

AUDIT AND GOVERNANCE COMMITTEE

21 SEPTEMBER 2018

INTERNAL AUDIT PROVISION UPDATE

Recommendation

1. **The Chief Financial Officer recommends that the update on the position of Internal Audit services transferring back in-house be noted, and that progress updates be received at future meetings.**

Background

2. Worcestershire County Council's (WCC) Internal Audit (IA) Service is provided by Warwickshire County Council (WarCC) following a public to public TUPE transferred shared service that started May 2015.
3. The original business case was centred around saving money through joint working efficiencies; access and use of an IT system 'Galileo'; and the ability for auditors to do work across councils on the same pieces of work.
4. The contract has been in place for 3 years and was extended by default 1 April 2018 for two years with an option to give a notice period break clause if this was to be different.
5. An assessment has been undertaken of the value for money of this provision and alternative options assessed. This report summarises that assessment.

Assessment of future provision of Internal Audit

6. The requirement to have an Internal Audit function is a statutory one, and ensuring an appropriate level of resources is the responsibility of the Section 151 Officer. As part of my annual assessment I have appraised the current performance and function of the existing Internal Audit arrangements with Warwickshire CC both against the original intentions of transfer and current standards. Key points to note from that review are set out in the following paragraphs.

- ***Audit Fee***

7. The IA Service at point of transfer cost the Council £270,000 plus overheads. The overheads were not in effect part of the shared service. The Council did not seek to reduce its overheads as a result of the shared service, which is understandable given the small resource that transferred. As such it is assumed all overheads are not a factor in this assessment.

8. The service was transferred at a contract value of £260,000 and then reduced in 2016/17 to £250,000. This gave WCC a small saving and a capped cost that was projected to increase (with no changes in assumptions / staffing).

9. The current cost of the Service is £300,000 following an agreement by the former WCC CFO with WarCC Chief Internal Auditor to increase the fee in 2017/18 to reflect a higher than forecast cost to WarCC of the agreement. It is noted that the additional costs arose from a. a higher need for management of the WCC contract than was originally forecast and WarCC using a third party audit provider to cover some of the work under the contract following a number of vacancies post transfer and inability to recruit.

10. As such the current price of the contract is both higher, and only variable by contract. A conversation with WarCC CIA May 2018 also identified that WarCC were proposing writing to WCC in the Summer of 2018 to request a further increase in fee (c£25,000) due to the former WCC staff changes in terms and conditions resulting in higher costs. This is not considered in WCC interest at this particular time. It is estimated that the cost of the service could be circa £50,000 less for the same service in-house.

- **Audit Quality**

11. There have been a number of improvements in the service since the transfer:

- The use of Galileo recording system has improved the speed of reporting and performance management
- The style of reporting has improved, with great focus on assessment
- The service as a whole has just received a good external third party assessment. This was reported to the Audit and Governance Committee on 26 July 2018. This though did raise an issue around focus on risk (see later notes).
- Generally the feedback from clients has been very positive on the outcome of audits.
- There is good added value work being performed on an advisory front.

12. Against that as Section 151 Officer and a former External Audit Director and Chief Internal Auditor I have assessed the service as having a number of areas of development:

- There has been a lack of performance management of the team by WCC, a fault that lays with WCC but this has meant issues such as delays in completing audits or responding to recommendation have not always been picked up and managed. This in itself can be managed by maintaining a higher profile and focus on IA and its role / importance to the WCC. As such it is not a direct factor to consider in this assessment
- Performance management of the CIA is confused as split between Councils. This combined with the previous factor has made it harder to influence and shape the function

- Vacancies have struggled to be recruited to and there is a risk of further staff leaving. As such a number of audits have slipped / been delayed; or third party auditors TIAA have been used at extra cost to complete the audit plan. This does not fulfil one of the original benefits of the business case for transfer of shared staffing
- The reduced resources was a key factor in work on the new financial and payroll/HR systems (E5 and iTrent) not being undertaken before 31 March 2018. This work has now been completed (May / June 2018) with a number of 'limited assurances'. In two cases (AP and Bank Reconciliation) the audit findings relate to incidents that occurred in June/July 2017. This is too late, and Finance were already aware and resolving matters so these audits gave no additional value to WCC. The audits should have taken place at the time of problems.
- The Annual Plan was presented to July 26 Audit & Governance Committee, i.e. the end of Period 4. The contract requires presentation to the Committee in advance of the financial year.
- Initial review of reports has raised a need for a heavy steer regarding improvements in style, content and focus on risk. The CIA has responded positively.

- Options to address

13. Three options were considered:

- As is, although with improved management of the contract with potential changes;
- Serve notice on the contract and bring the contracted service back in-house; or
- Serve notice on the contract and procure a contract with another provider.

14. An assessment has been undertaken against the following criteria and is set out in detail in the Appendix:

- Price
- Quality
- Complexity
- Partnerships
- Reputation

- Control Environment

15. The chosen option is: 2 - Serve notice on the contract and bring the contracted service back in-house, based on both price and quality. This does not preclude a future review of the service provision and options for partnership.

16. Discussions with WCC Monitoring Officer confirmed that the decision is delegated to the CFO around this service. As such option 2 was the chosen route to pursue and notice was served by 30 July 2018 to WarCC. However, due to the need to assess the HR implications and management of that process this is the first opportunity to inform this Committee.

17. Cabinet Members with responsibility for Finance at both Councils have been engaged and informed, and the Chairman and Vice-Chairman of this Committee were kept informally briefed of this decision.

18. WCC are keen to express its gratitude to WarCC for the improvements they have made to the IA service, and it is envisaged that joint working and sharing of information will still flow between the two councils in relation to IA.

19. The process is being managed within Finance and supported by the HR teams at both WCC and WarCC. The majority of the transfer is expected to be managed without much risk, the key issues that have been flagged to address that will need action in the Autumn are diligence surrounding the TUPE of staff to WCC, and the procurement and establishment of an audit software / database. Both these risks are being managed.

Contact Points

County Council Contact Points

County Council: 01905 763763

Worcestershire Hub: 01905 765765

Specific Contact Points for this report

Michael Hudson, Chief Financial Officer

Tel: Ext 6268

Email: mhudson@worcestershire.gov.uk

Supporting Information

- Appendix – Assessment criteria

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report:

Assessment criteria

Criteria of assessment	Option 1 – As is	Option 2 – Insource	Option 3 – other provider
Price	£300,000 to £325,000. So an increase in budget. However capped.	<p>The current cost without consideration of a new system is c£264k subject to consideration of CIA post. It is assumed the CIA costs can be met through a Finance restructure, so the option supports a saving / standstill.</p> <p>Future budgets would increase for pay as per the rest of the council and would not be capped as is the greater potential under options 1 or 2.</p> <p>There would also be a capital outlay of c£30,000 for a new system, and ongoing c£7,000 licence costs. This will need to be managed and could be funded on an annual repayment of £3,000 from savings.</p>	Soft Market testing suggests a fee in the region of £350,000 to £400,000 capped subject to change variations. As such the higher cost option

Criteria of assessment	Option 1 – As is	Option 2 – Insource	Option 3 – other provider
Quality	See above commentary on as is.	This option would require a CIA and good management and there is a risk associated with this. The service will also need to pursue a robust IA recording system. The choice will need to be managed. However, it is anticipated the greater focus on direction will improve quality.	This would depend on the specification, tender and provider. It is assumed this option would provide the greater quality, albeit at a price.
Complexity	No transition, main issue is around ensuring improved performance management.	Transition and in-source process. This can be mitigated but needs to be resourced. With a 9 month lead in period this is not expected to be a significant risk.	This would require a specification and tender process. Again nothing complex but will take time to manage, and a successful bidder would need to be appointed by end of November at the latest to allow for hand over and planning. That is manageable.
Partnerships	Promotes joint council working.	Options around sharing still possible around systems, knowledge, quality assurance, fraud.	Could be Public to Public partnership.
Reputation	No real impact	In-sourcing message need to be managed.	Reasons for change would need to be managed.

Criteria of assessment	Option 1 – As is	Option 2 – Insource	Option 3 – other provider
Control Environment	Would need strong performance management	Would need strong performance management and change control	Would need strong performance management and change control