

Report to: **Audit, Best Value and Community Services Scrutiny Committee**

Date: **28 February 2012**

By: **Director of Corporate Resources**

Title of report: **Internal Audit Service Review**

Purpose of report: **To advise the Committee of the outcome from the Internal Audit Service Review as set out the attached report (Appendix A)**

RECOMMENDATION:

The Committee is recommended to consider and comment on the findings and recommendations arising from the review.

1. Financial Appraisal

1.1 The review recommendations can be delivered within a reduced budget, allowing a further contribution of £60,000 towards the Corporate Resources Department savings target, over and above the £40,000 of savings delivered in 2011/12. This equates to a total saving of 13.4% of the service budget.

2. Supporting Information

2.1 Over the next four years, the County Council will be systematically reviewing all its services and this is likely to result in significant changes to the structure of the organisation and the way in which services are delivered.

2.2 The Internal Audit Service Review was part of this programme and has been undertaken in order to ensure the future delivery of an efficient, cost effective and high quality internal audit service, which meets the needs of the organisation and the requirements of professional standards. Ultimately, the review has sought to establish what the organisation needs from an internal audit service and how this can be best delivered. The review has also allowed a further contribution to be made to the Corporate Resources Department savings target.

2.3 The report was presented to the Chief Officers Management Team on 10 January 2012 and the recommendations were all agreed for implementation.

2.4 The recommendations made the report will form part of a more detailed implementation plan, to be developed in conjunction with staff and potential partners. Progress will be reported on a regular basis to the Chief Officers Management Team and the Audit, Best Value and Community Services Scrutiny Committee via quarterly Internal Audit Progress Reports.

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Local Member: All

Background Documents
Internal Audit Service Review Report (Appendix A)

Report to: **Chief Officer Management Team**

Date: **January 2012**

By: **Russell Banks, Principal Audit Manager (Project Manager)**

Title of report: **Internal Audit Service Review**

Purpose of report: **To summarise the approach and outcomes from the Internal Audit Service Review and to provide recommendations to ensure the continued delivery of high quality internal audit, which meets the needs of stakeholders and professional standards, whilst also reducing costs in line with corporate expectations.**

RECOMMENDATIONS:**COMT is recommended to:**

- 1] Note the findings from the review, including the results of benchmarking, stakeholder consultations and external peer review;
- 2] Agree the recommendations set out within section 7.

1. Executive Summary

1.1 Since 2008, the Internal Audit Service has reduced in size from 15.4 full time equivalent (fte) staff to 9.2 fte in 2011. In the past 5 years, it has also reduced costs by almost 40%, from £985 per £1 million of County Council expenditure to £608. Whilst benchmarking data shows that the service is well below the national average for all local authorities in terms of both size and cost, further savings of £100,000 will be delivered between 2011/12 and 2012/13.

1.2 In spite of these ongoing reductions, a quality service continues to be delivered, with a high degree of satisfaction among stakeholders. Those consulted, including Chief Officers and members of Finance and Resources Group, highlighted the responsiveness and engagement of Internal Audit to be particularly valued, especially where this relates to major change programmes and projects. The Authority's external auditors, PKF, continue to place a high degree of reliance on the work of Internal Audit, thereby maintaining lower fees relative to the majority of other county councils.

1.3 A range of options for the future delivery of internal audit have been considered and evaluated as part of this review. On the basis that the service has been through a successful journey in recent years to both reduce costs and improve quality, the primary driver in evaluating future delivery models is that of business resilience. In particular, ensuring that the service is able to cope with unplanned loss or reductions in staff and/or any unexpected peaks in workload.

1.4 It is therefore recommended that, initially, the service be delivered based on a partially outsourced/co-sourced arrangement, whereby the smaller in house team is supplemented with external specialists, commissioned as and when required. This model will offer the benefits of an internal audit service that continues to have a sound knowledge of the organisation, its people and culture, whilst also enabling it to access skills and experience from outside when required.

1.5 In the longer term, it is felt that the County Council should work towards an eventual shared service for internal audit with other local authority partners. Whilst this model will clearly provide increased business resilience and the potential for some further financial savings, there is a risk of deterioration in service quality, particularly in the short term, where the establishment of the shared service is not carefully managed.

1.6 It is our assessment that there is not currently a suitable shared service for internal audit which ESCC could join. For this reason we are exploring with local partners the development of a more collaborative approach to service delivery which, if it is successful, would provide the foundations for a more formal shared services model, subject to a robust business case, in the next 12 – 36 months. Progress is already being made with Brighton and Hove City Council in developing a local shared services market for internal audit, with a number of joint working initiatives underway, including the potential for the informal pooling of existing staff and a jointly funded programme of specialist audit work on the new Public Service Network.

1.7 In the meantime, Internal Audit should continue to explore all potential income generation opportunities, providing these are charged at a sufficient rate to reduce the overall net cost to the County Council and are not to the detriment of core service delivery.

2. Scope of Review

Introduction

2.1 Over the next four years, the County Council will be systematically reviewing all its services and this is likely to result in significant changes to the structure of the organisation and the way in which services are delivered.

2.2 The Internal Audit Service Review is part of this programme and has been undertaken in order to ensure the future delivery of an efficient, cost effective and high quality internal audit service, which meets the needs of the organisation and the requirements of professional standards. Ultimately, the review has sought to deliver cost savings whilst also establishing what the organisation needs from an internal audit service and how this can be best delivered.

The Role and Purpose of Internal Audit

2.3 Internal audit in local government is a statutory requirement, as defined within the 1972 Local Government Act (S151) and the Accounts and Audit Regulations 2011, with the activities expected to be delivered in accordance with the professional standards as set out within the 'CIFPA Code of Practice for Internal Audit in Local Government' (CIPFA Code). This Code provides the following definition of internal audit:

'Internal audit is an assurance function that provides an independent and objective opinion to the organisation on the control environment, by evaluating its effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.'

Scope

2.4 The scope of this review has covered all aspects of internal audit activity including, but not limited to:

- Risk Assessment and Audit Planning – at a macro and micro level;
- Audit Techniques and Methodologies – potential for use of alternative and more innovative approaches to assurance;
- Audit Reporting – including assignment reports, quarterly progress reports and annual reports;
- Anti Fraud and Corruption Arrangements – proactive work and reactive anti fraud / investigations work;
- Schools Audit Activity;
- Advice and Support to Management – including major projects and systems implementation;
- Internal Audit role in overall County Council governance and risk management;
- Management Information Systems;
- Management and Support Arrangements.

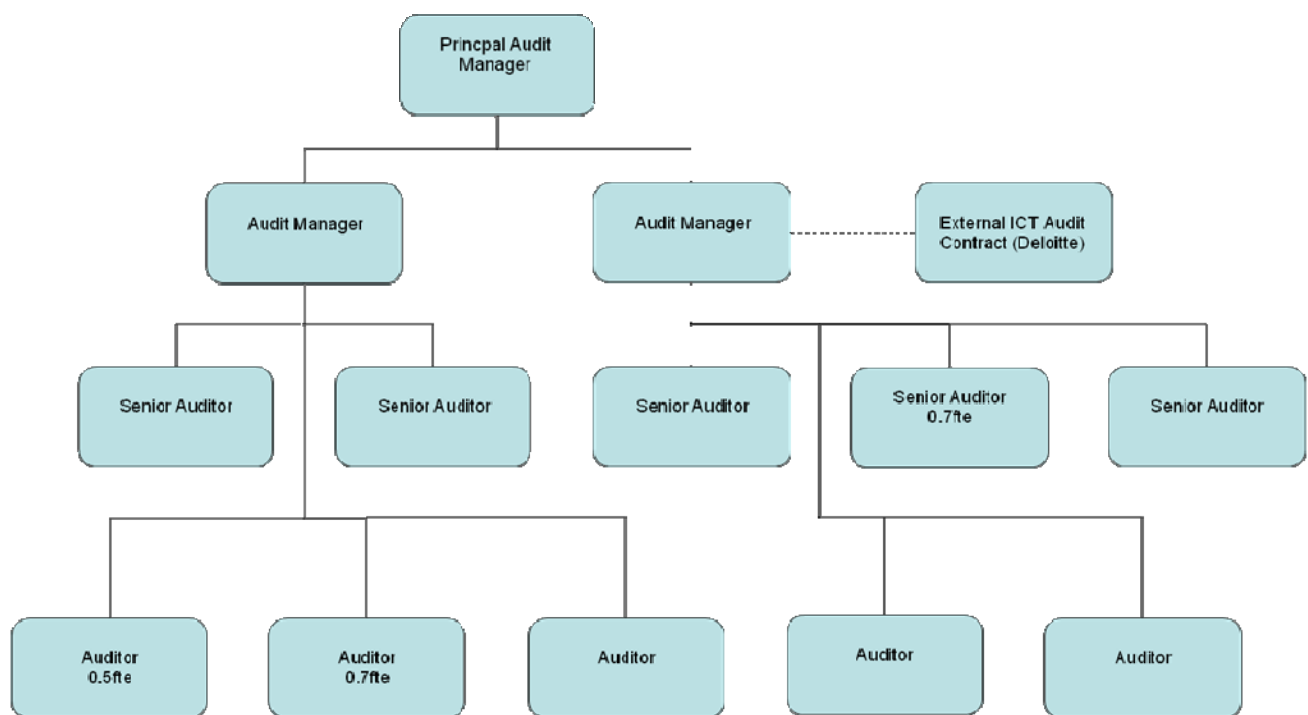
2.5 The review has focussed on addressing two key issues, namely:

- a) What does the organisation need / expect from an internal audit service? and;
- b) What is the most appropriate service delivery model to meet those needs / expectations?

2.6 This review has been undertaken against the backdrop of significant financial savings being made across the organisation and, consequently, the likelihood for major change in terms of systems, structures and personnel. These changes bring with them a range of financial, regulatory, reputational and service delivery risks which the organisation needs to understand and, where appropriate, manage. It is important therefore to recognise that a strong internal audit function plays a vital part in advising and supporting management in such a time of change.

Budget and Structure

2.7 The structure chart for the current Internal Audit Service is:



2.8 The 2011/12 gross and net budget for the service is £787,500 and £715,000 respectively, with approximately £72,500 of external income generated per annum through contracts with East Sussex Fire Authority, Plumpton College and a small number of academies. These budget figures are based on all posts in the above structure being filled and savings of £40,000 having already been made in the current financial year.

2.9 During 2010/11, Internal Audit entered into a framework contract with Deloitte and Touche Public Sector Internal Audit Ltd, via the London Borough of Croydon, for the provision of specialist ICT audit services. This arrangement was set up following the loss of the specialist ICT Senior Auditor, previously employed internally, and has enabled the service to access specialist technical skills in an area where it has been traditionally difficult to recruit. Other external providers have also been utilised in relation to contract audit, investigation procedures and forensic examination of computer equipment.

3. Approach

3.1 The review has been undertaken in accordance with the County Council's project management standards and service review guidance.

3.2 A Project Board has been established, consisting of Sean Nolan, Director of Corporate Resources, Duncan Savage, Assistant Director – Audit and Performance (Project Sponsor), Mo Hemsley, Assistant Director – Resources, Finance and Performance, Economy, Transport and Environment (FRG representative) and Samantha Williams, Assistant Director of Planning, Performance and Engagement, Adult Social Care (service department representative). The Project Manager is Russell Banks, Principal Audit Manager.

3.3 Further independent advice and challenge to the project has been provided by Shân Allan, Chief Executive's Office. In addition, Mark Taylor from Dorset County Council and Jackie Barnes from Somerset County Council have been engaged to provide external peer review, with both having particular experience of internal audit delivered via a shared service model.

3.4 The review has involved:

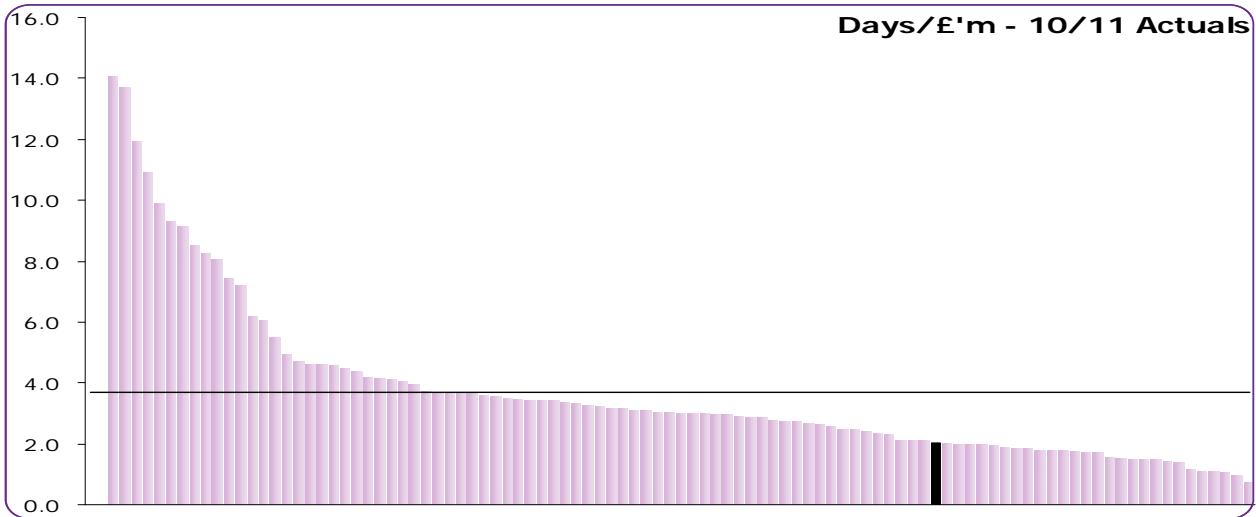
- an analysis and assessment of current performance against best practice;
- use of official benchmarking data from CIPFA, including costs and audit coverage;
- extensive consultation with a range of stakeholders, including the Chief Executive, all chief officers, members of Finance and Resources Group, the Chair of Audit, Best Value and Community Services Scrutiny Committee (ABVCSSC), the County Council's external auditors (PKF) and staff within the Internal Audit Team.
- results of research involving other internal audit services across the public sector.

4. Evidence Considered

Benchmarking – Size and Coverage

4.1 The benchmarking data utilised for the review covered the 2010/11 actual results and the plans for 2011/12. Although the CIPFA Benchmarking Club includes a separate group for county councils, the number of county participants reduced significantly in 2010 and therefore, in order to make more comprehensive comparisons, data covering all authorities across the country was utilised.

4.2 The service is currently made up of 9.2 full time equivalent (fte) staff, having reduced from 15.4 fte since the last restructuring in 2008. A number of posts are also being held vacant pending the outcome of this service review. Ultimately, responsibility for determining whether internal audit has sufficient resources to deliver a service in accordance with the CIPFA Code, rests with the Head of Internal Audit and 'those charged with governance'. At ESCC this is the ABVCSSC and the Governance Committee. Whilst there are a range of factors which need to be considered when making this determination, comparison with other local authority audit teams is a useful indicator. In order to make such a comparison, a calculation based on the number audit days delivered per £million of expenditure (i.e. size of internal audit relative to the size of the organisation) is used by CIPFA. The following graph sets out how ESCC internal audit, displayed as the black bar, compared to other authorities for 2010/11:



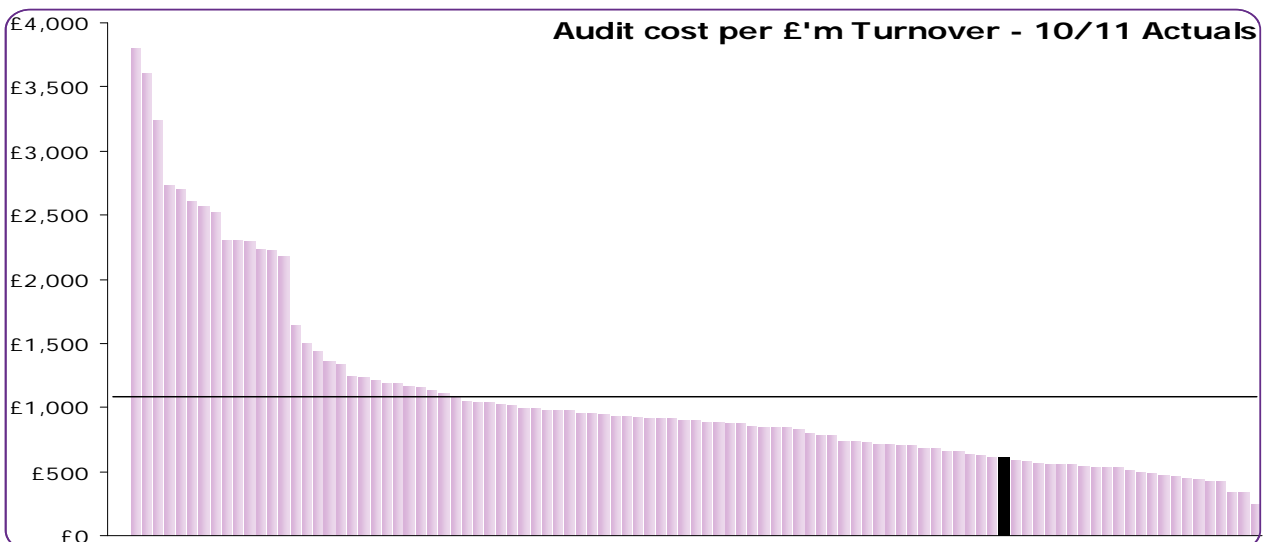
4.3 Whilst this graph shows a team below the size of the national average across all forms of local government, ESCC remains relatively consistent with other county councils, based on discussions at national and regional networking groups and the small number of counties who took part in the benchmarking club.

4.4 Over recent years, the focus of internal audit activity at ESCC and management expectations has shifted from traditional, low level, establishment audit work to high level reviews covering the County Council's strategic risks. The decision to position the service in this way reflects a modern approach to internal audit assurance and is consistent with best professional practice. CIPFA benchmarking data therefore shows ESCC to be above the average for audit work on strategic risks and well below the average for lower level operational activity.

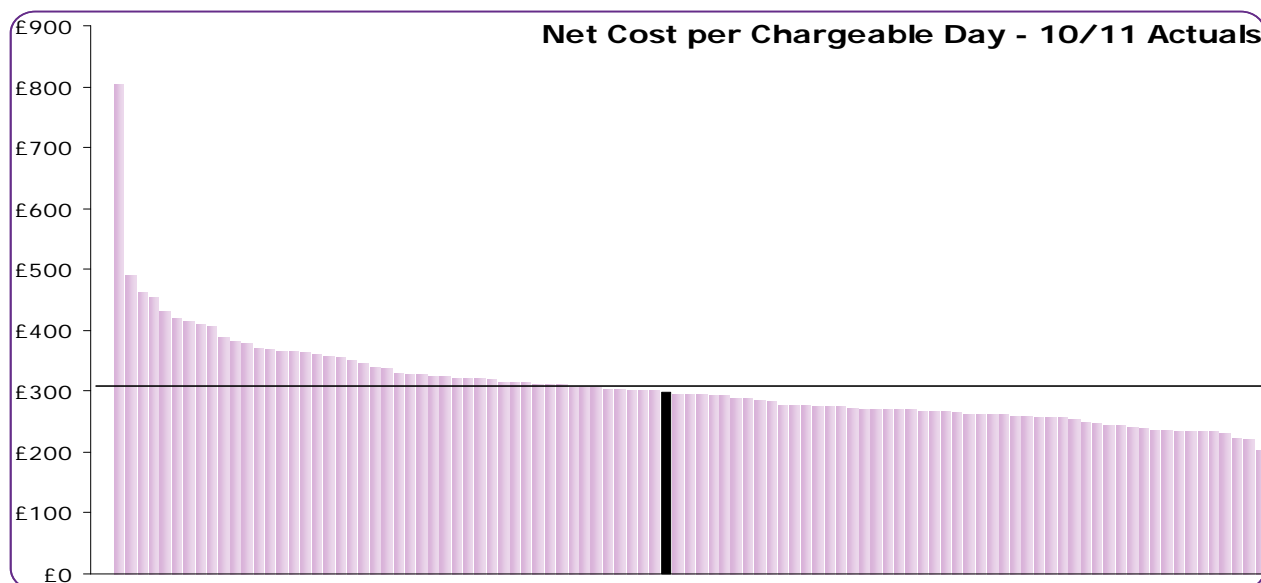
4.5 In order to deliver this type of work to the standard required, investment has been made in the professional development of staff, with all bar one member of the current team a professionally qualified accountant or holding the equivalent internal audit qualification (Institute of Internal Auditors).

Benchmarking – Costs

4.6 The two main cost measures for an internal audit service are cost per £m turnover (expenditure) and cost per audit day. As explained above, the service has reduced in size considerably in recent years with a corresponding reduction in the cost of the service from £985 per £m turnover in 2005/06 to £608 in 2010/11, a reduction of almost 40%. This compares to the national average for all authorities as follows:



4.7 In terms of cost per audit day, this has also reduced from £362 in 2005/06 to £299 per day in 2010/11. This is based on a high level of productivity being delivered by the internal audit team of 187.4 days per year, against a national benchmarking average of 174.4 days. The cost per day compares to the rest of local government internal audit teams as follows:



4.8 Research was also undertaken amongst members of the Home Counties Chief Internal Auditors Group, which incorporates all members of the SE7, as to the daily costs of audit services purchased from external providers. The responses received were limited, primarily due to other authorities not buying in any externally provided audit services or due to the daily rate information being deemed commercially sensitive. However, based on those responses obtained, the average outsourced daily rate for general audit work was £308.75 and for specialist work (such as ICT audit) £436.00 per day. As set out above, the in house cost per day at ESCC is currently £299.

4.9 A recent survey of members of the Home Counties Chief Internal Auditors Group has shown that ESCC external audit fees are lowest amongst the eight authorities who responded (covering authorities with gross expenditure ranging from £85m to £2.3bn) and nationally, ESCC has the fourth lowest external audit fee among all county councils.

4.10 On the basis of this work and discussions with the external auditor (PKF), it is clear that there is a relationship between the higher quality and cost of internal audit and lower external audit fees. This relates, at least in part, to the level of reliance the external auditor is able to place on the work of internal audit. At ESCC, the level of reliance is high, as confirmed by PKF. Another key factor influencing the level of external audit fee is the risks faced by the organisation and benchmarking data clearly shows that ESCC internal audit activity is amongst the highest for county councils in the extent to which it focuses on the Council's strategic risks.

4.11 Historically, external audit have undertaken a triennial review of internal audit to assess the service against the CIPFA Code of Practice. The last of these reviews reported on the effectiveness of internal audit and made no recommendations for improvement.

Performance

4.12 Currently, internal audit performance is measured and reported on a regular basis via a range of local performance measures (some of which are published as part of quarterly progress reports to COMT and ABVCSSC). Whilst some of the data from CIPFA benchmarking is utilised in measuring performance, these results focus primarily on cost and quantitative (economy / efficiency) measures and therefore do not provide a complete picture as to the effectiveness of the service.

4.13 The current set of internal performance measures, along with the latest results, is set out in the table below.

Performance Measure	Annual Target	Current (Qtr 2)	Status
Economy			
Cost of IA per £m revenue budget.	<£739	£608	
Benchmarked direct cost per audit day.	<£290	£299	
Efficiency			
Planned audits completed = final reports issued.	>90%	46.2% (Qtr 2)	
Percentage of plan days delivered.	>90%	47.1%	
Overall productivity exceeds annual target.	>78%	82.5%	
Delivery of audit assignments within 105% of agreed time allocation.	<105%	97.4%	
Effectiveness			
At least maintain proportion of staff with PIIA or higher qualification, all of which are subject to CPD.	>90%	92%	
Recommendations accepted.	>90%	99.2%	
Overall positive customer feedback rating.	>87%	89.5%	
Continued external audit reliance on the work of internal audit.	Achieve	Achieved – PKF Report to ABVCSSC 1.9.11	
Quarterly and annual audit reports to Chief Officers and Members.	Achieve	Achieved	
Percentage of draft reports issued within 2 weeks of completion of the audit fieldwork.	>90%	82.5%	
Percentage of final reports issued within 1 week of client agreement to draft report.	>90%	83.3%	

N.B: Remedial action is being taken in relation to all those targets not currently being met.

4.14 Whilst the above performance indicators cover a range of areas, one of the most important measures of internal audit performance is that of quality, assessed principally through customer satisfaction and compliance with professional standards. A key consideration as part of this service review has therefore been the adequacy and effectiveness of the current range of performance indicators and this is an area where a recommendation for improvement has been made later in this report.

4.15 As part of arrangements for ensuring that the internal audit service continues to develop and identifies opportunities to improve based on best practice, representatives regularly attend and contribute to local and national networking groups. Specifically, the Assistant Director – Audit and Performance is currently Chair of the County Chief Auditors Network whilst the Principal Audit Manager is Chair of the Home Counties Chief Internal Auditors Group. One Audit Manager from the team also attends the Sussex Audit Group.

Consultation / Customer Focus

4.16 In broad terms, the service review stakeholder consultation process has been focussed around the following key questions:

- *What is the view of current service provision?*
 - Overall, the responses from stakeholders were positive about the quality of the current service, with particular value placed on the proactive advice and support provided on major projects and developments. Many explained that the service is continuing to be more flexible and pragmatic in its approach and that liaison and communication with customers is effective, including the quarterly reporting arrangements to COMT and ABVCSSC. There is a high level of satisfaction with the audit planning process and subsequent coverage as set out within annual audit plans. A number of consultees commented on the need to improve internal audit performance indicators, with less emphasis on quantitative measures, and also on ensuring that all recommendations deliver sufficient value, focussing on 'real risk'.
- *What are the needs and expectations from internal audit?*
 - Whilst stakeholders appreciate the importance of internal audit providing a challenge to management and assurance in areas such as regulatory compliance and the risk of fraud, it is clear that they also expect the service to be supportive and pragmatic in delivering its activities. Management in particular felt that an effective internal audit service should be flexible and proportionate, with a clear recognition of the need to balance risk with the cost of any controls intended to mitigate them. Quality of work was highlighted as having a clear priority over quantity, with many emphasising the value placed on internal audit having a sufficient understanding of the organisation, its culture and risk appetite.
- *What improvements could be made to the service to better meet these needs?*
 - Some of those consulted felt that there was still insufficient understanding within the organisation of what internal audit does and what it can offer. This could be improved with a more clearly articulated service offer / mission statement, encompassing user friendly language about the service and its values. As explained above, internal audit performance measures should be refocused on more qualitative aspects of the service. Whilst some officers commented on the potential to shorten the quarterly progress reports to COMT and ABVCSSC, the Chair of ABVCSSC identified these as being of particular value in terms of length and coverage. There was a general consensus among stakeholders that utilising external specialist resources would be of value but that this would be most effective when delivered in conjunction with an in house service i.e. utilising skills and experience from other organisations whilst maintaining the benefits of knowledge and understanding of the County Council. Finally, some consultees felt that further improvement could still be made to ensure audit recommendations add sufficient value and that opportunities are taken to share the lessons from individual reviews with the rest of the organisation.

Peer Review

4.17 As explained above, the Chief Internal Auditors from Dorset County Council and Somerset County Council have provided the external peer review to this service review, utilising their own knowledge and experience of managing an internal audit service, delivered both via an in-house model and more recently via a shared service. Overall, they have endorsed the review findings and recommendations and, where comments and feedback have been provided, these have been reflected throughout this report.

5. Outcomes and Investment

5.1 In addition to previous decreases in the size of the internal audit service, further budget reductions will be made over 2012/13 in accordance with CRD savings plans. Service priorities have therefore been identified based on both the remaining cash limited investment and the results of this service review. These have been articulated within the following draft mission statement for internal audit:

'Internal audit is an independent assurance function which conducts reviews and provides advice, support and challenge to the organisation on risk, governance and internal control matters. In achieving this, the service aims to:

- Deliver a high quality, cost effective service in line with best practice and professional standards;*
- Work constructively with management to support new developments and major change programmes;*
- Be pragmatic and proportionate with its recommendations, having regard not just to risk, but also the cost of controls;*
- Be flexible and responsive to the needs of the organisation in all its work.'*

6. Service Options Considered

6.1 Having regard to all of the above evidence, a range of potential service delivery models have been considered as part of this review and each of these is commented on below:

Option A – Cease the Service

6.2 This is not considered a viable option on the basis that internal audit is a statutory function in local government as defined within the 1972 Local Government Act (S151) and the Accounts and Audit Regulations 2011. This is also supported by the results of the stakeholder consultation process referred to above, whereby all of those consulted recognised the value and benefits of an effective internal audit service.

Option B – Fully In House Service

6.3 The service has historically been delivered by an in house team but this has reduced in size significantly over recent years. Whilst the quality of the service is considered to be good, some difficulties have been experienced in recruiting and maintaining the right calibre of staff. This is particularly the case in specialist areas such as ICT and contract audit. The main advantages and disadvantages of a fully in-house service have been set out below.

Advantages:

- knowledge of the organisation, its systems, culture and risk appetite;
- development of strong working relationships with management;
- more reactive, particularly in relation to ad hoc advice and support;
- greater focus on quality than where services are delivered through an outsourced contract i.e. less focus on the time taken;
- opportunity to make use of the skills and experience of internal audit staff elsewhere in the organisation.

Disadvantages:

- need for investment in training and development to ensure the necessary skills sets are maintained;
- time, cost and effort involved in recruitment, selection and management of staff;
- potential for the service to be less objective and independent than an outsourced provider.

6.4 Whilst a fully in house internal audit service can still be delivered within a reduced budget, in line with corporate and departmental savings plans, this will result in a reduction in staff, exposing it to an increased risk of being unable to respond to the needs of the organisation, both in terms of available skills and experience and business continuity in the event of further staff loss.

Option C – Fully Outsourced Service

6.5 There are a range of potential providers of internal audit services across the country, delivering contracted services either on an ad hoc basis, partially outsourced or fully outsourced.

6.6 Anecdotal evidence, obtained through discussions with colleagues and based on ESCC's own experience of using outsourced providers, is mixed with regard to the quality of work. This is particularly the case for the more general, non specialist audit activity where contractors have tended to use newly qualified, less experienced and therefore, cheaper staff. Where external providers are used for specialist work such as ICT audit, feedback on quality is more positive.

6.7 In terms of cost, based on the rates currently paid by ESCC as part of the London Borough of Croydon framework contract with Deloitte, and the limited amount of information it has been possible to obtain regarding other local government internal audit contracts, the outsourced daily rates, at around £300 per day, are roughly comparable with the current in house cost per day (£299). There are certain issues to be aware of however, when making this comparison. Firstly, the in house cost per day is the average cost based on all grades of staff within the service, from Auditor through to Principal Audit Manager and covers all work carried out by the team, including fraud investigation and contract audit. The approximate rate of £300 for an outsourced provider tends to cover general audit work only with any of this specialist work being charged at a higher rate. Secondly, in outsourcing an internal audit service, the organisation will also need to consider any client side costs associated with managing a contract of this kind, over and above the direct cost of the contract.

6.8 The main advantages and disadvantages of a fully outsourced service have been set out below.

Advantages:

- provides access to wider pool of staff, offering more expertise, particularly in specialist areas;
- opportunity to access knowledge and experience from other organisations with whom the contractor also works;
- flexibility in terms of resourcing work, subject to other contractual commitments and cost;
- no recruitment, selection or retention issues for the local authority.

Disadvantages:

- contractor knowledge of the organisation, its people, culture and risk appetite is likely to be less, thereby impacting on quality and customer satisfaction;
- greater focus on profitability, with focus on delivery of work within time budgets potentially at the expense of quality and depth;
- the audit staff working on each contract are more likely to differ from year to year, increasing the potential workload for auditees, particularly where auditors need to develop an understanding of systems;
- potential for external providers to be less responsive.

6.9 At this stage it is not possible to accurately calculate the cost of a fully outsourced service, principally due to the number of factors which would need to be determined in advance. Specifically, the nature of the work required, the number of audit days to be delivered and the state of the marketplace at the time. However, based on the very small number of indicative rates obtained as part of this review, to deliver an audit plan of the current size, the cost is likely to be comparable or slightly higher, with the additional client side costs to also be added. As far as the future of current in house staff are concerned, this would need to be determined but is most likely to involve a TUPE transfer to any outsourced provider.

Option D – Partially Outsourced/Co-Sourced Service

6.10 This option would involve delivering the service via a combination of an in house team and externally provided services. Whilst for this option to be financially viable, the size of the in house team would have to be smaller, the specific ratio between in house and external provision would need to be determined.

6.11 A partially outsourced/co-sourced service would offer the majority of the advantages of both a fully in house and fully outsourced model, whilst also mitigating many of the potential disadvantages of each option. In particular, this service model would enable the Authority to access a wider range of skills, including specialist activities provided via framework agreements, whilst maintaining the knowledge of the organisation, culture and risk appetite. It will ensure that the service remains responsive to clients needs with quality and depth of coverage a priority, but will also offer increased flexibility through alternative resourcing options. This arrangement will include ensuring appropriate knowledge transfer to County Council audit staff and allowing the in house service to access specialist professional briefings provided by many of the larger audit firms.

6.12 As with a fully outsourced service, determining the cost of a co-sourced model would depend on a number of factors and is therefore not possible to accurately calculate at this stage. Whilst there is a potential that the daily rate for external specialist services may be higher, these resources would only be commissioned as and when required. The contract management role for this work would be performed by the in house team, thereby limiting any additional client side costs.

Option E – Shared Service

6.13 There are clear benefits of a shared service model and this is something which ESCC Internal Audit are continuing to explore with neighbouring authorities at both a district and county/unitary level. When implemented successfully, this option has the benefits of improving business resilience by increasing the pool of available staff whilst also delivering potential service efficiencies and cost savings.

6.14 There are, however, issues which must be considered and carefully managed in order to achieve the full benefits of a shared service. These include:

- Quality – like any other service, internal audit teams deliver work to different standards and this is likely to have an impact on the client when bringing two or more teams together of differing standards, especially during the early stages of any new shared service arrangement;
- Geographical location – even with modern technology and new flexible working arrangements, there remains the need for auditors to be on site to conduct reviews. This has the potential to increase travel time and cost, especially where the service covers a wide geographical area. Whilst it would be possible to have teams based at each authority, this has the potential to reduce some of the benefits of a shared service, particularly in terms of resilience and making best use of all available skills and experience;
- Culture and Risk Appetite – organisations, even those of a similar size and geographical location, have the potential to be quite different in terms of culture, risk appetite and expectations from internal audit.

6.15 To date, agreement has been reached with Brighton and Hove City Council and West Sussex County Council to develop increased collaboration and joint working arrangements. Initially, this is focussed on making the best use of available skills and resources across the teams, especially in terms of building future resilience. This work is also likely to include:

- The agreement to a shared vision for closer working;
- Establishing a pool of audit staff able to work across all the authorities, with shared management arrangements (where appropriate);
- A jointly funded graduate trainee programme;
- Joint procurement and licensing of audit automation software;
- Joint training programmes for staff.

6.16 It is anticipated that, in the short term, the shared service activities set out above will not provide significant financial savings, principally because they are focussed on providing increased business resilience at a time when local services are being reduced. In the medium to long term however, it is hoped that financial benefits will be realised, especially if these arrangements develop into more formal shared services. Separate discussions are also continuing with colleagues across the district and borough councils within East Sussex over the potential for closer working. So far, limited progress has been made, although liaison is ongoing and it is hoped that opportunities may arise sometime in the future.

6.17 Whilst efforts are clearly being made to work more closely with neighbouring internal audit teams, it is important to recognise that currently no viable local shared service arrangement exists which ESCC could join. Such a partnership would therefore need to be constructed and this would take time and careful management, especially if this is not to be to the detriment of service quality, which is something stakeholders have clearly identified as a high priority.

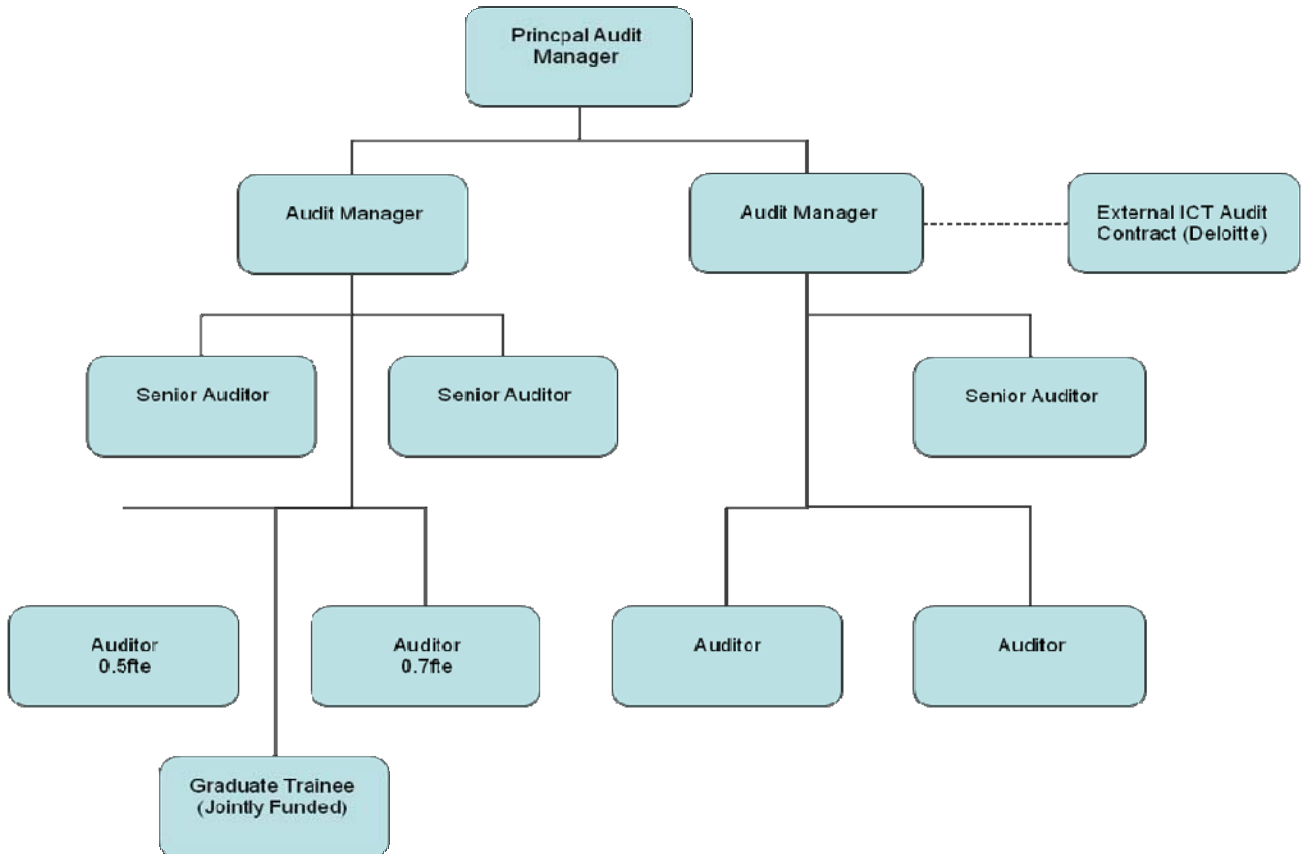
6.18 Where internal audit services are provided fully or partially through an in house team, efforts continue to be taken to generate further external income through selling audit services to other organisations. Whilst some contracts are already in place, management have developed a clear service offer to new academies and have experienced early success in winning these contracts. This work has been costed and charged for an appropriate rate in order to reduce the overall net cost of the audit service to the County Council.

7. Recommended Future Approach

7.1 Based on the findings of this service review, it is recommended that:

- a) The draft mission statement in paragraph 5.1 above be adopted as the basis for the future delivery of internal audit services at ESCC;
- b) This service is delivered initially through a partially outsourced/co-sourced arrangement as explained in Option D above. Primarily this will involve a smaller core in house team, supplemented with externally provided specialist services;
- c) Internal Audit continue to develop closer working arrangements with B&HCC and WSCC internal audit teams, with a view to improving future resilience and, wherever possible, further reducing costs. Initially, this is to involve initiatives such as jointly funding new posts and the pooling of existing staff;
- d) In addition to the activity within c) above, Internal Audit should continue to explore the opportunities for more formal shared service arrangements with all potential partners, including district and borough councils within the region;
- e) Where it is in the best interest of the service to do so and where it does not impact on delivery of the core service to the County Council, efforts should continue to be made to maximise income generation by selling internal audit services, including to major public sector organisations in the region and new academies;
- f) Current internal audit performance measures should be reviewed and updated to include an annual consultation with key stakeholders on internal audit service quality, with results and associated actions to be reported annually;
- g) Wherever relevant, key findings from individual reviews should be communicated across the rest of the organisation to enable lessons to be learned more widely;
- h) The service should continue to review internal working practices and explore more innovative ways of working in order to deliver further efficiencies and improve the value of audit recommendations.

7.2 Should the recommendation in 7.1(b) above be agreed, this would be based on the revised structure set out below and would provide further savings of £60,000, over and above the £40,000 of savings delivered in 2011/12. These additional savings would be achieved even when allowing for increased investment in external resources to support the smaller in house team:



7.3 The recommendations made in this report are ultimately focussed towards making the transition, on a carefully managed basis, towards an eventual internal audit shared service model. It is, however, essential that this activity takes place on the principle of ensuring the best interests of the County Council are maintained and that it does not result in any detrimental impact on service provision.

8. Customer Impact and Equalities

8.1 The recommendations set out above have the primary objective of ensuring that the organisation continues to receive a quality internal audit service and that service continuity is maintained at a time when significant cost reductions are delivered. It is therefore anticipated that the impact on customers will be limited, subject to:

- The effective management of contracts where audit services are delivered via external providers;
- The existence of a sound business case to support any formal shared service arrangement, particularly with regard to the potential impact on service quality.

9. Next Steps

9.1 Subject to the agreement of the above recommendations, a more detailed implementation plan will be developed in conjunction with staff and potential partners, including B&HCC and WSCC. Progress will be reported on a regular basis to COMT and ABVCSSC via quarterly Internal Audit Progress Reports.

10. Lessons Learned

10.1 Whilst in this case the service review was delivered by the head of service, contrary to the corporate guidance (which was not finalised until after the review was well in progress), having someone involved who is close to the service area was very important in ensuring the various professional and practical requirements were properly considered throughout. The necessary independence and objectivity was however obtained by making sure that the review had:

- A Project Board which included senior managers from other departments;
- Independent internal challenge throughout (Shan Allan, Chief Executive's Office);
- Robust external peer review from professionals working in the internal audit sector, including those who have experience working with alternative service delivery models;
- Quality data and evidence to support the findings, including national benchmarking.

10.2 The following suggestions could also be considered for future reviews:

- Ensuring that Project Board membership includes managers from other service departments, including some who do not necessarily have any connection with, or experience of, the service concerned;
- Establishing a pool of managers who have had experience in delivering service reviews who can act as a point of advice, support and challenge for others involved in carrying out reviews.