

Shared Internal Audit Services and Proposed Way Forward 2022/23

Report by Chief Executive

Report for Noting

1 Recommendations

The Audit Committee is asked to:

- a) Note the wider options of joint working that have been explored since the 12 month pilot shared Internal Audit services arrangement and the evaluation associated with the provision of Internal Audit services; and
- b) Note that the Corporate Management Team has endorsed the proposal to mutual opt out of the Shared Internal Audit Services at the end of 2021/22, and progress to a permanent staff resourcing of the Internal Audit team of 1 FTE Chief Internal Auditor and 1 FTE AN Other Internal Auditor to maintain Internal Audit FTE staffing from 2022/23 onwards at the current level (2021/22 - 775 days). This will ensure provision of Internal Audit services to, and delivery of the Internal Audit Annual Plans for, Midlothian Council and MIJB.

2 Purpose of Report/Executive Summary

The purpose of this report is to set out an evaluation associated with the provision of Internal Audit services and propose a way forward from 2022/23 onwards.

Shared Internal Audit Services have been provided between Midlothian and Scottish Borders Councils since December 2017. Internal Audit assurance services are also provided by Midlothian Council's Internal Audit team to the Midlothian Integration Joint Board (MIJB).

The operating environment has changed significantly since the inception of the shared Internal Audit services arrangement, in particular over the past 21 months, which provides the opportunity for both Councils to evaluate the arrangement.

The report provides details of the wider options of joint working that have been explored and the evaluation of the shared Internal Audit services arrangement. The report proposes a way forward for 2022/23 onwards for the mutual opt out of the Shared Internal Audit Services at the end of 2021/22 and progress to a permanent staff resourcing of the Internal Audit team to maintain Internal Audit FTE staffing from 2022/23 onwards at the current level (2021/22 - 775 days).

Date 13 January 2022

Report Contact:

Jill Stacey

jill.stacey@midlothian.gov.uk

3 Background

- 3.1** Councils continue to face significant challenges as a result of constrained funding combined with demographic and other cost pressures associated with current and projected growth. In addition, managing the impact of a number of government policy and legislative changes places additional demands and reinforces the urgent need to change the way Councils operate.
- 3.2** This continues to present an ever growing need to respond in ways that provide the opportunity to 'future proof' services and to create resilience and sustainability within the context of reducing resources.
- 3.3** Under local authority Accounts (Scotland) Regulations 2014 7(1): *"A local authority must operate a professional and objective internal auditing service in accordance with recognised standards and practices in relation to internal auditing"*.
- 3.4** Furthermore, the PSIAS framework defines Internal Audit as follows: *"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes"*.
- 3.5** The Audit Committee at its meeting on 12 December 2017 agreed to a 12 month pilot arrangement over the sharing of a Chief Internal Auditor post between Midlothian and Scottish Borders Councils. At its meeting on 11 December 2018, the Audit Committee approved the proposal to continue with shared Internal Audit services between Midlothian and Scottish Borders Councils, including the opportunity for a wider exploration of joint working activities and benefits. The shared Internal Audit services arrangement has continued since then, recognising that either Council could still decide to opt out/revert back at any time subject to an appropriate period of notice.
- 3.6** The Internal Audit Strategy and Plan, most recently for 2021/22, set out the Internal Audit staff resources and activity to enable the Chief Internal Auditor, as the Council's Chief Audit Executive (CAE), to provide the statutory annual internal audit opinion regarding the adequacy and effectiveness of internal control within the Council. Internal Audit assurance services are also provided by the Council's Internal Audit team to the Midlothian Integration Joint Board.

4 Evaluation of Shared Internal Audit Services

- 4.1** The challenges and benefits that arose during the 12 month pilot arrangement over the sharing of a Chief Internal Auditor were included in the report 'Shared Internal Audit Services between Midlothian and Scottish Borders Councils', item 5.9 to the Audit Committee on 11 December 2018 [Midlothian Council > Meetings \(cmis.uk.com\)](https://cmis.uk.com)
- 4.2** The operating environment has changed significantly since the inception of the shared Internal Audit services arrangement, in particular over the past 20 months, which provides the opportunity for both Councils to evaluate the arrangement.

4.3 To assist with the evaluation of the shared Internal Audit services arrangement, the wider joint working activities that have been explored and the associated outcomes are as follows:

- The principles for development of proposals to expand the current Shared Internal Audit (and Counter Fraud) Services between Midlothian and Scottish Borders Councils to include East Lothian Council were considered in November 2019 by the Corporate Management Teams in each Council. The proposals were not supported by Midlothian Council CMT mainly due to the exacerbation of the challenges of sharing a Chief Internal Auditor from two to three Councils and IJBs, and the impact this might have on the quality of the current shared service provision;
- The option of shared Risk Management services between Midlothian and Scottish Borders Councils did not progress beyond initial consideration in early 2020 in light of the different approaches within Midlothian and Scottish Borders Councils for the provision of corporate support to Services in the management of risks;
- The option to deploy Internal Audit team members to work on similar planned audits across the two Councils and IJBs was considered. Due to practical constraints (requirement for IT hardware and access to each organisation's systems and documents), only the Chief Internal Auditor and Interim Specialist Auditor were shared. In addition, the synergies were less than expected due to differences between Councils in their organisation structures and strategies for service delivery, policy framework, and ICT systems. Internal Audit team members continued to work on terms and conditions of their employing authorities.
- The option for Midlothian Council (MLC) to share Corporate Fraud Officers with Scottish Borders Council (SBC) in light of the vacant Corporate Fraud & Compliance Officer post in SBC since December 2020 due to retirement of the post holder. In light of current workload for the MLC Corporate Fraud Officers, including ongoing fraud investigations, participation in the National Fraud Initiative 2020/2021, and refocus with revised MLC Counter Fraud Policy and Strategy 2020-2023 on fraud prevention and detection, there was insufficient staff resource capacity in the short term.

4.4 Additional challenges, such as:

- impact of differences between Councils in the provision of specialist compliance and assurance support services of Internal Audit, Corporate Fraud and Risk Management;
- the impact of differences between Councils in their governance and management arrangements, which includes the leadership, culture, organisation structures and strategies for service delivery, policy framework, risk appetite, ICT systems, etc.;
- reduced capacity of the shared Chief Internal Auditor post impacting team management and development, in particular at times when the respective Principal Internal Auditors had unplanned periods of prolonged absence from work. Furthermore, there has been a change in the counter fraud and risk management support staff at Scottish Borders Council, from experienced and empowered post holders to a vacant post and new appointment respectively; and
- the impact in Midlothian Council of ongoing fraud investigations on capacity to implement new approaches such as those set out in the revised Counter Fraud Policy and Strategy.

- 4.5** In conclusion: the benefits were primarily realised in the first 12 months and have been maintained, though further benefits from joint working options have not been realised in the medium term; and some of the challenges experienced in the short term will continue in the medium term due to differences between Councils in their governance and management arrangements, which includes the leadership, culture, organisation structures and strategies for service delivery, policy framework, risk appetite, ICT systems.

5 Proposal on the Way Forward

- 5.1** The proposal is the mutual opt out of the Shared Internal Audit Services arrangement between Midlothian and Scottish Borders Councils at the end of 2021/22 and provide an appropriate period of notice to Scottish Borders Council. In addition, the proposal is for Midlothian Council to progress to a permanent Internal Audit staff resourcing arrangement to recruit a 1 FTE Chief Internal Auditor and 1 FTE AN Other Internal Auditor. This staff resourcing will replace the shared 0.5 FTE Chief Internal Auditor and 1.42 FTE Interim Specialist Auditor resource from Scottish Borders Council to provide greater certainty and allow for longer term planning of work and teams. It is important that Internal Audit FTE staffing levels are at least maintained at the current level albeit a proposed change in the mix and FTE of the relevant posts, to ensure delivery of the Internal Audit Annual Plans (2021/22 - 775 days) for Midlothian Council and MIJB.
- 5.2** The Corporate Management Team and Elected Members of Scottish Borders Council have been consulted on the evaluation conclusions and endorsed the mutual opt-out of the Shared Internal Audit Services arrangement between Midlothian and Scottish Borders Councils. This is of particular note due to the challenge of reduced capacity of the shared Chief Internal Auditor post impacting team management and development, in particular due to the change in the counter fraud and risk management support staff at Scottish Borders Council, from experienced and empowered post holders to a vacant post and new appointment. Furthermore, revisions to the Risk Management Policy and Strategy and the Counter Fraud Policy and Strategy of Scottish Borders Council for 2021-2024 have recently been approved; the implementation of which will be led by SBC's Chief Officer Audit & Risk (the shared Chief Internal Auditor).
- 5.3** The Corporate Management Team and the Audit Committee of Midlothian Council play an important role in ensuring that the Internal Audit function has sufficient staff resources with the appropriate skills and capabilities to ensure that its position and standing within the organisation is such that it can provide robust independent challenge to Senior Management and fulfil its statutory audit opinion requirement.
- 5.4** The Internal Audit Strategy and Plans set out the Internal Audit staff resources and activity to enable the Chief Internal Auditor to provide the statutory annual internal audit opinion regarding the adequacy and effectiveness of internal control within the organisations. The Internal Audit Strategy and Plans for 2022/23 that are in the initial stages of development will incorporate the proposed Internal Audit staff resources set out in this report.

6 Report Implications (Resource, Digital, Risk and Equalities)

6.1 Resource

Internal Audit reports directly to the Chief Executive (operationally) and the Audit Committee (functionally). There is currently a staff resource of 4.64 FTE for Internal Audit provision, comprising Chief Internal Auditor (0.5 FTE - shared with Scottish Borders Council), Interim Specialist Auditor resource (1.42 FTE - shared with Scottish Borders Council), Principal Internal Auditor (0.72 FTE), and Internal Auditor (2.0 FTE). Within the structure there are also 2 FTE Corporate Fraud Officers, who are line managed by the Principal Internal Auditor then to the Chief Internal Auditor, who are resources to support Management in tackling fraud, approved in August 2020 as part of the Council's Counter Fraud Policy and Strategy.

The proposal is to progress to a permanent arrangement to recruit 1 FTE Chief Internal Auditor and 1 FTE AN Other Internal Auditor. This Internal Audit staff resourcing will replace the shared 0.5 FTE Chief Internal Auditor and 1.42 FTE Interim Specialist Auditor resource from Scottish Borders Council. It is important that Internal Audit staffing levels are at least maintained at the current level albeit a proposed change in the mix and FTE of the relevant posts, to ensure delivery of the Internal Audit Annual Plans (2021/22 - 775 days) for Midlothian Council and MIJB. No changes are proposed within the rest of the structure. The proposals associated with this report are capable of being met from within existing budgets.

Midlothian Council's Internal Audit team provides assurance services to the Council and to the Midlothian Integration Joint Board, as part of the Council's commitment to partnership working.

6.2 Digital

There are no digital implications arising from this report.

6.3 Risk

It is important that Internal Audit staffing levels are at least maintained at the current level albeit a proposed change in the mix and FTE of the relevant posts. This is to ensure that a sufficient range and breadth of assurance audit work will be carried out each year to underpin the statutory Internal Audit opinion to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council. The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process.

6.4 Ensuring Equalities

An Integrated Impact Assessment (IIA) will be carried out in advance to ensure not adverse impact on people (public or staff) or outcomes.

6.5 Additional Report Implications (See Appendix A)

APPENDIX A – Additional Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), by providing an independent and objective annual assessment of the adequacy of the entire control environment, Internal Audit supports the Council to achieve its objectives.

A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☒ Holistic Working
- ☒ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☒ Preventative
- ☒ Asset-based
- ☒ Continuous Improvement
- ☒ One size fits one
- ☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious

A.4 Delivering Best Value

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control

and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

A.5 Involving Communities and Other Stakeholders

Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives for the benefit of Midlothian's communities and other stakeholders.

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders.

A.6 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year, which are designed to maintain and / or enhance internal controls, governance arrangements and risk management, assists the Council in improving its performance and outcomes.

A.7 Adopting a Preventative Approach

Having robust internal controls, governance arrangements and risk management in place contributes to safeguarding the Council's resources for delivery of services, as part of protecting the public purse. Internal Audit assurance and consultancy activity is designed to improve operations and assist the Council in accomplishing its objectives.

A.8 Supporting Sustainable Development

This report does not relate directly to supporting sustainable development. Good governance, including the provision of an Internal Audit service, is important to enable Midlothian Council to achieve its objectives.