



INTERNAL AUDIT – SHARED SERVICES

SUMMARY

- 1.1 The purpose of this report is to seek approval for the establishment of a Shared Internal Audit Service by means of a partnership between Derby City Council (DCC) and South Derbyshire District Council (SDDC).
- 1.2 The proposal is to create a Shared Internal Audit Service which will deliver a full, professional internal audit function to meet the needs of the Derby City Council and South Derbyshire DC and the requirements defined in the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Internal Audit in Local Government in the United Kingdom 2006.
- 1.3 It is proposed that the Shared Service will be governed by a Partnership Agreement which will set out the detailed arrangements for the Shared Service. Partners will be required to sign-up to the terms and conditions of this document for a set period of time in order to be part of the Shared Service.
- 1.4 Human Resource implications of the transfer are being worked through in consultation with SDDC and all staff who may be affected by this proposal.
- 1.5 The proposal will reduce the overall cost of internal audit in the Councils which participate in the Shared Service, with efficiencies sought over the period of the agreement.

RECOMMENDATION

- 2.1 To approve the proposal that Derby City Council hosts and becomes a partner in the Shared Internal Audit Service with South Derbyshire District Council from 1 November 2011.

REASONS FOR RECOMMENDATION

- 3.1 The Audit and Accounts Committee is responsible for monitoring the management and performance of internal audit service providers.

SUPPORTING INFORMATION

- 4.1 The function of Internal Audit is recognised by all councils as core to effective governance, risk management, and control arrangements. The requirement for councils to maintain appropriate and effective internal audit arrangements is set out in the Accounts and Audit Regulations 2011.
- 4.2 Detailed work has been carried out to develop a proposal for a shared internal audit service hosted by Derby City Council. The original work to assess options for delivery of the internal audit function was started in June 2010. It was borne out of the requests from 2 neighbouring local authorities for Derby's Internal Audit team to supplement their existing internal audit services.
- 4.3 The Council's internal audit service currently has 4 external clients:
- Derby Homes
 - Derbyshire Fire Authority
 - South Derbyshire DC
 - Amber Valley BC

The proposal for the shared internal audit service was put to both SDDC and AVBC. SDDC has already approved its participation in the shared service. AVBC has decided not to commit to the shared service at this point in time. Until the time that AVBC makes its decision, the internal audit service will continue to be provided under the current arrangements. The internal audit service for Derby Homes is provided under a 3 year contract and the service to Derbyshire Fire Authority is governed by a service level agreement. These two arrangements will continue as they are now.

- 4.4 The shared service approach will not generate immediate savings to DCC. These may be generated over time through efficiencies and if other organisations seek to join the partnership. The Council has already seen efficiency savings generated in Internal Audit from new working practices and the generation of new income streams. The external contracts are generating income to DCC of around £90,000 per annum. The shared service will however, formalise the internal audit agreement with SDDC, which provides a long-term commitment.
- 4.5 From 1 November 2011, DCC and SDDC propose jointly to establish a Shared Service to deliver a full, professional internal audit service to meet the needs of the Councils and the requirements defined in the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom 2006.

Drivers for change

- 4.6 Internal audit teams have a vital role to play in helping Councils manage effectively through the challenges they face by ensuring that governance, risk management and control arrangements remain effective. To do this successfully, internal audit teams need to be fit for purpose and provide assurance of the necessary quality, depth and coverage. Often this will mean giving assurance on complex and risky issues and using specialist resources when necessary.

- 4.7 The partners consider that establishing a shared internal audit service will allow greater resilience in internal audit, and sufficient economy of scale to allow for access to specialist audit skills.
- 4.8 The partners also require the shared internal audit service to deliver efficiencies through standardisation of approach and removal of duplication, allowing reductions in the number of audit days required by each Council and consequent cost savings.
- 4.9 Across the public sector an increasing number of partnerships and consortia are emerging for the delivery of internal audit. The development of the shared internal audit service is in line with these wider trends.
- 4.10 The concept of joint internal audit services is well established in the public sector, particularly in the NHS. The most developed in local government is the South West Audit Partnership (SWAP). SWAP was implemented in 2005 with 3 councils and now has 11 local authorities covering Somerset, Dorset, Devon and Gloucestershire. In addition, SWAP also undertakes audits under contract for 10 public agencies in the region. SWAP has stated that the key benefits it has delivered to its partners are:
- Productivity increases of the order 25 per cent
 - More affordable specialist services as costs are shared
 - Cost reductions of the order of 10 per cent
 - Streamlining in managerial arrangements allowing greater responsiveness and flexibility.
- 4.11 DCC's Internal Audit Strategy aims to improve the performance of the internal audit service at DCC so that it is operating at 'best practice' levels. Whilst the shared internal audit service is intended to support all partners, it will also be consistent with the strategic drive to improve the City Council's own internal audit arrangements; for example by introducing new skills and ways of working.

Shared Internal Audit Service Model

- 4.12 This shared service option was considered to provide the opportunity to deliver the benefits of an in-house service, greater resilience in an area where recruitment can be difficult, and the scope to deliver efficiencies of process resulting from the economy of scale of a larger service.
- 4.13 This decision led to the development of a detailed proposal for a shared Internal Audit service to be delivered through a partnership hosted by DCC.
- 4.14 The proposed objectives of the shared internal audit service will be:
- i) to deliver a programme of high quality and reliable assurance on all key governance, risk and control systems to each Council, operating in accordance with statutory requirements, professional standards, and recognised best practice methodology
 - ii) to deliver high standards of customer service and be responsive and flexible in its approach, offering the benefits of a 'close' in-house team
 - iii) to offer a wide base of experience, resilience, specialisms and skills, taking

advantage of the economy of scale available to larger audit teams

- iv) to deliver efficiencies through exploiting opportunities for joined-up working, adopting a common methodology and service standards, sharing knowledge, skills and expertise
- v) to provide a supportive and stimulating working environment for those staff working in the shared service with opportunities for career development
- vi) to be open to future opportunities to expand the shared service, thus enabling greater efficiencies to be achieved.

4.15 The key benefits will be:

- i) Increasingly effective use of the total audit resource available to participating authorities resulting from knowledge sharing, efficiency in research and development work and efficiency in audit planning.
- ii) Economies of scale in terms of management structure, working practices and systems, resulting in efficiency savings.
- iii) Potential for other partners to join the shared internal audit service, with further efficiencies arising.

4.16 It is envisaged that the proposed arrangement will be a collaboration falling within the scope of Section 1 of the Local Authorities (Goods and Services) Act 1970, which allows authorities to collaborate in relation to administrative, professional or technical assistance. This permits DCC to offer an internal audit service to the other Councils and allows those other Councils to commission DCC to provide this service for a fee. Shared services is, however, a new and complex area of law involving governance and procurement issues, and the Council's legal section is providing advice in this area.

4.17 It is proposed that oversight of the shared internal audit service will be through a joint officer (operational) board comprising those Chief Financial Officers of the authorities participating in the service, given their particular interest in ensuring the adequacy and effectiveness of internal audit arrangements. The board will monitor the performance of the shared service to ensure that it delivers the standards and expectations set out in the proposed agreement.

4.18 A Partnership Board will be established which will be the supreme authority for the shared internal audit service. Two members from each Council's Audit Committee will sit on the Board with equal voting rights if any disagreements arise then there will be a dispute mechanism included in the agreement to deal with such disputes. The main terms of reference of the Board will be to approve reports from the Operational Board and the Head of Internal Audit on the budget, accounts, work programmes, new partners and additional contract work.

4.19 Whilst the partners will jointly oversee the performance of the shared internal audit service, the responsibility for the adequacy of the whole system of internal audit will remain with the Councils themselves, who will retain responsibility for approving audit plans and monitoring delivery via the Councils' respective Audit Committees (or

equivalent). The individual Councils will continue to:

- be responsible for overseeing the effectiveness of the internal audit function at Council level, and holding the Head of Internal Audit to account for delivery
- be responsible for the effectiveness of their respective governance, risk management and control arrangements, holding managers to account for delivery
- receive regular progress updates on internal audit work, consider key themes and issues, and take them forward as necessary.

- 4.20 The shared service will have its own 'brand' to promote the shared service ethos and opportunities amongst the team.

Risks and Mitigations

- 4.21 A full risk assessment was undertaken as part of the original proposal. Generally, all risks are considered to be low due to actions that are or can easily be put in place. In addition, with 2 neighbouring authorities working together and still within a local authority environment (same rules, controls, procedures, existing staff, etc.) then risks are mitigated further. There is a risk around service provision if the shared internal audit service was to fail or does not deliver as planned. This will be covered in the contractual agreement to protect both authorities. In addition, some provision has been built into the proposed budget to cover financial risks, especially around the potential for a reduction in income from current contracts and the failure to adequately grow the Partnership.

Financial arrangements

- 4.22 Initial indications of the level of service required have been given by the partners, and this information has been used to determine indicative costs of the proposed service. The costs will be shared with partners, in proportion to the level of service they require, on a full recovery basis with the overall position being cost neutral in terms of the City Council's budget.
- 4.23 The partners will require further work to identify efficiency targets and deliver cost savings over time, and these targets will form part of the partnership agreement. This will mean that over time the total cost of the internal audit arrangements in DCC and participating districts will reduce.

Human Resources arrangements

- 4.24 The Human Resources arrangements are being considered. Legal and Human Resources support is being received in order to ensure that the process of employee transfer is handled in accordance with the law.
- 4.25 The Head of Governance and Assurance will act as Head of Internal Audit to all the partners of the shared internal audit service and fulfil the expectations of the Head of Internal Audit as set out in CIPFA's guidance document on the Role of the Head of Internal Audit in Public Service Organisations (December 2010).

- 4.26 The management structure below the Head of Internal Audit has been developed. An Audit Manager will report to the Head of Internal Audit, and will be responsible for overseeing the operational aspects of the shared service and the management responsibility for all staff within the shared services organisation. The Audit Manager will manage the audit function at each Council and will draw on the pooled resources of the shared service to deliver the agreed audit plans. The shared service organisation will operate from the main office in Derby, but a satellite office will be maintained in Swadlincote.
- 4.27 The structure for the team only contains one Audit Manager post. Both DCC and SDDC have an Audit Manager in post. It is intended to invite both post holders to participate in an assessment process which, if we can obtain their agreement, will take place prior to the transfer on 1 November 2011. If not, it will take place as soon as possible after the transfer date. There is a vacancy at Principal Auditor level within the team structure for the unsuccessful candidate. Protection of earnings will apply in this case.

Consultation arrangements

- 4.28 SDDC concluded its consultation prior to approval by its members to collaborate with DCC in a shared services arrangement. DCC is currently consulting with internal audit staff.
- 4.29 Arrangements are being made to consult with the External Auditors as a key stakeholder in the Service. Both Councils have Grant Thornton as External Auditor.
- 4.30 Further staff consultation will be carried out as part of the process for transferring staff to the employ of DCC and into the roles within the shared internal audit service.

OTHER OPTIONS CONSIDERED

- 5.1 To continue providing internal audit services on an ad-hoc basis. There is a risk that this short term provision will not provide the security around income that can be obtained from a shared services partnership.

This report has been approved by the following officers:

Legal officer	Clare Wasteney
Financial officer	
Human Resources officer	Elaine Inns
Service Director(s)	
Other(s)	

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Background papers:	None
List of appendices:	Appendix 1 – Implications

IMPLICATIONS

Financial and Value for Money

- 1.1 This is a longer term commitment to an existing income stream and provides opportunities for further expansion and new income streams.

Legal

- 2.1 Under the Accounts and Audit Regulations 2011, the Council is required to maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with the proper internal audit practices.
- 2.2 A partnership agreement is being negotiated with SDDC.

Personnel

- 3.1 TUPE Regulations will apply to any staff transferring to Derby City Council as the Host Authority.

Equalities Impact

- 4.1 None directly arising.

Health and Safety

- 5.1 None directly arising.

Environmental Sustainability

- 6.1 None directly arising.

Asset Management

- 7.1 None directly arising.

Risk Management

- 8.1 Internal Audit provides the organisation with objective assurance on whether the major business risks are being managed appropriately and provides assurance that the risk management and internal control framework is operating effectively.

Corporate objectives and priorities for change

- 9.1 Internal Audit contributes through its review work on the major corporate risks to the Council achieving corporate objectives and priorities. This is achieved by the audit of key systems and corporate governance issues and the associated risks. The work of Internal Audit is also relevant to the priority of 'value for money'.