

MIDLOTHIAN COUNCIL

Audit Committee

Annual Report from the Chairman Year ended 31 March 2015

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".

Meetings

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

Compared to the maximum possible 42 aggregate attendances at the Audit Committee of the permanent members of the Committee during 2014/15, 5 apologies for absence were received, representing an 88% attendance record.

In 2014/15 it has been agreed, in line with the general picture across Scottish local authorities, to reduce the number of formal meetings from 7 to 5.

Membership

Apart from the independent Chairman there had been (up to March 2014) an Independent Voluntary Member. A replacement Independent Member is currently being sought. There are six Councillors represented on the Committee. Four of the 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 Section 95 Officer are regularly in attendance; and other officers as appropriate. The internal audit team attended every meeting as did Grant Thornton, the Council's External Auditors.

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 the 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. These proposed changes, previously reported, require to be authorised, along with other changes to Standing Orders, by the full Council and this process is underway. The Audit Committee Members are also being asked to complete a Core Knowledge Self Assessment (Appendix 3) so that any training needs can be identified.

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 national reports.

The Chairman 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 level of compliance against the Public sector Internal Audit Standards.

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

Assurance Framework

The Annual Governance statement is set out at Appendix 2. Other than the identified need to update the Code of Corporate Governance to align to the new International Framework of Good Governance in the Public Sector and new CIPFA code of practice on Managing the Risk of Fraud and Corruption there have been no changes arising or proposed in respect of the Assurance Framework in the year. Both these areas are to be progressed in 2015/16.

Internal Audit

The Internal Audit team has had a complement of 3.7 FTE employees in the period to February 2015, then rising to 4 up to the year end. An internal assessment against the Public Sector Internal Audit Standards (PSIAS) was reported to the Audit Committee on 5 May 2015 and showed compliance against the code. A comprehensive checklist accompanied the report and was based on the agreed Scottish Local Authority Chief Internal Audit Group format. Going forward there will be a system of reciprocal assessments within local government with the first external assessment to be undertaken in 2016/17.

Grant Thornton's external audit report published in November 2014 found the Internal Audit function to be operating satisfactorily.

In December 2014, the Committee noted the output position of the Internal Audit function. There had been 636 recommendations made in the prior three years, with 92% of the recommendations reported by management as implemented or "on target" to be implemented by the agreed date. The outlying 8% are the subject of continuing follow-up. This contrasts to the performance reported in December 2013 where 378 recommendations had been raised and 96% of these were reported as complete by management. The Internal Audit Section is to sample a number of issues that have been reported as closed during the year and aims to report this to the June 2015 Audit Committee.

The Audit Committee considered and approved an Annual Assurance Report on the Internal Audit function submitted by the Internal Audit Manager for the financial year 2014/15. This report provided a summary of the work undertaken by the section in comparison to its plan and provided an overall opinion on the Council's system of control based on that work.

Value for Money

Although there is no specific caption in the Standing Orders (http://www.midlothian.gov.uk/download/downloads/id/61/standing_orders) at present which specifies this goal (this is included in the revised version awaiting Council approval), in practice the concept continues to determine the content of debates within the Audit Committee. In addition specific areas where unanticipated risks had been, or might be, encountered were discussed. The following examples show the approach:

ALEO's and connected parties- following reviews in 2011/12 and consideration of the Audit Scotland document, "Following the Public Pound", ongoing consideration took place regarding strengthened governance of financial exposures where arms Length External organisations have financial support from the Council. Inconsistency in reporting and control structures was detected by internal Audit in their paper of June 2014 and corrective measures have been implemented.

Fraud and Money laundering- Although Local Authorities are not obvious conduits for illegal money laundering, a residual risk exists; and an anti-Money laundering policy was adopted in 2014. A paper was also presented to the Audit Committee on the establishment of Integrity Group to look at any vulnerability to serious organised crime and included consideration of the Scottish Government paper on "Letting our Communities Flourish".

Business transformation- this programme is central to the reformation of Midlothian as a service provider achieving best value through efficiency gains, and thus maintaining a positive revenue account over the medium term. The Audit Committee considered an Internal Audit report on this area and

endorsed the need for improved reporting including to the Audit Committee of performance against the financial strategy.

Council Tax Payments- revenue collections for rental income, non-domestic rates and council tax continue to be challenging to secure income to the Council in a background of Welfare Reform and economic difficulties for residents and businesses in Midlothian. The Audit Committee discussed Midlothian Council's performance in relation to the percentage of Council Tax income collected in the year (2013/14) of 93.5% compared to the Scottish average of 95.2%. The internal audit noted that Midlothian was in the lower quartile in terms of Council Tax collection and of cases to be processed.

Newbyres- unanticipated CO2 emissions from old mine workings has triggered the demolition of 66 recently constructed Council Houses. The consequent c. £12 million replacement expense and the capital write-down in relation to the houses have been matters of high concern to the Audit Committee (and to full Council) and a number of meetings have been held outside of, as well as within, the committee timetable. To date it has been explained that the Council, in consultation with officers from the NHS, consider demolition unavoidable under public sector statutory obligations relating to the protection of public health and wellbeing. The original project planning identified geological risk and that appropriate professional advice was received at the time by the Council; that the Council's procedures, decisions and actions since the discovery of the problem have not compromised its ability to pursue third part settlements including, if appropriate, through professional indemnity insurance. The situation is under review and dialogue continues as to the implications for the Council's Risk Register. It is understood that the matter will be reported to Audit Committee at a future meeting.

Housing Benefit- Audit Scotland provided a report which considered the effectiveness of the benefit service in meeting national and local priorities, business planning and reporting and delivering outcomes. The report concluded that Midlothian had made significant progress in this area since an adverse risk assessment in 2011 when 21 risks were reported. The report highlighted that the benefit service had significantly improved claim processing performance and change event performance since 2010. In addition the report noted an excellent performance in relation to meeting or exceeding its accuracy targets and in the recovery of overpayments for in-year and all debt.

A further 11 recommendations were included in the report and are being progressed by management. Midlothian has also actively participated in the National Fraud Initiative, aimed at using data matching to identify benefit fraud more generally.

Health and Social Care Integration- the Audit Committee has been kept up to date with the development of the new joint commissioning boards and the possible impact on the current Audit Committee and Internal Audit function.

Debtors- The Committee considered the unsatisfactory position regarding sundry debtors in excess of 12months, and over £2m of rent arrears. Further work and follow-up audit is planned in this area. However it is noted that progress is being made to reduce the levels of debt.

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 (as noted above). Both these reports are presented to and discussed by the Audit Committee. 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.

Effectiveness of Internal Controls

The Committee has made several recommendations in 2014/15 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 resultant controls and systems.

Internal Audit now reports directly to the Chief Executive, which strengthens the influence and independence of the function. The External Auditor also noted positively the follow-up work on audit recommendations. The External Auditor's review of IT controls produced low-level recommendations and identified that the controls operating were generally satisfactory.

In the year an Internal Audit Report identified weaknesses in the management of petty cash across the Council. Although the amounts concerned are small, remedial action has been given a high priority in view of the importance of managing liquid and therefore potentially vulnerable cash assets and associated verification and potential perceived reputational damage.

Financial Management and External Audit

The Committee reviewed and discussed Grant Thornton's Annual Audit Report.

We had, in the prior year, considered financial resilience in the light of the utilisation of £2.14m of reserves in the financial year ended 31 March 2013, a net £1.254m overspend and necessitating reclassification of reserves. However, in the year ended 31 March 2014, an unexpected under spend of £5.3m occurred and has been investigated; a number of factors are at work, principally strict vacancy management control following reorganisation. The aggregate uncommitted reserves now stand at £11.96m, around 6.5% of expenditure. It is noted within the financial statement for 2013/14 that the level of reserves are higher than recommended but it is anticipated that there will be further one off costs associated with the Council's Transformation

programme and current Voluntary Severance and Early Release Scheme as well as continued unforeseen financial pressures.

Nevertheless the Committee are conscious that there remains a budget gap of £16.6m for the period to 2017-18, of which £5m exceeds the predicted efficiency gains under Business Transformation and other measures. In this context delays in achieving savings are of high concern. Conversely, anticipated payroll savings of £2m (at a one off cost to the General Fund of £4.7m) indicate progress provided the staff reductions do not undermine essential service delivery obligations. The balancing of the Consolidated Income and Expenditure Account is the top priority.

There have also been further discussions as to the appropriateness of asset valuations in the Balance Sheet. Fair Value Accounting necessitated a write-down of £74.45m so as to ensure housing stock is at a value which reflects the associated beneficial leases granted to tenants. The impact of European System of accounting rules to the proposed Newbattle Hub project was noted by the Audit Committee.

The Committee also considered on 3 February 2015 a report on Treasury Management Strategy and the funding position of the Council.

In general the Council's cost of capital continues to reflect a positive market position, enjoying a marginally lower coupon on third party debt compared to other Scottish local authorities. In addition, it has access to Public Works Loan Board finance over long repayment profiles and has pre-funded capital expenditures so as to ensure matching at perceived attractive rates.

The Committee noted that professional advice is taken on the strategy regarding debt commitments. It is considered that headroom is adequate with regard to the next 12 months and, in the longer term, satisfactory provided revenue account savings occur as anticipated.

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.

The Committee in 2015/16 will thus continue to question any perceived weaknesses in financial management but will also focus on the forward-looking strategy for stabilising the Consolidated Income and Expenditure. In this a continuing emphasis on Value for Money harmonises the aims of balancing the Council's financial position while generating optimal public benefit from the Council's operations. The trend visible in 2013/14 is that anticipation of risks prevents costly later interventions and this theme complements the quest for taxpayer value accordingly.