

AUDIT AND RISK COMMITTEE

19 July 2016

FUTURE OF INTERNAL AUDIT

Report of the Director for Resources

Strategic Aim:	All		
Exempt Information	No		
Cabinet Member(s) Responsible:	Councillor Terry King, Leader and Portfolio Holder for Corporate Finance		
Contact Officer(s):	Debbie Mogg, Director for Resources	Tel: 01572 758358 dmogg@rutland.gov.uk	
	Saverio Della Rocca, Assistant Director - Finance	Tel: 01572 758159 sdrocca@rutland.gov.uk	
Ward Councillors	N/A		

DECISION RECOMMENDATIONS

That the Committee comments on the proposal to delegate the Internal Audit function to LGSS

1 PURPOSE OF THE REPORT

- 1.1 To obtain the Committee's views on the proposal for the future delivery of the Internal Audit service.

2 BACKGROUND AND MAIN CONSIDERATIONS

2.1 The 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 In accordance with Section 6 of the Accounts and Audit Regulations 2011, the Chief Finance Officer and the Chief Executive are 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. The Internal Audit Section is required

to comply with the current CIPFA Code of Practice for Internal Audit in Local Government, in undertaking its functions.

- 2.1.3 This requirement 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 legal agreement between the partners and there is a Welland Internal Board (comprising the Section 151 Officers of each Council) which oversees its work and reports through to the Welland Joint Committee.
- 2.1.4 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.
- 2.1.5 In terms of performance, the Council acknowledges that the existing service managed by LGSS 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).
- 2.1.6 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 is the range of £260 - £375 with the average around £310 - £320. The Council's day rate cost is c£265 so at the lower end¹.

2.2 Rationale for consideration of alternative delivery options

- 2.2.1 The current arrangement with LGSS is in place until 31 March 2016. The Welland 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 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.

¹ The Council is not a member of the CIPFA benchmarking club for internal audit but has sourced publicly available information (published over the last few years) to arrive at an estimate for the average cost per day of internal audit.

- *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 Board have invested significant time into resolving management issues and this level of investment cannot continue.

2.3 Other options

2.3.1 The Welland 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	<p><u>Advantages</u></p> <ul style="list-style-type: none"> • Greater resilience • Access to wider/specialist resources • No recruitment costs • Potentially better quality but experience of Welland partners has been mixed in the past <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> • Contract management required • Continuity of staffing not guaranteed • Increased cost even if external providers argue 10-20% productivity gains • Takes time and cost as OJEU process is

Option	Costs	Advantages/Disadvantages
		required (or use of framework if possible) <ul style="list-style-type: none"> • Change of scope may require changes in contract
Co-source (2)	£480k - £520k	Combination of models 1 and 3
Fully staffed model (3)	£300-£320k	<u>Advantages</u> <ul style="list-style-type: none"> • Continuity of staffing • Greater familiarity with clients • Scope of service easily modified <u>Disadvantages</u> <ul style="list-style-type: none"> • Lack of resilience • Access to specialist advice is limited • Some difficulties in recruitment as pay rates not always competitive in this market
Collaboration/ Delegated model (4) e.g. Another Council take over Audit service	£320k	<u>Advantages</u> <ul style="list-style-type: none"> • Greater resilience • Access to wider/specialist resources • No recruitment costs or sickness problems • Continuity of staff with TUPE transfer • Avoids any redundancy costs as staff TUPE • No OJEU required but negotiation needed over TUPE etc <u>Disadvantages</u> <ul style="list-style-type: none"> • Management of agreement required • Continuity of staffing not guaranteed • Lack of resilience if not collaborating with a partner of sufficient size • Potential for cost increases
<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, 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 to delegate the service to it for the same fee. On this basis, after some consultation (with the Chief Executive, Portfolio Holder, Chair of Audit and Risk Committee and other Welland s151 Officers), 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;
- The Council would gain access to a bigger team with wider skills.

2.3.5 Officers are preparing a report for Cabinet with the preferred option to delegate the internal audit service to LGSS.

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. Since the implementation of the delegation impacts on staff terms and conditions, informal and formal consultations would need to be undertaken with staff if Cabinet agree to this option.

3.2 As indicated above, the Welland Internal Audit Board has also been consulted. All authorities are provisionally supportive of the plans.

4 ALTERNATIVE OPTIONS

4.1 Officers have set out alternative options above which have been assessed. The Committee can support the proposed option – in full or with variations - or offer an alternative view which can be fed into the options paper for Cabinet consideration.

5 FINANCIAL IMPLICATIONS

5.1 There are no direct financial implications arising from this report.

6 LEGAL AND GOVERNANCE CONSIDERATIONS

- 6.1 In accordance with Section 6 of the Accounts and Audit Regulations 2011, the Chief Finance Officer and the Chief Executive are 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.
- 6.2 The delegation of functions to another local authority is permissible under sections 101 and 102 of the Local Government Act 1972 and sections 19 and 20 of the Local Government Act 2000. Formal approval for this delegation will be sought in due course.
- 6.3 The Audit and Risk Committee is responsible for oversight of Internal Audit work and assessing whether the Council has adequate provision in place hence the reason for the report.

7 EQUALITY IMPACT ASSESSMENT

- 7.1 An Equality Impact Assessment (EqIA) has not been completed for the following as this report does not impact on Council policies and procedures.

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 CONCLUSION AND SUMMARY OF REASONS FOR THE RECOMMENDATIONS

- 10.1 It is important that the Council has appropriate internal audit arrangements in place. The proposed option effectively secures the future provision of internal audit without comprising the high performance and low cost model in place.

11 BACKGROUND PAPERS

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

12 APPENDICES

- 12.1 None

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