

## Annual Statement on the Internal Control Environment as at 31 March 2013

Report by Elaine Greaves, Internal Audit Manager

### 1. Purpose of Report

This report presents my findings on the Council's Internal Control Environment and the Annual Statement on Internal Control for the year ending 31 March 2013.

### 2. Background

#### 2.1 Code of Practice

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

My statement is aimed at providing assurance on the internal control environment for senior management, the elected /independent members of the Audit Committee, other elected members and external audit.

#### 2.2 Risk Assessment

The Internal Audit Plan is compiled as a result of a risk assessment of the Council's main business affairs and the Council's aims and objectives. The audit plan is risk based and concentrates on governance, risk and internal control matters affecting the Council. This is aimed at giving optimum assurance over these key areas.

For the financial year 2012/13, the risk assessment approach has been consistent with the Internal Audit Strategy, approved by the Audit Committee and has focused internal 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;
- investigations, where required; and
- the provision of an Internal Control Help Desk service.

#### 2.3 Reporting lines of Internal Audit

During the financial year 2012/13, the reporting line for Internal Audit was to the Council's s95 officer (Head of Finance and Human Resources). This senior manager is responsible for the financial

stewardship of the Council and is a member of the Corporate Management Team.

The Risk and Audit Manager had access to the Chief Executive and during the year met him on a six-weekly basis along with the Director, Corporate Resources and the s95 Officer when governance, risk management and internal control matters were discussed.

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

#### **2.4 Internal Audit Resource**

The Internal Audit resource during 2012/13 was less than budgeted due to maternity leave and the reduction in hours of the senior auditor post from September 2012. However, the Internal Audit resource has been sufficient to complete a challenging and added-value Internal Audit Plan and this in turn has provided management, external audit, the Audit Committee and other interested parties with a significant level of assurance. Progress with the year's Internal Audit Plan was presented regularly to the Audit Committee during 2012/13.

#### **2.5 Miscellaneous audit tasks**

During the year Internal Audit has provided professional advice on a wide range of internal control topics including:

- updating the Fraud and Corruption Policy and Strategy;
- creating a whistle blowing facility for members of the public and employees;
- championing the electronic Authorised Signatories system;
- developing an E-Learning Internal Control Guide to heighten internal control awareness; and
- monitoring outstanding audit recommendations (internal audit and external audit) and carrying out a sample of follow up audits.

The Council's Anti-Fraud Policy was updated during the year and a new Whistle-blowing policy was created to assist in identifying and detecting fraud. A facility to raise concerns, anonymously, if desired, was set up in January 2013 on the Council's webpage to provide another vehicle for raising concerns. The implications of the Bribery Act 2010, reference to the Local Government Fraud Strategy and a Fraud Response Plan were included in the updated policy. Both policies and the methods available for raising concerns have been placed onto the intranet and internet and suitable publicity, both within and outwith the Council, was conducted to raise awareness amongst employees and the public.

An E-Learning Internal Control Module was created and placed on the Council's MILO system. This will be rolled out to areas due to be audited during the 2013/14 financial year.

Meetings and discussions with external audit have been undertaken during the year and these have been helpful and assisted in forming my opinion on internal control.

Internal Audit has regularly accessed the Council's Risk Management system to help inform Internal Audit assignments.

## **2.6 Level of reported fraud**

The level of reported fraud during the year has been low. There has been a theft of fuel using fuel cards which has been reported to the procurator fiscal. Management have implemented additional controls to help prevent any future thefts in this area.

Fraud and corruption prevention is a key part of the Council's Fraud and Corruption Policy and during the year Internal Audit was contacted directly by members of the public over various concerns on 9 separate occasions (2 of these were via the new whistle-blowing facility on the internet). These concerns were appropriately investigated and were recorded on the Helpdesk system.

Housing and Council Tax Benefit amounting to £23m was paid out by the Council and detected fraud continues to be relatively small on these payments (1%). The National Fraud Initiative (a UK data match between public sector bodies) continues to be a very useful exercise in identifying benefit fraud.

## **2.7 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. However, there is a new best practice guide called the 'Public Sector Internal Audit Standards' which replaces the CIPFA Code and comes into effect for the new financial year. A report will be submitted to the Audit Committee once an assessment to determine the level of compliance with the new code has been undertaken and discussed with senior management.

## **2.8 Internal Audit's opinion of the Internal Control Environment during 2012/13**

Midlothian Council's Internal Control Environment (ICE) is made up of:

- Macro and micro governance;
- Corporate Policies;
- Risk Management;
- Counter Fraud and Corruption;
- Financial Regulations and Directives;
- Statutory posts e.g. Monitoring Officer, s95 Officer; and
- Internal Controls.

To assess the adequacy of the ICE, the following audit / consultancy work was completed in the financial year:

- HR Transactional;
- Property Maintenance Rechargeable Work;
- Performance Indicators;
- Authorised Signatories System;
- Financial and Other Controls in Children's Centres;

- Fuel Management;
- Strategic Environmental Assessment;
- Corporate IT Resilience;
- Registrars (Births, Deaths, Marriages and CPs);
- Social Care Contracts – Home Care;
- Lasswade High School Replacement Project;
- Carbon Management/Energy Saving;
- Accounts Receivable;
- Housing and Council Tax Benefit: Audit Scotland Risk Assessment;
- Asset Management ICT;
- Accounts Payable ;
- Payment Card Industry Standard;
- Internal Audit Recommendations Follow Up;
- 9 Investigations; and
- 24 Help Desk Enquiries.

As a result of a higher number of investigations being conducted than expected (budgeted for 4 investigations and 9 have been undertaken) and reduced audit resource, audit work which is currently underway / still to be conducted is as follows:

- High value payments generated in divisions;
- Accounts Receivable follow up;
- Frameworki;
- Data Protection; and
- Council Tax (this has been moved onto the 2013/14 plan due to a request from management).

## 2.9 Opinion on the Council's Internal Control Environment

Each Internal Audit assignment has identified strengths and weaknesses and overall I have found that adequate internal controls have been implemented and are monitored by management in line with Financial Directives, Council Policy and the other key essentials of a robust Internal Control Environment.

However, the following audit assignments concluded that there was room for improvement in governance, management of risk and internal control:

**Accounts Receivable:** there is an element of debt which is proving challenging to collect. A follow up of this audit is currently being undertaken and will be reported to the Audit Committee in due course.

**Performance Indicators:** while our sample testing of Statutory Performance Indicators (SPIs) in 2011/12 showed a very low error rate in calculation, our review of Local Performance Indicators (LPIs) in 2012/13 revealed errors in calculation (some minor but some more serious) and governance over the production process needed to be more robust. PIs are important for monitoring service performance.

### **Authorised Signatories System**

An electronic authorised signatories system was introduced in 2011, and is a significant improvement on the previous manual version.

However some weaknesses still need to be resolved to reduce the risk of fraud, waste or error.

**Children's Centres:** this audit, requested by the Head of Children and Families, found that two centres (Midfield and Gorebridge) needed to improve their financial controls. The weaknesses identified in the audit are due to be addressed before the two new centres are opened.

**Corporate IT Resilience:** it was noted that the Corporate IT function had a Business Recovery Plan for the recovery of key network and applications but testing of the plan was not yet in place.

**Fuel Management:** control weaknesses over the use of fuel cards by operatives extracting petrol from private garages were identified.

**Social Care: Home Care Contracts:** we acknowledged that controlling and monitoring external care providers in the current economic climate was difficult but made recommendations in terms of financial checks, quality control, monitoring and risk management to improve control going forward.

**Carbon Management/Energy Saving:** we found that carbon reduction and energy savings had been tangible to date but recommended that the governance over this could be improved to achieve challenging targets.

**Property Maintenance Rechargeable Work:** recommendations were made to improve risk management, audit trails, the urgency with which invoices are raised and the collection of debts from rechargeable rates.

**Previous Internal Audit Recommendations:** a review of 379 internal audit recommendations made in the calendar years 2010-2012 showed that 84% had been implemented, 6% were being progressed and were within timescales and only 10% were time expired but were very close to being completed. However, an in-depth review of the implemented recommendations indicated that occasionally management had not fully installed the recommendations.

**Residual Risk in the Risk Management System:** we have noted that there is residual risk in the Covalent system where management has set risk tolerance levels but these are currently exceeded. Within the 385 risks listed, almost half are rated as medium risk. We have been assured that this risk profile is mainly due to the economic climate and the change that the Council is passing through. However, we will be closely looking at residual risk during the financial year 2013/14.

**Code of Corporate Governance:** we have noted that the Local Code was due to be updated in 2012 but its completion has been delayed.

I am pleased to report that management is currently addressing these areas for improvement and the Internal Audit team will be following up its recommendations during 2013/14.

### **3. Report Implications**

#### **3.1 Resource**

There are no direct resource implications arising from this report.

#### **3.2 Risk**

In overall terms, our Internal Audit assignments, External Audit, the Risk Management System, Investigations, Consultancy and Help-Desk Advice provides a sufficient level of assurance over the Governance, Risk Management and Internal Control compliance with Financial Directives and key Council Policies.

However, the areas highlighted for improvement present residual risk which management is currently dealing with.

#### **3.3 Single Midlothian Plan and Business Transformation**

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

#### **3.4 Impact on Performance and Outcomes**

None

#### **3.5 Adopting a Preventative Approach**

This report addresses the Council's policy to have a robust internal control environment, management of risk and effective governance.

#### **3.6 Involving Communities and Other Stakeholders**

This statement on the Council's Internal Control Environment is as a result of consultation with management during audit assignments, consultation with the s95 Officer, the Corporate Management Team, the Chair of the Audit Committee and External Audit.

#### **3.7 Ensuring Equalities**

We found no equalities issues to report on during the financial year. Going forward, the Corporate Improvement Team has invited Internal Audit to directly consider equalities in each audit assignment. This will be built into audit testing.

### **3.8 Supporting Sustainable Development**

Internal Audit provides an independent assurance function which assists the sustainability of the Council's Internal Control Environment, governance and management of risk. During the year, we have found no sustainability issues.

### **3.9 IT Issues**

None.

## **4. Recommendations**

The Audit Committee is invited to:

- (1) Endorse the Annual Statement on the System of Internal Control; and
- (2) Note that the internal control areas for improvement will be included in the Council's Annual Governance Statement (AGS).

**Date:** 18 April 2013  
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*Declaration Box*

*Instructions: This box must be completed by the author of the report. The box will be copied and saved by the Council Secretariat who will delete it from the report prior to photocopying the agenda.*

***Title of Report: Annual Statement on the Internal Control Environment as at 31 March 2013***

***Meeting Presented to: Audit Committee  
7 May 2013***

*Author of Report: Elaine Greaves*

***I confirm that I have undertaken the following actions before submitting this report to the Council Secretariat (Check boxes to confirm):-***

- All resource implications have been addressed. Any financial and HR implications have been approved by the Head of Finance and Human Resources.***
- All risk implications have been addressed.***
- All other report implications have been addressed.***
- My Director has endorsed the report for submission to the Council Secretariat.***

***For Cabinet reports, please advise the Council Secretariat if the report has an education interest. This will allow the report to be located on the Cabinet agenda among the items in which the Religious Representatives are entitled to participate.***

***Likewise, please advise the Council Secretariat if any report for Midlothian Council has an education interest. The Religious Representatives are currently entitled to attend meetings of the Council in a non-voting observer capacity, but with the right to speak (but not vote) on any education matter under consideration, subject always to observing the authority of the Chair.***