

## Annual Assurance Statement on Internal Control as at 31 March 2012

### Annual Governance Statement 2011/12

#### Report by Gerald Tait, Risk and Audit Manager

#### 1. Introduction

This report presents the findings for 2011-12 in relation to (1) the Annual Assurance Statement on the system of Internal Control and (2) the Annual Corporate Governance Statement which will be included in the Council's financial accounts.

It should be noted that the comments relating to item 1 are those made in April/May 2012 and should have been reported to the June Audit Committee. However, the June Audit Committee was devoted to audit committee training. Wherever possible, more up-to-date comments are inserted in italics.

#### 2. Background

##### 2.1 (1) Annual Assurance Statement on Internal Control as at 31 March 2012

###### Best Practice

It is acknowledged best practice (CIPFA Code of Practice) for the independent officer in charge of Internal Audit to prepare an annual statement on the robustness of the Council's internal control system. This in turn helps to inform the Council's overall Annual Corporate Governance Statement (item 2) which is included in the published financial statements, signed by the Leader of the Council and the Chief Executive and is appended to this report.

My statement (item 1) is aimed at providing assurance on the Council's internal control system for senior management, the Audit Committee elected and independent members, other elected members and external audit.

###### Risk Assessment

It is traditional for the audit plan to be compiled as a result of a risk assessment of the Council's major IT and financial systems and operations. The audit plan must be risk-based and concentrate on crucial governance, risk and internal control matters affecting the Council. This is aimed at giving optimum assurance over these key areas.

For the three financial years 2009-10 to 2011-12, the risk assessment approach has been consistent and has focused audit attention towards:-

- The Council's main IT and Financial Systems;
- High risk exposures as identified in the risk management system, particularly the corporate risk register;
- Consultancy exercises requested by management in this period of transition;
- Investigations, where required; and
- The provision of an Internal Control help-desk service.

This approach has generally been accepted by all parties that the means of deciding where internal audit resource should be operating is in fact robust.

#### Miscellaneous audit tasks

For management assurance, it has also been found useful to provide professional advice on a wide range of internal control topics such as:-

- The updating of the Fraud and Corruption Policy and Strategy;
- Whistle blowing facilities for members of the public and employees;
- Championing the electronic Authorised Signatories system;
- Development of an e-learning Internal Control Guide which is planned to heighten internal control awareness;
- Control and monitoring of outstanding audit recommendations (internal audit and external audit);
- Analysing the Bribery Act 2010 and facilitating training; and
- Helping with an update of the Council's Code of Corporate Governance.

#### Reporting lines of Internal Audit

As a result of the organisational and management reviews, the reporting lines of Internal Audit were approved as being to the Council's s95 officer (Head of Finance and Human Resources). This senior manager is responsible in law for the financial stewardship of the Council and is a member of the Corporate Management Team.

In my role as Risk and Audit Manager I have access to the Chief Executive and during the year have met him on a six-weekly basis along with the Director, Corporate Resources and s95 Officer and discussed governance, risk management and internal control matters.

The reporting lines have been effective and in accordance with the CIPFA Code of Practice.

#### Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice

Using the CIPFA Code of Practice, an internal assessment across all internal audit essentials showed that the Internal Audit service is operating in accordance with the code.

#### Internal Audit Resource

During 2011/12 the Internal Audit resource has been sufficient to complete a challenging and adding-value Internal Audit Plan and this in turn provided management, external audit, the audit committee and other interested parties with a significant level of assurance.

At each of the Audit Committees during 2011/12, I have reported progress with the year's Internal Audit Plan and progress has been accepted without any serious challenge.

#### Internal Audit's opinion of the Internal Control system during 2011-12

Having properly risk assessed the assurance needs of Midlothian Council for 2011-12, and having had the resource to progress a challenging and focused audit plan, my key findings for the year 2011-12 are as follows:-

### Level of reported fraud

There have been no general frauds reported or detected during 2011-12. General frauds are every fraud outside Housing and Council Tax Benefit (HCTB). HCTB fraud continues to be relatively small but can reach £200k to £300k pa. This has to be viewed however in the context of the benefit paid out. The National Fraud Initiative (NFI) (a UK data match between public sector bodies) continues to be a very useful exercise in identifying benefit fraud.

During the financial year the Fraud and Corruption Policy and Strategy were updated for the Bribery Act and issued to managers. A risk assessment was carried out in accordance with the Act and this was approved by the Corporate Management Team. The assessment is regularly reviewed. The extended Corporate Management Team received training on the Act.

There have been improvements made to the Council's whistle blowing procedures in that previously the focus was on fraud and corruption only but now the procedures cover non-financial malpractice as well. The facility can be accessed by members of the public and Midlothian employees on the Council website under 'Report It'. Details of whistle blowing reports are mentioned later. During 2012/13, another review of policy and procedures is underway.

### Main findings from Internal Audit Assignments

- **Accounts Payable** – this is a system central to all Council services in making payments on behalf of these services. Payments include those relating to treasury management. Up to 100,000 payments can be made each year, generally valued at around £400m pa. Our testing found that controls are contributing to a low-risk operation. However, we have recommended enhanced use of management information, covering changes made to supplier data, to reduce risk further. We have also advocated greater use of exception reporting.
- **Accounts Receivable** – the Head of Customer Services invited internal audit to make recommendations that would push this £14m pa income source to a higher collection rate percentage than the current mid-80s. We recently completed our audit and have made recommendations that should improve collection performance and the governance around the process. We are intending following up this audit during the latter part of 2012/13.
- **Authorised Signatories System** – over a year ago management introduced an electronic authorised signatories system which shows authorising powers of managers, with certain financial restrictions and specimen signatures (which cannot be copied). The system is available to most officers in the Council, in 'read-only' format. Moving away from an inefficient paper-based system has been a good move. However, during the year we examined the robustness of the system and made recommendations about (1) the appropriateness of some authorising powers and (2) separation of duties issues so that no, one officer had control of transactions from start to finish. Divisional system administrators have tackled these weaknesses and a follow-up review will be conducted shortly.
- **Procurement** – Internal Audit carried out a review of the progress with the procurement action plan to move the council to a higher rating in its procurement capability assessment. With additional recommendations, we

considered the action plan now to be robust. However this will be the subject of a follow-up review in 2012/13.

- **Statutory Performance Indicators (SPIs)** – the Council has a statutory duty to report each year on 25 SPIs. Our review of three of these (Home Care, Libraries and Sport and Leisure) showed robust control and accuracy of the SPIs. In 2012/13, we are examining some Local Performance Indicators (LPIs)
- **Data Protection** – internal audit carried out an examination of the Council's data protection governance and found improvements were required. Coincidentally, the Council was fined £140k for a series of reported data losses in the Children and Families service. Various initiatives are underway to ensure compliance in the future. This is viewed by management as being of high importance in 2012/13.
- **Corporate IT Assets Follow Up** – Internal Audit tested 16 previously-made recommendations and found progress had been made. However, one recommendation had to be reopened and seven extra recommendations have been made.
- **Arrears Management Follow Up** – Internal Audit found that, generally satisfactory progress had been made with recommendations it had previously made.
- **Frameworki** – this is a computer system operated by the Adult and Care in the Community and Children and Families services to control significant care package commitments and payments. Internal Audit assisted the project manager identify adequate financial controls for the Finance Module of the system. A detailed audit is to be carried out in 2012/13.
- **ICT Assets Control in Schools** – Internal Audit reported on robust control with only a few recommendations made to improve control further.
- **Income Control** – the arrangements for collection of the Council's cash and electronic income were reviewed and found to be robust.
- **Housing and Council Tax Benefit** – Internal Audit reviewed the improvement plan put in place by Customer Services to improve certain aspects of performance in the benefit service. Generally the improvement plan was found to be potentially robust..
- **Whistle Blowing Episodes** – there were three significant reports received during the year: (1) allegations of wrong-doing at one of the Council depots (2) alleged misuse of a Council grant by a charity and (3) allegations of wrong-doing in allocating property maintenance work. In respect of (1), the allegations were found to be false and there was no evidence of wrong-doing. Regarding (2), there was no evidence of fraud found but the charity and the persons making the allegations could have worked better to make fuller and more transparent use of the grants awarded by the Council. Furthermore, Council officials attending the charity meetings could have helped in avoiding the disputes. In report (3) there was no clear evidence of wrong-doing and the service had put in place extra controls over the past two years to deter corrupt practice. However, management has agreed to host further audit testing in 2012/13 in relation to term contracting, the 3 quotes system for jobs between £5,000 and £10,000, jobs valued at under £500 and property repairs recharges to private parties.
- **Help Desk** – during the year Internal Audit has helped improve control in the cash receipting and collection of licence income, direct payments to social work clients and other matters of a day-to-day nature.

### Conclusion

- The Internal Audit Strategy and Plan continued in 2011-12 to focus on high risk matters and this will continue into 2012/13;
- During the year Internal Audit was able to devote time to consultancy covering accounts receivable, authorised signatories, whistle blowing,

- code of corporate governance, e-learning module on internal control and compliance with the Bribery Act 2010;
- In the way it works and is organised Internal Audit continues to be compliant with the CIPFA Code of Practice;
  - During the year Internal Audit resource was sufficient to complete a challenging Internal Audit Plan;
  - The level of reported fraud has been relatively low;
  - Within internal audit assignments, generally Financial Directives have been found to have been followed and internal controls are normally robust. Management and the Audit Committee have been keen to close any gaps on internal control and extra controls have been installed arising from internal audit recommendations;
  - However, we have noted the following outstanding issues:-
    - Divisions will have to reallocate existing resource to improving collection performance in Accounts Receivable as the level of unpaid debt is relatively high (currently circa £2m) and inevitable write off will impact on current service budgets;
    - The authorised signatories system requires further improvement, especially regarding separation of duties;
    - Extra controls installed in and around data protection must work, otherwise the Council could risk further data losses;
    - Occasionally, management needs to ensure that Internal Audit recommendations are fully implemented (Corporate IT Asset Control being an example) otherwise issues will be raised during follow up; and
    - In most audit assignments, management has accepted that extra internals would be worthwhile and lower risk even further.
    - These were the main weaknesses that should be addressed during 2012/13 and we will be assisting management overcome these issues; and
    - We will also pursue another challenging Internal Audit Plan, which was originally endorsed by CMT and the Audit Committee in February 2012.

## **2.2 (2) Annual Corporate Governance Statement 2011-12**

During the latter part of 2011-12, Internal Audit reviewed the Council's Code of Corporate Governance and the Assurance System that informs management that the code is being complied with. The Assurance System is basically a self-assessment covering over 20 key elements of governance. The Internal Audit Statement of Internal Control above (item 2.1) is but one of these key elements.

Positive results were obtained from this review of the Council's Corporate Governance and any matters for improvement had been highlighted by management. These were included in the Annual Governance Statement which is attached.

## **3. Report Implications**

### **3.1 Resource**

There are unlikely to be any direct resource implications arising from this report. The Internal Audit resource remains the same. Divisions will need to devote time to taking part and understanding the new e-learning package on internal control. Internal Audit recommendations are generally implemented by management within existing resources.

### 3.2 Risk

With the present audit staffing complement and the way the Audit Plan is structured, the assurance work of Internal Audit is unlikely to stray from important matters for the Council. There is always a residual risk that investigations and consultancy could overtake routine checks on the main financial systems but this risk is being controlled. There is evidence above (e.g core systems like Accounts Payable, Accounts Receivable, Procurement, Data Protection, Assets, Arrears Management and Income Control) of this risk being controlled.

Each internal audit assignment is examining the control of risk and the perception of risk that the auditee has. 'Risk' is central to each internal audit report. This can only strengthen the Council's approach to risk management and the internal control system.

### 3.3 Policy

**Strategy** – this report addresses directly the council's policy to have a robust internal control environment, management of risk and effective governance.

**Consultation** – the Internal Audit Plan has been discussed with the Chief Executive, Director, Corporate Resources, Head of Finance and Human Resources, Audit Scotland, Audit Committee and within the Internal Audit team. So that Internal Audit recommendations are robust and add value, managers spend time at the close of each audit agreeing the recommendations and the timescales for implementation.

**Equalities** – during the year's internal auditing, we found no equalities issues to report on. Going forward, the Corporate Improvement Team has invited Internal Audit to directly consider equalities in each audit assignment. This can be easily built into audit testing.

**Sustainability** – Internal Audit provides an independent assurance function which assists the sustainability of the Council's internal control system, governance and management of risk. During the year, we have found no sustainability issues.

## 4. Recommendations

The Audit Committee is invited to:-

- (1) Endorse the Risk and Audit Manager's Annual Assurance Statement on the System of Internal Control; and
- (2) Note that the issues regarding Accounts Receivable Collection Performance and Data Protection are included in the Council's Annual Governance Statement.

**30 April 2012**

**Report Author: Gerald Tait, Risk and Audit Manager**

**Tel: 0131-271-3284**

**E-Mail: [Gerald.tait@midlothian.gov.uk](mailto:Gerald.tait@midlothian.gov.uk)**

## Appendix

### Annual Governance Statement 2011-12 (AGS)

Midlothian Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards. This is to allow public funds and the assets at its disposal to be safeguarded and used efficiently and effectively in pursuit of best value.

Elected members and senior management are responsible for the governance of the business affairs of Midlothian Council and have therefore developed a Code of Corporate Governance based on the Chartered Institute of Public Finance and Accountancy and Society of Local Authority Chief Executives' framework.

Each year, the Internal Audit service monitors the level of compliance with the code by requiring Heads of Service (including the statutory posts of Section 95 Officer and Monitoring Officer) to complete a self-assessment against the key elements of this code. Internal Audit also independently test-checks a sample of these, and other elements, as well as using evidence from its own reviews of Council performance undertaken during the year. The conclusions of any external inspections are also used to help inform this annual governance statement.

There is a significant number of governance elements detailed in the Code of Corporate Governance, which include both financial and non-financial elements. These include: independent audit function and audit committee; external audit; community planning structures; corporate aims and objectives; business continuity planning; preparation for new legislation; employee development; financial and operational policies and procedures; risk management; elected member and employee standards in public life; strategic financial management; procurement policies and procedures; counter-fraud policies and whistle blowing; performance management and reporting; standing orders and scheme of administration and feedback and complaints systems.

A revised Code of Corporate Governance is in development, with the above elements included, and will be approved by the new Midlothian Council. This will be used as the basis for assessment next year.

A number of governance improvements were highlighted in the 2010-11 self assessment which have been completed or progressed during 2011-12:

- A new procurement strategy has been developed and a new procurement section recruited to help deliver this strategy. The Council, through introducing a number of new processes and controls, also received a higher rating assessment in its procurement capability assessment, moving from non-conformant to conformant in 2011/12. These improvements have led to savings in 2011/12;
- Improved governance for the Business Transformation programme was introduced in 2011/12 through the establishment of a programme office and joint liaison group; and
- Emergency and business continuity plans have been improved and exercised and there is on-going training provided to officers in compliance with the Civil Contingencies legislation.

While the 2011/12 review cannot provide absolute assurance, it has found generally robust governance. However, the following areas of improvement have been identified and are to be progressed in 2012/13:

- Work will continue to improve the Council's procurement of goods and services with the aim of fully embedding the new strategy and policies and procedures with further budget savings to be delivered. The Council is also working towards obtaining an "improved performance status" in the 2012/13 procurement capability assessment;
- The Information Management Groups will continue to promote and develop the Council's systems and process over the security of personal information through implementation of an action plan following a recent internal audit review;
- Work will continue to improve collection rates over accounts receivable debts through a number of recently introduced processes and controls;
- Work on Health and safety will be progressed during the year including update of existing policies and procedures, improved reporting on health and safety indicators as well as the development of a training strategy;
- Guidance made available to management on internal control have been re-drafted and an on-line course developed which will include an assessment to test awareness of internal control;
- Work will continue through the Business Transformation Programme to deliver improved services and processes at reduced cost;
- The Council will continue to assess the impact of the new Welfare Reform Act on Council services and Midlothian citizens and develop local action plans;
- The Council will continue to progress actions to reduce the residual risks within a number of areas of the Council including Community Planning, Following the Public Pound and Business Continuity; and
- Issues arising out of the Best Value 2 report by Audit Scotland will be taken forward through an action plan (including improved use of customer satisfaction information).

On the basis of the Council's assurance system, and the elements of governance at its disposal, we are satisfied that overall, Midlothian Council's corporate governance arrangements are of a satisfactory standard. We are aware of areas where improvements are required and steps will be taken in the forthcoming year to address these areas allowing the Council to advance its corporate governance arrangements and seek continuous improvement.

Signed:

Leader of the Council

Chief Executive

Date: