

MEETING:	CABINET
MEETING DATE:	10 APRIL 2014
TITLE OF REPORT:	CHANGE OF INTERNAL AUDIT PROVIDER
REPORT BY:	CHIEF FINANCIAL OFFICER

Classification

Open

NB Appendix 1 to this report is exempt by virtue of paragraph 3 of the Access to Information Procedure Rules set out in the Constitution pursuant to Schedule 12A Local Government Act 1972, as amended

Key Decision

This is a Key Decision because it is likely to result in the council incurring expenditure which is, or the making of savings which are, significant having regard to the council's budget for the service or function to which the decision relates.

NOTICE has been served in accordance with Part 3, Section 10 (General exception) of The Local Authorities (Executive Arrangements) (Meetings and Access to Information) Regulations 2012.

Wards Affected

Countywide

Purpose

To agree future service delivery arrangements.

Recommendation(s)

THAT:

- (a) The South West Audit Partnership (SWAP) is selected to provide the council's internal audit service;**
- (b) The Chief Financial Officer is delegated authority to finalise contractual arrangements including a TUPE transfer of staff within the approved annual budget;**
- (c) The council join SWAP and become part owners of the local authority owned company at zero cost – subject to approval by the SWAP Board; and**
- (d) The Chief Financial Officer is delegated authority to be the council's representative on the SWAP board and to exercise the council's vote at**

shareholder meetings.

Alternative Options

- 1 Remain with our current provider, KPMG. This would have had the advantage of less disruption but would be outweighed by not achieving the proposed budget savings or having less audit input. The service would in any event require re-procuring prior to the expiry of the contract on 31.3.15.
- 2 Bring the function back in-house. The number of audit days could have been maintained within the proposed budget but given the size of the team would not have given the required capacity and resilience (i.e. cover for sickness, vacancies and ability to respond to urgent requests for support etc) or the range of skills and access to specialists.

Reasons for Recommendations

- 3 The recommended provider has a proven track record of delivering quality internal audit services to 12 local councils, including Wiltshire and the Forest of Dean on a not for profit basis within the reduced budget for the service approved by Full Council on 7 February 2014. It was selected following a soft market testing exercise which considered both private and public sector providers as well as partnering opportunities. SWAP represented the best value for money and greatest resilience for the council as well as the option to be flexible going forward if the needs of the council changes. The council is keen to look at ways of working in partnership with other organisations to provide back office services more effectively. This proposal is a clear example of working with colleagues from other councils to achieve this.

Key Considerations

- 4 Cabinet approved formal shared service arrangements with its partners, NHS Herefordshire (NHSH) and Hereford Hospitals Trust (HHT), adopting a 'multi-source' approach; enabling different fit-for-purpose models to be used to deliver shared services for each service or group of services on 21 October 2010. This included internal audit services that were tendered as a joint contract; KPMG were appointed. However given the changes in the NHS it was decided to have separate contracts rather than a joint one. To reduce the costs the existing staff were not TUPE transferred to KPMG but were transferred to Hoople Ltd. The contract with KPMG was for three years from 2012/13 – 2014/15 but with an option to terminate the contract with 30 days' notice. KPMG managed the 2.6fte internal audit staff. KPMG charged the council £236k pa for 300 days work, the equivalent of 1.2fte in addition to the cost of the 2.6fte in-house staff of approximately £90k. In reviewing the budget for the council it was felt that better value for money could be delivered from the contract and a £100k or 40% efficiency saving for the same level of service was proposed. This budget saving proposal was approved by Council as part of the 2014/15 – 2016/17 budget.
- 5 A soft-market testing exercise was conducted to inform procurement strategy and determine the most value for money approach, supported by the Head of Commercial Services and with independent external support from the Chief Internal Auditor of Bristol City Council – acting as a critical friend.
- 6 In undertaking the soft market testing the council invited indicative proposals from a

range of public and private sector organisations. Based on these a number of organisations were subsequently invited to a discussion with the Chief Finance Officer, Head of Commercial Services and the Chief Internal Auditor of Bristol City Council. Exempt appendix one sets out a matrix showing how each proposal compared against inputs, charging, quality and resilience. It is confidential as information was provided on this basis.

7 The potential options presented a range of procurement strategies including: a full competitive tender process; the use of an existing pre-tendered collaborative framework; the sharing of resources with other councils or a public-public shared-service approach through a Teckal exempt organisation.

8 A Teckal exemption is an principle permissible under UK procurement regulations (Public Contracting Regulations 2006) that supports greater collaboration between council and the establishment of public-public shared-services arrangements. It can apply where a contracting authority can exercise the same level of control over a wholly-owned entity that is similar to the control it has over its own 'in-house' departments ("the control test"); and the entity carries out the essential part of its activities for that authority. The control test can be satisfied even where the entity is covered by several authorities. A Teckal exemption confirms that an authority does not need to run a procurement procedure where the exemption applies. In considering the options the SWAP proposal presented the most advantageous approach , presenting:

- similar levels of quality to the current arrangements at a reduced cost.
- Capacity and resilience (i.e. cover for sickness, vacancies and an increased ability to respond to urgent requests for support etc.).
- A range of skills and access from a pool of over 60 staff.
- Increased training and development opportunities for staff.
- Better career opportunities for staff.
- Certainty of audit provision and cost to the council.
- Independence of the audit function.
- The ability to share resources across the authorities in the operational delivery of audit activity.
- Efficiencies through the development of collaborative work programmes.
- Shared development resources to maintain continuous improvement and deliver best practice.
- Access to a recognised audit management system and associated benefits from streamlining of workflow, enhanced opportunities for remote working etc.

9 The South West Audit Partnership:

- Started in 2005 as a Joint Committee with two initial partners
- Now has a membership including nine district, two county and one unitary council
- Is present in five counties
- Since 1 April 2013 it has been a publically owned "Teckal" compliant company limited by guarantee, wholly controlled by the partners
- Employs 60 full time equivalent staff
- Has been assessed and found to comply with the Institute of Internal Auditors professional practices framework and public sector internal audit standards – PSIAS
- Aims to provide a professional cost effective, high quality internal audit service and improve the standard of corporate governance, risk management and internal control systems for all partners.

Community Impact

- 10 Supports achievement of council's corporate plan, in particular the objectives to manage finances effectively to secure value for money; and make best use of the resources available.

Equality and Human Rights

- 11 No implications

Financial Implications

- 12 The cost of the contract with SWAP is anticipated to be £225k per annum, including the cost of the in-house team. This is within the council's approved budget and represents a £100k saving on the current arrangement (having a total annual cost of £336k). The council will receive 900 deliverable audit days for this, plus an element of management time. This compares to the 850 days previously delivered which included an element of management. SWAP has also agreed to cover any sickness of the 2.6fte staff with productive days at no cost, whereas previously the days would have been lost or additional days charged to the council.
- 13 There will be a one-off payment of approximately £20k to SWAP when the 2.6fte staff transfer under TUPE. This represents the accrued pension deficit of the staff transferring that is currently owed to the Herefordshire and Worcestershire Pension fund as part of the council's overall pension deficit that is being repaid over 21 years.
- 14 The proposal, as with the current arrangement, includes the council providing accommodation for the internal audit team at no cost.

Legal Implications

- 15 Herefordshire Council is required under Regulation 6 of the Accounts and Audit Regulations 2011 to:

“undertake an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control”.

- 16 Herefordshire Council's Internal Audit Charter includes the need for independence and direct lines of reporting to the Chief Financial Officer (S151 Officer), Chief Executive (Head of Paid Service), Monitoring Officer and Chair of the Audit and Governance Committee when required. Herefordshire Council Internal Audit Service have adopted and follow the Public Sector Internal Audit Standards (PSIAS), introduced in April 2013, which provide a national standard for all Public Sector Internal Auditing within the UK.
- 17 Under the recommended arrangement, the contract remains open until a partner wishes to exit; the exiting partner bears the cost of redundancy or takes the TUPE transfer of staff back to their authority, equivalent to the days being provided.

Risk Management

- **Staffing issues.** Internal audit is a staff-intensive service and it is therefore important

Further information on the subject of this report is available from
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that morale is maintained, both during the transition period and into the future. To mitigate this risk, staff have been kept involved and informed of the proposals from the earliest stages to ensure that relevant issues can inform the way forward. Feedback from staff indicates that they are very positive about joining the partnership. Whilst direct dialogue will continue, the formal HR consultation process will also ensure that any outstanding issues and/or concerns are adequately considered and appropriately addressed.

- **Quality and performance issues.** The internal audit team is rightly proud of the high quality of their work and their performance target achievements. It is essential that not only are current quality and performance levels maintained, but that where possible these are improved. Considerable effort will be put into comparing working practices between the partners, evaluating the different methodologies and adopting the best from SWAP.

Consultees

- 18 Audit and Governance Committee (AGC) – Were supportive of the proposals and requested that the future role of AGC should include a periodic review of the effectiveness of internal auditors to inform future appointments. AGC also sought assurance that SWAP has the capacity to deal with ‘worst case scenario’ re. audit requirements. that an exit strategy was in place should the council wish to end the arrangement, and it was possible to terminate the arrangement with appropriate notice. Termination arrangements are set out within the legal implication section above and the AGC’s remaining issues will be addressed in the finalising of the contractual arrangements.
- 19 Directly affected staff – have been consulted and are supportive of the proposals, in particular welcoming the greater opportunity for career development and more access to on-site management, and improved value for money offered by a not for profit organisation.
- 20 Trade union – Unison are content that staff views have been taken into account.

Appendices

Appendix 1 – Soft Market Testing Matrix (exempt by virtue of paragraph 3 of the Access to Information Procedure Rules set out in the Constitution pursuant to Schedule 12A Local Government Act 1972, as amended).

Background Papers

None identified.