



**MIDLOTHIAN COUNCIL  
SCOTLAND**

**CLIFF NICHOLSON AWARD 2010**

**'Improving Assurance'**

**January 2010**

## Cliff Nicholson Award 2010

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## **1. Executive Summary**

Midlothian's Internal Audit service has moved from very limited assurance to full assurance. This all began with efficiency savings and smarter working. Then we developed novel and innovative tools including an 'open' audit plan, an internal control guideline showing auditees how to score highly in an audit review, expanded use of CAAT's, a closer focus on risk management and the production of an easy assurance system to assess corporate governance. This has brought real benefit to Midlothian Council which is tangible, real and welcomed. Sharing of services will extend the efficiency and value of Internal Audit. The status and reputation of Internal Audit has been heightened and all stakeholders requiring assurance are reporting enhanced levels of satisfaction. Midlothian's approach could be used by other bodies.

## **2. Background to Midlothian Council**

Serving a population of only 80,000 residents, Midlothian Council is the second smallest local authority in Scotland. It is located immediately to the south of the City of Edinburgh and some 45 miles from the English border. As a result of local government reorganisation in 1996, it became a unitary authority with important services to run like Education, Social Work, Housing, Economic Development, Community Services, Environmental Health, Development Control, Transportation and several back-office services supporting the front-line. Midlothian has recently completed its Single Status exercise and as a result is equal pay compliant, despite considerable cost. It has several key Strategic, Corporate, Project and Operational risks though risk and opportunity is generally fully understood and every effort is made to control risk, and seize opportunities, under its Risk Management Policy and Framework.

The Single Status project severely affected finances and several innovative projects, capital receipts and developer contributions have been stalled because of the recession. Therefore not all corporate priorities have yet been achieved. On a brighter note, Midlothian has a good record in economic development, its social housing programme is innovative and delivering best value and homes, attainment levels in schools are slowly rising and sickness absence has been reduced from around 6.5% to about 4.7%. Some services like Social Work are being praised by external inspections for their improvement. The Council's Best Value report of 2007 (BV1), from the statutory body Audit Scotland, could be said to be average and BV2 is expected shortly. The Council has a new Chief Executive, some new Heads of Service and is currently embarking on a Management Structure Review and an ambitious Integrated Improvement Plan. With all this potentially high risk change, Midlothian Council requires strong leadership, careful management of priorities, finances and risk coupled with a robust Internal Audit function.

## **3. Midlothian's Internal Audit service**

Midlothian Council can only afford a small Internal Audit team, and faced with all the above risk and challenge, decided in Mid-2008 to produce an audit philosophy and strategy that sits right at the core of business need. First of all, management recognised the inter-relationship of risk management and internal audit and as a result amalgamated the two services, with control measures to sustain Internal Audit's independence. New members of staff were engaged from both the public and private sectors ensuring the staffing establishment of five officers was complete and the team could provide a wide range of skills and experience. The way Internal Audit (and Risk Management) operates

was also improved, as well as saving a valuable £15,000 in the pay bill, by combining the separate posts of Risk Manager and Audit Manager. Prior to 2008, due to various circumstances, Midlothian had difficulty in filling internal audit posts and Audit Scotland could not place reliance on the sporadic work of Internal Audit. The staffing establishment of five is made up as follows:-

- Risk and Audit Manager (spending 50% on internal audit and 50% facilitating and coordinating risk management)
- Principal Auditor
- Senior Auditor
- 2 Auditors (one Auditor has a similar 50/50 remit to the Risk and Audit Manager)

Budget £200k

Reporting lines:-

These have recently been changed from both Internal Audit and Risk Management services reporting to a Head of Finance to a much more high profile situation of reporting to:-

- Chief Executive – on Strategic and Major Change matters
- Director, Corporate Services on s95 matters
- Chair of the Audit Committee

The Risk and Audit team is comprised of a range of internal auditing and risk management skills, able to fully complete both the Internal Audit and Risk Management strategies of the Council.

#### **4. Background to Midlothian's Internal Control Environment, Governance and Management of Risk**

*Inherent, past issues* 

1. Over the past few years, there have been isolated, yet important, contraventions of financial directives and regulations, the Council's standing order on contracts and also procurement policies and procedures;
2. The financial directives stipulate that departments should produce procedures for every financial process and effectively train members of staff in these. In several cases these procedures were either not in place, or were out of date. Therefore members of staff evolved disparate methods of working, occasionally ignoring or by-passing separation of duty necessities;
3. External Audit (Audit Scotland) could not place reliance on the Internal Audit service completing an Annual Audit Plan. When audit assignments were completed, they were of the proper quality and standard but were insufficient in number and regularity;
4. Occasionally middle managers were found to have the incorrect perception of risk within their services eg no real impression of fraud potential;
5. While the Council's risk management policy, strategy and risk control programme were commended, there had been areas of poor buy-in and out of date risk registers;

6. The Council did not have a systematic approach to assess governance, resulting in extra and time-consuming work in compiling the Annual Statement of Corporate Governance to support the published accounts.

## **5. Internal Audit's new Philosophy, Strategy and Planning**

Midlothian Council was entering, and remains in the middle of, a difficult phase involving regular budget cuts, rationing of expenditure, delivering local services with fewer staff, recovering from equal pay commitments, managing the impact of the recession and heading into BV2. The Risk and Audit Manager, and his team, devised an Internal Audit approach designed to overcome the 'inherent, past issues' above and support the Council through this difficult period. In August 2008, senior management and the Audit Committee endorsed the new audit philosophy, strategy and three-year internal audit plan. The Audit Committee receives a report on progress towards meeting the plan every month, with senior management in attendance.

## **6. The Way Internal Audit operates**

### **(a) The Three-Year (Macro) Internal Audit Plan**

Internal Audit received endorsement from the Audit Committee, senior management and Audit Scotland to operate an Internal Audit Plan that covers core financial systems, consultancy and strategic risks as follows:-

- **40% of the Internal Audit resource is devoted to around 20 core financial and business systems.** As examples, these include all the Revenue streams, HR, Payroll, Accounts Payable, Treasury Management, ICT, Insurance, Budgetary Control and Capital Planning. The Internal Audit service is able to cover these systems, in much detail, at the rate of around 7 per annum, with interim testing and invasive follow up work included as an addition. This means that all major financial and business systems are reviewed within this three year period. All Internal Audit recommendations are registered in corporate, quarterly performance reporting making them easier for management to implement and for senior management and elected members to monitor their progress. This approach is satisfying the Audit Scotland need for assurance that Internal Audit is cyclically covering the key financial systems. Result – **good foundation to assurance and guaranteed coverage;**
- **40% of the Internal Audit resource is reviewing Strategic and Corporate Risks** and the service is able to review around 8 of these important topics each year, or 24 over the three-year plan. The Risk Management Policy dictates that the Corporate Management Team reviews the Strategic and Corporate Risk Register every six weeks and monitors the existing, and new, control measures to control risk. This register contains around 75 key matters that could cripple the Council, attract adverse attention, disrupt services and lead to poor inspection reports. The register includes risks in relation to the Management of Assets (Finance, Property, ICT and People), Duty of Care to the Public, Community Planning, Performance, Achieving Priorities, Recycling, State of the Roads Infrastructure, Equalities, Sustainability and Climate Change, Ultra Vires and New Legislation, Health and Safety Culture, Sustainable Workforce, Pupil Attainment, Health of Citizens, Managing Sickness Absence and Major Change Programmes. Internal Audit leaves this part of its plan 'open' and, as priorities become crucial, senior management and the Audit

Committee may request assurance over the sustainability of existing, or new, control measures. The Internal Audit service thoroughly tests these controls. For example, if the Corporate Management Team has reduced a Strategic or Corporate risk from a high risk rating, to medium or low, Internal Audit examines these situations to independently review this assessment and to comment on the perception of risk and the sustainability of the control measures. Audit Scotland is satisfied with this approach, as it helps them observe, and gain assurance, that Strategic and Corporate Risks are understood and reviewed– **Result – good integration of risk management and internal audit; audit resource quickly directed to areas of most need, satisfies senior management, cabinet and audit committee;**

- **20% of the Internal Audit Plan is devoted to Help Desk Enquiries (around 50 are received each year), Investigations, Fraud Investigations, the National Fraud Initiative and advising Project Teams/Boards on Internal Control matters.**

#### (b) Day-to Day (Micro) Approach

- Core financial and business systems (40% of the Plan) – the Internal Audit service has published and distributed, through the endorsement of the Corporate Management Team and Audit Committee, a guide **'Improving Internal Control – Achieving a High Rating from Internal Audit'**. Three months before an Internal Audit, the Head of Service and Manager in charge of the system/process to be reviewed is reminded about the guide, invited to compare their current practice to the guide's high standards. They are then alerted to the fact that the internal audit is going to be a significant test of their management of internal control and risk. A summary of the 20-page guide is attached for information at **appendix 1**;
- Across the Internal Audit Plan - adopting Committee of Sponsoring Organisations of the Treadway Commission (COSO) principles, the Internal Auditors directly examine the risk assessment, control environment, the monitoring controls and communication controls as well as control activities to determine the strength of the overall control environment;
- All detailed Internal Audits are rated as follows – Blue (excellent Internal Control and full assurance); Green (sound internal control but some weaknesses; reduced assurance); Amber (weaknesses are reducing the effect of internal control, limited assurance) and Red (serious weaknesses, no assurance). Auditees and the Audit Committee can quickly see the status of each audit and the particular risk management and internal control skills, perception and commitment of each auditee visited;
- Normally an auditee receiving a red or amber rating would receive help from the risk management service ('the back up') and would be subject to a follow up audit to determine if the management actions have been implemented satisfactorily.

#### ©. Accountability

- Because of the importance given to the Internal Audit Strategy and Plan (and merged risk management), the Risk and Audit Manager meets the Chief Executive every six weeks to discuss Strategic and Corporate Risk;
- The Chief Executive meets the full Risk and Internal Audit team every quarter;

- The Risk and Audit Manager meets the Director, Corporate Services (section 95 officer) every quarter and intermittently;
- In accordance with the CIPFA code of practice, the Risk and Audit Manager and Audit Scotland meet the Elected Members on the Audit Committee in private twice per year;
- The Risk and Audit Manager meets the Chair of the Audit Committee on an ad-hoc basis;
- The Risk and Audit Managers meets divisional directors on a quarterly basis to discuss any emerging risks;
- The Risk and Audit Manager and Principal Auditor meet Audit Scotland once a quarter.

**Result – much higher profile given to Internal Audit; auditors responding positively to being valued.**

(d) Reporting to the Audit Committee

Previously elected members on the Audit Committee complained about the lack of time between receiving the Audit Committee agenda (which typically includes Internal Audit reports) and the Audit Committee meeting, to read and fully understand the implications of the findings of an audit review. This problem has been overcome by issuing to the Audit Committee finalised, internal audit reports as soon as they are published. This can give the Audit Committee up to one month to read reports prior to the official Audit Committee meeting.

**Result – enhanced scrutiny and promotion of good practice**

(e) Use of Computer Assisted Audit Techniques (CAAT's)

Before embarking on an internal audit, we routinely consider whether we can use CAATs in the review. This has led to greater efficiencies in conducting audits, as well as spotting frauds and financial leakage e.g. employees owing the Council money, duplicate payments, rogue VAT numbers etc. Coupled with the National Fraud Initiative, this is proving to be a successful and powerful approach. Using the IDEA software, normally whole populations of transactions can be scanned, rather than samples, giving greater accuracy in the findings. Computer projects have also benefited from our proactive use of IDEA, as data being transferred to a new computer system can be 'cleansed' before its entry.

**Result – more representative samples being taken.**

(f) Corporate Governance

Internal Audit was asked to devise a simple system to assess the sustainability of corporate governance, so a comprehensive assurance system has been set up. This takes 22 key areas of the Council's business and invites an annual review, not by Internal Audit, but by senior officials. The assurance system comprises 10 crucial financial elements like Financial Strategy, Financial Risk, Efficiencies, Risk and Audit Manager's Annual Assurance statement, Capital Programmes, Budgetary Control and Fraud. The 12 non-financial elements include Performance, Operational and Project

Risk, compliance with legislation, standards in public life, duty of care over employees, PI results and the level of complaints about services. Each year, in April and May, key officials compare the 22 elements to actual practice. This work leads into an overall assessment of governance which is signed by the Leader of the Council and the Chief Executive. This approach is approved by Audit Scotland and provides a focus for its annual testing.

### **Result – time savings**

#### (g) Edinburgh, Lothians, Borders and Fife Internal Audit Partnership (ELBF) and Scottish Local Authorities Chief Internal Auditors' Group (SLACIAG)

Six local authorities in the Edinburgh area (ELBF) have decided to work in partnership to achieve efficiencies, led by Midlothian Council as the project lead. This is not a legally-binding partnership with attendant governance, but rather a forum approved by the six Chief Executives to develop ideas. To date, shared internal audits are discussed, comparison of the average cost of an audit day is in place and is being reviewed. Some of the bigger internal audit sections are to assist the smaller ones with computer auditing and any staff turnover issues. Regional trends in internal control and risk are being devised and savings are envisaged in computer software and training, and possibly in other cost heads. It is predicted that as the shared service agenda develops within the ELBF area, there will be further opportunities for efficiencies. For example, if ELBF decides to have one Payroll system, instead of six, one internal audit section could conduct an internal audit for the benefit of the other five authorities. Elsewhere, there are other smaller examples of shared services within ELBF, and the sharing of internal audits will be ratcheted as progress with the shared services agenda is made.

SLACIAG is a Scottish Forum where 34 public sector bodies (mostly Councils) meet and share best practice. Cost savings have arisen through shared training exercises, reducing the bill for each body by around 50%, and SLACIAG has a website where Audit Manuals, PIs, Audit Programmes can be viewed. All changes of a national focus, like an update on the CIPFA code of practice on internal auditing, are normally passed through SLACIAG to ensure a consistent approach by the constituent bodies.

### **Result – Whole of Scotland/ELBF region works smarter**

#### (h) Internal Audit PIs, Risk Register and Audit Manual

We do not create an industry over PIs and prefer to adopt a small number of PIs that are meaningful. These are:-

- Internal Audit budget as a % of Council's budget (for comparison with other Scottish Councils);
- Has the Internal Audit Plan been completed in the year of account?
- Did we have time in each audit to get into the required detail ie no corner-cutting?
- Are all Internal Audit assignments in the year of account started by Christmas?
- Is the Internal Audit budget on target?
- Is the Internal Audit savings register proving that the service is helping the council to save money, increase income, avoid reputation damage and grasp opportunities?
- Have internal auditors all received Personal Development Plan reviews?

- Is Audit Scotland reporting positive assurance comments about Internal Audit?
- Are members of the Audit Committee and the director in charge of finance satisfied with the level of assurance?

We feel that these PIs genuinely test the effectiveness and efficiency of Internal Audit, without creating an industry.

Like all other operational services, the combined services of Internal Audit and Risk Management have a risk register, which is reviewed quarterly, along with the PIs to identify problems on the horizon more quickly than hitherto.

We recently benchmarked our Audit Manual against other public sector bodies, and condensed it so that it basically guides an auditor through an internal audit. The Internal Audit Terms of Reference and Charter are kept separate from the Audit Manual and are located on the intranet. When conducting an internal audit, an inexperienced Internal Auditor is not presented with superfluous amounts of material to digest, but instead a well-presented and easy to understand, fifteen page document. This markedly reduces supervisory time.

### **Result – more time for auditing**

#### (i) Corporate Risk Management Group

Internal Audit plays a vital part in the corporate Risk Management Group, as all 'risk' specialists e.g. Risk, Audit, Health and Safety, Insurance, Business Continuity, Information Security and Front-Line services are brought together in one forum.

### **Result – Internal Audit at the 'coal-face' of risk and opportunity**

#### (i) Fraud

Along with the Head of Revenues and Housing Management, who manages the approach to Council Tax and Housing Benefit Fraud, Internal Audit takes the lead on Fraud Prevention and Detection measures. A whistle-blowing facility has been set up on the Council's website and intranet and this is proving useful for the reporting of fraud. Internal Audit also chairs a Fraud Risk Sub Group, which reports to the corporate Risk Management Group and the s95 Officer. This sub group has been very successful in highlighting fraud 'hotspots' which has led to management action and/or specific internal audits or risk management surveys.

### **Results – senior management and Audit Committee appreciative of this work**

## **7. Benefits Realised/Ongoing Benefits**

Strong indications suggest that we have the right skills and experience in the Internal Audit service, and we are making cost-effective use of the five posts available. However, we are also keen to prove that our approach is bringing genuine benefits to Midlothian Council, whether quantitative (e.g. saving money) or qualitative (e.g. Audit Scotland satisfaction). Here are the benefits we can prove:-

1. A saving of £15,000 on the Internal Audit/Risk Management pay bill, yet a more cost-effective service is in place – **a true efficiency;**
2. Further monetary savings, and efficiencies, envisaged from ELBF – **again likely to be a true efficiency;**
3. Motivated Internal Audit team – auditing key business areas; meeting the Chief Executive; feeling valued - **prospect of staff retention/higher performance much improved;**
4. The results of the savings register are positive – **genuine evidence of savings, avoiding leakage and reputation damage;**
5. Local data matches, using CAAT's and supporting the National Fraud Initiative, are exposing fraud – **identifying savings, closing the gap on fraud;**
6. Because of the guide '*How to achieve a High Rating during an Internal Audit*', Managers' perception of internal control has been raised - **they now recognise more clearly the link between financial regulations, the standing order on contracts and the procurement policy and what they need to do on the internal control front;**
7. As a result of the Internal Audit approach to risk, incorrect auditee perceptions of risk are exposed and rectified fairly rapidly - **genuinely better risk management;**
8. A series of green (adequate internal control) as opposed to amber and red (inadequate internal control) internal audit reports are emerging – **strengthening internal control;**
9. Senior Management and Middle Managers are guaranteed a detailed, internal audit inspection every three years, with some receiving interim testing and follow-up in between – **strengthening internal control;**
10. If not all Strategic and Corporate risks are reviewed by Internal Audit, in its three-year plan, these are automatically reviewed by the risk management service – **therefore 100% coverage from the Risk and Audit team;**
11. The annual assessment of corporate governance is simple and easy to use – **exposes weaknesses quicker;**
12. The Audit Committee is appreciative of the work Internal Audit is producing and the availability of Internal Audit reports immediately they are finalised. The Audit Committee has been able to heighten its promotion of robust internal control, management of risk and governance – **much improved scrutiny.**

### **8. Midlothian's Bid for the Cliff Nicholson Award 2010**

In comparing Midlothian's progress with the criteria set out in the Cliff Nicholson Award, namely clarity, originality, content and impact, Midlothian's Internal Audit service would like to be judged on its all-round performance and improvement since August 2008. While there have been important single initiatives, like taking internal control to managers through the proactive internal control guideline, we feel that these have to be viewed as a whole.

On the path of improvement since August 2008, Internal Audit set **specific and appropriate objectives**, namely that we wanted positive comments coming from senior management, Audit Scotland and the Audit Committee, instead of negative ones. We wanted Internal Audit to merge and work closely with risk management. We wanted to be radical about improving internal control, the management of risk and fraud prevention. We were invited to lift the 'fog factor' and time-consuming industry from

assessing corporate governance. All these objectives have been achieved, as witnesses in a testimonial from the Chair of the Audit Committee in **appendix 2**.

From the improvements, **there is clarity in the status and importance of internal audit**. There is clear evidence of the impact it is having, even to the point of 'paying its way' through savings. There are non-monetary benefits making it easier to make forward-looking decisions on the internal audit service, and generally on the internal control environment, management of risk and governance.

**Internal Audit has clearly expanded its scope and horizons**. We have created a valuable link between the basic, bare-bones, financial regulations and internal control and risk management expectations at the 'coal-face'. Auditees know well in advance the standards expected during an internal audit, as they have a step-by-step guide to guarantee a blue or green rating in an internal audit, should they follow the guidance. This approach brings internal control improvements much earlier than hitherto. Currently, in the background, the Corporate Management Team has agreed that every Manager compares practice with the internal control guideline and reports findings into Departmental Management Teams. This way, auditees are self-auditing and self-assessing. The 12 Managers in charge of systems/projects/processes to be reviewed by internal audit before 31 March 2010 have been given due notice.

**We feel that these are novel techniques. We take internal control and risk management to the client, instead of waiting for the next internal audit, or risk management survey, to uncover weaknesses**. We have the backing of the senior management, through the Corporate Management Team, and the Audit Committee, to do this. We also think our expanded use of CAAT's is novel, taking an established piece of software and using it proactively. The evidence is that savings are accruing and increased levels of fraud and non compliance are being uncovered.

**Using COSO principles, normally associated with the private sector, is also breaking new ground in local government**. Our integration of internal audit and risk management, without affecting internal audit's independence, is working very well with all concerned having a sharper focus on risk management.

**The profile of Internal Audit (and Risk Management) has been heightened through this approach and the duality of regularly meeting the Chief Executive and s95 Officer**. The focus of the Internal Audit Plan, with its 'roundedness' and inclusion of key business risks, the 'can do' and helpful attitude of the auditors, and the endorsements coming from senior management, the Audit Committee and Audit Scotland all indicate that Internal Audit is valued and making a difference.

We are acutely aware of best practice in both the public and private sector; we regularly **benchmark** with other bodies, through ELBF and SLACIAG etc, and make changes accordingly. This ensures that our Internal Audit service should always be a best practice service.

Because of the Internal Control Guideline, the nature of the Internal Audit Plan, and the close link with risk management service, **we can easily interpret data and trends** in governance, risk management and the internal control environment. At any given time, we can report to senior management and the Audit Committee on areas for

improvement. The new corporate governance assessment system provides an overview for best value purposes.

**We feel that our improved approach could be used by other local authorities and we have relayed this initially to SLACIAG and to ELBF.**

Thank you for spending time reading the story of Midlothian's Internal Audit service.

**Appendix 1**

**Extracts from Midlothian's internal control guidance 'Achieving a High Rating from Internal Audit'**



**IMPROVING INTERNAL CONTROL – ACHIEVING A HIGH RATING FROM  
INTERNAL AUDIT**

**Produced by the Internal Audit and Risk Management services  
With effect from 1 April 2009**

The guideline is essentially meant to a very easy read, of about 20 pages on the basics of internal control and taking a manager through basic steps to improve internal control. The requirement to comply with this guideline is built into our managerial competency list.

Basically the guideline is structured as follows:-

1. Purpose of the guideline
2. The theory of internal control – why you need it
3. Why Financial Regulations are essential to you but are brief and require further explanation
4. A brief list of the matters covered by Financial Regulations where internal control of a high standard is expected
5. Who across the Council is responsible for internal control, including you (highlighting that its not safety in numbers, you are responsible for your operation)
6. The high expectations of Internal Audit and the Audit Committee – what we will be looking for
7. How your internal control will be rated at the end of an audit (Red, Amber, Green or Blue) (see the grid on the next page)
8. The range of internal controls available to management – two examples, segregation of duties and internal check and procedures and training are illustrated on a later page
9. A checklist (shown below) to compare practice on a regular basis with the guideline

**Item 9 is shown below**

**System/process:**

**Manager:**





**Head of Service:**

**Date of Review**

<b>Internal Control</b>	<b>Satisfactory? Please tick</b>	<b>Notes</b>
1. Policies, Strategies and Work Plans		Are these up to date, relevant, achieving outcomes?
2. Control Objectives		Are you clear what your service is meant to be doing?
3. Legislation/Regulation		Are you sure you are complying with legislation?
4. Team Meetings/Briefing		Are these regular and minuted? Are the agenda items relevant and making a difference?
5. Risk Register		Is this up to date and contains the relevant threats and opportunities to your operation?
6. Segregation of Duties/Internal Check		Have you securely mapped out who does what to reduce the risk of fraud and error?
7. Documentation		Is this up to date, relevant and helpful? Do you regularly review

<b>Internal Control</b>	<b>Satisfactory? Please tick</b>	<b>Notes</b>
		your business processes?
8. Financial Regulations and Directives training		Do you and your staff fully understand these? Does this guideline help?
9. Procedures and Training		Are procedures up to date, relevant and helpful? Are all staff, including new starters, trained in them?
10. Accesses to computer systems, buildings and hard copy documents		Are computer accesses relevant? When you have leavers, do you notify ICT? Do you have a clear desk policy?
11. Authorised signatories		Are authorizing powers up to date and include financial limits? Do you monitor compliance?
12. Recruitment Gateway		Do you follow the HR guidance?
13. Procurement		Do you always comply with the procurement policy and procedures?
14. Project Management		Do you follow the council's project management methodology?
15. Management Information (MI) on Performance		Do you review MI on a regular basis and discuss it with your team and line manager?
16. System Exception Reports		Are these reviewed by a person not involved in day to day processing?
17. Performance Indicators		Do you review these on a regular basis?
18. Budgetary Control		Do you review statements on a monthly basis? Is your budget in control?
19. Monitoring and spot checks		Do you regularly monitor the work of your staff?
20. Fraud Policy		Do you apply the dictates of the policy in your operation?
21. Stocks		Do you follow the council's stocks and stores procedures?


Each internal audit report has an assurance statement:

Full Assurance	<b>BLUE</b> 	There is a <u>sound system of internal control</u> designed to achieve the system objectives and the controls are being consistently applied. Risk is managed to a high standard.
Reduced Assurance	<b>GREEN</b> 	Whilst there is <u>basically a sound system of internal control</u> there are some areas where it is viewed improvements can be made and risk controlled further.
Limited Assurance	<b>AMBER</b> 	There are <u>weaknesses in the system of internal control</u> which should be addressed within a reasonable timescale. Improvements are required in the way risks are managed.
No Assurance	<b>RED</b> 	There are <u>significant weaknesses</u> in the system of internal control which must be addressed as a matter of urgency. Unnecessary risks are being carried and the Council remains exposed.

Examples of 2 of the 21 internal control guidelines:-

### Example 1

#### Segregation of Duties (SD) and Internal Check (IC)

 - Internal Audit regularly finds flaws in SD/IC and occasionally this has led to serious error and financial loss. Occasionally Middle Management has failed to report issues to Senior Management.

This is so that no, one officer has unlimited authority over a whole process or system and at various stages work can be checked to expose any fraud or error. Of course the level of checking should be commensurate with the risk involved.

Here are three examples:-

#### Construction Service in Commercial Services

The officer compiling a specification and tender documents to refurbish a building should not then be able to receive and open tender documents and award the contract. The latter duties should be carried out by someone else. Refer to Standing Order 20.

#### Allocation of Jobbing Work in the Property Maintenance Service

Clerks of Works cannot allocate work to external contractors without the Senior Management having first approved the use of these contractors.

#### Ordering goods and services and paying invoices


Ideally the person ordering the goods should then not be the person receiving the goods and authorising the payment of the invoice.

Please compare your day to day processes and workload with the officers at your disposal and work out a system of SD/IC, where the work of one officer is checked by another officer.

Consider aspects where fraud or error could be perpetrated and consider where SD/IC could deter, prevent or detect this.


You may be in charge of a business area that has few staff, or vacancies, and an effective system of SD/IC cannot be installed. This is for you to report to your Line Manager, who is encouraged to consult Internal Audit.

If frontline SD/IC is not possible, a system of retrospective spot checks may be the solution, so that officers with fuller than normal authority in a process/system, know that their work is being reviewed.

 - there is clear evidence that no, one person has unfettered authority throughout an entire system and process and the work of one person is automatically checked by another. Or where SD/IC is not totally possible, Management has created compensatory controls.

## **Example 2**


### **Procedures and Training**

 - occasionally Internal Audit finds that there are no procedures, or they are out of date and if they are present, they are occasionally not used.

These should direct how processes are operated and be kept up to date

Procedures need not be lengthy documents and can be in note form.

Every Manager must annually remind officers about the procedures, involve them in any updates and brief new starters in these, especially temporary or agency staff.

 - there is clear evidence that procedures are easy to read, are up to date and all officers are using them.

## **Appendix 2**

### **Testimonial from the Chair of the Audit Committee (Performance, Scrutiny and Audit Committee – PSA)**

I am the chair of the committee that scrutinises performance, cabinet policy and promotes robust internal control, governance and the management of risk. Being a small Council with only 18 elected members, it was felt reasonable to merge the three topics of performance review, scrutiny and audit committee into one meeting. I have been in the scrutiny and audit committee role since becoming a councillor in 2005 and became Chair of the PSA committee in 2007. While it became apparent that our risk management policy and practice were in line with the best value legislation, the authority always seemed to struggle with assurance from internal audit. There had been problems with recruitment and fulfilling an internal audit plan. The result was that the PSA, External Audit and Chief Officials had reservations about the soundness of the council's internal control environment.

Since the middle of 2008 this has all changed significantly. The PSA is now receiving internal audit reports on a regular basis and the audit plan is addressing key business areas. Reports have exposed, and helped to quickly rectify, inherent control problems and the council is benefitting from stronger internal control. The Risk and Audit Manager reports monthly on the progress with the internal audit plan and a full year picture of internal control is emerging. The PSA meets him regularly. This provides a good focus for PSA that was missing before. The above is of course a basic requirement of assurance and should be in place as a routine. However, the bid for the Cliff Nicholson Award alludes to the fact that Midlothian's internal audit (and risk management) service has brought depth, clarity, innovation and newness to the assurance requirements. I wholeheartedly endorse this suggestion and I put forward the following points in support:-

- 1) in the PSA eyes the internal audit team has, through various tools, including an Audit Committee Reporting Calendar, easy to understand reports and a comprehensive internal audit plan, brought freshness to the audit committee's work making the elected members' job a lot easier;
- 2) elected members like the approach that around a half of the internal audit plan is left flexible so that elected members can discuss in committee the topics they would like assurance on, generally the Council's high risks. This approach has presented us with important reports on topics such as Community Planning, Health Improvement, Performance Reporting and we are looking forward to reports soon on Managing Sickness Absence, Business Opportunity and Homelessness;
- 3) the PSA likes the idea of the internal auditors giving auditees a guideline on how to improve their internal control and achieve a high rating during an audit. We welcome 'up-front' initiatives like this, as issues can be identified earlier than previous;
- 4) Giving the PSA members internal audit reports as they come off the production line allows us plenty time to read and understand them and formulate the right questions for discussion in committee;
- 5) The PSA also like the integration of risk management with internal audit, these two services are feeding off each other to the benefit of the Council;
- 6) I know that internal audit can produce evidence that it is saving money and/or helping the Council steer clear of reputation damage or disrupted services. PSA is looking forward to the final tally at the year-end;

7) The external auditor was previously constantly reminding the PSA of the lack of assurance. By the early part of 2008 the problem had become acute. Now the external auditor is completely satisfied with the approach taken.

I hope the internal audit service does well in the Cliff Nicholson Award this year.

**Owen Thompson**  
**Chair of the Performance, Scrutiny and Audit Committee**

**27 January 2010**