

**MINUTES of MEETING of the MIDLOTHIAN COUNCIL AUDIT COMMITTEE** held in the Council Chambers, Midlothian House, Buccleuch Street, Dalkeith on Tuesday, 28 October 2014 at 11.00 am.

**Present:** - Mr Smaill (Independent Chair); Councillors Baxter, Bryant, Milligan, Muirhead, Thompson and de Vink.

## **1 Declarations of Interest**

There were no declarations of interest.

## **2 Order of Business**

On consideration of a request by Councillor de Vink, the Committee agreed to advance consideration of a situation report by the Director, Resources in respect of Newbyres Crescent, Gorebridge to Item No. 4 hereof.

## **3 Minutes**

The Minutes of Meeting of 18 June 2014 were submitted and approved, subject to the substitution of "accounts" by the words " financial strategy" in paragraph 3(a) thereof.

## **4 Exclusion of Members of the Public**

In view of the nature of the business to be transacted, the Committee agreed that the public be excluded from the meeting during discussion of the undernoted item, as contained in the Addendum hereto, as there might be disclosed information as defined in paragraphs 9 and 12 of Part I of Schedule 7A to the Local Government (Scotland) Act 1973:-

Newbyres Crescent, Gorebridge – Situation Report by Director, Resources – Agreed (a) to note the advice given by legal and structural engineering consultants; (b) to receive a further update report in the early part of 2015; (c) to note that no claims for compensation other than claims for Home Loss and Disturbance Payments under the Land Compensation (Scotland) act 1973 had been received; (d) to note that the Chief Executive would be submitting a further report to the Council on 4 November 2014; and (e) to otherwise note the report.

## **5 Business Transformation – Internal Audit Report**

There was submitted report, dated 21 October 2014, by the Internal Audit Manager, on an audit undertaken in respect of the Council Transformation Programme. The purpose of the Audit was to (i) form an opinion on the adequacy and effectiveness of the governance arrangements for the

transformation programme; (ii) to sample of individual work streams including service reviews; (iii) review progress to date against original aims and objectives at a programme level and on a sample of individual work streams; and (iv) assess the effectiveness of the programme to deliver change. The audit had concluded that the Transformation Programme had been and continued to be critical to the Council both in terms of delivery of savings and to improve the quality of service provided to users of Council services. There were however a number of issues above the acceptable level of residual risk which needed be addressed within a reasonable timescale. The report accordingly incorporated a management action plan to address these issues.

### **Decision**

- (a) To approve the management action plan;
- (b) To note that a number of the remedial measures referred to in the action plan had already been implemented; and
- (c) To otherwise note the report.

(Action: Corporate Management Team; Business Transformation Manager).

## **6 Council Tax Liability and Billing – Internal Audit Report**

There was submitted report, dated 21 October 2014, by the Internal Audit Manager, on an audit undertaken in respect of Council Tax Liability and Billing. The purpose of the Audit was to review the adequacy of controls in place for these particular aspects of Council Tax operations. The report had concluded that Internal Control, Governance and the Management of Risk had displayed a mixture of little residual risk, but that other elements of residual risk were slightly above an acceptable level and therefore needed to be addressed within a reasonable timescale. The report accordingly incorporated a management action plan to address these issues.

### **Decision**

- (a) To approve the management action plan;
- (b) To note that a number of the remedial measures referred to in the action plan had already been implemented; and
- (c) To otherwise note the report.

(Action: Head of Customer and Housing Services).

## **7 Review of Information Technology Control Environment**

There was submitted report by the External Auditors (Grant Thornton) in respect of a review undertaken by them in respect of the Council's Information Technology Control Environment. The review concentrated on IT general controls including logical access, change management and IT operations and assessed the operational effectiveness of security administration controls

including users that had access to post invoices in the financial ledger. The review had identified five weaknesses, which represented a control deficiency and had a risk of inconsequential financial misstatement. . The report accordingly incorporated a management action plan to address these issues.

### **Decision**

- (a) To approve the management action plan;
- (b) To note that a number of the remedial measures referred to in the action plan had already been implemented;
- (c) To note that officials would explore options for the location of a back up server in the context of both the EWIM and new school build programmes; and
- (d) To otherwise note the report.

(Action: (a) and (b)Head of Finance and Integrated Service Support; (c) Head of Properties and Facilities Management).

## **8 Audit Reporting Calendar**

There was submitted report, dated 1 July 2014, by the Internal Audit Manager, providing the Committee with an indication of Reports which were intended to be presented to each of the Committee's meetings during the period November 2014 to June 2015.

### **Decision**

To approve the Reporting Calendar.

(Action: Internal Audit Manager).

## **9 Updated Audit Report Template**

There was submitted report by the internal Audit Manager, presenting for approval, a revised internal audit report template which was incorporated into the report. The main changes to the report format were as follows:

- streamlining the executive summary so that the emphasis was on the audit opinion;
- updating the audit opinion rating definitions and moving away from the colour coding system;
- providing definitions of high, medium and low priorities when applied to recommendations; and
- including the audit Terms of Reference in full as an appendix to the report.

### **Decision/**

**Decision**

To approve, for its interest, the revised report format.

(Action: Internal Audit Manager)

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

There was submitted report, dated 2 October 2014, by the Internal Audit Manager, presenting an updated Audit charter for approval. The report explained that the charter had been updated to reflect the fact that the Internal Audit unit now reported structurally to the Chief Executive and that the Council participated in the Scottish Local Authority Chief Internal Audit Group scheme for external inspections.

**Decision**

To approve the revised Audit Charter as shown in the **Appendix** hereto.

(Action: Internal Audit Manager: All to note).

**11 Scottish Local Authorities Chief Internal Auditors Group**

There was submitted report, dated 30 June 2014, by the Internal Audit Manager, providing the Audit Committee with an update on the activities of the Scottish Local Authorities Chief Internal Audit Group during the period 2013/14. The report incorporated the annual report of the Chair of the Group for this period and detailed the contributions of the Midlothian representatives in respect of the Group's activities.

**Decision**

To note the report and the activities of Scottish Local Authorities Chief Internal Auditors Group during 2013/14.

**12 Audit Scotland Report: "Charging for Services: Are you getting it Right?"**

There was submitted report, dated 1 September 2014, by the Director, Resources, on the relevance of the National Audit Report entitled "*Charging for Services: Are you getting it right*" which was published in October 2013. The report detailed the guidance given by Audit Scotland in this matter and drew attention to the fact that the advice had been followed during the Council's review of fees and charges which had resulted in the Council on 24 June 2014, determining fees and charges for 2014/15 and adopting a Corporate Charging Framework and Corporate Charging Strategy.

**Decision**

To note the report.

### 13 **Audit Scotland Report: “Options appraisal: Are You getting it Right?”**

There was submitted report, dated 7 October 2014, by the Head of Finance and Integrated Service support, providing the Committee with a summary of the Audit Scotland report, ‘*Options appraisal: are you getting it right?*’ and the proposed actions to be taken by the Council in response thereto. The report provided detailed information on the key findings and messages from the Audit Scotland report; the role of Councillors in options appraisal; the options appraisal process; and the current position within the Council, which was that the options appraisal process was incorporated within the project management framework for service reviews and also as part of the Decision Matrix within the Council’s Service Delivery Framework.

#### **Decision**

- (a) To note the Audit Scotland report and Midlothian Council’s current approach to options appraisal;
- (b) To note that the ‘Questions for Members’ appendix within the Audit Scotland report would be used to inform a future “refresh” scrutiny session within the ongoing Elected Member Development Programme; and
- (c) To note that the ‘Questions for Officers’ appendix within the Audit Scotland report would be circulated to those officers identified as “leads” for the various reviews noted in the single delivery plan and that this exercise would be monitored by the Business Transformation Programme Manager.

(Action: Business Transformation Manager).

### 14 **Audit Scotland Report: “An Overview of Local Government in Scotland 2014”**

There was submitted report, dated 9 October 2014, by the Chief Executive, providing the Committee with a summary of the Audit Scotland report, ‘*An overview of local government in Scotland 2014*’ and the Council’s position in relation to the report’s findings. The report therefore detailed each of the recommendations of the Audit Scotland report and the steps taken within the Council to accord with those recommendations.

#### **Decision**

- (a) To note the report; and
- (b) To note that the Audit Scotland report would be discussed with the Council’s Community Planning partners.

**15 Financial Strategy 2015/16 to 2017/18**

With reference to paragraph 15 of the Minutes of the Council of 23 September 2014, there was submitted report, dated 16 September 2014 by the Head of Finance and Integrated Service Support, providing an update on the delivery of the Financial Strategy approved by Council on 4 February 2014 including;

- Scottish Government Grant Settlements;
- Projections for 2015/16 and 2016/17;
- Initial projections for 2017/18;
- Delivery of the strands of the Financial Strategy, including the Transformation Programme; and
- Reserves.

**Decision**

- (a) To note that a further update report would be submitted to the Council on 4 November 2014;
- (b) To note the projected budget shortfalls through to 2016/17; and
- (c) To note the demographic and inflationary pressures on the Council's Revenue budget.

**Sederunt**

Councillor de Vink left the meeting during discussion of the foregoing item of business (12. 15 pm).

The meeting terminated at 12.20 pm.



## **Appendix (relative to paragraph 10)**

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### **MIDLOTHIAN COUNCIL – INTERNAL AUDIT CHARTER**

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#### **INTRODUCTION**

The Public Sector Internal Audit Standards (PSIAS) requires that the purpose, authority and responsibility of the Internal Audit activity must be formally defined in an Internal Audit Charter, consistent with the *Definition of Internal Auditing*, the *Code of Ethics* and the *International Standards for the Professional Practice of Internal Auditing* (Standards) detailed in the PSIAS. The Internal Audit Manager will periodically review the Internal Audit Charter and present it to senior officers within the Council and the Audit Committee for approval.

The authority for Internal Audit to operate in Midlothian Council is contained in the Local Code of Corporate Governance, the Council's Standing Orders and in the Financial Regulations. This Internal Audit Charter expands upon that framework, defines the detailed arrangements and sets out the Internal Audit Manager's strategy for discharging his / her role and providing the necessary annual assurance opinion.

Midlothian Council's Internal Audit service will comply with the PSIAS and will apply these standards to all Internal Audit service providers, whether in house, shared services or outsourced.

#### **DEFINITIONS (standards 1000, 1010)**

Midlothian Council has adopted the definition of Internal Auditing as given in the PSIAS (**standard 1010**):

*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.<sup>1</sup>*

The Public Sector Internal Audit Standards require that the Internal Audit Charter defines the terms 'board', 'senior management' and 'Chief Audit Executive' in relation to the work of Internal Audit. For the purposes of Internal Audit work, at Midlothian Council:

- the 'board' refers to the Council's Audit Committee which has delegated responsibility for overseeing the work of Internal Audit;
- 'senior management' is defined as the Chief Executive and members of the Council's Corporate Management Team; and
- 'Chief Audit Executive' refers to the Internal Audit Manager.

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<sup>1</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Section 3



## **CODE OF ETHICS AND CONFIDENTIALITY**

Internal auditors will conform to the Code of Ethics as set out in the PSIAS (**standard 1010**).<sup>2</sup> This includes the principles of:

- integrity;
- objectivity;
- confidentiality; and
- competency.

Disciplinary procedures of professional bodies and the Council may apply to breaches of this Code of Ethics. Additionally, internal auditors are bound by the rules of confidentiality set out in their local conditions of service and job description. If individual internal auditors have membership of another professional body then he or she must also comply with the relevant requirements of that organisation. Internal auditors must also have regard to the Committee on Standards of Public Life's Seven Principles, information on which can be found at [www.public-standards.gov.uk](http://www.public-standards.gov.uk).

## **RIGHTS OF ACCESS AND AUTHORITY (standards 1000, 1010)**

The Council has given the Internal Audit Service, for the purpose of its audit work, full, free and unrestricted access at any reasonable time to all the Council's records and other documentation (electronic and manual), personnel, Elected Members, premises, assets, and operations of the Council and partner organisations. It also has authority to obtain such information and explanations as it considers necessary to fulfil its responsibilities. All employees, including senior management, are required to assist the Internal Audit activity in fulfilling its roles and responsibilities.

Internal Audit has permission to be provided with a separate log-in to any computer system within the Council and have full access to any system, personal computer or other device in the ownership of the Council. Internal Audit can require any employee of the Council to produce cash, stores, or any other Council property under the employee's control.

Internal Audit will safeguard all information obtained in the carrying out of its duties and will only use it for the purposes of an audit, investigation, or consultancy work. Internal Audit will make no disclosure of any information held unless this is authorised or there is a legal or professional requirement to do so.

## **POSITION OF INTERNAL AUDIT WITHIN MIDLOTHIAN COUNCIL AND REPORTING LINES (standards 1000, 1010, 1110)**

Structurally, Internal Audit reports directly to the Chief Executive. At least eight times a year, the Internal Audit Manager meets the Chief Executive to discuss progress with the audit plan, audit findings, the internal control environment, levels of residual risk and governance matters. Reporting at this level helps ensure the independence of Internal Audit, for example in terms of audit selection, scope, audit procedures, frequency of reporting, the content of reports, and that issues raised in reports receive a sufficiently high profile. Additionally, this reporting structure enhances the

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<sup>2</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Section 4

perception of independence from the perspective of auditees (ie that Internal Audit is free from the influence of Council services).

The Internal Audit Manager has unrestricted access to the Chair of the Audit Committee, and the Committee Members, and discusses before each Audit Committee, the agenda with the Chair (**standard 1111**). Additionally, Internal Audit has unrestricted access to all Chief Officers and employees of the Council.

The reporting relationship described above along with the access to Audit Committee Members and senior management ensures that *“the Internal Audit activity is reporting to a level within the organisation that allows the internal audit activity to fulfil its responsibilities.”*<sup>3</sup>

Functionally, Internal Audit Reports to the Audit Committee (the Board). The Internal Audit Service reports 7 times a year to the Audit Committee, whose membership consists of 6 Elected Members, an independent chair and an independent member.

The Audit Committee will:

- approve the Internal Audit Charter;
- approve the Risk Based Internal Audit Plan;
- approve the Internal Audit budget and resource plan;
- receive communications from the Internal Audit Manager on the Internal Audit activity’s performance relative to its plan and other matters;
- approve decisions regarding the appointment and removal of the Internal Audit Manager; and
- make appropriate enquiries of management and the Internal Audit Manager to determine whether there are inappropriate scope or resource limitations.

In addition, the Audit Committee reviews all Internal Audit reports including the Annual Assurance Statement.

The Audit Committee has delegated to the Chief Executive the responsibility of setting the remuneration and performance assessment of the Internal Audit Manager and feedback is also sought from the chair of the Audit Committee. Decisions in relation to the appointment or removal of the Internal Audit Manager have likewise been delegated to the Chief Executive.

This will all be managed within the Council’s existing Human Resource policies and procedures.

## **INDEPENDENCE AND OBJECTIVITY (standards 1000, 1010, 1110, 1111)**

In Midlothian Council, Internal Audit is an independent review activity. It is not an extension of, or a substitute for, the functions of line management and will remain free from any undue influence or other pressure affecting its actions and reporting.

At all times, management’s responsibilities include:

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<sup>3</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Standard 1110

- maintaining proper internal controls in all processes for which they have responsibility;
- the prevention, detection and resolution of fraud and irregularities;
- providing Internal Audit with full support and co-operation, including complete access to all records, data, property and personnel relevant to the performance of their responsibilities at all levels of operations, without unreasonable delay;
- agreeing Terms of Reference no later than the agreed deadline, to include agreements on duration, scope, reporting and response;
- sponsoring each audit at Head of Service level;
- considering and acting upon Internal Audit findings and recommendations or accepting responsibility for any resultant risk from not doing so;
- implementing agreed management actions in accordance with the agreed timescales; and
- updating Internal Audit with progress made on management actions, informing Internal Audit of proposed changes and developments in process and systems, newly identified significant risks and cases of a criminal nature.

In addition, (**standard 1110.A1**) Internal Audit:

- has no executive responsibility, thus protecting its independence of reporting and action;
- has the authority to report in its own name;
- reserves to itself the right to determine its own work plans and priorities, which it will do in full compliance with recognised professional standards. Whilst Internal Audit will respond to requests for specially commissioned assistance, this is always subject to its existing commitments and the respective levels of identified risk; and
- will prepare annually, for the endorsement and agreement of the Audit Committee, a risk based audit plan of the activities and areas that are to be covered by its work. This will be based on an audit risk assessment and prioritisation of key business, operational, management and financial risks.

Given the safeguards in place outlined above and the access Internal Audit has to senior management, the Internal Audit service is free to act independently and objectively. The Internal Audit Manager will confirm to the Audit Committee, at least annually, the organisational independence of the Internal Audit activity.

### **PURPOSE (standards 1000, 1010, 2000, 2100)**

Internal Audit is an independent appraisal function and is part of Midlothian Council's system of Corporate Governance.

The Internal Audit Service's purpose is to support the Council in achieving its objectives by:

- supporting the Council in continuing to improve its governance arrangements;
- contributing to the Council's management of risk;
- supporting the Council in raising the standard of internal control;
- supporting the Director, Resources, Head of Finance & Integrated Service Support (s95 officer) and the Audit Committee in the discharge of their duties;
- contributing to the development and implementation of the Council's policies and procedures;

- supporting the Council with governance, risk and internal control advice in the development of new systems and improvement of existing systems;
- supporting the Council with governance, risk and internal control advice on projects;
- acting as an aid to ensure that the Council and its Members, managers and officers are operating within the law and relevant regulations;
- contributing towards the accuracy and reliability of financial statements and other published information;
- supporting of the Council in its management of human, financial and other resources in an efficient and effective manner;
- supporting the Council in meeting its social, environmental and community priorities;
- promoting and raising the standards of an anti-fraud and corruption culture; and
- contributing towards establishing and maintaining a culture of honesty, integrity, openness, accountability and transparency throughout the Council in all its activities and transactions.

These objectives will be achieved via the delivery of a high quality Internal Audit service that meets the needs of the Council.

The Internal Audit Manager will effectively manage the Internal Audit activity to ensure it adds value to the Council. The Internal Audit Service is effectively managed by:

- the results of the Internal Audit service's work achieving the purpose and responsibilities outlined in this Internal Audit Charter;
- the Internal Audit activity conforming with the *Definition of Internal Auditing* and the *Standards*;
- the individuals who are part of the Internal Audit activity demonstrating conformance with the *Code of Ethics* and the *Standards*; and
- performance against the Internal Audit balanced scorecard reported annually to the Audit Committee.

The Council's Internal Audit Service adds value to the Council by providing objective and relevant assurance, and contributing to the effectiveness and efficiency of governance, risk management and control processes.

### **SCOPE OF INTERNAL AUDIT ACTIVITY (standards 1000, 1010, 2100, 2110, 2120, 2130)**

The scope of the work carried out by Internal Audit is designed to evaluate and recommend improvements to the Council's governance, risk management, and control processes using a systematic and disciplined approach (**standard 2100**).

Internal Audit shall review, appraise, make appropriate recommendations for improvement, and report upon:

- the Council's governance arrangements and processes;
- the design, implementation and effectiveness of the Council's ethics-related objectives, programmes and activities;
- the information technology governance of the Council in support of the Council's strategies and objectives;

- the systems and processes in place to ensure effective organisational performance management and accountability;
- the coordination of activities and communication among the Audit Committee, external and internal auditors and management;
- the identification and assessment of risk by management;
- the effectiveness and appropriateness of controls and other arrangements put in place to manage risk;
- the risk appetite of the part of the Council under review and the residual risk;
- the communication of risk and control information in a timely manner across the Council, enabling staff, management and the Audit Committee to carry out their responsibilities;
- the potential for the occurrence of fraud and how the organisation manages fraud risk;
- the completeness, reliability, integrity and timeliness of information, both financial and operational;
- the systems and processes established to ensure compliance with policies, plans, procedures, laws, and regulations, whether established by the Council or externally, and that employees' actions are in compliance;
- the action(s) taken to address significant legislative or regulatory issues;
- the economic acquisition of resources;
- the effectiveness of arrangements for safeguarding the Council's assets and interests;
- the economy, efficiency and effectiveness with which resources are deployed;
- the effectiveness and efficiency of operations and programmes; and
- the extent to which operations are being carried out as planned and strategic objectives and goals are met.

Internal Audit's work covers:

- all Council activities, systems, processes, controls, policies, and protocols;
- all Council departments, cost centres and other business units and establishments; and
- all services and other activities for which the Council is responsible or accountable, whether delivered directly or by third parties through contracts, partnerships or other arrangements.

Where other assurance providers (such as Grant Thornton or Audit Scotland) have undertaken relevant assurance work, Internal Audit will seek to rely on the work of these other assurance providers where professional standards and the nature and quality of the work they have undertaken would make it appropriate to do so.

### **DUE PROFESSIONAL CARE (standard 1220, 1220.A1, 1220.A2, 1220.A3, 1220.C1)**

Internal auditors will apply the care and skill expected of a reasonably prudent and competent internal auditor. This means Internal Auditors will be alert to the significant risks that might affect objectives, operations or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified (**standard 1220.A3**). Due professional care does not imply infallibility.

Internal auditors will exercise due professional care by considering (**standard 1220.A1**):

- the extent of work needed to achieve the engagement's objectives;
- relative complexity, materiality or significance of matters to which assurance procedures are applied;
- adequacy and effectiveness of governance, risk management and control processes;
- probability of significant errors, fraud, or non-compliance; and
- cost of assurance in relation to potential benefits.

In exercising due professional care, internal auditors should consider the use of technology-based audit and other data analysis techniques and significant risks that might affect objectives (**standard 1220.A2**).

Specifically for consulting engagements, internal auditors should consider (**standard 1220.C1**) the:

- needs and expectations of clients including the nature, timing and communication of engagement results;
- relative complexity and extent of work needed to achieve the engagement's objectives; and
- cost of the consulting engagement in relation to the potential benefits.

### **RESPONSIBILITIES AND REPORTING REQUIREMENTS OF INTERNAL AUDIT (standards 1000, 1010, 2010, 2020 2050, 2060, 2200, 2201, 2210, 2220, 2230, 2240, 2300, 2310, 2320, 2330, 2400, 2410, 2420, 2421, 2440, 2500, 2600)**

Internal Audit's responsibility is to report to the Council on its assessment of the adequacy of the entire control environment, delivering opinions through the Audit Committee.

The Internal Audit Manager will establish risk-based plans to determine the priorities of the Internal Audit activity, consistent with the Council's goals. The plan will be flexible in nature, can be updated to reflect the changing risks and priorities of the Council, and will take into account (**standards 2010, 2010.A1**):

- Midlothian Council's risk registers and risk management framework, including risk appetite levels set by management for the different activities and parts of the Council;
- the balance of coverage required so External Audit can place reliance on Internal Audit's work;
- the Internal Audit Manager's experience from previous Internal Audit Reports;
- establishing whether previous audit recommendations have been implemented satisfactorily;
- the impact of national issues (e.g. economic factors or the introduction of new legislation);
- the impact of local issues (e.g. corporate or service action plans and issues raised by external assurance bodies);
- input from senior management and Members of the Audit Committee;
- the periodic review of core financial and operational systems in line with Internal Audit's three year strategy;
- the available audit resource and skills;
- the need for specialist skills, where they are not available already;
- staff development and training;

- time needed for the management of the Internal Audit service e.g. audit planning, development of the annual opinion, attendance at meetings, the appraisal process, the updating of relevant audit policies and procedures;
- contingency set aside for consultancy, ad hoc reviews or fraud investigations; and
- liaison with other assurance providers, to share information and audit plans, such as the External Auditor.

The risk-based plan and resource requirements, including significant interim changes, are reported to the Chief Executive, the Corporate Management Team which includes the Head of Finance and Integrated Service Support (s95 officer), and the Audit Committee. The Audit Committee will approve, but does not direct the risk-based audit plan (**standard 2020**).

Internal auditors will develop and document a Terms of Reference (i.e. an audit brief) for each engagement, including the engagement's objectives, scope, timing, resource allocations, management expectations and reporting format required (**standards 2200, 2201**). The Terms of Reference will be discussed and agreed with relevant managers and be approved at Head of Service level and by the Internal Audit Manager. Audits are carried out using a risk based approach, and will consider the objectives of the activity being reviewed, the significant risks to the activity, the adequacy of the governance, risk management and control processes and the opportunities to make significant improvements to the activity's processes.

Internal auditors will conduct a preliminary assessment of the risks relevant to the activity under review and document these in the Terms of Reference and engagement objectives will reflect the results of this risk assessment. Adequate criteria are needed to evaluate an activity's governance, risk management and controls. In the public sector, criteria may include value for money (e.g. the effective use of money, people or assets). Audit work will also consider the probability of significant errors, fraud, non-compliance and other exposures when developing the engagement objectives (**standard 2210**).

The established scope will be sufficient to satisfy the objectives of the engagement. The scope of the engagement will include consideration of relevant systems, records, personnel and physical properties, including those under the control of third parties. Internal auditors will determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints and available resources (**standards 2220, 2230**).

Internal auditors will develop and document work programmes that achieve the engagement objectives. Work programmes will include the procedures for identifying, analysing, evaluating and documenting information during the engagement. The work programme will be approved by the Internal Audit Manager or Lead Auditor prior to its implementation and any adjustments approved promptly (**standard 2240**).

Internal auditors will identify sufficient, reliable, relevant and useful information to achieve the engagement's objectives. Also, internal auditors will document relevant information to support the conclusions and engagement results and base their conclusion on appropriate analyses and evaluation. Records for audit and consultancy engagements are compliant with the Council's retention policies. The Internal Audit Manager will control access to engagement records. The Internal Audit

Manager will obtain the approval of senior management and/or Legal Services prior to releasing such records to external parties, as appropriate (**standards 2300, 2310, 2320, 2330**).

Internal auditors will communicate the results of engagements. All audit reports will be communicated to the Audit Committee. Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client. Draft reports will be agreed with relevant management for factual accuracy prior to submission to the Audit Committee. If a final communication contains a significant error or omission, the Internal Audit Manager will communicate corrected information to all parties who received the original communication. Engagement results will specify the engagement's objectives and scope as well as applicable conclusions, recommendations and action plans. The Internal Audit service will strive to ensure that communications are accurate, objective, clear, concise, constructive, complete and timely. Additionally, internal auditors are encouraged to acknowledge satisfactory performance in engagement communications (**standards 2400, 2410, 2420, 2421**).

The following table describes the different assurance opinions that are provided by Internal Audit:

<b>Level of Assurance</b>	<b>Reason for the level of Assurance given</b>
<b>Very High</b>	Internal Control, Governance and the Management of Risk are at a very high standard with no unacceptable residual risk existing.
<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.
<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.
<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.
<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.

Each Internal Audit report, except possibly a report rated with a very high level of assurance, is likely to result in internal audit recommendations (Management Action Plan). The Head of Service in charge of the service/operation/system/process/risk which has been audited will be in charge of the Management Action Plan. If the audit assignment examined a corporate matter (impacting on more than one services, or all services), then a Head of Service will be designated by the Corporate Management Team to take charge of the Action Plan, across services.

At the conclusion of an audit assignment, the Internal Audit Manager and Head of Service will agree recommendations and timescales for these, along with priority ratings (High, Medium or Low). These recommendations will then be input by the



Internal Audit Service into Covalent (the Council's performance management system) and will be subject to quarterly performance reporting and Audit Committee scrutiny. If appropriate actions to mitigate an identified risk cannot be agreed with management, this is recorded in the Management Action Plan section of the audit report and the residual risk will be explained and highlighted. If this risk is deemed to be high, then the risk will be reported to the Corporate Management Team and Audit Committee and the Council's risk registers can be updated where appropriate (**standard 2600**).

The Internal Audit Manager is responsible for reviewing and approving the final engagement communication before issue and deciding to whom and how it will be disseminated. When the Internal Audit Manager delegates these duties, he or she retains overall responsibility. The Internal Audit Service follows Midlothian Council's policy on exempt information in the decision of making reports publically available. In compliance with the Data Protection Act and other relevant statutory and professional standards, no personal data is included in final Internal Audit reports (**standard 2440**).

The following table describes the three priority levels given to audit recommendations:

Priority	Reason for level of priority
<b>High</b>	The following would be regarded as high risk issues: <ul style="list-style-type: none"> <li>• Non compliance with Legal / regulatory requirements;</li> <li>• Strategic risks; and</li> <li>• Financial impact of £50K or more and / or national press interest.</li> </ul>
<b>Medium</b>	Financial impact of between £5K to £49K and / or local press interest
<b>Low</b>	Financial impact of under £5K and / or no press interest.

The Internal Audit Manager accepts that the responsibility of Internal Audit does not end when the Audit Report is issued, and that there will be a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action. This will be achieved by undertaking regular reviews of closed issues to confirm that these have been adequately addressed. Additionally, Internal Audit activity will monitor recommendations arising out of consulting engagements to the extent agreed upon with the client (**standard 2500**).

During the Management Action Plan period for **Very Limited** and **Limited** rated reports, Heads of Service are expected to discuss progress with **Limited Assurance** reports at Divisional Management Team level. For **Very Limited** rated reports, it is expected that Corporate Management Team will receive progress reports from Heads of Service.

The Internal Audit Manager, in the discharge of his /her duties, shall be accountable to the Audit Committee and the Chief Executive for:

- providing, at least annually, an opinion on the overall adequacy and effectiveness of Midlothian Council's framework for governance, risk management and control (the entire control environment).
- periodically providing information on the results of the annual audit plan and the sufficiency of the Internal Audit Service's resources;

- periodically reporting to the Audit Committee on the Internal Audit Activity's purpose, authority, responsibility and performance relative to its plan (**standard 2060**);
- reporting on significant risk exposures and control issues, including fraud risks, governance issues and other matters needed or requested by senior management and the Audit Committee;
- periodically reporting on the status of audit recommendations; and
- co-ordinating with other significant assurance functions (**standard 2050**).

The opinion will incorporate a summary of work that supports the opinion, a statement of conformance with the PSIAS and the results of the quality assurance and improvement programme. Additionally, the opinion will include details on the scope and time period of the opinion, scope limitations, reliance on other assurance providers, risk management framework used when forming the opinion and the overall opinion reached. The reasons for an unfavourable overall opinion will be stated (**standard 2450**).

Where other assurance providers (such as Grant Thornton or Audit Scotland) have undertaken relevant assurance and audit work, Internal Audit will seek to rely on the work of these other assurance providers where professional standards would make it appropriate to do so.

## **CONSULTANCY WORK**

Internal Audit may undertake non-assurance, consultative or fraud- related work at the request of senior management. Provided that the independence of the service is not compromised, the request does not impact on core assurance work, sufficient resource is available and there are sufficient skills, knowledge or other competencies needed to perform the engagement (**standard 1210.C1**), then these requests will be considered for acceptance by the Internal Audit Manager. The Internal Audit Manager will consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value and improve the Council's operations (**standard 2010.C1**). Accepted engagements will be included in the audit plan.

When performing consultancy work the auditor will remain objective and not take on management responsibility (**standard 2120.C3**). Internal auditors will establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities and other client expectations and this must be agreed with the relevant senior manager. For significant engagements, this understanding will be documented in a Terms of Reference (**2201.C1**).

During consulting engagements, internal auditors will address risk consistent with the engagement's objectives and be alert to the existence of other significant risks. Internal auditors will incorporate knowledge of risks gained from consulting engagements into their evaluation of the organisation's risk management processes (**standards 2120.C1/C3**).

Consulting engagement objectives will address governance, risk management and control processes to the extent agreed upon with the client and will be consistent with the Council's values, strategies and objectives (**standards 2210.C1/C2**). If

significant consulting opportunities arise during an assurance engagement, a specific written understanding as to the objectives, scope, respective responsibilities and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards. In performing consulting engagements, internal auditors will ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations will be discussed with the client to determine whether to continue with the engagement (**standards 2220.A2/.C1**).

During consulting engagements, governance, risk management and control issues may be identified. Whenever these issues are significant to the organisation, they will be communicated to senior management and the Audit Committee (**standard 2440.C2**).

This work could take many forms, but will typically include special reviews or assignments which fall outside the approved work plan and for which a contingency is included in the audit plan. Work programmes for consulting engagements may vary in form and content depending upon the nature of the engagement.

Examples of such work include, but are not limited to:

- advice on controls for systems and activities to reduce risk;
- advice on opportunities to reduce costs through greater economy and efficiency within systems and activities;
- provision of quality assurance on projects involving major change and systems development; and
- provision of an independent and objective assessment of the evidence on progress in implementing action plans.

Approval will be sought from the Audit Committee if there is to be a significant variation in consultancy work above the contingency included in the audit plan (**standard 1130**).

The role of Internal Audit in a consultancy assignment is to provide advice, facilitation and support to management who retain the responsibility for the ultimate decisions taken within the area under review. The Internal Audit Manager is responsible for communicating the final results of consulting engagements to clients (**standard 2440.C1**). Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.

Where Internal Audit provides advice on the setting up of controls, it does so as a consultant and the provision of such advice does not prejudice the right of Internal Audit subsequently to review, comment on and make recommendations on the relevant systems or controls in appropriate circumstances.

### **ARRANGEMENTS FOR AVOIDING CONFLICTS OF INTEREST (standards 1000, 1120, 1010, 1130)**

Internal auditors will have an impartial, unbiased attitude and avoid any conflict of interest. The Internal Audit service will preserve objectivity by ensuring that all

internal auditors are free from any conflicts of interest and that the undertaking of non-audit duties does not impair independence. Internal auditors are required within the PSIAS to refrain from participating “*in any activity or relationship which may impair or be presumed to impair their unbiased assessment.*”<sup>4</sup>

A conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfil his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the internal auditor, the Internal Audit activity and the profession. A conflict of interest could impair an individual’s ability to perform his or her duties and responsibilities objectively.

Internal auditors will:

- not accept any gifts, hospitality, inducements or other benefits from employees, clients, suppliers or other third parties (other than as may be allowed by the Council’s own policies);
- not use information obtained during the course of duties for personal gain;
- disclose all material facts known to them which, if not disclosed, could distort their reports of cones (not disclosing known information), unlawful practice, subject to any confidentiality agreements; and
- comply with the Bribery Act 2010.

Non-compliance with the above will be considered an offence for disciplinary purposes.

Where Internal Audit staff are required to undertake non-audit duties, the Internal Audit Manager will make it clear that those audit staff are not fulfilling those duties as internal auditors. The Internal Audit Manager will ensure that within the service there remains sufficient impartiality to enable the actions and activities of those Internal Audit staff to be subject to audit by those independent from the activity. This could be achieved, for example, by using staff from a partner authority in the case that all internal auditors at Midlothian Council are impaired in terms of their independence.

Internal auditors will refrain from assessing specific operations for which they were previously responsible. Objectivity, for the purpose of audit work, is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year (**standard 1130.A1**). The Internal Audit Manager does not have executive responsibility for any Council functions other than the Internal Audit Service (**standard 1130.A2**).

Internal auditors may provide consulting services relating to operations for which they had previous responsibilities (**standard 1130.C1**). If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure will be made to the Internal Audit Manager and the engagement client prior to accepting the engagement (**standard 1130.C2**).

Where the Internal Audit Manager is engaged in a non-audit role and has been in a position of management responsibility, for example in response to an emergency, the subsequent audit of any such activity will be delegated to an appropriate independent ‘deputy’ from Internal Audit or a party outside the Internal Audit service to undertake

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<sup>4</sup> Public Sector Internal Audit Standards (PSIAS) (2013) – Section 4 - 2.1

any work that may be necessary and to report independently to those charged with governance.

If any member of the Internal Audit Service, or any individual or organisation engaged to act on its behalf, considers that there is or is perceived to be a conflict of interest, this will be declared to the Internal Audit Manager who will then consider the validity of the claim. If the claim is found to be accurate and reasonable, then the Internal Audit Manager will direct alternative and independent resources to the audit. If the Internal Audit Manager's own independence is impaired, the Internal Audit Manager will declare this in writing to the Chief Executive and another independent person or body will be appointed to fulfil this role.

## **FRAUD**

As outlined in the Council's *Fraud and Corruption Policy*, the responsibility for the prevention and detection of fraud and corruption rests with management.

Audit procedures alone, even when performed with due professional care, cannot guarantee that fraud or corruption will be detected. Internal Audit does not have responsibility for the prevention or detection of fraud and corruption. Internal auditors will, however, be alert in all their work to risks and exposures that could allow fraud or corruption. Internal Audit may be requested by management to assist with fraud related work.

Where any matter arises which involves, or is thought to involve, a fraud, corruption or financial irregularity, the relevant Head of Service / Divisional Director will immediately notify the Internal Audit Manager for consideration of appropriate action. Managers will only establish the basic facts of the suspicion and should not attempt to carry out any detailed investigation themselves.

Where Internal Audit is satisfied that a matter will be investigated appropriately, the responsibility can be discharged to the Service. Suspected fraudulent claims in relation to Housing Benefit and the Council Tax Reduction Scheme are investigated by the Operations Support Manager (although this responsibility may move to a different Council function in the future).

Further information on Internal Audit's role and responsibilities in relation to fraud, are detailed within the Council's *Fraud and Corruption Policy*.

## **AUDIT RESOURCES AND WORK PRIORITISATION (standards 1000, 1010, 1210, 1230, 2030)**

Work is directed according to the assessed level of risk, the judgement of the Internal Audit Manager, with direction from the Audit Committee. The annual risk based audit plan agreed by the Audit Committee will be the main determinant of the relative priority to be placed on each Internal Audit assignment. The risk-based plan will explain how Internal Audit's resource requirements have been assessed. The Internal Audit Manager will determine the actual deployment of available resources based on the risk assessment described above.

The plan will have within it the provision of resources to address unplanned work. This contingency will be directed towards unplanned work including consultancy engagements and covering other unforeseen variations in the level of resources available to Internal Audit, such as staff vacancies.

The Internal Audit Manager will ensure that Internal Audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan. Appropriate refers to the mix of knowledge, skills and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimises the achievement of the approved plan.

The Internal Audit Manager will hold a professional qualification (CMIIA, CCAB or equivalent) and be suitably experienced (**standard 1210**). Each job post within the Internal Audit structure details the skills and competencies within the approved job description and person specification. In line with the Council's competency appraisal framework and the PSIAS, each member of the team will be assessed against these skills, competencies and appropriate work related objectives. Any development and training plans will be regularly reviewed, monitored and agreed with the Internal Audit Manager and the Chief Executive. There will be ongoing assessment of training needs through the competency appraisal framework. Employment of new staff will be in line with the Council's HR policies. External resources will be procured in line with the Council's Financial Regulations, Standing Orders and Procurement Policy.

Additionally, Auditors are also required to maintain a record of their continual professional development in line with their professional body (**standard 1230**).

The Internal Audit Manager will obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement (**standard 1210.C1**). Internal auditors will have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. Internal auditors will have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing (**standards 1210.A1/.A2/.A3**).

In the event that the audit risk assessment identifies a need for a greater degree of audit work than there are resources available, the Internal Audit Manager will identify the shortfall in the annual Internal Audit Plan and initially advise the Chief Executive. Where the Internal Audit Manager believes that the level of agreed resources will impact adversely on the provision of the annual Internal Audit opinion, the consequences will be brought to the attention of the Audit Committee (**standard 2030**). It shall be for the Audit Committee and the Chief Executive to decide whether to accept the risks associated with the non-delivery of such audit work or to recommend to the Council that it requires the Chief Executive to identify additional resources.

#### **QUALITY ASSURANCE (standards 1300, 1310, 1311, 1312, 1320, 1321, 1322, 2040, 2430, 2431)**

Public Sector Internal Audit Standards require that the Internal Audit service is subject to a quality assurance and improvement programme that will include both internal and external assessments. This will be developed by the Internal Audit Manager and cover all aspects of Internal Audit. These assessments aid the Internal

Audit Manager in the annual assessment of Internal Audit's efficiency and effectiveness and in identifying opportunities for improvement.

The Internal Audit Manager is responsible for informing the Audit Committee and Senior Management whether the Internal Audit Service is compliant with the PSIAS and achieves its objectives. An assessment against the requirements of the PSIAS will be completed on an annual basis and, along with the results of the quality assurance program, will be reported to the Audit Committee as part of the Internal Audit Annual Report. The Internal Audit Manager may only state that the Internal Audit service conforms with *the International Standards for the Professional Practice of Internal Auditing* if the results of the quality assurance programme support this statement. Instances of non-conformance will be reported to the Audit Committee and significant deviations will be considered for inclusion in the annual governance statement (**standards 2430, 2431**).

#### Internal assessments

All of the Internal Audit engagements are subjected to a thorough internal peer review of quality, to ensure that its work meets the standards expected from its staff. For example, the internal quality reviews are undertaken by the Internal Audit service to ensure that:

- all work undertaken is in accordance with PSIAS;
- supervision is provided to all levels of staff ;
- work is allocated to staff with appropriate skills, competence and experience;
- work is monitored for progress, assessed for quality and to allow for coaching;
- the work is planned and undertaken in accordance with risks associated with areas under review; and
- the conclusions are fully supported by the detailed work undertaken and with sufficient and appropriate evidence held on file.

All Auditors have access to an up to date electronic audit manual, the Internal Audit Charter, Midlothian Council Policies and Procedures and the Public Sector Internal Audit Standards (**standard 2040**). Internal auditors are regularly reminded to become familiar with these documents. The Internal Audit service uses resources from CIPFA, IIA, ACCA, and SLACIAG (Scottish Local Authorities Chief Internal Auditors Group). Additionally, Midlothian Council's Internal Audit service shares audit reports and test plans/strategies with East Lothian Council's Internal Audit service.

#### External assessments

An external assessment will be conducted at least once every five years by a qualified, independent assessor or assessment team from outside the Council. In order to fulfil this requirement Midlothian Council's Internal Audit Service has elected to be part of SLACIAG's validated self-assessment framework. Full details of this scheme were presented to the Audit Committee on 18 March 2014.

This fulfilled the PSIAS requirement to discuss with the Audit Committee:

- the form of external assessments;
- the qualifications and independence of the external assessor or assessment team, including any potential conflicts of interest; and
- the frequency of the external assessments.

**APPROVAL**

The Charter was reported to and approved by the Audit Committee at its meeting on 18 June 2013, and again on the 28 October 2014. This latter review was conducted to reflect the changes in reporting lines of Internal Audit and to reflect the approach that is to be taken to external assessments. The Charter will be subject to continuous review by the Chief Executive, the Internal Audit Manager and the Audit Committee.