

## **CABINET**

**20<sup>th</sup> September 2016**

### **FUTURE OF INTERNAL AUDIT**

#### **Report of the Director for Resources**

Strategic Aim:	All	
Key Decision: Yes	Forward Plan Reference: FP/150716/01	
Exempt Information	No	
Cabinet Member(s) Responsible:	Mr T C King, Deputy Leader and Portfolio Holder for Places (Development and Economy) and Resources	
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Ward Councillors	N/A	

#### **DECISION RECOMMENDATIONS**

1. That subject to satisfactory completion of due diligence and any consultations as appropriate, Cabinet approve the delegation of the delivery of internal audit services to LGSS under section 101 of the Local Government Act 1972.
2. That authority be delegated to the Director for Resources in conjunction with the Portfolio Holder for Corporate Finance to formalise, approve and enter into a collaboration agreement with the Local Government Shared Service for delivery of internal audit services from 2017/18 in accordance with the principles set out in this report.

#### **1 PURPOSE OF THE REPORT**

- 1.1 In accordance with Section 6 of the Accounts and Audit Regulations 2011, the Chief Finance Officer and the Chief Executive shall be responsible for maintaining an adequate and effective internal audit of the Council's accounting records, control systems and financial transactions including any operations affecting the financial arrangements or the finances of the Council.
- 1.2 This report proposes an option for the future delivery of the Internal Audit service.

## **2 BACKGROUND AND MAIN CONSIDERATIONS**

### **2.1 Internal audit service**

- 2.1.1 The primary role of the Internal Audit Service is to objectively examine, evaluate and report on the adequacy of the Council's internal control environment as a contribution to the proper, economic, efficient and effective use of resources and the management of risk. Internal Audit also advises on, carries out and directly supports investigations into suspicions of fraud or financial irregularity.
- 2.1.2 The requirement to maintain an adequate internal audit function is achieved presently through the Council directly employing the Welland Internal Audit team. The internal audit team provide internal audit services not only to Rutland but to other Welland authorities (Melton and East Northants) and other partners, Corby and Harborough. The work of the team is underpinned by a delegation agreement between the partners and there is a Welland Internal Audit Board (comprising the Section 151 Officers of each Council) which oversees its work and reports through to the Welland Joint Committee.
- 2.1.3 The internal audit team of 4.76 FTE is supported by interim external support including Head of Internal Audit provision from the Local Government Shared Service. The total cost of the service is c£320k of which the Rutland share is c£85k.
- 2.1.4 In terms of performance, the Council acknowledges that the existing service managed by LGSS (a public sector shared service venture wholly owned by Cambridgeshire, Northamptonshire County Councils and Milton Keynes Council) is very good and that the performance level is high (measured in terms of the % completion of the audit plan by the end of March and feedback from staff which has been very positive). The Audit and Risk Committee itself has also commented on the positive performance of the audit team and the quality of some of the work produced. Confidence in the team is high compared to a few years ago when the audit team was fully staffed in house. In that period, the audit plan was not delivered in fully in a timely fashion and an external review of the service concluded that significant improvements were needed (142/2013).
- 2.1.5 From a cost perspective, the main way in which cost is measured is on a per day basis. CIPFA produces various benchmarking reports on costs which indicate that costs per day per unitary authority is the range of £260 - £375 with the average around £320. The Council's day rate cost is c£265 so at the lower end<sup>1</sup>.

### **2.2 Rationale for consideration of alternative delivery options**

- 2.2.1 The current arrangement with LGSS is in place until 31 March 2017. The Welland Internal Audit Board acknowledges that whilst performance is good and costs are low, the existing model is not sustainable in the long term and has concluded that alternative arrangements need to be made to secure provision. The reasons for this are as follows:

- *Recruitment difficulties* – the Council has found it difficult to recruit when vacancies have arisen. The existing arrangement with LGSS was put in place

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<sup>1</sup> The Council is not a member of the CIPFA benchmarking club for internal audit but has sourced publicly available information to arrive at an estimate of the current cost of internal audit.

following two unsuccessful recruitment exercises after the retirement of the Head of Audit. The total number of candidates applying for the post was less than 5 even with an additional £5k market supplement.

- *Resilience* – during periods of sickness or when there are vacancies, there have been difficulties for the team in delivering the internal audit plan. The limited size of the team gives a lack of resilience. This has changed during the last year as the arrangement with LGSS has allowed the Council to draw down additional resource as required albeit at an additional cost.
- *Quality* – whilst the quality of service is good, the Council recognises that a small team does not have access to the specialist expertise that larger teams enjoy. For example, the team has no specialist IT auditor.
- *Uncertainty and development of service* – the existing arrangement is short term and is not secure with LGSS able to give 3 months' notice. Furthermore, the insecurity of tenure has restricted investment in the service. A longer term arrangement needs to be put in place which will allow management to invest in both staff and service.
- *Limited capacity for growth* – the team has limited capacity to grow and bring in new partners with the lack of a Head of Audit a key barrier. An inability to grow reduces the potential for resilience.
- *Management involvement* – the Section 151 Officers and Welland Internal Audit Board have invested significant time into resolving management issues and this level of investment cannot continue.

## 2.3 The options and preferred way forward

2.3.1 The Welland Internal Audit Board has considered different delivery models, including:

- Full outsource – the procurement of an internal audit service from an external provider;
- Co-source – combination of an in-house team and one or more external providers;
- Fully staffed model (the original Welland model as designed) – internal audit delivered by an internal team, employed by one of the member organisations, and who work across member organisations; and
- Collaboration/delegation (current model in place)– internal audit delivered by another local authority under delegation/collaboration agreement.

2.3.2 Indicative costs and advantages/disadvantages for each model were discussed by the Board. The results are shown below with notes:

Option	Costs	Advantages/Disadvantages
Full outsource (1)	£534k - £668k	<u>Advantages</u> <ul style="list-style-type: none"> <li>• Greater resilience</li> </ul>

Option	Costs	Advantages/Disadvantages
		<ul style="list-style-type: none"> <li>• Access to wider/specialist resources</li> <li>• No recruitment costs</li> <li>• Potentially better quality but experience of Welland partners has been mixed in the past</li> </ul> <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> <li>• Contract management required</li> <li>• Continuity of staffing not guaranteed</li> <li>• Increased cost even if external providers argue 10-20% productivity gains</li> <li>• Takes time and cost as OJEU process is required (or use of framework if possible)</li> <li>• Change of scope may require changes in contract</li> </ul>
Co-source (2)	£480k - £520k	Combination of models 1 and 3
Fully staffed model (3)	£300-£320k	<p><u>Advantages</u></p> <ul style="list-style-type: none"> <li>• Continuity of staffing</li> <li>• Greater familiarity with clients</li> <li>• Scope of service easily modified</li> </ul> <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> <li>• Lack of resilience</li> <li>• Access to specialist advice is limited</li> <li>• Some difficulties in recruitment as pay rates not always competitive in this market</li> </ul>
Collaboration/ Delegated model (4) e.g. Another Council take over Audit service	£320k	<p><u>Advantages</u></p> <ul style="list-style-type: none"> <li>• Greater resilience</li> <li>• Access to wider/specialist resources</li> <li>• No recruitment costs or sickness problems</li> <li>• Continuity of staff with TUPE transfer</li> <li>• Avoids any redundancy costs as staff TUPE</li> <li>• No OJEU required but negotiation needed over TUPE etc</li> </ul> <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> <li>• Management of agreement required</li> <li>• Continuity of staffing not guaranteed</li> <li>• Lack of resilience if not collaborating with a partner of sufficient size</li> <li>• Potential for cost increases</li> </ul>
<p>Costs based on days required (1335) multiplied by an estimated day rate range of £400-£500 per day following informal discussions with suppliers and knowledge of rates charged elsewhere. As current staff would TUPE transfer,</p>		

Option	Costs	Advantages/Disadvantages
<p>providers would wish to see terms and conditions before deciding rates.</p> <p>Assumes 400 days commissioned and the remainder provided in-house. Day rates higher as buying-in a Head of Audit would cost more per day (£500 - £650 per day) than a general composite rate.</p> <p>Costs are shared between 5 local authorities</p>		

- 2.3.3 The conclusion from the analysis was that the current model is favourable. The challenge for the Board therefore was to find a way of converting the existing temporary arrangement into a permanent model with LGSS or another local authority.
- 2.3.4 The Assistant Director – Finance discussed collaborative models with a number of local authorities albeit ones with which the Council has no direct experience of working with on internal audit. All were interested in principle but would need to undertake further due diligence to assess whether they could deliver the service for the existing fee. At the same time, LGSS came forward with its own proposal for the Welland partners to delegate the service to it for the same fee. On this basis, after some consultation (with the Chief Executive, Portfolio Holder and Chair of Audit and Risk Committee), Officers decided therefore that there was no compelling reason to continue deliberations with other authorities at this stage and that continuing to work with LGSS made the most sense for the staff and the Council generally. The reasons for this are as follows:
- LGSS are currently working with the Council and have demonstrated that they can deliver what is needed;
  - Current performance levels are very good;
  - There would be minimal disruption as LGSS are already managing the service;
  - LGSS know our audit staff (who would TUPE transfer under this proposal) and our staff know LGSS and how they work;
  - LGSS have confirmed that they can deliver within our existing budget;
  - LGSS have developed good relationships with senior management and have the confidence of the Audit and Risk Committee; and
  - The Council would gain access to a bigger team with wider skills.

### **3 CONSULTATION**

- 3.1 As internal audit and fraud services are 'back-office' functions, this change will not impact on the public and so has not been subject to external consultation.
- 3.2 LGSS's proposal is for all Welland authorities to delegate their internal audit service to them and is predicated on at least 4 of the existing 5 authorities delegating their service. All other authorities have taken reports to their own committees and are, in principle, supportive of the proposal.

- 3.3 Since the implementation of the delegation involves the transfer of staff, statutory consultation will be undertaken. In the meantime, the Assistant Director - Finance has met with the team to discuss the proposed delegation in broad terms. The team understand the proposal and are aware that, subject to consultation, they would transfer to LGSS on the same terms and conditions and no longer be employees of this council. The team is also aware that it is LGSSs intention for them to continue working at the existing Welland sites although there may be opportunities to work on other LGSS clients. At this stage the team have raised no specific concerns but based on initial discussions it is expected that detailed questions will come through as part of the consultation.
- 3.4 The Audit and Risk Committee, which is responsible for oversight of the Internal Audit function, has also been consulted on the proposal and the Chair of Audit and Risk met separately with LGSS to discuss it. The Committee is supportive of the proposal having looked at the other options.

#### **4 ALTERNATIVE OPTIONS**

- 4.1 The Board and this Council considered various options as set out above. Cabinet could:
- support the proposed option as it stands;
  - request further work prior to making a decision; and
  - propose an alternative option.
- 4.2 Should an alternative option be proposed or the other Welland authorities not agree to the delegation then the Council would need to reassess the financial impact and determine whether a new arrangement could be put in place for the start of 17/18 or whether an extension to the existing arrangement would be required. The latter is most likely.

#### **5 FINANCIAL IMPLICATIONS**

- 5.1 The current Council budget for Internal Audit is £85k. There will be no change to this cost.
- 5.2 As the Council is the employer of all staff, LGSS will seek some agreement that the Council (and other Welland Councils) underwrite the cost of any staff redundancies should the agreement be terminated on non-performance grounds within an initial agreed period (say 2-3 years) and in the event that TUPE does not apply (i.e. that staff working for LGSS would not transfer back to the Council). The Council considers that such an agreement would be acceptable.

#### **6 LEGAL AND GOVERNANCE CONSIDERATIONS**

- 6.1 There are various legal provisions that allow for collaborative working between local authorities. The delegation of functions to another local authority is permissible under sections 101 of the Local Government Act 1972 and sections 19 and 20 of the Local Government Act 2000.
- 6.2 The Constitution (Rule 130) states that the discharge of executive functions will be taken collectively by the Cabinet. Executive functions of the Cabinet may be

delegated by the Cabinet to be discharged by: a) a Committee of the Cabinet; b) an officer; c) joint arrangements; or d) another local authority. The Cabinet is therefore able to delegate the internal audit function to another local authority or joint arrangement under a delegation agreement.

6.3 The collaboration agreement will fall outside the scope of the Public Contracts Regulations 2015. Such administrative arrangements are expressly exempted from the EU procurement regime (Regulations 11 and 12 (7) of the Public Contracts Regulations 2015) so there is no requirement for Rutland County Council to tender these services.

6.4 The collaboration agreement with LGSS will amongst other key principles cover:

- Overall responsibility - the Assistant Director - (Finance) will be the RCC lead and an agreed representative from LGSS will be responsible for delivering the service;
- Welland Board – the Welland s151 Officers will form an officer board with LGSS representatives for oversight of the service;
- Delivery arrangements - how LGSS will deliver the service (this is set out in the proposal);
- Funding and cost sharing;
- Termination and other rights;
- Dispute resolution;
- Staffing and TUPE;
- Liability, indemnity and insurance;
- Data protection and information governance; and
- Exit provisions.

6.5 A schedule of key risks and how the Council will seek to manage them is included within Appendix A.

<b>Risk</b>	<b>Description</b>	<b>Action to avoid or mitigate risk</b>	<b>Risk rating</b>
Either party chooses to terminate the delegation	LGSS permanently takes on the responsibility for and costs of providing the audit function. Either party may choose to end the arrangement, the arrangement fails, leaving LGSS with additional costs and	A formal legal agreement will be made to include exit arrangements with appropriate notice periods for seeking to vary or terminate the services.	Low

<b>Risk</b>	<b>Description</b>	<b>Action to avoid or mitigate risk</b>	<b>Risk rating</b>
	Rutland with no service		
Failure to deliver effective service	The proposed service is a new way of working; it may fail to deliver an effective internal audit for the Council.	Current arrangements work well.  A formal legal agreement will be made to include required outputs and how performance will be measured, monitored and reported.	Low
Fee increases	Fees increases beyond original agreement.	The funding and cost sharing arrangements will require annual sign off but RPI and other assumptions will be built into the agreement.	Low
Council required to meet additional costs	Staff no longer required and Council asked to contribute to termination costs for those staff transferring	Due to longevity of existing staff, current costs of termination are low.  Position to be agreed in agreement.	Low
Staff grievance	Transfer of staff may not be undertaken appropriately.	HR staff from both councils are involved in the project and will lead on this workstream.	Low

## **7 EQUALITY IMPACT ASSESSMENT (EIA)**

7.1 This initial screening identified that a full EIA is not required.

## **8 COMMUNITY SAFETY IMPLICATIONS**

8.1 There are no community safety implications.



## **9 HEALTH AND WELLBEING IMPLICATIONS**

9.1 There are no health and wellbeing implications.

## **10 HUMAN RESOURCE IMPLICATIONS**

### **10.1 *Pension Matters***

10.1.1 Employees are given protection by the TUPE Regulations if the service in which they are employed changes hands. In effect their employment and any associated liabilities, legally moves from the old employer to the new employer.

10.1.2 Employees' pension rights are not directly protected by the TUPE Regulations. However, employers that participate in the LGPS should be aware of the legal position regarding staff TUPE transferring from their organisation to an external service provider (i.e. a Contractor) including obligations to ensure 'pension protection' going forward.

10.1.3 In cases of delegation to another LGPS Employer, pension protection can be achieved by ensuring that transferring staff have either:

- continuing access to Membership of the LGPS, or
- access to a pension scheme which has been certified by the Government Actuary's Department (GAD) as being 'broadly comparable' to the LGPS.

10.1.4 LGSS have indicated that staff will transfer to the Cambridgeshire Pension Fund.

10.1.5 Risk relates to liabilities and deficits which have already accrued or can accrue over the course of an agreement, regarding funding the provision of Members' LGPS benefits. RCC, as the Scheme Employer will need to decide whether any pensions deficit which there may already be in respect of the employees to be TUPE transferred will be retained by ourselves (i.e. the transferred service is to be treated as fully-funded); or any pensions deficit is to be transferred to the contractor.

10.1.6 It is assumed that the Council will not look to transfer any pension deficit which may exist (at this stage the Council is not aware of any deficit or what the level of it is) but given the number of staff involved this is not considered to be significant. Should the pension deficit remain with the Council this would be funded through ongoing contribution rates. (Once staff have transferred the Fund Actuary may calculate a new Employer Contribution Rate - the charge made to a Scheme Employer of underpinning costs of providing the occupational pension scheme benefits provided by the LGPS not met by Member contributions and returns on Fund investments. Given the likely number of staff transferring, it is unlikely that the Council's contribution rate would change significantly). A lump sum payment to clear any deficit is not required.

10.1.7 Future pension risk will be borne by LGSS and this has been provisionally agreed. If this approach is agreed then any pensions deficit above which does exist at the end of the agreement will be met by LGSS.

### **10.2 *Transfer of Undertakings (TUPE)***

- 10.2.1 In order to give LGSS full control over resources, it is proposed that existing staff TUPE transfer from Rutland County Council. There is no risk around the number to be transferred as all staff are linked to the internal audit service. The transfer of undertakings (TUPE) was discussed with LGSS and they have confirmed that they have undertaken this process from other authorities.
- 10.2.2 There is a requirement to undertake a TUPE consultation process and this will involve formal consultation with staff and Trade Unions. The Trade Unions will need to be briefed.

## **11 CONCLUSION AND SUMMARY OF REASONS FOR THE RECOMMENDATIONS**

- 11.1 The Council is required to have an internal audit service and this paper sets out alternative options and proposes a preferred option that will enable the Council to meet this requirement.

## **12 BACKGROUND PAPERS**

- 12.1 There are no additional background papers to the report.

## **13 APPENDICES**

- 13.1 There are no Appendices.

A Large Print or Braille Version of this Report is available upon request – Contact 01572 722577.