Midlothian Council

REVIEW OF LOCAL CODE OF CORPORATE GOVERNANCE
INTERNAL AUDIT AND RISK MANAGEMENT
# Contents

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I. Aim of the report

1. The aim of this report is to assess the extent to which Midlothian Council’s Code of Corporate Governance complies with best practice principles as set out in the CIPFA/SOLACE ‘Delivering Good Governance in Local Government: Framework’ (2007) and to provide assurance on the effective operation of the Internal Audit and Risk Management functions.

2. We assessed the extent to which Midlothian Council’s ‘Code of Corporate Governance’ (2007) complies with the CIPFA/SOLACE guidance using the CIPFA/SOLACE ‘Delivering Good Governance in Local Government: Guidance Note for Scottish Authorities’ (2008) which is intended to support Scottish local authorities in complying with the Framework.

3. We reviewed internal audit and risk management arrangements of Midlothian Council as part of our planned work identified in our Annual Audit Plan 2008/09. Following the retirement of the previous Audit Manager, Midlothian Council created the post of a Risk and Audit Manager, effectively bringing together internal audit and risk management functions. Such an arrangement is becoming more common throughout local authorities as integration of the two services can bring efficiency savings by bringing together two risk-based services. However, there is a risk that one area could take precedence at the expense of the other. In 2008/09 Audit Scotland was asked by the Risk and Audit Manager to undertake an assessment of both of these functions against best practice guidance to ensure that they are meeting the required standards.

4. We assessed joint internal audit and risk management arrangements against the following guidance:
   - The CIPFA ‘Code of Practice for Internal Audit in Local Government in the United Kingdom’ (2006); and

5. We would like to thank all staff for their cooperation and kind assistance during our review.

II. Executive summary

6. Midlothian Council’s ‘Code of Corporate Governance’ (2007) almost fully complies with the best practice principles set out in the CIPFA/SOLACE guidance. These principles and our assessment of compliance with them are summarised in Section IV (paragraphs 18 – 23) and detailed in Appendix A. We have only identified a few weaknesses which are also detailed in Appendix A. We have seen considerable progress in reviewing and updating governance arrangements in an attempt to bring...
them in line with best practice following the appointment of a new Head of Performance and HR at the beginning of 2009.

7. As already stated in our Annual Audit Plan 2008/09, the Internal Audit function has improved significantly as the resourcing issues of the last few years have been addressed. This has resulted in an improved level of audit coverage in 2008/09 enabling us to place reliance on an increased number of audits and areas of work carried out by Internal Audit, including systems evaluation and housing benefit casework. Internal Audit and Risk Management functions are managed effectively by the Risk and Audit Manager, who devotes 50% of time to each activity. Historically best practice suggested it was better to have these functions separated but it is now becoming more common to manage them jointly as benefits of integrated services are recognised. We are satisfied that the current arrangements are working successfully because an appropriate level of resource and attention is given to each of these functions. However such an arrangement requires careful management and key person reliance should not be underestimated. We therefore advise that the joint arrangement is reviewed on a regular basis. Our assessment of the Internal Audit function is summarised in Section V, paragraphs 24 – 33.

8. Our review has shown that the Risk Management function is well embedded and operates effectively to the extent that Midlothian Council has been recommended to several other councils as an example of good practice in risk management. Our assessment of the Risk Management function is summarised in section VI, paragraphs 34 – 46.

III. Introduction

9. The CIPFA/SOLACE ‘Delivering Good Governance in Local Government: Framework’ (2007) describes good governance as "how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner. It comprises the systems and processes and cultures and values by which local government bodies are directed and controlled and through which they account to, engage with and lead their communities".

10. Good governance enables the councils to:

   - pursue their vision effectively; and
   - underpin that vision with mechanisms for control and management of risk.

11. The Framework also states that good governance is important to all involved in local government. If done well, it leads to:

   - good management;
• good performance;
• good stewardship of public money;
• good public engagement; and
• good outcomes for citizens and service users.

12. If handled less well, the results in terms of public confidence and trust may be very damaging. Significant governance failings attract immense attention emphasising the importance for councils to ensure the delivery of high-quality services to all tax payers and citizens.

13. Efficient risk management and internal audit functions also play an important part in ensuring that local government bodies take informed and transparent decisions.

14. Internal audit is an assurance function that provides an independent and objective opinion to the organisation on the control environment by evaluating its effectiveness in achieving the organisation’s objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources (from CIPFA ‘Code of Practice for Internal Audit in Local Government in the United Kingdom’ (2006)).

15. The Code also states that internal audit should not be judged just by its adherence to the Code but also by its contribution to the organisation that it serves. An effective internal audit should play a vital part in advising the organisation if appropriate risk management processes, control systems, accounting records and governance arrangements are in place and operating properly. It should work in partnership with management to improve the control environment and assist the organisation in achieving its objectives.

16. Risk management is the process by which upwards and downwards risks to achieving organisation’s objectives are identified, evaluated and controlled. It should be a central part of any organisation’s strategic management and if effective it should be able to deliver:

• an appropriate balance between risk and control;
• more effective decision making;
• better use of limited resources; and
• greater innovation.

(summarised from the Audit Commission’s management paper Worth the risk: Improving risk management in local government (2001))

17. IRM/ARMIC/ALARM ‘Risk Management Standard’ (2002) states that risk management is a continuous and developing process which should be integrated into the culture of the organisation
with an effective policy and a programme. As such it should support accountability, performance management and reward and thus promote operational efficiency at all levels.

IV. Code of Corporate Governance


- **Principle 1**: Focusing on the purpose of the authority and on outcomes for the community and creating and implementing a vision for the local area;
- **Principle 2**: Members and officers working together to achieve a common purpose with clearly defined functions and roles;
- **Principle 3**: Promoting values for the authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour;
- **Principle 4**: Taking informed and transparent decisions which are subject to effective scrutiny and management of risk;
- **Principle 5**: Developing the capacity and capabilities of members and officers to be effective; and
- **Principle 6**: Engaging with local people and other stakeholders to ensure robust public accountability.

Each of these principles is supported by further sub-principles which are detailed in the Appendix A.

19. Midlothian Council’s ‘Code of Corporate Governance’ (2007) strongly adheres to best practice principles No. 1 and 2 and fully comply with principles No. 3 and 4 but more could be done to ensure Midlothian Council’s governance arrangements are in line with best practice principles No. 5 and 6.

20. Whilst we are happy to report that most supporting principles are adhered to there are a few that fall short of best practice:

- As recently reported by Internal Audit to the Performance, Scrutiny and Audit Committee (PSAC) some weaknesses were identified in the operation of the Community Planning Partnership (CPP), for example: (1) not all partners have signed off the agreements, (2) not all group action plans are complete or linked back to outcomes, (3) detailed responsibilities for planned actions are not clearly defined as not all partnership subgroups have terms of reference consistent with the partnership agreement template, (4) performance report on progress towards achievement of outcomes has not been
published as required by the Local Government in Scotland Act 2003, (5) reasons for changes to the Community Plan that are a result of the annual review are not always clearly documented, (6) there is no assessment of the effectiveness of the relationships in the Community Planning Partnership, and (7) the Working Group is charged with ensuring that the funding is spent in accordance with financial rules of the partners and yet it does not have control over the direct funding that Strategic Groups can receive directly from the government. It could however be argued that due to the complexity of the partnership structure it is not reasonable to expect that the Working Group could tightly coordinate all funding received but it instead provides a general direction for the partnership;

- Financial Regulations are not reviewed annually in line with best practice (last review in April 2006 and currently under review);
- Staff development plans are currently not linked to staff appraisals;
- Full competency framework is yet to be finalised, this has been delayed mainly due to the priority accorded to the implementation of single status during 2008 and 2009;
- No succession planning is in place for Elected Members;
- Public performance reporting (in particular through the Council’s website) is not user friendly; and
- There is no staff consultation policy in place.

21. While the Council’s Code of Corporate Governance is largely in line with best practice we note that it was last updated in 2007 and is therefore due to be reviewed. We recommend that the Code is updated on a regular basis, at least every two years.

22. In addition further governance weaknesses, identified by the Council itself, are detailed in the Annual Governance Statement published in the Financial Statements 2008/09. This statement was reviewed as part of our financial statements audit.

23. Despite some weaknesses we can conclude that Midlothian Council’s ‘Code of Corporate Governance’ (2007) almost fully complies with best practice principles set out in the CIPFA/SOLACE guidance. We have only identified a few weaknesses most of which are already being addressed to bring current governance arrangements in line with best practice. In particular, more could be done to develop the capacity and capabilities of members and officers and to improve engagement with local people and other stakeholders to ensure robust public accountability. Whilst we are aware that these areas are work in progress, the Council should ensure that they are fully addressed as soon as possible.
V. Internal Audit

24. Principal local government organisations should comply with the requirements set out in the CIPFA ‘Code of Practice for Internal Audit in Local Government in the United Kingdom’ (2006). In addition, auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on internal audit work wherever possible. To comply with International Statement on Auditing 610 (Considering the work of internal audit) and the Code of Audit Practice, we are required to carry out a review of the Council’s internal audit arrangements and to report on any deficiencies which are identified.

25. Our review performed at the beginning of 2009 covered the following:

- organisational status – specific status of internal auditing in the entity and the effect this has on the ability to be objective;
- scope and coverage of the internal audit function – the nature and extent of internal auditing assignments performed;
- staffing and technical competence – whether internal audit is performed by persons having adequate technical training and proficiency as internal auditors; and
- due professional care – whether internal audit is properly planned, supervised, reviewed and documented.

Organisational Status

26. In 2008/09, following the retirement of the Audit Manager, a new post was created covering the dual role of Internal Audit and Risk Management (the Risk and Audit Manager), effectively bringing together the internal audit and risk management functions. While there is a risk that one area could take precedence at the expense of the other, we consider that the internal audit function has appropriate status within the organisation for it to be objective. Specifically we found that:

- the Financial Regulations and Internal Audit Service Charter adequately set out the terms of reference, role and objectives of internal audit;
- the Risk and Audit Manager reports regularly to the PSAC in his own name and attends its meetings. Furthermore, starting in October 2009, the Risk and Audit Manager and Audit Scotland will regularly meet PSAC members in private;
- Internal Audit has unrestricted access to all records, assets, personnel and premises and is authorised to obtain such information and explanations as necessary to fulfil its responsibilities. This right of access is confirmed in the Financial Regulations;
- Internal Audit is free to communicate fully with external audit; and
• Line management responsibilities currently rest with the Head of Finance who is responsible for day to day operational matters and with the Director, Corporate Services for strategic direction. However, the Risk and Audit Manager also has a direct access to the Chief Executive in order to maintain the independence of Internal Audit. This relationship is recognised and understood by all parties at Midlothian Council. However, while there may be advantages in being line managed by the senior officers in charge of Section 95 matters there may still be a risk that this arrangement could compromise the independence or the scope of the internal audit work and their reporting. In light of this residual risk it might be beneficial to consider the option of the Internal Audit function reporting directly to the Chief Executive.

Staffing and Technical Competency

27. The current staffing establishment of Internal Audit is a Risk and Audit Manager, 1, Principal Auditor, 1 Senior Auditor and 2 Auditors. With all posts now filled, we are pleased to note the significant improvements in the level of Internal Audit resource, both in terms of numbers and experience.

Scope and Coverage

28. Following the appointment of the new Risk and Audit Manager, a revised audit plan for 2008/09 was prepared and approved by the PSAC in November 2008. We were able to place reliance on their work in the following areas:

• Review of Accounts payable system;
• Follow-up of implementation of Phase 1 Trent payroll system recommendations;
• Council tax discounts and exemptions;
• Housing rents;
• Housing benefit casework; and
• National Fraud Initiative and local data matching.

29. Last year we commented on the fact that failure by Internal Audit to cover key systems and complete other planned audit work could result in Internal Audit being unable to provide an overall opinion on the effectiveness and adequacy of internal controls across the Council. This reduces the amount of assurance available to support the Council’s Annual Governance Statement and to complement the work of external audit. While we note that the 2008/09 Annual Audit plan was assessed as “Amber” meaning there was a risk of non-completion, we are pleased to note the satisfactory completion of the overall plan. Some areas were completed later than planned but those areas on which we planned to place reliance were completed on time.

30. Auditing standards require controls on which reliance is placed to be fully tested at least once every 3 years. Internal Audit has produced a 3-year strategic work plan setting out the work they plan to undertake on key financial systems and core business systems. In addition, Internal Audit plans to
cover a number of strategic risks each year. The planned coverage provides a sound basis for ongoing cooperation in the future reducing the need for external audit to undertake additional work which could result in a higher fee. It also demonstrates the significant link between the identification and management of risk (risk assessment) and the testing of controls to provide assurance over the adequacy of risk mitigation measures (internal audit of risk controls).

Due Professional Care

31. In previous years we noted that there was scope for improving the content of audit plans by including more detail for stakeholders on how it was developed, how it supports corporate objectives, details of internal audit resources and how they are deployed. We also commented on the need to give the strategic audit adequate profile at the PSAC and on the need for the PSAC to have a more focused role in relation to audit matters. We are pleased to note considerable improvements in all of these areas and welcome the heightened awareness of the role of audit and risk management.

32. We note also that Internal Audit is reviewing their performance indicators to monitor their performance in the current year and to be able to demonstrate continuous improvement.

Concluding Remarks

33. The significant improvements in the overall staffing levels in Internal Audit in 2008/9 and the subsequent improvement in service delivery and planning has enabled us to place reliance on a number of areas of Internal Audit work in 2008/9, as detailed in paragraph 28. We endorse the Internal Audit philosophy set out in their Strategic Plan and support their risk-based approach to prioritising their future work programme which will provide a sound basis for future collaboration.

VI. Risk Management

34. Risk management should be embedded into the culture of the Council, with members and managers at all levels recognising that risk management is part of their jobs.

35. We have assessed Midlothian Council’s risk management against the CIPFA/SOLACE ‘Delivering Good Governance in Local Government: Guidance Note for Scottish Authorities’ (2008) and against the AIRMIC/ALARM/IRM ‘Risk Management Standard’ (2002). Our findings are summarised below.

36. Following consultation with external audit, Midlothian Council’s Risk Management Policy is now a clear and comprehensive document. It will be presented to the Elected Members for approval in November 2009. In line with best practice it clearly sets out the Council’s approach to and appetite for risk and its approach to risk management. It emphasises that positive risks (opportunities) as well as
negative risks (threats) are considered. It also sets out responsibilities for risk management throughout the organisation. The Risk Management Policy is reviewed and updated annually and progress is reported to the Elected Members.

37. An approved Risk Management Strategy is also in place. It clearly sets out the desired outcomes together with major potential risks, improvements made in the previous year and planned improvements to risk exposures. This document is also reviewed on an annual basis and progress is reported to the Elected Members.

38. In addition there is an approved Risk Management Framework which outlines the main building blocks of risk management – the structures, systems, events, processes and reporting lines that make up Midlothian Council’s approach to the management of risk, and states that the Council has adopted the IRM/AIRMIC/ALARM joint standards for risk management which are nationally recognised as best practice.

39. Midlothian Council has a Risk Management Group, chaired by the Risk and Audit Manager and attended by divisional representatives (including two Heads of Service) which operates as follows:
   - The Group’s remit was updated in January 2008 and it covers monitoring of risk performance targets, discussing risk exposures, promoting risk management across divisions and suggesting mitigating measures for identified risks;
   - The Group’s minutes are issued to Divisional Management Teams and to the Performance, Scrutiny and Audit Committee (PSAC);
   - Recommendations of the Group are presented to the Corporate Management Team (CMT) and can become part of the Strategic and Corporate Risk Register.

40. In line with best practice, the Council maintains a register of its corporate business risks linking them to strategic business objectives and assigning ownership for each risk, the Strategic and Corporate Risk Register. Strategic and corporate risks are reviewed and endorsed every 6 weeks by the CMT. They are supported by a series of Divisional Risk Registers that identify and assign lower level operational risks.

41. Every 6 months Heads of Service receive Operational Risk Improvement Plans (RIPs) from the Risk and Audit Manager. These focus on the high and medium risks within individual services and invite mitigating actions. A reminder system has also been set up in the Covalent system to alert ‘keepers’ of risk registers to review and update their risk registers.

42. From our discussion with the Risk and Audit Manager it is evident that some managers have better risk management practices than others:
- risk actions are in some cases not completed and so the gap between residual risk and risk appetite is not closed;

- divisions have been issued with guidelines on how to govern their risk management, however there are cases of non-compliance where governance of risk management should be improved;

- some divisions are further forward than others in integrating the review of risk into the quarterly performance reporting; and

- there are isolated instances of risk misconceptions, however these are usually addressed during risk reviews and/or internal audits.

43. All reports to Elected Members (Council, Cabinet and various committees) which support strategic policy decisions and project initiation documents (for example Modernising Midlothian) include a risk assessment and the identification of mitigating action. This means that Elected Members are made fully aware of the risk implications in taking certain courses of action. More recently, the free consultancy days of Gallagher Bassett have been used to review around 25 recent reports and the findings are generally positive.

44. Relevant risk management awareness training and guidance is delivered to the Elected Members and all levels of management. A quarterly risk newsletter is issued to the Elected Members and all Directors and there is also a risk management website which is updated quarterly.

45. The performance of the risk management function is subject to self assessment as follows:

- risk management Performance Indicators have been developed by the Risk and Audit Manager and compliance with them is assessed during the year and at the end of each financial year; and

- a self-assessment tool devised by a firm of consultants Liz Taylor Consulting (who occasionally work with ALARM) has been used to assess the risk management governance against the best practice.

46. In light of the above findings we can conclude that the Risk Management function is adequate and effective. While by their nature organisations such as Councils will be risk averse, well embedded risk management, as seen in Midlothian Council, also demonstrates risk awareness, i.e. opportunities and not just threats are considered. Risk management in Midlothian Council has been improving continuously to the extent that Midlothian Council has recently been recommended to several other councils as an example of good practice in risk management. Clackmannanshire, Argyll and Bute, South Lanarkshire and East Lothian Councils have visited Midlothian Council to note its risk.
management practice. Dumfries and Galloway, Falkirk and Stirling Councils have also sought advice on how to introduce or improve their risk management arrangements.

VII. Conclusion

47. Despite some weaknesses we can conclude that Midlothian Council's 'Code of Corporate Governance' (2007) almost fully complies with best practice principles set out in the CIPFA/SOLACE guidance. We have only identified a few weaknesses some of which are already in the process of being resolved to bring current governance arrangements in line with best practice principles.

48. The Council has made considerable progress in improving the effectiveness of the Internal Audit function as the resourcing issues of the last few years have been addressed. This has resulted in an improved level of audit coverage in 2008/09 which enabling us to place reliance on an increased number of audits carried out by Internal Audit. We endorse the Internal Audit philosophy and support their risk-based approach to prioritising their future work programme which will provide a sound basis for future collaboration.

49. The Risk Management function is well embedded and operates effectively. Risk management in Midlothian Council has been improving continuously to the extent that Midlothian Council has recently been recommended to several other councils as an example of good practice in risk management.