

# **ARGYLL AND BUTE COUNCIL – SERVICE REVIEW**

## **SUPPORT SERVICE REVIEW – INTERNAL AUDIT EXECUTIVE SUMMARY- 28 NOVEMBER 2011**

### **1 INTRODUCTION**

- 1.1 The council has committed to a 3 year programme of service reviews. Arising from a challenging financial outlook and ongoing increases in demands and expectations for public services, the council set a target for services to identify options to achieve 20% savings in cost from service reviews. The service reviews also support and provide the opportunity for the council to investigate options for improving the performance, value for money, economy, efficiency and effectiveness of services.
- 1.2 This report summarises the outcome of the review and the preferred option for future delivery of internal audit.

### **2 BASELINE REPORT**

- 2.1 The internal audit section is located within Strategic Finance / Chief Executives Unit. The Chief Internal Auditor reports to the Head of Strategic Finance who reports to the Chief Executive. The Chief Internal Auditor can report direct to the Chief Executive and also has a dotted line responsibility to the Chairman of the Audit Committee. Internal audit is delivered and developed in accordance with its Terms of Reference and links to the organisational objectives and aims of the Council. Internal audit complies with good practice as set out by the Chartered Institute of Public Finance (CIPFA) Code of Practice for Internal Audit in Local Government in the United Kingdom, 2006. Consideration is also given to the CIPFA guidance on the role of the Head of Internal Audit in developing both the audit risk based strategy and plan.
- 2.2 The section has 6 FTE staff comprising, a Chief Internal Auditor, 3 Qualified Accountants, a Senior Audit Assistant and a Trainee Accountant. All staff members undertake Continuing Professional Development (CPD) as part of their professional accountancy qualification. Internal audit has a partnership with KPMG who provide support when required.
- 2.3 Internal audit prepares a 3 year audit plan which is approved by the Audit Committee which is prepared following a risk assessment exercise, and in consultation with management and External Audit. The audit plan details the audits to be undertaken according to a methodology and risk ranking. The Audits are set out under 4 areas: Finance Systems, Business Systems, Corporate Performance, Corporate/ Service Plans. Each audit has a scope and objectives which outlines what the audit activity will be. This is discussed, agreed and signed by the appropriate Head of Service.
- 2.4 Areas for improvement in internal audit have been identified as follows:
- The development of a communication strategy for Internal Audit to raise its profile in areas not traditionally covered in detail by the audit plan;

- Provide internal audit staff with audit specific training and developing continuous auditing through the use of IT software packages;
- Give consideration to employing non-finance personnel within the section and developing a career path for staff; and
- Heads of Service requesting more interaction with internal audit on service priorities addressing risks as well as financial audit.

2.5 The table below shows the forecast outturn for 2010-11 incorporated into the baseline report.

	<b>Internal Audit 2010-11 £</b>
Employees	241,390
Premises	0
Supplies and Services	2,891
Transport and Travel	5,912
3 <sup>rd</sup> Party Payments	50,000
Income	0
Net Expenditure	300,193

### 3 **BENCHMARKING REPORT**

3.1 The Service has used three benchmarking routes to obtain information:

- CIPFA Benchmarking Club – Internal Audit ;
- Director of Finance PIs; and
- A separate KPMG benchmarking review.

3.2 CIPFA benchmarking club allows Internal Audit to compare its performance with a selected group of similar local authority internal audit sections across the UK. The Director of Finance PIs compares information on the finance function across all Scottish councils. The KPMG benchmarking review provided a good practice assessment with some additional benchmarking. Overall they are sufficient in detail to allow the results to be used in looking at:

- Reducing costs;
- Improving results;
- Improving processes; and
- Improving organisation/structure.

3.3 Although costs are broadly in line with average for Scottish councils compared to other councils in the CIPFA Benchmarking Club there is scope to reduce the cost of the internal audit function. Although the cost per auditor is lower than the average the effect of the lower than average number of days per auditor

and the higher than average audit days per £m gross turnover pushes the overall cost of internal audit above the average.

- 3.4 In terms of results the Council has achieved 88.5% (2008/09) and 87.53% (2009/10) productive audit days achieved as a percentage of productive days per the audit plan. This compared to an average of 94.26% (2008/09) and 97.23% (2009/10). This ranked the Council 23rd and 27th respectively out of 32 councils in Scotland.
- 3.5 The review undertaken by KPMG concluded that:
- Internal audit is supported by management;
  - Internal Audit delivers its services in accordance with the principles set out in the CIPFA Code of Practice and standards set by the Institute of Internal Auditors; and
  - The methodology and process of internal audit is in line with internal audit standards and is consistent with processes across both private and public sector organisations.

## **4 FUTURE CHALLENGES**

- 4.1 Funding reductions and drive for more efficient processes create a situation of increased risk and reduced controls:
- The current financial situation and need to have efficient and effective processes in place includes internal audit;
  - Service redesign results in changes to the overall management control environment, placing increased pressure on the management control system; and
  - This reinforces the need for a focussed risk based programme of work that is executed at lowest cost, but with a balance of risk and assurance.
- 4.2 To address the above the Council needs to consider adopting a risk based approach to assessing the effectiveness of the Councils management controls system:
- Developing a risk based audit universe and a strategy to increase coverage of non-financial risks;
  - Review risk assessment, allocation of audit days and overall audit plan; and
  - Reviewing the level of audit days per £m gross turnover.
- 4.3 Internal audit need to focus on delivering a programme of risk based audits that assess the effectiveness of the Council's management control system, in an efficient and effective manner:
- Delivering a higher proportion of planned productive audit days;
  - Deploying new tools to make the audit process more efficient and effective; and
  - Application of more rigour and challenge to documenting processes and identifying risks.

- 4.4 To achieve the above will require developing the skills base of staff.
- Providing Internal Audit staff with audit specific training and develop the use of IT audit packages; and
  - Give consideration to employing non-finance personnel within the function;
- 4.5 In the current financial climate internal audit needs to ensure it is delivered in a cost effective manner by:
- Increasing the number of audit days per auditor;
  - Reviewing the number of internal audit staff;
  - Reviewing the cost of external partnering; and
  - Reducing the cost of audit per £m gross turnover.

## **5 STAGE 1 OPTIONS APPRAISAL**

- 5.1 Having assessed the services in detail, a range of options was considered during the Stage 1 Options appraisal for each work stream. The options were scored using the approach set out in the Service Review Guidance. Four elements were identified in the guidance (Impact, Savings, Deliverability and Risk).
- 5.2 Option 1, is to make incremental improvements to the processes currently adopted within Internal Audit, without any partnership support. This would cover:
- Improving the risk based approach to assessing the effectiveness of the Councils management controls system – reviewing the risk universe, risk assessment process and matching of audit days to assessed risks;
  - Focussing on delivering a programme of risk based audits - Delivering a higher proportion of planned productive audit days, deploying new tools and improved audit processes;
  - Developing the skills base of staff – through deployment of IT tools and reviewing skills base of staff; and
  - Improving cost effectiveness – through improving audit days per auditor, reviewing staff levels and eliminating the partnership.
- 5.3 Option 2 also requires making internal incremental improvements but with partnership support. The option would be similar to that outlined above but with continued partnership support albeit the level and focus of partnership support would be subject to review.
- 5.4 Option 3 would be to contract out internal audit. A specification would need to be developed detailing the Councils requirements. Consideration would need to be given to the risk assessment and risk appetite as part of this. The improvements in process and staff development would effectively be passed over to the contractor. Any contract would need to be phased to avoid limiting decisions when the options around wider shared services are being considered.

- 5.5 Option 4 would be to look at opportunities for integrating internal audit with other similar activities within the Council. This option is not evaluated as part of this report as the cross service work streams will be considered as a separate piece of work.
- 5.6 Option 5 would be to look at shared services. There are a number of similarities with contracting out in terms of preparing a detailed specification. However, consideration needs to be given to ensuring an appropriate package of work and preparedness of potential partners. This would best be taken forward as part of a wider project to outsource or share services. Consideration would need to be given on how internal audit was packaged as part of a wider shared service arrangement. It may be that the Council would want to keep internal audit out with the shared service arrangement or packaged as part of a separate shared service or contracted out. The key being to ensure internal audit continues to provide an independent assurance function which is not compromised by being under the control of those providing other support or management services.
- 5.7 The table below summarises the outcome of the stage 1 options appraisal for internal audit. The 3 highest scoring options 1-3 went forward to Stage 2 options.

Rank	Option Number	Option Description	Score
1	1	Incremental improvements to current processes - no partnership support	94.0
2	2	Incremental improvements to current processes - with partnership support	76.5
3	3	Contracting out	74.0
4=	4	Integrate with other services of the authority	Out with terms of report
4=	5	Outsourcing and shared services	Out with terms of report

## 6 STAGE 2 OPTIONS APPRAISAL

- 6.1 Following the Stage 1 appraisal, the highest scoring options as outlined above were taken forward to stage 2 options appraisal. At stage 2 a more detailed review and assessment of the options was undertaken following the service review guidance. This was also based on factors of impact (35 points), savings (35 points), deliverability (15 points) and risk (15 points). The lower scoring at stage 2 represents a more detailed analysis of each option. In addition, the savings scoring is based on the target saving of 20% scoring 50% of the available points, for the savings elements with the score stepping up to 100% at 25% savings and down to nil at 15% savings.

6.2 The stage 2 options appraisal scores are summarised in the table below. Option 2 is the preferred option but is not the highest scoring option.

Rank	Option Number	Option Description	Score
1	1	Internal incremental improvements with no partnership	57.6
2	2	Internal incremental improvements with partnership	44.1
3	3	Contracting Out	40.1

6.3 Option 2 scores 44.1 points whereas option 1 scores 57.6 points. The main difference is the scoring for savings as the inclusion of the partnership contract reduces the savings from 20.4% in option 1 to 11.2% in option 2. The shortfall in savings of £24,032 will be met by other areas of Strategic Finance. Internal Audit contributed £27,130 to the budget challenge savings in 2011-12.

6.4 The partnership contract is strongly recommended given the reduction in audit days. This recommendation is not driven by the need to recover or offset some of the loss of direct audit days. The role of the partnership support contract would be to ensure the audit days that are delivered, are challenged to deliver a standard of work that is of high quality, effective and at a high level of performance. We need to make the most out of the reduced audit days and the partnership support contract is aimed at achieving that.

## 7 Implementation Plan

7.1 The preferred option for internal audit is option 2. To make incremental improvements to the processes currently adopted within Internal Audit but with partnership support. This would cover

- Improving the risk based approach to assessing the effectiveness of the Councils management controls system – reviewing the risk universe, risk assessment process and matching of audit days to assessed risks;
- Focussing on delivering a programme of risk based audits - Delivering a higher proportion of planned productive audit days, deploying new tools and improved audit processes;
- Developing skills base of staff – through deployment of IT tools and reviewing skills base of staff; and
- Improving cost effectiveness – through improving audit days per auditor, reviewing staff levels and eliminating the partnership.

7.2 The total potential savings identified as a result of the service review for internal audit are £55,487 less cost of partnership support £25,000 to give a net saving of £30,487.

7.3 The main steps in implementation of the review are as follows:

- Staffing changes as part of wider Strategic Finance review by 31 March 2012;
- Internal audit partnership contract in place by 31 May 2012;

- Audit plan revised and focussed as per the stage 2 options report by 31 March 2012;
- IDEA audit tool rolled out by 30 April 2012;
- Review of file management and documentation by 30 April 2012;
- Review of clearance and sign off process by 30 April 2012; and
- Use of workforce deployment tools 1 July 2012.

## **8 Employee Engagement**

- 8.1 Employee engagement to date has comprised:
- Detailed discussions with the Head of Strategic Finance and staff in the Internal Audit Team to consider the options and how they could be taken forward; and
  - A workshop to develop the PSIF improvement plan provided useful input.

## **9 Customer and Community Engagement**

- 9.1 Strategic finance is an internal service. Along with all other services forming part of the Support Service review there has been attendance at each DMT to discuss issues and requirements related to the service. There has also been a meeting with the Head of Strategic Finance in his role as the Chief Financial Officer to discuss his requirements in ensuring proper administration of the Council's financial affairs.

## **10 Third Sector Engagement**

- 10.1 There has been no engagement with the third sector. It is not clear what role the third sector could play in carrying out the Council's strategic finance function.

## **11 Social Impact**

- 11.1 No social implications have been identified to date in terms of considering changes to the operation of Strategic Finance. An effective strategic finance function will assist in using resources effectively which can assist the Council in discharging its other obligations and commitments

## **12 Equality Impact Assessment**

- 12.1 An equality impact assessment has been undertaken and a separate report on the equality impact assessment prepared. A neutral impact on all employees and stakeholders is expected as a result of the equalities impact assessment. Arrangements will be made to monitor and review the impact.

## **13 Sustainability Assessment**

- 13.1 A sustainability assessment has been undertaken and a separate report on the sustainability assessment prepared. No negative sustainability impacts have been identified. Arrangements will be made to monitor and review the impact.

## **14 Conclusions**

- 14.1 The service review has been completed in a way which ensures compliance with the council's performance management framework, Public Service Improvement Framework (PSIF) and the HM Treasury Green Book. It is focussed on sustainable service delivery which meets the challenges ahead.
- 14.2 The overall service review for Strategic Finance meets the Council target of identifying options to achieve 20% savings in costs and supports the opportunity for improving performance, efficiency, effectiveness and value for money.
- 14.3 It is proposed that the options described above are taken forward to deliver the savings and efficiencies required. All have been scored according to the guidance and each meets the criteria to ensure minimum negative impact, meeting the savings target (with the exception of Internal Audit as outlined in stage 2 section 6.3 above), deliverability and a level of risk which is acceptable within acceptable tolerances.