



PAPER H

Purpose: For Decision

Committee report

Committee	AUDIT COMMITTEE
Date	4 DECEMBER 2017
Title	FUTURE ARRANGEMENTS FOR INTERNAL AUDIT
Report of	DIRECTOR OF FINANCE AND S151 OFFICER

EXECUTIVE SUMMARY

1. This report considers the future arrangements for the provision of the Internal Audit Service. It reviews and evaluates the existing Internal Audit service specified by the Council (provided by Price Waterhouse Coopers LLP) against potential alternatives. The evaluation includes the review of overall audit coverage (i.e. the scope and scale of the audits undertaken), quality, cost, efficiencies, synergies and any longer term prospects for the service.
2. It is recommended that the Committee considers the options outlined in the report and determines its preference on the direction of the future provision for Internal Audit Services to cover the period commencing 1st July 2018. The three options to be considered are as follows:
 - (a) The agreement with Price Waterhouse Coopers LLP is extended for a further period.
 - (b) A combined arrangement of in-sourced supported by Portsmouth City Council under a shared service provision for internal audit.
 - (c) The council goes out to tender to procure an internal audit service.
3. The council, through its Section 151 Officer, has a legal obligation to provide an effective internal audit service. Additionally, the council's Section 151 officer has an obligation to secure value for money for the council. The recommendations set out in this report seek to best achieve those objectives through a combined arrangement noted in option (b) above, which will provide a wider scope of audit provision (to include advice and policy guidance) as well as improved coverage and value compared with the alternatives.

BACKGROUND

4. Internal audit is a statutory function required by the Accounts and Audit Regulations 2015 (see below). It forms part of the requirement for the Section 151 officer to discharge responsibilities for the proper administration of the council's financial affairs under the Local Government Act 1972. The Accounts and Audit Regulations 2015, Part 2 Section 5: Internal Audit state, "*a relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance purposes, taking into account public sector internal auditing standards or guidance*".
5. The purpose of Internal Audit is to undertake an annual review of functions of the authority, to enable it to provide an opinion as to the effectiveness of the control framework within which the authority operates. The audit coverage should be sufficiently broad to enable this advice to be relied upon.
6. Internal Audit is required to comply with the Public Sector Internal Audit Standards (PSIAS). Under these standards, Internal Audit makes an annual assessment as to governance, risk management and control.
7. Since July 2010, the Isle of Wight Council has contracted out its Internal Audit function to Price Waterhouse Coopers LLP for an annual sum. This arrangement was renewed in May 2013 and 1 July 2015. A copy of the latest agreement is annexed to this report at Appendix 1.
8. Options for the future provision of Internal Audit Services are set out in the following section.

OPTIONS

Option 1 - Extend Internal Audit Function provided by Price Waterhouse Coopers LLP

9. The Isle of Wight Council entered into an agreement with Price Waterhouse Coopers LLP to provide the internal audit function for an initial term of three years from 1 July 2015 ("the agreement").
10. There is provision for the agreement to be extended beyond its initial term for a period of up to two years.
11. Under the agreement, Price Waterhouse Coopers (PwC) charge the council an agreed annual sum of £184,222.
12. The agreement provides that internal audit function will:
 - (a) be provided across a range of activities;
 - (b) investigate internal fraud and corruption when requested to do so for an anticipated additional charge;
 - (c) improve the internal audit outcome through quality and increased cost efficiency.

Internal Audit PwC provision for the year 2015/16

13. PwC undertook to complete 21 audits within the year. The average charge per audit was £8,772, based on the annual agreed sum of £184,222.

Internal Audit PwC provision for the year 2016/17

14. PwC undertook to complete 19 audits within the year. The average charge per audit was £9,696.00, based on the annual agreed sum of £184,222.

Internal Audit PwC provision for the year 2017/18

15. PwC has undertaken to complete 25 audits within the year. The average charge per audit will be £7,368, based on the annual agreed sum of £184,222.
16. In each year a number of audits were considered optional and dependent on resource availability.

Adequacy of the current contract specification

17. The contract specification developed by the Isle of Wight Council for the period July 2010 to date has delivered audits that cover 60 per cent of the audit universe, however this has also resulted in the following:
- 40 per cent of the audit universe (133 Audits) has not been audited since 2010.
 - 16 % (22/133) of the audit universe are medium to high risk auditable areas - these have not been audited over the 3 year period.
 - 29% of all auditable areas are not undertaken within the recommended frequency.
18. Key risk areas identified by the council's Section 151 officer that are not covered by the current contract specification.
- Delivery of counter fraud arrangements, including a programme of activities encompassing training, awareness and ongoing fraud checks.
 - Investigations.
 - Data analytics, for example the identification of duplicate payments.
 - National Fraud Initiative (mandatory requirement by the Cabinet Office).
 - Grant verifications.
19. A key consideration for the committee will be whether the extent of the audit coverage specified by the IOW council in its current audit contract is sufficient to provide the necessary assurance to the council that its major risk areas are operating adequately.

20. Under a budget provision of £184,222, the agreement with PwC is naturally limited with regard to the extent of resources that can be dedicated to the council for Internal Audit and this is reflected in the audit coverage. In consequence, the annual audit opinion is based on a lesser coverage of both risk and the audit universe.
21. Within the current contractual arrangement, there is no capacity to take on special investigations without cost implications or an impact on the extent of audit coverage.
22. Any extension of the contract would be subject to an indexation review which could increase the cost of the service.

Option 2 - Provision of Internal Audit by way of a combined in-sourced provision supported by Portsmouth City Council under a Shared Service agreement.

23. The Isle of Wight Council may also consider a combined arrangement of in-sourced provisions supported by Portsmouth City Council under a shared service agreement. This will provide the Council with visible and on-site presence and provide benefits such as knowledge of local issues and Local Government.
24. The skills needed could be covered by both the in-sourced resource and Portsmouth City Council under the supported shared service team which can be interchanged to meet the needs of the Council. This will allow for the costs to be shared in relation to the use of computer aided auditing techniques and software. A level of resilience to staff absences would also be included with a combined model.
25. A combined arrangement tends to be more flexible than contractual arrangements, can be more cost effective and offer greater influence over how resources are directed towards the Council's priorities.
26. The current cost, if contributed through a combined arrangement, would enable significantly greater audit coverage. In the first instance, it is intended to recruit an in-sourced team and then share this resource with Portsmouth City Council. On the basis that the services are shared, the cost of the services provided will also be shared through a full cost recovery mechanism, rather than on a commercial basis with a profit margin mark up. The service would be provided on the basis that either side would be able to terminate the shared service arrangement giving 6 months notice.
27. In addition to expanded coverage and cost efficiencies above, a shared service arrangement would also include further joint initiatives currently not covered within the existing contract such as risk management advice, governance policies and advice, fraud detection and investigation, whistleblowing and anti-money laundering policy guidance. A counter fraud programme would include coverage of high risk fraud areas such as council tax discount and service user abuse, i.e. direct payments.

28. This would enable investigations to be undertaken and advice and direction given with regard to strategy and policy. Support would also be given to reporting to Audit Committee and where requested, attendance at other committee meetings.
29. Currently the Chief Internal Auditor post is a shared post across Portsmouth, Southampton and the Isle of Wight. By developing a shared service across these authorities, the internal audit function would reap the benefits of the existing partnerships, audit officers' local government knowledge and local knowledge. There would also be an opportunity for officers across authorities to share insight and best practice with regard to historic audits and high risk areas. Officers would also be able to attend joint training events with a potential cost saving to the council.
30. Portsmouth City Council currently operates similar support shared service arrangements with Southampton and Fareham. Portsmouth has been working successfully with other local authorities for five years and with repeat business.
31. It is anticipated that the arrangements with Southampton and Fareham plus the Isle of Wight (under this proposal) will evolve into a formal partnership arrangement across the Solent region with shared governance and shared cost saving arrangements.
32. The total cost of the internal audit provision provided will be dependent on the overall number of audits commissioned by the council which is proposed to be agreed in consultation with the council's Audit Committee and Section 151 officer. The proposal laid out in this report sets out 526 day available, in the event of a reduced audit plan, consistent with the Councils risk appetite the annual costs can be reduced at a cost of £350 for each day.
33. Following development of the service it might be possible to provide internal audit services to external clients such as academies and colleges, thereby providing a further income stream to the Isle of Wight Council.

Option 3 - Tender to procure Internal Audit Service

34. The procurement process would be dictated by the value of the contract. Under the assumption that the value of the contract would be in the region of £184,222, the value of the procurement would be over the EU tender threshold and therefore would need to be published across the EU in accordance with the Public Contracts Regulations 2015.
35. Procurement would involve the following stages:
 - Preparation of specification and documentation.
 - Advertisement and invitation to tender.
 - Evaluation of tender returns.
 - Internal budget approvals.

- Standstill period.
- Mobilisation of the contract.

The timescale to complete the above stages would be in the region of four months.

36. Other providers in the market place include Southern Internal Audit Partnership, Mazars, BDO, Devon Audit Partnership, Baker Tilly and RSM. Portsmouth City Council could also elect to tender via a full procurement but this would be on a commercial basis as opposed to a shared service arrangement.
37. Until such time as the tenders are received, the council would be unclear whether a proposal would give sufficient audit coverage to satisfy the council's statutory responsibility to provide an effective audit function and be of sufficient scope to provide the CIA with audit coverage adequate to provide an annual opinion within the existing resources.

EVALUATION OF OPTIONS

38. The options have been evaluated in objective, quantitative and qualitative terms as well as in more subjective terms from the benefits arising from likely future advantages that fit with the council's overall Corporate Plan objectives. This is set out below:
 - Cost (weighted 40per cent)
 - Quality (weighted 20per cent)
 - Audit coverage (weighted 20per cent)
 - Additional services (weighted 10per cent)
 - Other corporate objectives (weighted 10per cent)

The scores have been defined on the following basis:

- 5, equals very high value for money/ very high quality
- 4, equals high value for money/ high quality
- 3, equals medium value for money/ medium quality
- 2, equals low value for money/ low quality
- 1, equals very low value for money/ very low quality

Criteria	Option 1 Extend PWC contract	Option 2 Combined In- sourced supported by LA shared service	Option 3 Full tender*
Cost			
Average cost per audit	£8,612 (based on the last 3 years)	£3,500	
Total audit cost	£200,000	£200,000	£200,000
Cost score (40%)	3	5	Likely Less than 5
Quality			
Accreditation and Qualifications	Relevant professional qualification. Public Sector Internal Audit Standards (PSIAS) accredited	Relevant professional qualification and PSIAS accredited	Expected to be equivalent to options 1 and 2.
Resilience	Resilience within the organisation, able to draw upon all required skill sets.	Resilience within the organisation, and other partnership arrangements will be able to be drawn upon.	Expected to be equivalent to options 1 and 2.
Reputation	Long standing organisation on the FTSE100.	Leading in the Solent region for local authority internal audit.	Expected to be equivalent to options 1 and 2.
Quality score (20%)	5	4	Likely to be 5 or less

Audit Coverage - Comparison against 2017/18 agreed plan)			
Total Number of 10 day Audits (includes management quality checks)	24 (2017/18 agreed audit plan)	52	Likely to be equivalent to option 1 less likely to be as many as option 2.
No. of days available.	245	526	
Audit coverage score (20%)	2	5	Likely to be less than 5
Additional Services <i>On the basis that PCC match the audit coverage agreed, IOW would release 281 days to be allocated to either additional audits or the areas noted below:</i>			
Special Investigations	Nil. Additional service cost not within contract, additional resource required to cover.	Yes	Likely to be equivalent to option 1 less likely to option 2.
Counter fraud programme includes prevention and detection checks		Arrangements to include counter fraud programme with experienced officers	
Policies: To include drafting and ownership (examples include Anti-Money Laundering and Whistleblowing)		Devised and maintained as part of on-site and support service offering. This could also include access to online training	
Project Board attendance / advice		Yes	
Consultancy process/procedure advice		Yes	
Financial Rules waiver reviews / advice		Yes	
Grant verification		Yes	
Chief Internal Auditor		Yes. Charged within the contract price rather than as an additional charge.	
Computer Forensics		Yes	
Nation Fraud Initiative (NFI) data		Yes	

matching			
Guidance for Audit Committee	Ad hoc consultation, provided at cost, unless as part of audit plan consultation	Regular briefings and attendance at Committee	
Additional Services Score (10%)	1	5	Likely to be less than 5
Other Corporate Objectives			
Potential for future cost reduction	None within the current contract. Fees are likely to increase if broader audit coverage is required.	Yes, through a lower cost per audit, in-sourced/ shared Internal Audit services across the Solent region and potential to offer service to external clients.	Not anticipated.
Knowledge sharing	Limited to in-house team knowledge of working with local government.	Yes - build on and exchange knowledge and insights across Solent local government networks and existing partnerships.	Contract award would not necessarily go to provider with local government knowledge /experience.
Total Other Corporate Objectives Score (10%)	1	3	Likely to be less than 3
<u>Total Weighted Score (out of 5)</u>	2.8	4.6	Potential maximum score 4.0

**A comprehensive analysis for Option 3 Full Tender is not available unless a route to tender is pursued.*

39. In overall terms, the evaluation supports Option 2 and the entering into a combined in-sourced supported by Portsmouth City Council through a shared services arrangement. Option 2 provides for a significant margin of improvement versus Option 1 and a meaningful improvement over the maximum potential score for Option 3. In particular, Option 2 represents a significant improvement in value for money with opportunities for further cost savings not offered through other alternatives. It provides significantly enhanced risk coverage providing the council with greater assurance over its key operations.

STRATEGIC CONTEXT

40. The recommendation supports the [Corporate Plan 2017](#) in which one of our core values is, **Engaging with partners to maximise integrated working.**

FINANCIAL / BUDGET IMPLICATIONS

41. The current budget allocated to Internal Audit is agreed at £184,222 per annum. Should the Committee decide to remain with the existing provision or seek to pursue a full tender option it is anticipated that, with inflation, the cost will remain at circa £200,000 per annum. Should the Committee support Option 2, and enter into a combined in-sourced supported by Portsmouth City Council in a shared service arrangement, the cost would be no more than £200,000 but will provide a greater level of audit and policy coverage. Subject to the agreement between the S151 Officer and the Audit Committee regarding a lower level of audit coverage but still achieving an acceptable level of control risk, the cost of the shared service arrangement could be reduced below £200,000.
42. Option 2 also provides for potential future income streams and cost savings for the council which other alternatives do not for the same level of audit coverage
43. If the council decides to go out to tender for internal audit provision, a further financial appraisal will be required.

LEGAL IMPLICATIONS

44. The legislative authority for local authorities to share services is in the Local Government Act 1972. Section 112 provides that local authorities may appoint officers to enable them to discharge their own functions and any functions they carry out for another local authority. Section 113 allows a local authority to enter into an agreement with another authority to place its officers at the disposal of the other authority, subject to consultation with the staff concerned and negotiation about any changes in terms and conditions. Additionally, section 1 of the Local Authorities (Goods and Services Act) 1970 enables a local authority to enter into an agreement to provide another local authority with goods and services, including administrative, professional or technical services.

45. Whilst the cost of the internal audit function means that in order to enter into a contract, a formal procurement process would need to be undertaken, where two public bodies enter into a shared arrangement, such as that proposed in option 2, an exemption to the need for a formal process can be applied.

EQUALITY AND DIVERSITY

46. The council, as a public body, is required to meet its statutory obligations under the Equality Act 2010 to have due regard to eliminate unlawful discrimination, promote equal opportunities between people from different groups and to foster good relations between people who share a protected characteristic and people who do not share it. The protected characteristics are: age, disability, gender reassignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex and sexual orientation.
47. Under the Equality Act 2010 we are required to have due regard to our equality duties when making decisions, reviewing services, undertaking projects, developing and reviewing policies. The contents of this report do not affect the protected characteristics under the Equality Act 2010.

RISK MANAGEMENT

48. The internal audit service needs to be sufficient to review the internal control framework of the authority. The audit coverage therefore needs to be of an appropriate extent to enable the Chief Internal Auditor to give an annual opinion. If reliance cannot be placed on internal audit provision, external audit will be required to undertake further work, at greater cost to the authority.
49. Where there is insufficient audit coverage, the council also exposes itself to reputational risk in circumstances where it is viewed to operate an inadequate internal control framework.

EVALUATION

50. The objective of this report is to consider, from the options presented, which alternative Internal Audit service provision offers the most cost effective solution together with the broadest audit coverage, to minimise risk exposure to the Authority. Option 2 - Combined in-sourced, supported by Portsmouth City Council in a shared service can both be met from the existing budget and provide a broader audit coverage to the council, together with additional benefits.

RECOMMENDATION

51. Option 2 - Provision of Internal Audit by way of a combined in-sourced provision supported by Portsmouth City Council under a Shared Service agreement.

BACKGROUND PAPERS

Isle of Wight Council Internal Audit Plan 2015/16

<https://www.iwight.com/Meetings/committees/Audit%20Committee/19-2-15/Paper%20D%20-%20Appendix.pdf>

Isle of Wight Council Internal Audit Risk Assessment and Plan, 2016/17

<https://www.iwight.com/Meetings/committees/Audit%20Committee/18-2-16/PAPER%20E%20-%20APPENDIX%20A.pdf>

Isle of Wight Council Internal Audit Risk Assessment and Plan, 2017/18

<https://www.iwight.com/Meetings/committees/Audit%20Committee/13-3-17/Paper%20E.pdf>

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