

BUSINESS CASE FOR AN INTERNAL AUDIT SHARED SERVICE

LEAD OFFICER: Julie Crellin, Head of Finance & Management Information Systems

REPORT AUTHOR: Julie Crellin, Head of Finance & Management Information Systems

Summary: This report provides an update on the progress to establish a shared service for internal audit for Copeland Borough Council, Carlisle City Council and Cumbria County Council. Appendix 1 provides the revised business case for the establishment of the shared service, hosted by the County Council. This is an opportunity to provide more robust arrangements for internal audit across the County and gives scope for some savings.

The agreement to participate in a shared service for internal audit from 1st April 2010 will enable the preparation of an integrated audit plan for 2010/11. The delivery of the audit plan will be reported quarterly to the Committee. This will be the fundamental mechanism for the Council to evaluate the performance of the shared service throughout the financial year and will contribute to the statutory annual review of the effectiveness of the system of internal audit.

Members will continue to receive an update on the progress of the shared service during the delivery phase of implementation.

Recommendation: Members are asked to :-

- a. consider the report ;
- b. to support this final business case for an Internal Audit Shared Service
- c. to recommend the business case to Executive for its approval at its meeting on 10th February
- d. to note the governance arrangements being developed for the shared service – integral to this being the regular reporting of the delivery of the audit plan and the work of the Chairs of Audit and Assurance Committees Group and the Joint Operational Audit Steering Board.
- e. to note that the progress of the shared service during the delivery phase of implementation will be reported to the Committee.

1.0 INTRODUCTION

- 1.1 As reported to the September and December Audit Committee meetings, the Council has been discussing possible arrangements for a shared internal audit service with Allerdale Borough Council, Carlisle City Council and Cumbria County Council. Members were advised verbally at the December meeting that Allerdale Borough Council had decided not to proceed at this time and that a revised business case would have to be drafted and brought to the next meeting.
- 1.2 As previously stated, the key drivers and proposed benefits from a shared audit service are as follows:
- To establish a more robust audit service fully able to meet increasingly complex demands (overcoming recruitment and retention problems), through establishing an audit unit of a critical mass;
 - To provide more efficient audits (more audits for the same or less cash);
 - To increase the range of audit services (a wider mix of audits for the same or less cash e.g. specialist computer audit, value for money reviews).
- 1.4 A secondary driver was the opportunity to realise and release (cashable) savings to all partner authorities.
- 1.5 The conclusion of the business case appended to this report is that a shared internal audit service be established with a host authority (the County Council), which would ensure delivery of more robust audit arrangements. Achievement of this key priority would provide all participants with assurance over audit provision and provide scope for developing audit expertise over services and rolling out best practice. The proposed structure recognises the increasing complexity of public sector audit and the need for appropriately qualified and experienced staff. The benefits of a shared audit service are set out in the business case, which has been subject to an independent review by Sector.
- 1.6 The business case provides quantification of savings. Initially, annual savings, generated as a result of a revised management structure and efficiencies in planning and delivering similar audits, are estimated at around £31,000 in 2010/11 and £58,000 in 2011/12. Further longer term savings may result from further value for money work and the identification of efficiencies in audit recommendations and/or additional income as the unit extends its provision of audit services to third parties.
- 1.7. The potential impact upon other services within the Council from adopting a shared audit service approach has been considered. As the service is largely regulatory and self-contained, impacts are limited to e.g. recharges from HR, as the employing authority will change for the four staff involved and these costs will have to be absorbed by the rest of the Council. The audit service will retain a base in the building and will continue to have access to key IT

systems as this is essential to undertaking Copeland audits. SLAs/working arrangements will need to be agreed as part of the implementation stage.

2.0 SERVICE DELIVERY OPTIONS

- 2.1 Service delivery options have been reviewed and Table 1 sets out an overview of the potential service delivery options. All offer advantages and disadvantages. However, given the commitment of the three Councils to pursue shared service arrangements, where appropriate, the emerging preferred option is service delivery through a joint organisation with a host authority, the County Council.
- 2.2 The greater complexity of public sector business is fully recognised and audit services need to meet these demands. Ensuring that there is an appropriate range of staff skills and experience is essential for the success of the shared service. Income generation and developing value for money work aimed at identifying savings will be key areas.
- 2.3 The shared service approach provides an opportunity for improved resilience, auditor rotation, independence and improved staff training and development, strengthening the role and position of internal audit. It also provides an audit presence at all three Council locations and the opportunity to operate a critical mass.

Table 1 – Service Delivery Options

	Option	Overview
	Status Quo – No Change. Continue current operations	Service provision remains as it is at each Council. Accepting this option would result in a lost opportunity for achieving economies of scale and rolling out best audit practice across internal audit in Cumbria.
1	Work in partnership regarding selected audits	This would require closer collaboration in planning and running audits. Potentially more efficient if audit programmes were shared. Would benefit from a limited number of joint audits. However, no real economies of scale. No increase of robustness of service. Each organisation would still need its own management function.
2	Joint Organisation with a host authority	Most likely option to deliver best value in terms of audit coverage and recruitment / retention of skilled staff. Planned allocation of responsibilities / specialisation would result in audit planning & review efficiencies. Opportunity to streamline the management function. However, a revised governance structure and legal agreements would need to be put in place and there are Human Resources terms & conditions issues to be resolved.

	Option	Overview
		This is the Board's preferred option, being the option most likely to provide the best balance of advantages, within present budgetary constraints.
3	Joint Organisation - externalised	<p>Two potential options –</p> <ul style="list-style-type: none"> • Purchase service from an external provider. This offers the opportunity for a commercial arrangement with local, regional and national benchmarked providers. A review of current arrangements within the County suggests that for a full service, taking into account the management days needed, including supporting Audit Committees, externalisation is more expensive. Daily rates from national audit and accountancy providers are in excess of current internal rates from the three Councils. • Establish an independent joint venture company. The Board considered that, legally, this would be more complex, time-consuming and expensive to set up. It has not been explored further.

2.4 Since the December Audit Committee, the business case has been revised to accommodate the withdrawal of Allerdale Borough Council. The impact has been:-

- a reduction in the monetary and staffing resources contributing to the shared service;
- a corresponding reduction in the audit days needed in respect of Allerdale Borough Council;
- proposal to reduce from 4.7 Audit Managers in the base case to 4 Audit Managers (rather than from 5.7 to 5 Audit Managers, when Allerdale was included); and
- a re-allocation of responsibility for the various types of audit between four Audit Managers, instead of five.

2.5 The Board has been in general agreement that a shared service hosted by the County Council should be pursued and the draft business case has evolved throughout the period. The advantages and disadvantages of a hosted shared service are set out in more detail in Appendix 2. The effect of the revised business case is minimal and does not change the advantages of entering into the Shared Service. Version 4 of the draft business case was passed to Sector to review, as an independent adviser, and their suggestions (summarised in section 8 of the business case) have been incorporated in this final business case.

3.0 PROPOSED PRINCIPLES UNDERLYING THE SHARED SERVICE

3.1 The business case for establishing a shared service for audit has been developed. The Project Board has endorsed a set of broad principles for a shared service involving a joint organisation (which would have a 'brand' identity, separate from all three Councils, further demonstrating its independence and objectivity) and these are set out below.

- a) Each Council would continue to have its own Audit Committee, operating to its own approved terms of reference, including approving the annual audit plan and monitoring the performance of internal audit against the plan;
- b) The Audit Committee Chairs and the Section 151 Officers would agree the governance arrangements and oversee the strategy and performance of the shared service;
- c) A single overall Operational Audit Steering Board, comprising the relevant Heads of Service / Directors would oversee the overall direction and focus of the shared service;
- d) The County Council would host the shared internal audit service, given its number of staff and extent of audit coverage. Audit staff would either transfer or be seconded to this organisation. The shared service would have its own 'brand'. This would promote the shared service ethos and opportunities amongst the team;
- e) There would be a Head of Internal Audit for the Shared Service, who would also lead for Cumbria County Council. The Head of Internal Audit would have delegated powers (from the Operational Audit Steering Board), within agreed budgets and policies, to act in the best interests of the service and its users;
- f) The management structure initially includes four Audit Managers, reporting to the Head of Internal Audit. An Audit Manager would be responsible within the shared service for a specified range of audits and the management responsibility for staff, and for liaising with management and Members;
- g) The greater complexity of public sector business is fully recognised and Audit Managers would be leading these critical high risk audits;
- h) An Audit Manager would be assigned to each District Council, spending 50% of their time managing District Council audit work and would attend all of the routine meetings of that Council's Audit Committee. The Audit Manager would draw on the pooled resources of the shared service to deliver the agreed audit plans. The arrangements would aim to provide continuity of staffing, where possible, to ensure organisational and subject expertise. There would be an audit presence in all participating organisations;
- i) System audits would be the core audit product, as per the Accounts and Audit Regulations and the CIPFA Code of Practice for Internal Audit in Local Government. However, there is an opportunity for the audit service to become more proactive in helping organisations meet their corporate

objectives, in giving assurance during the implementation of major operational changes and in developing counter-fraud work;

- j) Costings are included in the draft business case, with savings expected in the early years. Further savings in later years would be possible from income generation and from a programme of audit work identifying savings from specific audits.
- k) Based on previous experience, to ensure a framework for planning and continuity, a 6 year agreement has been suggested, each Council giving a commitment to contribute an agreed amount to the provision of the shared service. The detail of this will be worked through in the next stage of implementation

4.0 TIMESCALE FOR IMPLEMENTATION

- 4.1 Subject to approval by all the participating Councils, and to appropriate legal agreements being put in place, the target date for practical 'go live' is 1st April 2010. At this point, there would be a single Head of Audit in post and a joint audit management team.
- 4.2 1st April 2010 is an ambitious date and it is expected that final legal and HR processes would be completed after that date. Planning for the new shared service is a priority, with all participants agreeing to a common methodology for developing 2010/11 plans. This is the business imperative for striving for the 1st April deadline. It is likely that the final staffing structure would be refined and developed over a further 12 months. This is in effect the delivery phase of the implementation. Specific HR expertise has been engaged by the Project Board and this will further inform timescales.
- 4.3 A copy of the proposals, version 4 of the business case, was sent to Union representatives, advising them that a joint meeting would be arranged. Formal consultation with the Unions will be addressed as part of the implementation phase, once formal agreement of the three Councils is reached to set up an Audit Shared Service.
- 4.4 Governance and performance monitoring of the shared service is a key concern of the participants and this is recognised in the business case. Equally, it is also important that the shared service has the opportunity to demonstrate its effectiveness and added value to the Councils it supports. The Accounts and Audit Regulations (Amended) 2006 make it a requirement upon local authorities to carry out an annual review of the effectiveness of the system of Internal Audit. Indeed the internal audit approach is defined by the regulatory body, CIPFA, and there is much prescription and guidance in how audit work is delivered e.g. systems based audit matrices and auditing standards.

4.5 In undertaking the annual review, compliance with the CIPFA Code of Practice has to be evaluated. This involves monitoring compliance with the CIPFA Standards which set out best practice for Internal Audit in Local Government. Key performance indicators against which the service is measured include:-

- % of approved audit plan completed
- % of time delivered for non-assurance work (non-audit work)
- % of time that is chargeable (direct audit time)
- % of time spent on client support and advice
- % of time that is specifically requested

4.6 The Audit Committee will continue to receive quarterly reports setting out the performance against the audit plan; the annual report on internal control; surveys from the recipients of the audit service will continue to be undertaken and the findings reported back; reports from the Audit Commission (the key report being the results of the triennial review of internal audit and the Use of Resources report) indicating audit issues, including qualitative aspects of internal audit. In addition, Council will receive a quarterly update of the work of the Audit Committee. Collectively, these will provide the performance evaluation framework.

4.7 In addition, the governance arrangements will involve the regular meeting of the Chairs of the Audit Committee with the Heads of Service and regular meetings of the Joint Operational Audit Steering Board. The outcomes of these meetings will be reported to the Audit Committee.

5.0 CONCLUSION AND RECOMMENDATION

5.1 The Project Board considers that a shared internal audit service, hosted by Cumbria County Council, would provide the most robust audit arrangement, with the scope for improved performance with modest savings initially and the potential for longer term savings through income generation and delivery of specific audits to identify savings for participant organisations.

5.2 The Audit Committee is recommended to support this proposal. Delivery of shared services across Councils requires commitment, co-operation and much detailed and sustained work. Change is not easy. However, the shared service proposal for internal audit services provides opportunities to benefit from a robust service which is provided as a critical mass to all participants.

List of Appendices

Appendix 1 – Business Case for Internal Audit Shared Service

Appendix 2 - Advantages and Disadvantages of Option2 – Joint Organisation with a Host Authority

List of Background Documents: None

Officers Consulted: Corporate Team