

Report to the Cabinet

Report reference: C-026-2009/10
Date of meeting: 7 September 2009



Portfolio: Finance and Economic Development
Subject: Internal Audit – Options for Service Delivery
Responsible Officer: Peter Haywood (01992 564080).
Democratic Services Officer: Gary Woodhall (01992 564470).

Recommendations:

- (1) To agree in principle to supplement the resources of the in-house Audit Team within the approved budget, by engaging an external audit provider to undertake an agreed schedule of audits up to 31 March 2011.**
- (2) To delegate to officers authority to appoint the preferred audit provider on the basis of the most economically advantageous tender.**

Executive Summary:

In recognition of the importance of the internal audit function and the previous problems experienced in recruiting and retaining staff when vacancies have arisen, the Cabinet is requested to consider a report on the options for the provision of the internal audit service.

Reasons for Proposed Decision:

The Council's Internal Audit team has lost two fully qualified accountants in recent months and is vulnerable to further reductions in qualified and experienced staff. A viable solution needs to be found in order that the governance arrangements of the Council are maintained.

Other Options for Action:

The options to retain the existing Internal Audit arrangements fully in-house, or to fully outsource the service, are considered in the report.

Report:

1. The Internal Audit Team is managed by the Chief Internal Auditor, who reports to the Chief Executive. This approach is in line with good practice, as it maintains the independence of Internal Audit from the services that it reviews. The work of Internal Audit is within the remit of the Portfolio Holder for Finance and Economic Development, and is reported to the Audit and Governance Committee.

Context

2. The purpose of Internal Audit is to provide the Council, through the Audit and Governance Committee and the officer Corporate Governance Group, with an independent and objective opinion on the effectiveness of the Authority's control environment in support of the achievement of the Authority's key objectives.

3. Internal Audit is a statutory function required under The Accounts and Audit Regulations 1996. These Regulations place a duty upon the Authority to provide an adequate and effective internal audit function. The current cost of the Division including overheads is approximately £297,000 (2009/10 estimates). The Section has an establishment of 4.8 full time equivalent staff. At the time of writing this report, there were 3.8 full time staff in post, supplemented by a temporary agency auditor. The current budget is broken down as follows:

Description	Budget Allocation 2009/10
	£
Employee Costs	221,630
Contract Staff/Consultants	17,250
Training Costs	3,940
Travel & Subsistence	5,130
Computer Costs	16,910
Books & Publications	620
Telephones	2,880
Printing/Photocopying	710
Other Supplies & Services	1,110
Accommodation	17,220
Central Services	9,360
Total Expenditure	296,760

Options for the future delivery of the Internal Audit Service

4. Essentially there are three options for the future delivery of the internal audit function, to provide an internal audit service using council employed staff, to appoint an external service provider, or a combination of the two. Various models are in operation across Essex.

In-house Provision

5. Traditionally, internal audit at district council level has been provided by relatively small in-house teams, led by a Chief Internal Auditor or Audit Manager. The size of the teams can result in a lack of service resilience, and the work plan could be disrupted where there was long-term sickness or if a member of the team left. This situation has occurred at EFDC on occasions in recent years, but the Audit Plan has been sufficiently flexible to ensure that the main finance systems audits were carried out to the satisfaction of the Council's External Auditors.

6. Furthermore, the size of the teams creates little opportunity for the development of specialisms, potentially a lack of development opportunities and a limited career structure. In recent years there have been increasing expectations placed on Internal Audit, with the service being in a position to make a significant contribution to improved governance arrangements, with enhanced and higher profile reporting to the Audit and Governance Committee. The CIPFA Audit Code of Practice also sets high standards for the provision of the internal audit service.

7. Increasingly the external auditors expect a high quality of internal audit to be in place so that they can place reliance on the work of Internal Audit. Where this is not the case the external auditors will undertake more work with a subsequent increase in the annual external audit fee. In recent years the Council's external auditors have been able to place reliance on the work of the EFDC Audit Team for the purposes of their statutory audit.

8. The performance of the in-house team improved in 2008/09, mainly as a result of

reduced sickness levels providing a base for the completion of a greater percentage of the planned audits. The following table illustrates the improving trend in recent years:

	Actual 2006/07	Actual 2007/08	Target 2008/09	Actual 2008/09	Target 2009/10
% Planned audits completed	82%	89%	90%	95%	90%
% chargeable "fee" time	67%	68%	70%	71%	72%
Average cost per audit day	£314	£307	£320	£309	£320
% User satisfaction	83%	81%	83%	85%	85%

9. The establishment of the Audit Team comprises a Chief Internal Auditor, a Senior Auditor, one full time Auditor and three part time Auditors. Only 3.8 posts have been filled during 2009/10 as a result of a part time Auditor post becoming vacant on 31 March 2009, and the Chief Internal Auditor leaving his position in April and subsequently providing temporary part time assistance from May. Temporary (3 month) cover was in place for the Auditor post from the end of June through to the end of September. The former Senior Auditor was promoted to the Chief Auditor role with effect from 3 August 2009.

10. Few skills gaps have been identified other than for specialist IT audits, although the Council has benefited in the past from external reviews of some finance and procurement functions. In these cases the reports and findings have generally been of a similar nature to those identified by the in-house team and no issues have been identified in relation to the quality of work undertaken on these audits previously by the in-house staff.

11. There are operational benefits in retaining a knowledgeable and suitably qualified in-house team, and this approach has served the Council well in recent years, as reflected in the raised profile of the Team and its work, and improved performance as shown in the local performance indicators. Previous consultations on the quality of the in-house work have demonstrated that clients feel that the quality and standard of the audit work is good. There is a danger that this could be lost if the work was fully outsourced.

12. The past improvement in performance does not, therefore, obviously lead to a conclusion that a change in the current arrangements is necessary. However, the creation of a partnership for Internal Audit with an external provider may offer the opportunity to create a forward thinking, progressive internal audit team and an improved service to the Council.

Outsourcing

13. Some authorities have sought an external solution linked to testing value for money, or when there has been a failing internal audit service, or through difficulties in being able to recruit to small teams. On occasions, an adverse external audit assessment has also led to consideration of outsourcing.

14. The full or partial appointment of an external audit service provider shifts some responsibility for resourcing the service to the supplier, and can result in frequent changes in personnel. However there is the potential to benefit from having access to a pool of skilled auditors and to benefit from best practice elsewhere. This option has the potential to be more expensive but costs can be controlled through the annual assessment of the service required.

15. A contract with a private sector firm could mean limited or no onsite presence at certain times as staff move between contracts and clients. Issues such as attendance on site and continuity of staff would need to be dealt with in service level agreements or within

contract documentation.

16. When using the private sector, authorities tend to base the outsourced work around the more straightforward audit subjects, for example the financial systems such as payroll or payment of creditors, etc. The firms would lack, at least initially, valuable local background knowledge in carrying out more Council specific audits, e.g. Building Control, Licensing, Section 106 Agreements, Waste Collection etc. The value of retaining a core in-house team to undertake these audits, and to maintain a continuous advisory presence for all aspects of internal control, should not be underestimated, particularly in the context of the Council's overall risk management arrangements.

17. Another issue that has arisen when using the private sector is the use of junior auditors supervised remotely by the firms' supervisors and managers. The main on-site presence tends to comprise trainee auditors at various stages of the career ladder. This is partly in recognition of the budgets available to local authorities to resource the work. EFDC has used a number of external providers to undertake specific audits on an ad hoc basis in the past. Whilst the experience has generally been very positive, there have been occasions when intervention by the Chief Internal Auditor has been required, particularly in quality assuring the final audit report after it has been through the firm's quality assurance process. This is sometimes a result of the lack of local knowledge of Directorate structures etc, which should be easier to overcome if there is continuity in the external provision.

18. When the private sector has been engaged in other authorities, there is usually a need to continue to employ an in-house officer to manage the contract on the Council's behalf. Because of the specialist nature of the job, the officer has tended to be the Head of Internal Audit who acts as the in-house quality control, reviewing the work of the private sector team before reports are issued within the authority. At EFDC the Chief Internal Auditor has managed any arrangements with external firms, as well as quality assuring the final audit reports. For day to day management of the contract arrangements it would be beneficial at EFDC for another officer (the Senior Auditor) to act in a support role, as well as that post having a quota of service audits to undertake. It is doubtful whether cost efficiencies would be realised from the total outsourcing of the work to be undertaken by the remaining pool of 2.8 full time equivalent established posts.

Working in Partnership

19. The in-house team has lost two of its three fully qualified accountants in the past few months, and while the remaining staff have a good level of qualification and/or experience, the Team is now vulnerable to further reductions in staffing levels. As an alternative to full outsourcing, another option in considering the best way of maintaining the level of service achieved in recent years could involve the engagement of external expertise working in partnership to complement the experience and knowledge of the in-house team.

20. Under such an arrangement the options would include a form of partnership with one or more councils, or the appointment of a recognised private sector firm. Partnering with one or more neighbouring district councils could provide the opportunity to share specialist skills, of, for example a computer auditor, with the added benefit of possible savings resulting from shared management costs. It has to be recognised however that a small partnership, formed with another district council, could suffer recruitment problems, and this approach was considered some years ago by EFDC without fruition. A separate request by EFDC to share IT audit resources with another Essex District failed several years ago when the member of staff left the other Authority and was not immediately replaced. For these reasons it is not proposed to pursue the option of seeking a partnership with another district at this stage.

21. As indicated above, the Council has previously engaged consultancy or agency staff to fill resource or skills gaps, and the process has generally been successful with reports well received by management. It is however felt that the local knowledge and experience of a core

in-house team is important in minimising risk, as well as maintaining the reliance placed by the External Auditor on Internal Audit's work as a way of reducing external audit fees.

22. The option of partnership working between the in-house team and an external commercial provider is considered a viable alternative approach at EFDC, as this is an extension of the past ad hoc approach to outsourcing specific audits at times of staff shortage which has been adopted successfully in the past. With this option the Council would retain the in-house expertise to deal with the full range of systems audits and ad hoc work including investigations that arise from time to time. This resource could be complemented by outsourcing an identified part of the audit work plan in a more structured way, to cover specific audit topics, including where specialist knowledge was deemed beneficial.

23. The Internal Audit budget would be restructured and a vacant part time auditor post deleted to enable the existing agency budget to be supplemented to meet the cost of the outsourced element. The overall budget for the externalised work would be in the region of £37,000 in both 2009/10 and 2010/11, but there is potential for a saving to be achieved through competitive tendering.

Proposal

24. In view of the loss of qualified in-house staff it is considered timely to seek an external supplier to work in partnership with the in-house team, to assist in the completion of the agreed Audit Plan in the second half of 2009/10, in particular the core financial systems and ICT audits. The exact composition of the specification will be dependent upon the level and range of audits the in-house team are capable of conducting, which is primarily a capacity issue. At this stage it is further proposed that the external provision be for an initial period for approximately sixteen months through to the end of 2010/11, in order to make it commercially attractive. This would allow the Council to consider the options available to it for 2011/12 and later years once it has the benefit of experience of the joint working arrangements.

25. It is further proposed that until the appointment of an external supplier to undertake the package of audits to be identified, the service continues to use consultancy or agency staff as necessary to ensure the progress of the Audit Plan in 2009/10.

26. All contractual arrangements would be subject to competition as set out in Contract Standing Orders. It is proposed to delegate to officers authority to select the preferred audit provider on the basis of the most economically advantageous tender for the Council, using a combination of price and quality, within the available budget.

27. At present there is a broad and visible level of audit coverage across all Directorates as reflected in the Annual Audit Plan. There are no proposals to significantly reduce the number of audits at this stage, as this would dilute the level of assurance that could be given by the Chief Internal Auditor on the adequacy of the Council's internal control environment.

Financial Implications

28. In sourcing fully managed audits from external providers on an ad hoc basis in the past, the average daily rate has been in the region of £330 per day for a finance systems audit. Assuming some economies of scale, the available budget of £37,000 per annum would equate conservatively to approximately 125 audit days and would provide for at least eight of the planned finance system and ICT audits to be undertaken in both 2009/10 and 2010/11. This would equate to approximately 40% of the allocated time provision for the main Finance and ICT systems audits. The Audit Plan schedule, indicating the audits that could be outsourced, is attached at Appendix 1. The budget available over the two financial years is approximately £74,000. As indicated earlier in this report, it is assumed that savings would be achieved on this budget through competitive tendering.

29. The current daily cost of outsourced work for finance systems audits (£330) compares with the cost of the existing in-house team of around £320 per audit day including overheads such as office accommodation, IT, telephones etc (approx. £240 per audit day excluding overheads). The Council would still have to bear the fixed overhead element of £80 per day within the in-house cost, at least in the short term, if work is outsourced. The overall cost of the outsourced work has therefore previously been higher than for the in-house team, but this has been on the basis of quotes for ad hoc pieces of work. It is expected that savings will arise by inviting tenders for a package of audit work. The overall costs and benefits of the proposed partnership approach should be reviewed towards the end of the initial contracting period in March 2011, when consideration is given to Audit delivery options beyond that date.

Resource implications:

From existing resources and as detailed in the report.

Legal and Governance Implications:

No specific implications other than included in the report.

Safer, Cleaner and Greener Implications:

No specific implications.

Consultation Undertaken:

Corporate Executive Forum.

Background Papers:

The CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom.

Impact Assessment:

Internal Audit is a key contributor to the Council's governance arrangements, providing an independent appraisal function to assess the adequacy of the controls that have been put in place to manage the risk to the successful delivery of corporate and service objectives.

It is essential for the Council to provide an appropriate level of resources to maintain an Internal Audit service, capable of delivering the approved work plan. Failure to do so will impact on the governance arrangements of the Council and will lead to criticism by the External Auditor.

Audit Plan 2009/10
Status Report at 30 June 2009

Appendix 1

Audit area (L denotes past limited assurance audit rating)	Audit type	Days allocated	Days spent 1 April – 30 June	Completed/ Provisional Timescale	Auditor
FINANCE AND ICT					
Finance					
Bank Reconciliation (L)	system/follow up	15	2	in progress	SL
Sundry Debtors	system/follow up	20	-	Qtr 3	contractor
Creditors (L)	system/follow up	20	-	Qtr 3	contractor
Treasury Management (L)	system/follow up	15	-	Qtr 3	SL
Payroll	system/follow up	25	-	Qtr 2	temp
Budgetary Control (capital and revenue)	system/follow up	10	-	Qtr 4	contractor
Risk Management and Insurance	system/follow up	15	-	Qtr 4	NH
Main Accounting and Financial Ledger	system/follow up	15	-	Qtr 3	contractor
Housing Benefits	system/follow up	25	-	Qtr 3	SL
Council Tax	system/follow up	25	-	Qtr 3	contractor
National Non Domestic Rates	system/follow up	15	-	Qtr 2	SL
Cash receipting and Income control	system/follow up	15	-	Qtr 3	NH
Cash receipting IT system	IT	5	-	Qtr 4	contractor
Provision for 'top up' testing	systems	15	8	Qtr 4	All
Cash Office spot checks	verification	5	-	Qtr 3	NH
ICT					
Data (L) and Network Security	system/follow up	20	-	Qtr 4	contractor
IT Procurement	system	10	-	Qtr 4	contractor
Revenues and Benefits IT system	follow up	5	-	Qtr 3	tba
IT System Logs (L)	follow up	5	-	Qtr 3	tba
TOTAL		280	10		
PLANNING AND ECONOMIC DEVELOPMENT					
Building Control (L)	system	20	12	in progress	in progress
Countrycare	system	7	-	Qtr 3	NH
External Funding and Housing/Planning Delivery Grant (L)	follow up	6	-	Qtr 2	NH
Strategic Housing Assessment	system	3	3	in progress	BB
TOTAL		36	15		
ENVIRONMENT AND STREET SCENE					
Waste Management (L) and Recycling	system/follow up	25	-	Qtr 4	tba
Public Health	system	15	13	in progress	BB
Licensing Enforcement	system	12	-	Qtr 2	temp
Pest Control	system	10	-	Qtr 2	DP
Car Parking (L)	follow up	7	3	in progress	DP
Waltham Abbey Sports Centre (L)	follow up	5	-	Qtr 2	NH
TOTAL		74	16		
HOUSING					
Housing Rent Collection and Arrears	system/follow up	25	-	Qtr 3	DP
Private Renewal Grants/DFG/'CARE'	system	25	22	completed	SL
House Sales and Leaseholder Services	system	20	-	Qtr 4	SL
Depot (L)	system/follow up	15	-	Qtr 4	DP
Housing maintenance contract	contract	10	-	Qtr 2	BB
Stores - Depot stock take (L)	stocktake	4	4	completed	BB
Stores - Parsonage Court stock take (L)	stocktake	2	2	completed	DP
Housing Repairs Working Group	management review	5	-	-	BB
Sheltered Housing establishments	establishment	-	-	reserve	-
TOTAL		106	28		
PARTNERSHIPS AND VOLUNTARY SECTOR					
Local Area Agreements	system	15	-	Qtr 4	BB
Grants to Voluntary Organisations (L)	follow up	7	2	in progress	temp
TOTAL		22	2		

Audit area	Audit type	Days allocated	Days spent 1 April – 30 June	Completed/ Provisional Timescale	Auditor
COMMUNITY SERVICES AND CUSTOMER RELATIONS					
Arts and Sports Development	system	20	-	Qtr 4	NH
Bookings and Cash collection (L)	system/follow up	7	4	completed	SL
Information Desks	system	-	-	reserve	-
TOTAL		27	4		
CORPORATE SUPPORT SERVICES					
Human Resources					
Recruitment and Selection	system	15	-	Qtr 3	tba
Management of Sickness absence	system	10	12	completed	DP
Travel and Subsistence claims (L)	follow up	10	10	completed	NH
HR/Payroll Integration (L)	follow up	6	-	Qtr 3	NH
Health and Safety Policy	system	5	-	tba	tba
Estates/Facilities Management/Other					
Commercial Property portfolio (L)	system/follow up	20	-	Qtr 4	tba
Licensing	system	15	-	Qtr 2	temp
Asset Management system	system	8	-	Qtr 2	SL
Facilities Management (Mech. And Elec.) (L)	follow up	5	-	Qtr 3	tba
Non-HRA Repairs (L)	follow up	5	-	Qtr 3	NH
Fleet Operations (L)	follow up	5	-	Qtr 3	tba
Reprographics (commenced 2008/09)	vfm/systems	10*	10	completed	BB
Legal					
Land Charges	system/vfm	15	-	Qtr 4	DP
Land Charges Data Quality	verification	10	-	Qtr 2	tba
* 10 days from contingency to facilitate completion					
TOTAL		139	32		
MISCELLANEOUS					
CPA and BEST VALUE					
Key and Local Performance Indicators	verification	15	-	Qtr 2	NH
Business Plans (L)	verification	7	5	completed	DP
CONTRACTS					
Contract Compliance (L) - commenced 2008/09	system	7	7	completed	SL
Contract Compliance 2009/10	system	13	-	Qtr 4	SL
CORPORATE					
Corporate Procurement (L)	system/follow up	10	-	Qtr 4	contractor
Use of Consultants (L)	follow up	8	-	Qtr 3	NH
Gifts and Hospitality (L)	system/follow up	6	3	in progress	temp
Governance Statement	management review	5	1	Qtr 4	BB
Use of Resources work plan	management review	5	-	ongoing	JA/BB
Review of financial regulations and internal controls	management review	3	-	Qtr 3	BB
Inventory Control (L)	follow up	8	-	Qtr 2	NH
Email, Internet and Telephone usage (L)	follow up	8	7	completed	SL
Use of Regulation of Investigatory Powers Act	system	5	6	completed	BB
Follow up of Priority 1 Audit recommendations	follow up	6	-	ongoing	CIA
FRAUD AND CORRUPTION					
National Fraud Initiative (NFI) - 2008	c/fwd	15	13	in progress	NH
TOTAL DAYS ALLOCATED					
		805	149		
Contingency/Spot checks/Minor investigations		30		ongoing	All
Corporate/Service Advice		65	11	ongoing	JA/BB
TOTAL		900	160		