

Internal Audit Work to October 2021

Report by Chief Internal Auditor

Report for Decision

1 Recommendations

The Audit Committee is asked to:

- a) Consider the Executive Summaries of the final Internal Audit assurance reports issued;
- b) Note the Internal Audit Assurance Work in Progress and Internal Audit and Other Work carried out; and
- c) Acknowledge the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.

2 Purpose of Report/Executive Summary

The purpose of this report is to provide members of the Audit Committee with details of the recent work carried out by Internal Audit and the findings and recommended audit actions agreed by Management to improve internal controls and governance arrangements.

The Internal Audit Annual Plan 2021/22 was approved by the Audit Committee on 9 March 2021. Internal Audit has carried out work associated with the delivery of the Plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance.

An Executive Summary of the final Internal Audit assurance reports issued, including audit objective, findings, good practice and recommendations (where appropriate), and the Chief Internal Auditor's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1.

The MLC Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017) including the production of this report to communicate the results of the reviews.

Date 25 November 2021

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3 Progress Report

- 3.1** The Internal Audit Annual Plan 2021/22 was approved by the Audit Committee on 9 March 2021. Internal Audit has carried out the following work in the period from 1 September to 31 October 2021 associated with the delivery of the Plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance.
- 3.2** The MLC Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017) including the production of this report to communicate the results of the reviews.
- 3.3** Internal Audit issued final assurance reports on the following subjects:
- Risk Management
 - EU Funded Programme Tyne Esk LEADER
 - Roads Maintenance Service
 - Performance Management Local Government Benchmarking Framework (LGBF)
- 3.4** An Executive Summary of the final Internal Audit assurance report issued, including audit objective, findings, good practice and recommendations (where appropriate), and the Chief Internal Auditor's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1.

The definitions for Internal Audit assurance categories are as follows:

| Level | Definition |
|-------------------------|---|
| Comprehensive assurance | Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required. |
| Substantial assurance | Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse. |
| Limited assurance | Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse. |
| No assurance | The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or misuse is unacceptable. Significant improvements are required. |

Current Internal Audit Assurance Work in Progress

- 3.5** Internal Audit assurance work in progress to deliver the Internal Audit Annual Plan 2021/22 consists of the following:

| Audit Area | Audit Stage |
|--|---------------------|
| Digital Learning Strategy | Drafting the report |
| Income Collection | Testing underway |
| Performance Management (Framework) | Testing underway |
| Scottish Welfare Fund | Testing underway |
| Early Learning and Childcare Expansion | Testing underway |

Internal Audit Consultancy and Other Work

- 3.6** Internal Audit staff have been involved in the following for the Council to meet its aims and objectives, and its roles and responsibilities in accordance with the approved Internal Audit Charter and Strategy:
- In its critical friend role provided an independent view and challenge at various forums including Business Transformation Board, Capital Plan and Asset Management Board, and Information Management Group.
 - Learning and development during the research stage of new audit areas for all Internal Audit team members and through joining virtual audit forums and meetings.
 - Monitored publication of Audit Scotland reports and co-ordinated submission by Management of Audit Scotland Reports to the Audit Committee or other Committee as relevant.
 - Carried out background research and analysis associated with the Financial Policy and Governance Framework assurance audit. This has been preparation in advance of working with Financial Services in a critical friend role in alignment with the timescales of their work programme of financial policy review.

Recommendations

- 3.7** Recommendations in reports are suggested changes to existing procedures or processes to improve the controls or to introduce controls where none exist. The grading of each recommendation reflects the risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact:

| |
|--|
| High: Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high to require immediate action within one month of formally raising the issue. Added to the relevant Risk Register and included in the relevant Assurance Statement. |
| Medium: Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue. |
| Low: Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to attention of senior management. |
| Outwith the report, Internal Audit informs operational managers about other matters as part of continuous improvement. |

- 3.8** The table below summarises the number of Internal Audit recommendations made during 2021/22:

| | 2021/22 Number of Recs |
|---|------------------------|
| High | 0 |
| Medium | 12 |
| Low | 4 |
| Sub-total reported this period | 16 |
| Previously reported | 7 |
| Total | 23 |
| Recommendations agreed with action plan | 23 |
| Not agreed; risk accepted | 0 |
| Total | 23 |

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

4.1 Resource

Resource implications of implementing Internal Audit recommendations are considered as part of the audit process to ensure these are reasonable and proportionate to the risks.

4.2 Digital

There are no digital implications arising from this report.

4.3 Risk

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process. At the start of each audit engagement, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered. During each audit engagement the management of risk has been tested.

It is anticipated that improvements in the management and mitigation of risks will arise as a direct result of Management implementing the Internal Audit recommendations made. If audit recommendations are not implemented, there is a greater risk of financial loss and/or reduced operational efficiency and effectiveness, and Management may not be able to demonstrate improvement in internal control and governance arrangements, and effective management of risks.

4.4 Ensuring Equalities

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those within the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its independent and objective assurance about risk management, internal control and governance.

4.5 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), good governance is important to enable Midlothian Council to deliver its key priorities in support of achieving the Council's 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

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.

This report has been presented to the Corporate Management Team to outline the key messages of assurance and areas of improvement. Senior Management relevant to the areas audited have agreed the final Internal Audit assurance reports as set out in the relevant Executive Summary within Appendix 1.

A.6 Impact on Performance and Outcomes

The Findings and Recommendations from Internal Audit work during the year are designed to assist the Council in improving its performance and outcomes.

A.7 Adopting a Preventative Approach

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

A.8 Supporting Sustainable Development

This report does not relate directly to supporting sustainable development. Good governance is important to enable Midlothian Council to achieve its objectives.

| Report | Summary of key findings and recommendations | Recommendations | | | Status |
|---|--|-----------------|---|---|---|
| | | H | M | L | |
| <p>Subject: Risk Management</p> <p>Category: Assurance – Cyclical</p> <p>Date issued: 02 June 2021 Draft; 22 November 2021 Final</p> <p>Level of Assurance: Substantial (Risk Management policy, and application of principles at Strategic level) and Limited (provision of Risk training for Managers, inconsistent application of systematic risk management at Service operational level, and 2nd line monitoring for assurance purposes).</p> | <p>The purpose of this assurance audit was to review the process for identifying, evaluating, controlling / mitigating, recording, monitoring and reporting risks that potentially have a detrimental impact on the effective and efficient delivery of Services, to review risk management policy, strategy, training and toolkits, and to assess risk registers at Strategic, Service Operational, Programme/Project, and Partnership levels.</p> <p>The Covid pandemic has been pervasive, simultaneously impacting employees, suppliers and customers and for a duration previously not considered a possibility. The Covid pandemic response, which exhibits elements of Risk Management, has successfully navigated the Council through this very serious crisis and demonstrated the ability to adapt and innovate in extreme circumstances. Our audit is focussed on the Risk Management Framework and not on responses to the Covid pandemic.</p> <p>The Risk Management Policy currently in place was produced in 2015 with refreshed guidance subsequently issued in 2018. The policy and guidance have not been reviewed and revised since then due to a lack of capacity. The Policy nevertheless represents a sound basis for managing risk but requires updating to reflect best practice, current conditions and identified improvements. Risk Management is well established at the Strategic level but there are inconsistencies in the application of the principles that underpin the Policy at the Service/Operational level.</p> <p>Improved provision of training to Managers is necessary to equip them with the necessary competence and capacity to apply the risk management policy and practices.</p> <p>Business planning and performance management processes are not fully aligned and integrated with the risk management cycle. This is particularly evident at Service level.</p> <p>Risk management information and reporting to CMT and the Audit Committee in respect of strategic risks is sufficiently relevant, accurate and timely to enable them to fulfil their respective roles and responsibilities. An effective monitoring and review structure of the risk management process is not in place. Neither CMT nor the Audit Committee receive adequate information to be assured that risk management processes are being applied in accordance with Policy consistently across all Council Services.</p> | 0 | 6 | 0 | <p>Management in the Place directorate have accepted the report findings and agreed to implement improvement actions.</p> <p>The review and refresh of the Risk Management Framework will be led by the Chief Officer Place and the Protective Services Manager, enabled through the Risk and Resilience Group of officers. Full implementation of the improvement actions will require engagement by Service Managers who are responsible for the application of Risk Management Policy and practices consistently in all Council Services.</p> <p>Internal Audit will be available as a critical friend to follow-up on these developments.</p> |

| Report | Summary of key findings and recommendations | Recommendations | | | Status |
|-----------------------------------|--|-----------------|---|---|--------|
| | | H | M | L | |
| Subject: Risk Management (cont'd) | <p>Internal Audit considers the level of assurance is Substantial in relation to Risk Management policy, and application of principles at Strategic level, and Limited in relation to provision of Risk training for Managers, inconsistent application of systematic risk management at Service operational level, and 2nd line monitoring for assurance purposes. Internal Audit made the following recommendations which are designed to improve the application of the Risk Management framework across the Council:</p> <ul style="list-style-type: none"> Resources dedicated to risk management should be reviewed to initially apply risk management processes consistently across Council Services, and then maintain standards at this level. (Medium) The Risk Management Policy and Guidance should be updated to reflect best practice and the current conditions, specifically roles and responsibilities, the Council's risk appetite particularly when taking on high and critical risks, and quantification of the Council's risk appetite, tolerance and capacity. (Medium) Arrangements for monitoring and reporting of risks requires improvement in some areas, specifically to ensure CMT and Audit Committee receive annual assurance of compliance with the Risk Management Policy, escalation of high operational risks, and quality assurance checks of risk management process to DMTs. (Medium) Following the completion of the update to the CPP risk register, Senior leadership should carefully consider the implications of any identified risks for the Council. (Medium) An ongoing training programme should be established to develop the competence, capacity and confidence of Managers in post and to those new to the Council. (Medium) Risk management should be integrated with business planning and performance management processes. All plans and performance reporting should clearly demonstrate linkages with risks. (Medium) <p>Following the update of the Risk Management Policy, Senior Management should explicitly re-emphasise the importance of risk management, ensure the application of risk management policy and practice consistently in all Council Services, and confirm this in their annual assurance statements.</p> | | | | |

| Report | Summary of key findings and recommendations | Recommendations | | | Status |
|---|--|-----------------|---|---|--|
| | | H | M | L | |
| <p>Subject: EU Funded Programme Tyne Esk LEADER</p> <p>Category: Legislative and Compliance</p> <p>Date issued: 29 September 2021 Draft; 26 October 2021 Final</p> <p>Level of Assurance: Substantial</p> | <p>The purpose of this legislative and compliance audit, required by the SLA, was to assess the adequacy of the internal controls in place for the administration of Tyne Esk LEADER Programme to comply with the SLA. The LEADER programme is part of the Scotland Rural Development Programme 2014-2020 which aims to promote economic and community development within rural areas of Scotland. 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. Midlothian Council is the Accountable Body for the Tyne Esk LEADER programme.</p> <p>The SLA was signed on 30 December 2015 and the original funding allocation was £3.5m, with 25% of this budget being for administration of the programme. This funding allocation was updated to £3.6m in March 2021 in light of the LEADER programme's extension to December 2021, taking into account the impact of Covid-19 pandemic. Of the £2.7m available to be allocated to projects, £2.4m has been awarded to eligible projects (92.61%). The extension has given sufficient time for all original Tyne Esk LEADER projects to conclude and all projects from the programme have been fully claimed for.</p> <p>Internal Audit considers that the level of assurance is Substantial in terms of governance of the programme, grant application management and grant claims processes. Prior year Internal Audit recommendations have been implemented. There is sufficient staff resources to support the LEADER programme to its closure date and applicant grant claims and grant drawdown processes with the Scottish Government are up to date.</p> <p>Internal Audit made the following recommendations:</p> <ul style="list-style-type: none"> • Management should review and update the LEADER Programme risk Register and relevant Service Risk Register, and ensure it includes the risk of funding clawback (1 project was identified with risk of clawback, but the Chief Officer Place has confirmed that the Scottish Government has recently clarified that it will not pursue recovery). (Low) • Management should review the audit findings from the LEADER project file review and take appropriate action to rectify any issues, ensure the register of interests has been completed by all LAG members, and ensure that access is revoked in the LARCs system for users no longer requiring access. (Low) | 0 | 0 | 2 | <p>Management have accepted the factual accuracy of the report and its findings, and agreed to implement the recommendations which were completed prior to the finalisation of this report.</p> <p>This Internal Audit Report has been submitted to the Scottish Government along with the Programme's Annual Confirmation Certificate on 5 November 2021.</p> |

| Report | Summary of key findings and recommendations | Recommendations | | | Status |
|--|---|-----------------|---|---|--|
| | | H | M | L | |
| <p>Subject: Roads Maintenance Service</p> <p>Category: Assurance – Cyclical</p> <p>Date issued: 28 September 2021</p> <p>Draft; 26 October 2021 Final</p> <p>Level of Assurance: Limited</p> | <p>The purpose of this assurance audit was to undertake a review of the Roads Maintenance Service including both capital and revenue jobs ensuring that the service is complying with the relevant code of practice / risk based inspection regime.</p> <p>The operational labour force of 40 is a multi-skilled workforce able to undertake a comprehensive range of design maintenance, construction and servicing activities to maintain 433 miles of public road.</p> <p>The Revenue budget of around £3.1m covers minor repairs including pot holes, cyclical works and incident response. The Capital Works Programme has a budget of around £1.5 million per annum divided between roads (£1 million) and footways (£0.5 million) which funds pre-planned, frequently large roads maintenance schemes for which the in-house team is the contractor and the customer / budget holder is the Client in the Roads team. An annual programme is produced and a decision made as to which jobs, if any, should be offered to external contractors. This decision is based on the assumption that higher profile, higher value jobs will remain internal and only those which either require specialist skills or for which the in-house team does not have the capacity are offered to Framework Contractors, consisting of three for Roads Operations. These works are planned, scheduled and completed by the in-house team in consultation with the Client. Once completed the measurement and valuation of the works is agreed and the invoice signed off by the Client.</p> <p>In the short term, additional funding has been agreed for the Accelerated Roads Capital Programme which will provide an extra £2.5 million per annum for financial years 2021/22 and 2022/23 to deliver an accelerated resurfacing programme for the unclassified roads network in residential streets of Midlothian. As per Council approval, internal resources are engaged to deliver the Accelerated Roads Capital Programme and day to day emergency / reactive maintenance, with external contractors delivering on the current capital works programme within the two year timescale.</p> <p>Management made a conscious decision to delay a review of the Schedule of Rates (SORs) due to the pandemic and the low RPI rate. This is due to be undertaken taking into account the current risks in the market, and contingent values will be incorporated. The SORs will be appropriately benchmarked to ensure value for money.</p> | 0 | 4 | 2 | Management have confirmed the factual accuracy and findings of the report and agreed to the implementation of the recommendations within realistic timescales. |

| Report | Summary of key findings and recommendations | Recommendations | | | Status |
|---|---|-----------------|---|---|--------|
| | | H | M | L | |
| Subject: Roads Maintenance Service (cont'd) | <p>There have been significant improvements since the recruitment of the current Operations and Asset Manager Roads including the recruitment of additional staff and the shift in allocating work from contractors to the in-house team.</p> <p>The governance and strategic management of the Service requires improvement to achieve objectives and evidence best value. Internal Audit considers the level of assurance is Limited for those aspects. The Service's risk register requires update to take account of these findings and to re-evaluate the risks and mitigations.</p> <p>Internal Audit made the following recommendations:</p> <ul style="list-style-type: none"> • The Road asset management plan (RAMP) should be updated and published following engagement with relevant stakeholders. It should align with the corporate vision and demonstrate the contribution the RAMP makes towards achieving this vision. (Medium) • Financial plans should be prepared in alignment with the RAMP covering short, medium and long term time horizons. In reviewing the level of funding, the condition of the road network should be taken into account and lifecycle planning principles should be used. (Medium) • An asset management system should be acquired and asset and tool inventory registers created to enable effective asset management (road condition, inspection and maintenance). (Medium) • The Service should work with the Procurement team to establish framework agreements / contracts for plant hire. (Medium) • Appropriate performance monitoring arrangements including the use of benchmarking information require development to assist the operation of an efficient service which supports the Roads asset management plan (RAMP) and demonstrates value for money. (Low) • The possibility for more partnership working on road maintenance should be explored to optimise value for money. (Low) | | | | |

| Report | Summary of key findings and recommendations | Recommendations | | | Status |
|--|--|-----------------|---|---|--|
| | | H | M | L | |
| <p>Subject: Performance Management Local Government Benchmarking Framework (LGBF) – Improvement Service Return</p> <p>Category: Assurance – Cyclical</p> <p>Date issued: 08 October 2021 Draft; 22 October 2021 Final</p> <p>Level of Assurance: Limited for the 15 indicators submitted within LGBF SPI</p> | <p>The purpose of this assurance audit was to provide independent validation of performance indicators and benchmarking information, specifically to ensure accuracy of data of the 15 indicators submitted within LGBF SPI return to the Improvement Service for Local Government Benchmarking Framework (LGBF). This audit did not cover the full LGBF process.</p> <p>The LGBF brings together a wide range of information about how Scottish Councils perform in delivering better services to local communities. Overall there are 97 indicators which are submitted at different times.</p> <p>Individual Services are responsible for providing some of the data returns to the Continuous Improvement Team for the LGBF SPI return which includes 15 indicators and is required to be reported to the Improvement Service by 31 August 2021. They fall under 4 headings: Corporate; Corporate Assets; Culture and Leisure; and Environment. 9 indicators were selected for testing from the LGBF SPI return. The LGBF SPI return was submitted to the Improvement Service on time and the correction to one SPI was submitted during the validation period in September 2021.</p> <p>Internal Audit considers the level of assurance on the LGBF SPI return is Limited as testing of 9 performance indicators highlighted that 8 were either inaccurate, incomplete, based on historic data, or did not conform with the criteria stipulated in the LGBF data collection guidance. Within some Services there was a lack of procedures over the generation of the indicators, a lack of quality assurance checks, and there was not always an audit trail detailing how the indicators were calculated. It is useful to note that changes in staffing resulting in a lack of continuity reporting exposed a number of the issues identified.</p> <p>Internal Audit made the following recommendations:</p> <ul style="list-style-type: none"> • Services should: retain an audit trail of source documentation; create procedure notes; undertake quality assurance checks; and ensure compliance with the LGBF data collection criteria. Continuous Improvement Team should ensure a reminder of LGBF data collection guidance for the 15 indicators included in the LGBF return is disseminated to Services annually. (Medium) • The PIs where errors were highlighted should be re-calculated and reported to the Improvement Service for future correction. (Medium) | 0 | 2 | 0 | Management have confirmed the factual accuracy and findings of the report and agreed to the implementation of the recommendations within realistic timescales. |