

**Internal Audit: Annual Assurance Report 2014/15**  
**Report by Graham Herbert. Internal Audit Manager**

**1. Purpose of Report**

This purpose of this paper is to report on the work undertaken by Internal Audit during the financial year 2014/15 and to provide an overall assessment of the adequacy and effectiveness of the Council's framework of governance, risk management and control based on that work.

**2. Background**

**2.01 Public Sector Internal Audit Standards (PSIAS)**

From 1 April 2013, all audit work was undertaken in accordance with the new Public Sector Internal Audit Standards (PSIAS). A paper on these new standards was reported to the Audit Committee on 18 June 2013. One of the requirements of these standards is that the Internal Audit Manager is required to prepare an annual internal audit opinion and report that can be used to inform the Council's overall Annual Governance Statement which is included in the published financial statements. The annual internal audit opinion must conclude on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control and must incorporate:

- the opinion;
- a summary of the work that supports the opinion;
- a statement on conformance with the Public Sector Internal Audit Standards; and
- the results of the quality assurance and improvement programme over the level of compliance by the Internal Audit Section with the requirements of PSIAS.

The Standards require that an external assessment be conducted at least once every 5 years by a qualified, independent assessor from outside the organisation over the level of compliance against PSIAS. An external assessment was not undertaken in 2014/15 as the system of reciprocal assessments is currently being developed by the Scottish Local Authority Chief Internal Auditors' Group (SLACIAG). The first external assessment should be undertaken in 2016/17.

However, an assessment of Internal Audit's work is undertaken each year by the Council's external auditor (Grant Thornton) as part of their annual audit. Their report in 2013/14 found this to be satisfactory.

## **2.02 Self Assessment of Internal Audit against the Standards**

A self evaluation of compliance with the Public Sector Internal Audit Standards by Midlothian Council's Internal Audit Section was undertaken by the Internal Audit Manager. This demonstrated that the key elements of the Standards were complied with during the year and identified a small number of areas where performance could be improved. An action plan has been developed to address these issues and the majority have already been acted upon. A report on this assessment is to be presented to the Audit Committee on 5 May 2015.

## **2.03 Balanced Scorecard**

Internal Audit has adopted indicators developed by SLACIAG over the course of 2014/15 and is compliant with the established requirements. One area will be further developed in 2015/16 in relation to seeking formal customer feedback on completed audits and this is included within the Internal Audit action plan.

## **2.04 Organisational Independence**

The Standards state that the Internal Audit Manager is required to report to the Audit Committee and have free and unfettered access to the Chief Executive and the Chair of the Audit Committee. He/she must report to a level within the organisation that allows the Internal Audit activity to fulfil its responsibilities and the Internal Audit Manager must confirm to the Audit Committee, at least annually, the organisational independence of the internal audit activity.

The reporting line for Internal Audit functionally is to the Audit Committee and structurally to the Chief Executive.

The Internal Audit Manager met regularly throughout the year with the Chief Executive, the Director, Resources and the Section 95 Officer to discuss governance, risk management and internal control matters. The Internal Audit Manager has met the chair of the Audit Committee on six separate occasions during the year and, in addition, before each Audit Committee meeting.

There have been no threats to the independence of the internal audit activity during the period.

## **2.05 Proficiency and Due Professional Care**

The Standards state that internal auditors must possess the knowledge, skills and competencies needed to perform their individual responsibilities and are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications. The Internal Audit Manager must hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced. Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor.

For the majority of the year (March 2014 to February 2015) the Internal Audit section has had a resource of 3.7 FTE. The role of Internal Audit Manager during this period was undertaken by 2 employees on a job share basis to accommodate the working pattern of 1 employee. Both employees hold an appropriate professional qualification (CMIIA and CIMA) and have extensive experience in the public and private sectors. The auditor is professionally qualified (ACCA) and the trainee auditor is making good progress towards obtaining a professional qualification (ACCA).

From February Internal Audit resource has increased to 4 FTE as one of the job sharing Audit Managers is on maternity leave. The remaining job share Internal Audit Manager is now acting as the FTE 1 Internal Audit Manager and a new Senior Auditor (ACCA qualified) is acting as the Senior Auditor.

The Internal Audit team is also taking responsibility for the two Accredited Counter Fraud Specialist officers who from October 2015 will be used to provide additional skills and resource to review corporate fraud risks. Until October they will continue to work on benefit related fraud (which is transferring to Single Fraud Investigation Service).

## **2.06 Internal Audit Resource**

The Internal Audit resource has been sufficient to complete a challenging and value adding 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.

## **2.07 Internal Audit Plan**

The Internal Audit Plan for 2014/15 was approved by the Audit Committee on 18 March 2014 and was revised and approved by the Audit Committee on 9 December 2014 (following the Public Sector Internal Standard requirements). The audit plan is risk based and concentrates on governance, risk and internal control matters affecting the Council.

For the financial year 2014/15, the risk assessment approach was consistent with the Internal Audit Strategy and focused Internal Audit resource 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.

There have been no areas reviewed which had inappropriate scope.

Progress with the Internal Audit Plan was presented to the Audit Committee in December 2014. Internal Audit is on course to achieve a very challenging Audit Plan by the end of June 2015, which is the target completion date for the 2014/15 plan.

## **2.08 Internal Audit Opinion**

I am content that the breadth and depth of coverage is sufficient to allow me to provide a balanced opinion on the overall adequacy of the Council's control environment over the period 2014/15. No direct reliance has been made on the work of other assurance providers in providing this opinion.

It is my view that overall 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.

In arriving at this overall opinion I have considered:

- the ratings applied to each individual audit undertaken in the period and their relative importance in relation to the control environment within Midlothian Council;
- management's performance in addressing issues raised by Internal Audit;
- the strength of governance arrangements including the Code of Corporate Governance and adherence to its requirements;
- the risk management system; and
- strategies designed to manage fraud risk.

### Internal Audit Reviews

In relation to the 2014/15 Audit Plan, we reviewed the internal controls, governance and management of risk within a number of Council systems, both financial and non financial. The Internal Audit activities undertaken during 2014/15 and the conclusions arising from that work are set out at Appendix 1.

Internal Audit use a set of assurance categories to provide an opinion on the level of assurance given over internal control, governance and the management of risk within each audit assignment. This can be found in Appendix 2.

From the Audits undertaken in 2014/15 we have identified a number of areas that required improvement to the internal controls and management of risk. These include:

- the Transformation Programme (limited assurance);
- the controls operating over Petty Cash (very limited assurance);
- Council tax liability and billing (moderate assurance); and
- Statutory performance indicators (moderate assurance).

The results of our audits were reported to management and action plans for improvement over controls were agreed on the conclusion of each audit. The recommendations arising from the action plans were loaded into the Council's Covalent system and progress with their implementation is recorded on the system by management.

Audit assignments have identified strengths as well as weaknesses and for the majority of systems reviewed we found that internal controls have been implemented and are monitored by management in line with Financial Directives and Council Policies.

I am pleased to report that management is currently addressing areas for improvement and have reported significant progress with the Transformation issues raised. The Internal Audit team will be following up on a sample of its recommendations during 2015/16.

### Implementation of Internal Audit Recommendations

Internal Audit periodically reviews whether recommendations have been implemented and reports the outcome of this to the Corporate Management Team and the Audit Committee. A review of overdue recommendations was undertaken in December 2014 and this highlighted that 92% of all recommendations were either 'completed' or 'on target' and only 8% were overdue. In June 2014, a sample of recommendations recorded as 'completed' by management on the Covalent system were reviewed to confirm the adequacy of the actions taken. The majority were found to have been implemented satisfactorily. This exercise will be repeated in May 2015 and the results will be reported to the June 2015 Audit Committee.

### Code of Corporate Governance

Each year Internal Audit undertakes a review of the Code of Corporate Governance and tests a sample of the key elements listed as controls to determine whether they are working in practice. Our testing identified that the control elements were working effectively and no issues have been raised.

We are aware that a new International Framework of Good Governance in the Public Sector has been developed jointly between CIPFA and International Federation of Accountants and work is required in 2015/16 to ensure compliance against the new code.

### Risk Management

Internal Audit reviews management's perception of risk in all audits undertaken and reviews risk more generally as part of the planning cycle for each year's audit plan. From these assessments it is noted that Midlothian Council has a mature risk management process with key risks monitored by management on operational, corporate and

project risk registers. We also noted that in 2014/15 a new risk strategy was developed and is being rolled out across the Council.

However we have noted that the new Risk Management Group has only met on two occasions during the financial year and risk management reports have not been provided to the Audit Committee or Corporate Management team on a quarterly basis. In addition we noted that some of the individual risk registers are not regularly updated. The Risk, Safety & Civil Contingencies Manager, has however put in place a meeting schedule for the Risk Management Group to support the regular reporting of risk to the Corporate Management Team and Audit Committee going forward. This approach is in line with the revised Risk Management Policy. Internal Audit will continue to monitor delivery against this policy in 2015/16.

### Fraud

Midlothian Council has a number of controls in place to limit the risks of fraud and to highlight where fraud may have occurred. These include:

- a Counter Fraud and Corruption Policy and Strategy;
- whistle blowing policy and reporting system;
- segregation of duties;
- operational risk registers contain a fraud risk which managers are required to review on a quarterly basis; and
- Heads of Service are required to assess fraud risk annually as part of the Annual Governance process.

We did note that a new CIPFA code of practice on “Managing the Risk of Fraud and Corruption” has recently been published and that some areas of improvement are noted arising out of a self assessment against this new code.

The levels of reported fraud / theft within the Council continue to remain relatively low although there have been a number of reported incidents in 2014/15. These include an alleged theft of cash from a school (£2,760), an alleged theft of six mobile telephones, alleged thefts from Council re-cycling facilities and an alleged theft of fuel. Investigations (or disciplinary investigations) are currently being undertaken.

### Annual Governance Statement

The following issues from this report have been used within the annual Governance Statement. The need to:

- strengthen internal controls in a number of areas (including transformation and petty cash);
- update the existing Code of Corporate Governance following issue of the new International Framework of Good Governance in the Public Sector;

- review current fraud strategies and policy to allow full compliance against the new CIPFA code of practice on “Managing the Risk of Fraud and Corruption”; and
- continue to develop and roll out the new risk management strategies adopted within the Council.

### **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, 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 the Financial Directives and key Council policies. However, the areas highlighted for improvement present residual risk which management are progressing.

#### **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 Key Priorities within the Single Midlothian Plan**

This report does not relate directly to the key priorities within the Single Midlothian Plan.

#### **3.5 Impact on Performance and Outcomes**

None.

#### **3.6 Adopting a Preventative Approach**

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

#### **3.7 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, the Corporate Management Team and the Chief Executive.

### **3.8 Ensuring Equalities**

We found no equalities issues to report on during the financial year. Internal Audit considers equalities issues as part of every audit assignment.

### **3.9 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.

### **3.10 IT Issues**

There are no IT issues with regard to this report.

## **4. Recommendations**

The Audit Committee is invited to:

- (1) note the Annual Assurance Report; and
- (2) note that the weaknesses identified with internal controls in 2014/15 will continue to be followed up in 2015/16 and updates will be provided to the Corporate Management Team and the Audit Committee.

**Date:** 31 March 2015  
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## **Appendices**

Appendix 1 - Summary of 2014/15 Internal Audit Plan

Appendix 2 - Definition of Internal Audit Assurance Categories



**SUMMARY OF 2014/15 INTERNAL AUDIT PLAN**

No	Audit Activity	Date reported to Audit Committee and rating (where applicable)	Comment
1	A review of the code of Corporate Governance	May 2015 Audit Committee	An audit of a sample of controls listed in the code of corporate governance was reviewed for operational effectiveness. Testing identified the key elements to be in place and operating effectively.
2	Annual Assurance Report	May 2015 Audit Committee	A high level summary of the control environment of the Council by the Internal Audit Manager. The statement is also used to inform the annual governance statement.
3	Review of the Internal Audit Charter based on the Public Sector Internal Audit Standards	October 2014 Audit Committee	The charter is required to allow the Internal Audit Section to be compliant with s95 of the Local Government Scotland Act.
4	Internal Audit Recommendations Follow up	June 2014 Audit Committee	A follow up review was undertaken of a sample of previously raised recommendations made by Internal Audit. The majority were found to have been implemented satisfactorily.
5	Transformation Programme	October 2014 Audit Committee	This audit reviewed the progress being made with the Council's Business Transformation Programme. A number of issues were identified particularly around the quality of reporting and the Audit was rated as limited assurance (amber).
6	Council tax liability and billing	October 2014 Audit Committee	This audit reviewed the adequacy of controls over the Council Tax system with coverage limited to liability and billing. The audit identified that Midlothian was in the lower quartile in terms of Council tax collection and of cases to be processed. The audit was rated as moderate assurance (yellow).
7	Purchase to Pay	December 2014 Audit Committee	This audit reviewed the adequacy of the processes and controls in place to manage the risks in relation to the Purchase to Pay system and the governance and controls surrounding the purchase to pay business transformation project. The audit was rated as providing a high degree of assurance over the effectiveness of the controls (green).
8	A review over controls operating at Vogrie	February 2015 Audit Committee	This audit reviewed the controls over cash collection at Vogrie (Car Parking Machine and Golf Starters Hut) and made recommendations to improve on existing controls.
9	Review of controls operating over petty cash	March 2015 Audit Committee	This audit reviewed the adequacy of the processes and controls established at a Council level over the operation of petty cash accounts and the level of compliance against the established processes and controls for a sample of petty cash accounts. The audit

No	Audit Activity	Date reported to Audit Committee and rating (where applicable)	Comment
			identified a number of control failings and was rated as very limited assurance (red).
10	Statutory Performance Indicators	March 2015 Audit Committee	This audit reviewed a sample of Statutory Performance Indicators to determine the adequacy of processes and controls to allow accurate reporting. The Audit identified a generally sound system of control but did identify a small number of errors on individual performance indicators. The audit was therefore rated as moderate assurance (yellow).
11	Payroll	June 2015 Audit Committee	This audit reviewed the adequacy of controls operating over the payroll system. The report is planned to be presented to the June Audit Committee.
12	Cashless Catering	June 2015 Audit Committee	This audit reviewed the adequacy of controls operating over the Cashless Catering system. The report is planned to be presented to the June Audit Committee.
13	Developer contributions	Field work underway (Planned for June Audit Committee)	This audit is to review the controls operating over receipt and use of developer contributions.
14	House Rents	Field work underway (Planned for June Audit Committee)	This audit is to review the adequacy of controls over the collection of housing rents with coverage limited to billing and charging.
15	Commercial Rent	Field work underway (Planned for June Audit Committee)	This audit is to review the controls surrounding the renting of Council owned commercial property.
16	Arrears Management	Planning Stage	This audit is to review the controls operating over arrears management in relation to rents and council tax.
17	Audit Scotland Reports	Reported to various Audit Committees - ongoing	To alert the Audit Committee to any National Audit Scotland reports and to address any actions to the appropriate council officers.
18	Internal Audit Recommendations Performance Report	December 2014 Audit Committee	A review of overdue recommendations was undertaken and this highlighted that 92% of all recommendations were either 'completed' or 'on target' and only 8% were overdue.
19	National Fraud Initiative (NFI)	March and May 2015 Audit Committee	To provide oversight on the reporting of progress for the 2014/15 NFI exercise to the Audit Committee.
20	Self Assessment of the Internal Audit Section against PSIAS	To be reported to the May 2015 Audit Committee  Rating - Good Compliance found	To undertake a self evaluation of compliance with the Public Sector Internal Audit Standards by Midlothian Council's Internal Audit Section.
21	Self Assessment of the Audit Committee	To be reported to the June 2015 Audit Committee	To undertake an assessment of the Audit Committee against the new CIPFA guide "Practical Guidance for Local Authorities" published in December 2013.
22	Establishment of an Integrity Group	February 2015 Audit Committee	To assist management with the establishment of an Integrity Group.
23	Data Matching Exercise on staff debt (x2)	N/A	Assistance provided to the Income Maximisation Business Transformation Stream to identify Council staff with Council

No	Audit Activity	Date reported to Audit Committee and rating (where applicable)	Comment
			debt.
24	Help desk facility	N/A	58 individual enquiries were raised with Internal audit over the year. This included whistle blowing and requests for internal control advice.

### **Update to plan**

There have been two changes to the revised plan submitted to the Audit Committee for approval in December 2014:

- positive destination was on the 2014/15 Audit Plan and was a risk based audit (because of Midlothian's relatively poor position). Since the plan was established however there has been significant progress and Midlothian is now in the top quartile. As the audit was to review possible reasons for the poor performance the need for the review has been removed and therefore it has been deleted from the plan; and
- the sickness absence performance indicator was not included within the Statutory Performance Indicators audit but rather performance indicators where the Council performance was in the lower quartile were selected.

To compensate for the loss of these two audits additional work has been undertaken on: NFI, responsibility for which transferred to Internal Audit on a phased basis in February 2015 (and was not included in our 2014/15 plan); and in relation to planning work for the new Health and Social Care Integrated Board.

## DEFINITION OF INTERNAL AUDIT ASSURANCE CATEGORIES

Colour	Level of Assurance	Reason for the level of Assurance given
Blue	<b>Very High</b>	Internal Control, Governance and the Management of Risk are at a very high standard with no unacceptable residual risk existing.
Green	<b>High</b>	Internal Control, Governance and the Management of Risk are at a high standard with only marginal elements of residual risk, which are either being accepted or dealt with.
Yellow	<b>Moderate</b>	Internal Control, Governance and the Management of Risk have displayed a mixture of little residual risk, but other elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
Amber	<b>Limited</b>	Internal Control, Governance and the Management of Risk are displaying a general trend of unacceptable residual risk and weaknesses must be addressed within a reasonable timescale, with management allocating appropriate resource to the issues.
Red	<b>Very Limited</b>	Internal Control, Governance and the Management of Risk are displaying key weaknesses and extensive residual risk above an acceptable level which must be addressed urgently, with management allocating appropriate resource to the issues.

