request by Management to delay due to the Council's Covid-19 emergency response:
- Automated Invoice Payments (Deferred to 2020/21 though Internal Audit staff undertook training in early March 2020 on the system-based authorisation controls, including segregation of duties, and security controls over payments).
- 3.3 The range and breadth of Internal Audit work that has been performed during the year, which is listed below, is sufficient to inform the Internal Audit assurance on the systems of internal control, governance arrangements and risk management. For one audit marked^ the draft report was issued and Management Responses were awaited and for two audits marked* the draft reports were not issued; these will be pending until there is Management capacity, post-Covid-19 incident, to conclude to the finalisation of reports:

Strategic and Risk Based Audits

- 3.4 To provide assurance on the internal controls, risk management and governance arrangements in place to ensure efficient and effective use of assets and resources and achievement of strategic objectives, reviews included:
- Change and Transformation Programme (Monitor implementation of improvements to the governance and accountability arrangements for the change and transformation programme including processes for benefit (financial and other) identification, tracking and realisation).
 - Business Planning, Budget Setting and Monitoring (Evaluate the implementation of improvements to ensure that budgets set for 2019/20 are sustainable and based on realistic plans, and that appropriate scrutiny and challenge is undertaken on revenue budget monitoring reports to enable service delivery within approved budget).
 - Workforce Planning (Follow-up on implementation of previous recommendations to improve workforce strategy and planning processes to provide skills, knowledge and competency requirements for service delivery to meet the Council's objectives).
 - Procurement and Management of Contracts (Review the processes and internal controls relating to the procurement journey to ensure these adequately address the key risks, and assess compliance with the procurement framework and adequacy of contract monitoring arrangements).
 - Information Governance – Records Management (Review the Information Governance framework, specifically on the theme of Records Management i.e. Plan and actions to comply with good practice)*
 - Capital Investment (High level review of the established control framework and governance arrangements in place to plan Capital Investment projects).

Core Process / System Audits

3.5 To provide assurance on the internal controls in place and perform substantive testing of transactions to ensure completeness and accuracy of data in core systems, reviews included:

- Leisure Management Booking System (Evaluate the income management controls on Leisure Management online booking systems to ensure income is accurately collected)*
- Attendance Management (Assess the controls in place to manage sickness absence across the Council, including compliance with policy and procedures, which underpin the effective use of resources).
- Social Care Income Charging, Billing and Collection (Review the mechanisms in place to raise charges for Social Care clients in a timely manner and the process of collection and recovery of those charges, including the reliance upon various elements, namely: Care Plan, Funding, Contract, and Financial Assessment).
- Asset Registers (Review of systems, processes and controls that are in place to ensure complete and accurate records of all Property, Fleet, and IT assets that underpin Asset Management Plans to deliver Council's strategies, plans and priorities).
- Environmental Health (Review the business practices and ways of working within Environmental Health to ensure that regulatory obligations are met and risks are appropriately managed).

Assurance Audits Carried Forward from 2018/19

3.6 To provide assurance on the internal controls in place, reviews included:

- Community Empowerment (Review the implementation of the requirements of the Community Empowerment (Scotland) Act 2015).
- ICT Operational Processes (Evaluate the change / incident / problem management operational controls to ensure they are designed appropriately and that all parties are adhering to them. Assess response to Audit Scotland report May 2017 "Principles for a digital future: Lessons learned from public sector ICT projects")^
- Commercial Rents (Assess internal financial controls and governance arrangements linked to Corporate priorities, including estate management).
- Electronic Payment Systems (Review of security and authorisation controls, including segregation of duties).

Legislative and Other Compliance Audits

3.7 To test compliance with the terms of the funders' service level agreements or other requirements as part of the wider assurance framework, reviews included:

- EU Funded Programme Tyne Esk LEADER (Annual requirement to review the controls in place to deliver the EU Funded Programme Tyne Esk LEADER and to undertake compliance related work as defined by the Service Level Agreement).

Consultancy

3.8 In its 'critical friend' role provide an independent view and challenge at various forums including Business Transformation Board, Capital Planning and Asset Management Board, Learning Estate Strategy Board, Information Management Group, and Early Learning and Childcare Expansion Working Group, taking into consideration the findings from Internal Audit or external assurance work. On request by corporate Management, in response to concerns raised by third parties, carried out Internal Audit Consultancy work to ascertain the key timelines and current status in relation to school estate and housing developments.

Other Audit Work

3.9 During the year resources were deployed in undertaking the following other audit work relating to the whole Council:

- Annual Assessment of Internal Controls and Governance (Prepare this annual assurance report for Management and the Audit Committee summarising the work undertaken by Internal Audit during the year and forming the statutory opinion on adequacy of the Council's arrangements for risk management, governance and internal control. Test a sample of the key elements in the Local Code of Corporate Governance to determine whether these are operating as described).
- Assessment of Internal Audit against PSIAS (Undertake an annual self-assessment of the Internal Audit service against the Public Sector Internal Audit Standards (PSIAS) and report its findings to Management and the Audit Committee).
- Assessment of the Audit Committee against CIPFA Guidance (Provide assistance to the Chair in undertaking an assessment of the Audit Committee against the CIPFA Audit Committees Practical Guidance for Local Authorities and Police 2018 Edition).
- Recommendation Follow-Up Reviews (Two reviews were undertaken. The first included a sample check of Audit Recommendations which are flagged as closed, to check that they have been implemented and to ensure that the new controls had the desired effect on improving internal controls, risk management and governance; and the second assessed performance against closing Audit Recommendations by the agreed due date).
- Internal Audit Help Desk Enquiry System (Provide guidance and advice on request to Management and Staff on internal controls and governance).
- Administration of Audit Scotland Reports (Monitor publication of Audit Scotland reports and co-ordinate submission by Management of Audit Scotland Reports to the Audit Committee or other Committee as relevant).
- Support for the Risk Management, Serious Organised Crime and Integrity Groups (Attend and provide support in the form of relevant Internal Audit and Counter Fraud updates and advice to the Groups to fulfil their roles).
- Attendance at MLC Boards / Committees (Prepare for and attend Audit Committee meetings and other Boards/Committees as relevant).
- Planning for 2020/21 (Review and update the Internal Audit Charter and Strategy, and develop and consult on proposed coverage of the Internal Audit Annual Plan for 2020/21 for Midlothian Council).

Investigations

3.10 The most significant activity related to ongoing corporate fraud investigations which required the continued deployment of staff resources greater than the Plan. It is important that these complex and specialist investigations are carried out by specialist fraud investigators, with supervision by the Principal Internal Auditor and Chief Internal Auditor. The outcomes of corporate fraud activity and the Council's participation in the National Fraud Initiative will be included in the Counter Fraud Annual Report 2019/20. The Internal Audit role, in accordance with the Internal Audit Charter, is to ascertain whether there are any internal control weaknesses that are contributory factors in the occurrence of fraud and to make recommendations for the improvement of internal controls.

Non MLC Work

- 3.11 The MLC Internal Audit team has carried out assurance work during the year for the Midlothian Integration Joint Board (MIJB) based on a plan approved by MIJB Audit and Risk Committee in March 2019. An annual assurance report, including audit opinion on the adequacy of the MIJB's arrangements for risk management, governance and control of the delegated resources, will be presented to MIJB Audit and Risk Committee then to MIJB in due course.

4 Public Sector Internal Audit Standards and Quality Assurance & Improvement Plan

- 4.1 The professional standards as set out in Public Sector Internal Audit Standards (PSIAS) effective 1 April 2013 (updated 2017) include:
- Definition of Internal Auditing;
 - Code of Ethics;
 - Attribute Standards (Purpose, Authority and Responsibility; Independence and Objectivity; Proficiency and Due Professional Care; Quality Assurance and Improvement Programme);
 - Performance Standards (Managing the Internal Audit Activity; Nature of Work; Engagement Planning; Performing the Engagement; Communicating Results; Monitoring Progress; Communicating the Acceptance of Risks).
- 4.2 A self-assessment of Internal Audit practices against the Standards was carried out in 2019/20 (in March 2020), as required by the PSIAS, taking into account the progress with implementation of the improvement actions arising from the previous year's self-assessment, as set out within the Quality Assurance and Improvement Programme (QAIP).
- 4.3 The 2019/20 self-assessment has indicated Internal Audit 'Fully Conforms' with the requirements within the 13 Assessment Areas of the Definition of Internal Auditing, the Code of Ethics, Attribute Standards and Performance Standards. The minor improvement actions in the QAIP arising from the self-assessment are as follows: (1) Internal Audit Charter to include: the PSIAS Mission Statement; a high level reference to statutory officers; and the requirement for the CAE to hold a professional qualification; (2) archive electronic audit files in line with retention policy and record in register (3) streamline audit engagement planning and performing using new templates for audit work files to facilitate more concise reporting; and (4) update Audit Manual to reflect new operating arrangements.
- 4.4 PSIAS requires the self-assessment to be subject to an External Quality Assessment (EQA) each five years, by appropriately qualified and independent reviewers. To achieve this, an "EQA Peer Review Framework" was developed by the Scottish Local Authorities Chief Internal Auditors Group (SLACIAG), with Midlothian Council's first EQA in March 2018. SLACIAG has refined its "EQA Peer Review Framework" based on lessons learned and a programme for the second phase has been finalised, with Midlothian Council's EQA expected before or during 2023 to meet the requirements.

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14 May 2020