

Chief Internal Auditor's Annual Assurance Report and Opinion 2018/19 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, including assisting Management to improve the risk identification and management process in particular where there is exposure to significant financial, strategic, reputational and operational risk to the achievement of the Council's objectives.
 - 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, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.
 - 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 [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."

- 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 2019 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 though there are indications in some areas of non-compliance and a lack of evidence of Management monitoring that they are operating satisfactorily; therefore improvements are required to the second line of defence consistently across the Council to ensure probity in systems and operations, including the prevention, detection and resolution of fraud and irregularities. The implementation of Audit recommendations as part of a culture of continuous improvement is of importance particularly relating to the strategic governance arrangements that underpin financial management, workforce development, and delivery of change and transformation.
- 2.2 The Council's Local Code of Corporate Governance (approved December 2017) has been subject to recent review and update to comply with the CIPFA/SOLACE Framework 'Delivering Good Governance in Local Government' (2016). This is 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. It has been used as part of the 2018/19 annual assurance process by senior management.
- 2.3 Improvements over the Council's procurement and contract management are required as there were examples of contracts not being retendered when the existing contract had expired, Non Competitive Action forms not always being completed for single source suppliers, and Services not always using existing framework suppliers sometimes due to frameworks having insufficient capacity to meet demand. There is no system in place to manage contracts from cradle to grave and no dedicated resource to undertake contract monitoring to ensure that the controls are operating effectively.
- 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 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 periodic reports from the Risk Manager on corporate risks and mitigations to fulfil its oversight role to monitor the effective development and operation of risk management in the Council.
- 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.

3 Internal Audit Annual Plan 2018/19 Delivery

- 3.1 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 activity associated with the Roads Contract Management Investigation. This has had an impact on the delivery of the Internal Audit planned work, as indicated to Management and the Audit Committee during the year.

- 3.2 The following Audit Reviews from 2018/19 Audit Plan have not been carried out for a variety of reasons with explanation provided:
- Electronic Payments Systems (Deferred to 2019/20 to reflect the phasing of the planned system control change by Management).
 - ICT Operational Processes (Deferred to spread ICT audit assurance activity across years in agreement with Management and included in the approved Audit Plan 2019/20).
 - Community Engagement (Deferred due to impact on staff resources and included in the approved Audit Plan 2019/20; Best Value Assurance Review will cover aspects of this).
 - Commercial Rents (Deferred due to impact on staff resources and included in the approved Audit Plan 2019/20).
 - Business Gateway (Deferred due to impact on staff resources and included in the approved Audit Plan 2019/20).
- 3.3 In contrast, the deferred audit from 2017/18 on Pupil Equity Funding which was not included in the approved Audit Plan 2018/19 has been carried out.
- 3.4 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:

Strategic and Risk Based Audits

- 3.5 To provide assurance on the internal controls and governance in place to ensure efficient and effective use of assets and resources, reviews included:
- Performance Management – Local Government Benchmarking Framework (Provide independent validation of performance indicators and benchmarking information to support self-assessment and continuous improvement of the Council's services).
 - Workforce Strategy and Plans (Review of approach to workforce development in alignment with business and financial planning processes to provide skills, knowledge and competency requirements for service delivery to meet the Council's objectives).
 - Delivering Excellence Programme (Review of governance and accountability arrangements for Delivering Excellence programme including a review of processes for benefit (financial and other) identification, tracking and realisation).
 - Revenue Financial Budget Monitoring (Assess the review, scrutiny and challenge on revenue financial budget monitoring reports by elected members).
 - Procurement and Contract Management - (combination of three activities from within the Internal Audit Annual Plan 2018/19 relating to Contract Tenders, Procurement to Payment, and Contract Management in order to cover the end-to-end procurement journey; Review the Procurement Strategy and for a sample of contracts across Council's Services assess the systems and controls for compliance in the tender procedures that underpin effective contracts, the ordering of goods and services, commitment systems and processes including authorisation, and the contract monitoring systems and controls).
 - Information Governance Framework and GDPR (Review of the Information Governance framework including roles and responsibilities, policy development and implementation. Assess compliance with General Data Protection Regulations which came into force May 2018).
 - Capital Investment – Social Housing Programme Phase 2 (Review the adequacy of the capital investment control framework established by Management to allow for the successful delivery of the Social Housing Programme).
 - Learning Estate Strategy (Assess the governance in place to ensure key milestones / outcomes are being achieved).

Core Process / System Audits

- 3.6 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:
- Payroll (Testing of controls at Service level on Starters and Leavers to ensure completeness and accuracy).
 - Sales to Cash incorporating Financial Policy Framework (Review the adequacy of the control framework over the income collection on the ICON receipting system; Assess the Financial Policy Framework established, including Financial Regulations and associated policies, procedures and guidelines, and evaluate arrangements in place to review and update them).
 - ICT Security Controls (Assess the adequacy of the physical access and environmental controls to ICT equipment, software and data to prevent unauthorised access / damage, including 3rd party access and PSN compliance).
 - Following the Public Pound (Assess authorisation and monitoring processes and procedures against Following the Public Pound code of practice in support of securing Best Value).
 - Developer Contributions (Follow-up on implementation of improvement actions to enhance internal controls).
 - Pupil Equity Funding (Assess the arrangements in place to administer the Pupil Equity Fund (PEF) and ensure that it is being utilised in line with the National Operational Guidance issued by the Scottish Government as presented to Cabinet in February 2017).

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:
- Tyne Esk LEADER Grant Fund (Annual requirement to review the controls in place to deliver the Tyne Esk LEADER Grant Fund and to undertake compliance related work as defined by the Service Level Agreement).
 - Construction Industry Scheme (Annual requirement to undertake a review in this area to test that the scheme rules are being complied with as required by HMRC). It is proposed to reduce the frequency of this Compliance activity from Annual to 3-Yearly within the Internal Audit Plan which has been agreed by relevant Management.

Consultancy

- 3.8 In its 'critical friend' role provide internal challenge within the following:
- The review of the Learning Estate Strategy, taking into consideration the findings from Internal Audit assurance work.
 - The preparations from the Best Value Assurance Review including an independent and objective assessment of the evidence to support self-evaluation and improvement underpinning Best Value.

Annual Audit Work

- 3.9 During the year resources were deployed in undertaking the following work relating to the whole Council:
- Recommendation Follow-Up Reviews (Two reviews were undertaken. The first assessed performance against closing Audit Recommendations by the agreed due date; and the second 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).

- Review of Corporate Governance (Test a sample of the key elements in the Local Code of Corporate Governance to determine whether these are operating as described).
- Annual Assessment of Internal Controls (Prepare this annual assurance report for Management and the Audit Committee summarising the work undertaken by Internal Audit during the year and forming an opinion on adequacy of the Council's arrangements for risk management, governance and control).
- 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 the CIPFA Code (Provide assistance to the Chair of the Audit Committee in undertaking an assessment of the Audit Committee against the CIPFA Audit Committees Practical Guidance for Local Authorities and Police 2018 Edition).
- Internal Audit Help Desk Enquiry System (Provide guidance and advice on request to Management and Staff on internal controls and governance, and manage any enquiries received through the whistle blowing facilities offered by the Council).
- Administration of Audit Scotland Reports (Coordinate submission of Audit Scotland Reports to the Audit Committee by relevant Management).
- Support for the Risk Management and Integrity Groups (Attend and provide support to the Risk Management Group and the Integrity Group; the latter has recently changed its name to Serious Organised Crime Group to better reflect its role as approved by CMT in October 2018).
- Planning for 2019/20 (Review and update of the Internal Audit Strategy and development of the Internal Audit Annual Plan for 2019/20).

Investigations

- 3.10 The most significant activity during the year related to the ongoing activity associated with the Roads Contract Management which required continued deployment of Internal Audit and Counter Fraud staff resources during the year. Further to this, a report was presented to the Audit Committee on 11 December 2018 which provided an update on Management's progress with implementation of Internal Audit Recommendations arising from the May 2018 Report.

Non MLC Work

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

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 2018/19, as required by the PSIAS, taking into account the progress with implementation of the improvement actions arising from the previous year's self-assessment and the External Quality Assessment (EQA) peer review carried out by Highland Council in March 2018, as set out within the Quality Assurance and Improvement Programme (QAIP).
- 4.3 The 2018/19 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 self-assessment shows that progress has been made with the improvement actions in the QAIP arising from the EQA: (1) staff skills and capabilities (staff training and development plans completed in year; ongoing utilisation of "Make Performance Matter" to further enhance skills to fulfil revised approach in the Internal Audit Strategy); (2) client feedback (positive feedback from CMT during the year on new approach and enhanced profile of Internal Audit; learning applied from client feedback relating to individual audit engagements); (3) reduce duplication of manual and electronic audit files (default is electronic document management in year; historic manual records will be managed out over time in line with retention policy (4) review of the audit reporting process (change in content and style of Internal Audit endorsed by CMT and utilised in year, receiving positive feedback) (5) recommendations completion (enhanced Audit Actions monitoring reports for Management at each quarter and follow-up process).
- 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 EQA in March 2018 as stated above. SLACIAG has refined its "EQA Peer Review Framework" based on lessons learned and a programme for the second phase is being finalised, with Midlothian Council's EQA expected before or during 2023 to meet the requirements.

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