

## **MIDLOTHIAN COUNCIL - AUDIT COMMITTEE**

### **Annual Report from the Chair of the Audit Committee for the year ended 31 March 2017**

#### **1. Introduction**

This Annual report has been prepared to inform Midlothian Council of the work carried out by the Audit Committee during the financial year. In preparing this report reference has been made to the requirements of the Audit Committee Combined Code (2008) and the 2013 Chartered Institute of Public Finance and Accountancy (CIPFA) document "Practical Guidance for Local Authorities - Audit Committees".

#### **2. Meetings**

The Committee met formally five times in the year. A briefing session is held between the Chair and the Internal Audit Manager before each Audit Committee meeting. In addition the Chair also meets with the Chief Executive, Director Resources, Head of Finance and Integrated Service Support (Section 95 Officer) and Internal Audit Manager before each Committee. The Chair also met Elected Members, Senior Officers, Audit Scotland and the External Auditors outside of these formal meetings.

There was an attendance rate of 80% for the members of the Committee during 2016/17.

#### **3. Membership**

The Audit Committee has a total of 8 members. There are six Elected Members (voting members), an Independent Chair and an Independent Voluntary Member represented on the Committee. The quorum for meetings of the Committee of 3 Councillors was achieved at all meetings during the year. 5 members of the Committee have private sector financial experience and related qualifications. The Chief Executive, the Director, Resources, Director, Education Communities and Economy, Director of Health and Social Care and Head of Finance and Integrated Service Support are regularly in attendance; and other officers as appropriate. The Internal Audit team attended every meeting as did the Council's External Auditors.

#### **4. Governance**

The Committee operates under the Council's Standing Orders and its policy is to conform to the relevant CIPFA and Convention of Scottish Local Authorities (COSLA) Codes and Position Statements, and recommendations for Best Practice. An assessment against these codes is shown at Appendix 1. In light of the CIPFA position statement (issued in December 2013) alterations have been agreed to the Council's Standing orders in respect of the Audit Committee so as to continue in conformity with the CIPFA position (for example the need to assess value for money and approve the Audit Charter).

These proposed changes were authorised, along with other changes to the Standing Orders, by the full Council on 27 September 2016.

A training session for the new members of the Audit Committee is due to be held in June 2017 with EY, the External Auditors.

The Committee is also conversant with Audit Scotland's reports on Midlothian and its publications generally regarding local government in Scotland. The Audit Committee receives regular reports from Council officers presenting the actions taken against these reports.

The Chair and Committee Members have access to, and consult when appropriate, relevant publications of Audit Scotland, CIPFA, National Fraud Initiative (NFI), and relevant Accounting Standards. They also review the Council's Risk Management processes and Risk Registers, and monitor Internal Audit performance in terms of delivery of the Internal Audit Plan and the level of compliance against the Public Sector Internal Audit Standards.

The Members also review and have input to the Council's Annual Governance Statement.

## **5. Assurance Framework**

The Annual Governance Statement for 2016/17 sets out the actions proposed for 2017/18 to further improve the Council's assurance framework. These include:

- the 'Delivering Good Governance in Local Government: Framework' was updated by CIPFA/SOLACE in 2016 but this has not yet been fully embedded. Midlothian Council's Code of Corporate Governance has been updated but this is still in draft and hasn't yet been presented to Council;
- draft workforce plans have been developed but these require updating and a Council wide plan is required;
- although end of project post implementation reviews are completed for some projects, these are required to be completed for all projects;
- the Council's current Incident Response Plans focus heavily on disruption to service delivery associated with building availability. A Business Continuity Policy, detailing the Council's approach to ensuring critical services and outcomes can be delivered during periods of business disruption, has been created and once approved by CMT, training and Business Continuity Plans will be rolled out across the Council;
- a Register of Interests for Council Officials requires further development;
- a standalone Gifts and Hospitality policy requires to be developed; and
- the service review of Internal Audit should be completed and any subsequent changes to the Internal Audit plan (if any) should be approved by the Audit Committee.

## **6. Internal Audit Resource**

The Internal Audit team had a complement of 4.2 FTE employees for the majority of 2016/17. An internal assessment against the Public Sector Internal Audit Standards (PSIAS) was undertaken and this showed compliance against the code. The Council is participating in the Scottish Local Authority Chief Internal Audit Group's reciprocal assessments within local government and the first external assessment of Midlothian is to be undertaken in 2017/18. Internal Audit reports directly to the Chief Executive, which strengthens the independence of the function.

## **7. Internal Audit Reports**

Reports submitted by Internal Audit during the year have included:

Devolved School Management Scheme, Financial Assurance for money delegated to the Integration Joint Board, Follow up of Controls Operating over Developer Contributions, Follow-up Review of Audit Recommendations, Transformation Programme Follow-up Review, Review of Controls Operating over Care at Home, Follow-up Review of Petty Cash, Self-Directed Support, Corporate Fraud - Annual Report, Anti Fraud and Corruption, Anti Bribery and Whistleblowing Policies, Audit Scotland Report - National Fraud Initiative 2014/15, Tyne Esk LEADER and Welfare Reform - Universal Credits. These reports have been discussed by the Audit Committee and the recommendations made in the management actions plans have been endorsed.

The Committee observed a range of control weaknesses generally of a sporadic nature and capable of remediation. On areas such as Petty Cash, remediation, largely by payment card utilisation, has been a partial answer but further scrutiny will be desirable.

A number of Internal Audit reports encompassed areas of activity impacted on by governmental reforms. These include the Devolved School Management Scheme, Care at Home, Self-Directed Support and Welfare Reform. The risk control environment put in place is designed to ensure that there is no systemic failure in implementing the reforms and, in general, assurances were received that the risk control environment was effective. However in respect of Welfare Reform, it was noted that the early experience may not turn out to be statistically valid in the face of the full roll-out of Universal Credit which has the potential for significant impact on revenue due to be collected by the Council.

The Committee has also considered the questions of dispute resolution with regard to the Integration Joint Board (IJB) which is set out in the approved Integration Scheme. A further concern is the possibility of cross-subsidisation by one partner of the other and the arrangements will need continuing review to ensure that dysfunctional outcomes do not arise.

The Committee has made several recommendations in 2016/17 and endorsed the recommendations made by the Internal and External Auditors. Recommendations made in respect of internal controls are monitored by the Internal Audit team. Additionally, the External Auditor reviews the effectiveness of the controls and systems.

## **8. Annual Assurance Report**

The Annual Assurance Report on the Internal Audit function for the financial year 2016/17 will be submitted to the Audit Committee in June 2017 by the Internal Audit Manager. This report provides a summary of the work undertaken by the section in comparison to its plan and provides an overall opinion on the Council's system of control based on that work. The opinion states that overall the Council's framework of governance, risk management and control over the period 2016/17 was of a satisfactory standard and has been implemented and is monitored by management in line with Financial Directives, Council Policy and the other key essentials of a robust Internal Control Environment.

## **9. Progress Monitoring**

Internal Audit annually reviews whether a sample of recommendations has been implemented satisfactorily. In addition, a report is also prepared annually which details management's performance in closing issues by the agreed due date. Both of these reports are presented to and discussed by the Audit Committee. In December 2016, the Committee noted the output position of the Internal Audit function. There had been 497 recommendations made in the prior three years with 93% of the recommendations reported by management as implemented or "on target" to be implemented by the agreed date. This reflects a similar position to the previous year's performance (reported in December 2015) where 474 recommendations had been raised and 95% of these were reported as implemented or "on target" to be implemented by the agreed date.

However, staff indebtedness of around £1m and the age of the debtor book continues to be the subject of scrutiny.

In addition, specific matters are requested for follow-up discussions at the point of initial discussion, as is required by the Standing Orders and evidenced through the Audit Committee minutes.

## **10. Fraud**

The Council has a Corporate Fraud team and since October 2015 has undertaken reviews of council tax discounts and exemptions; worked with Housing to identify tenancy fraud; investigated matches as part of the Council's participation in the National Fraud Initiative; and delivered fraud awareness training to a number of areas in the Council. The team has identified circa £750,000 of savings (calculated using Audit Scotland's

guidance) in relation to this work. £651,000<sup>1</sup> of this is as a result of the recovery of 7 Council houses (4 of these houses totalling £372,000 were recovered in 2016/17).

## **11. National Fraud Initiative**

Midlothian participates in the National Fraud Initiative led by Audit Scotland using data-matching techniques to identify potentially fraudulent activity involving social security payments and other entitlements, such as the Blue Badge disabled parking scheme. A data match was undertaken in October 2016 and matches were received in January 2017. Key changes for the 2016/17 return include:

- Council tax reduction scheme data is an additional dataset required for the NFI 2016/17 exercise;
- Housing waiting list data is an additional dataset required for the 2016/17 exercise; and
- Council tax and electoral register data is now required the same year as the main exercise, but on a slightly different timescale.

Work is ongoing to check through the matches received to identify any fraudulent activity or overpaid benefits and discounts.

## **12. Newbyres Housing**

The Audit Committee retain interest in the progress of litigation aimed at recovery of losses incurred by the Housing Revenue Account relating to advice given in the construction of 66 council residential properties, which have now been demolished in consequence of CO2 emissions and the absence of foundation membranes.

## **13. Financial Monitoring, Strategy and Management**

The Committee has reviewed in 2016/17 regular reports submitted by the Head of Finance and Integrated Service Support in relation to Financial Monitoring, the General Services Capital Plan, Housing Revenue Account and the Financial Strategy.

The Committee has also reviewed the Financial Strategy for 2017/18 and the change programme aimed at addressing the projected budget gap.

In March 2017, the Committee received an annual report on the Business Transformation Programme which stated that delivery of the financial savings element of the programme has been and will continue to be a key contributor to the wider change programme aimed at addressing the projected budget shortfalls. Savings achieved to date (31/3/17) total £12.310 million which

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<sup>1</sup> Audit Scotland has advised that the appropriate calculation for the loss in respect of a fraudulent tenancy is £93,000 per tenancy to cover 2 years homeless accommodation, legal and administrative costs and 2 years future savings, assuming an average tenancy period of 4 years.

equates to 6.3% of the 2016/17 budgeted net expenditure. This includes further savings across the strands of the transformation programme of £2.791 million in 2017/18 rising to £5.437 million by 2021/22. Overall savings for the transformation programme are expected to be in the region of £17.8 million, or 9% of net expenditure.

However the Audit Committee has noted that the presentation of variances regarding the Transformation programme has changed to encompass departmental reforms in addition to the project specific work previously associated exclusively to the transformation group. The Committee was also aware of the comments of the Accounts Commission in March 2017: "Midlothian Council did not achieve its savings targets in 2015/16".

Internal Audit highlighted in its follow up report on the Transformation Programme in the review year 2016/17, that projections are not consistently derived and variances measured without further reference to aspirational forward-looking targets. Thus the delivery of savings to address the projected budget gap achievement remains a high concern for the Audit Committee.

The Committee was made aware of the opening General Fund Reserve of £24.625 million at 31 March 2016 of which £7.851 million was earmarked leaving a General Reserve of £16.774 million.

Changes approved to the utilisation of reserves coupled with operational performance in the year to 31 March 2017 were such that the Section 95 Officer reported to the Council in February 2017 that the projected General Fund Reserve at 31 March 2017 was £9.378 million of which £3.970 million would be utilised in setting the 2017/18 budget leaving a reserve position which is below the £8 million level previously considered appropriate.

The latest Financial Strategy report identified a budget shortfall for 2017/18 of £12.431 million, around 6% of net cost of services, which after reflecting the approved change programme required the utilisation of reserves of £3.970 million to deliver a balanced budget for the year.

It follows that the outlook is requiring immediate and sustained action to rebalance the revenue account.

#### **14. Treasury Management**

The Committee reviewed Treasury Management reports and noted that the average interest rate for Midlothian's portfolio of borrowing remains lower than all other Scottish Councils. The Council has continuing access to PWLB long-term borrowing and other shorter term borrowing markets.

The existence of £10 million of cash on deposit with a German counterparty, while made entirely within the existing protocols, was the subject of debate and in the future the Committee may wish to review the approved counterparty criteria set by Council against reputational, financial or regulatory risk.

## **15. External Audit**

The Audit Committee reviewed and discussed Grant Thornton's Annual Audit report, published in September 2016. Within the report it was stated that:

- while the Council generally budgets accurately, it does not have a good record of delivering savings. A number of observations reflecting the need for organisational tightening on IT systems, Register of Conflicts, Workforce Planning and Asset Revaluations were raised;
- the Internal Audit function was compliant with the requirements under Internal Audit Standards, delivers the specified plan and they have no concerns around arrangements currently in place to mitigate against fraud and corruption; and
- "our own observations of the Audit Committee are good. The Committee is well-attended, both by members and by senior Council officers. The Committee is also supported by Internal Audit, and by the Independent Chair, who provides additional perspective and financial expertise to the Committee".

## **16. Conclusion**

The Committee, in tandem with the Internal Audit function, has taken steps to streamline its workload by way of a more planned approach to subject scrutiny. It retains the flexibility to probe specific unanticipated problems, and increasingly views its work as related to assessing risks and not just enforcing good housekeeping as deficiencies become apparent, important though that function remains.

In 2017/18, close scrutiny on a consistent basis of the various strands of the change programme and income generating changes needed to secure financial sustainability will be the highest priority.