

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	26 th February 2015
DIRECTOR	Ewan Sutherland
TITLE OF REPORT	Transition to Shared Internal Audit Services
REPORT NUMBER	CG/15/23
CHECKLIST RECEIVED	Yes

1. PURPOSE OF REPORT

The purpose of this report is to advise members of arrangements being put in place to manage the transition to a shared Internal Audit Service with Aberdeenshire Council.

2. RECOMMENDATION(S)

that the Committee:–

- (a) Note the ongoing work to manage the transition from an outsourced internal audit service to a shared service between Aberdeen City and Aberdeenshire Councils.

3. FINANCIAL IMPLICATIONS

The current expenditure on Internal Audit is approx. £400,000 p.a. The proposal from Aberdeenshire Council identifies potential savings of £217,000 p.a. However, this is subject to the level of audit coverage required.

4. BACKGROUND/MAIN ISSUES

- 4.1 This Committee and the Council's Finance, Policy & Resources Committee have agreed to the development of a shared Internal Audit Service between Aberdeen City and Aberdeenshire Councils. Officers are currently working on designing and implementing transition arrangements which will ensure continuity of the function.

4.2 TRANSITION

Officers from both Councils have met, together with representatives from PWC to plan and begin the transition from, in the City Council's case, externally sourced provider to a shared resource.

A project plan has been prepared by Aberdeenshire Council for the actions which need to be undertaken in order for the new shared service to be effectively implemented. There are 6 key areas within the plan:-

Requirement	Status
Agreement and commitment from both Councils.	The proposal has been approved by both the Audit & Risk and Finance, Policy & Resources Committees of Aberdeen City Council. Aberdeenshire Council's Scrutiny and Audit Committee and Policy and Resources Committee have approved the proposal.
Formal Mechanism to Share	Discussions have progressed with colleagues on the most appropriate model for a shared service. Advice has been sought from Procurement colleagues and options are being prepared.
Staffing	Aberdeenshire Council have commenced recruitment of additional staff with appointments expected in January or February 2015. Induction and training of staff will be carried out prior to commencement of the new shared service.
Audit Planning for 2015/16	A number of points have now been agreed by officers and PWC:- i. PWC will complete all reviews within the 2014/15 Internal Audit Plan. Any reviews included in the 2014/15 Plan which are not completed by 31st March 2014 will continue to be the responsibility of PWC unless both Councils agree to these being passed to the new shared service; ii. PWC will include the new shared service in the preparation of the scoping of all reviews

	between now and the establishment of the new service; iii. PWC will include the new shared service in final review and “close out” of all reviews between now and the establishment of the new service; iv. The Chief Internal Auditor for Aberdeenshire Council has led on the preparation of an audit plan for Aberdeen City Council in 2015/16 which is reported to this Committee. v. PWC will undertake and submit to the Committee in June 2015 the required annual opinion, in accordance with the Public Sector Internal Audit Standards (PSIAS), based upon and limited to the work performed, on the overall adequacy and effectiveness of the Council’s framework of governance, risk management and control.
Physical and ICT Requirements	Plans are being progressed to ensure that the transition is supported by early and effective arrangements to put in place all practical elements relating to access, accommodation, ICT, communications, management, etc.
Methodology and Reporting Arrangements	The attached proposal from Aberdeenshire Council outlines the methodology envisaged for the new shared service. A proposed new Internal Audit Charter is included in the agenda for the Audit, Risk and Scrutiny Committee for approval.

5. REPORT AUTHOR DETAILS

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PROPOSAL FOR A SHARED INTERNAL AUDIT SERVICE BETWEEN ABERDEENSHIRE AND ABERDEEN CITY COUNCILS

Internal Audit

The Public Sector Internal Audit Standards define internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. A professional, independent and objective internal audit service is one of the key elements of good governance, as recognised throughout the UK public sector.

The Local Authority Accounts (Scotland) Regulations 2014 will make it mandatory to have an Internal Audit service complying with recognised standards and practices.

Vision

This document details a proposal for a shared Internal Audit Service between Aberdeenshire Council and Aberdeen City Council based on the current Aberdeenshire model. Although the proposal is for the staff of the Internal Audit Section to be employed by Aberdeenshire Council, the Section will be a shared resource and will be committed to providing a professional service, complying with Public Sector Internal Audit Standards, to both Councils.

The vision is for the Section to be embedded in, and be an integral part of, both Councils. It will be flexible in service delivery, with the ability to substitute planned works with other works that emerge as a requirement during the year, subject to the Chief Internal Auditor being satisfied that an annual Internal Audit opinion can be delivered. It will not be an external agency to either and will adhere to the requirement to report independently, without fear or favour.

Both Councils provide broadly similar services and by being embedded within both Councils, unlike an external service provider, best practice that is identified in each will be able to be shared for the mutual benefit of both, with the potential to enhance and embed more cost effective processes and procedures, and assist in identifying further areas for shared services, helping both Councils achieve their drive for Best Value and improvement.

It is acknowledged that the ways of working detailed in this document will be different to those currently in place in Aberdeen City Council, and that it will take time for these changes to become accepted and embedded. However, it is anticipated that both Councils will benefit from the proposed shared arrangements.

It is the intention that Aberdeenshire's Internal Audit will provide a service to the Aberdeenshire Health and Social Care Partnership and, should this proposal result in a shared Internal Audit service, it will provide the base for proactively seeking opportunities with existing and other public sector partners in relation to Internal Audit provision.

Aberdeenshire Internal Audit – Background

Aberdeenshire's Internal Audit has been provided in-house since Local Government re-organisation in 1996. Being a part of the Council's structure, and available every day, allows strong professional relationships to develop with other staff in the organisation. This has helped with the dissemination of best practice through the provision of advice outwith the formality of Internal Audit's reporting structure and format. Many improvements in systems, understanding and compliance have been made through these channels.

There is a wide range of experience within the Internal Audit Section at present. The Chief Internal Auditor has worked in Local Government Internal Audit since 1986, having commenced his career in Aberdeen District Council. In the shadow year leading to Local Government re-organisation in 1996, he was the Acting Chief Internal Auditor of the City of Aberdeen District Council, and has been the Chief Internal Auditor with Aberdeenshire Council since then. During the period of its existence, the Chief Internal Auditor also held this role with Grampian Fire and Rescue Service through a shared service arrangement.

The two Senior Auditors have been with Internal Audit for six and two years respectively, having previously both worked in Aberdeenshire's Finance Service. Both are professionally qualified, are required to undertake professional CPD, and bring previous experience of Local Government Internal and External Audit to the Team.

The Assistant Auditors have experience of Internal Audit ranging from one to more than twenty years. Some are pursuing professional qualifications and all are subject to quarterly reviews by their line manager as part of Aberdeenshire Council's career development scheme for Assistant Auditors and Accountants.

Trainee Accountants studying for the CIPFA qualification regularly gain the required experience of Internal Audit through working in the Section, and this has included a trainee from NHS Grampian successfully fulfilling the requirements through working in the Aberdeenshire team.

A decision was taken a number of years ago that there would be no specialist audit resources (eg Computer or Contract Audit) in the team, with each member of staff tackling these types of audits as part of their job. However, an Assistant Auditor regularly attends meetings of the Computer Audit Sub-group of the Scottish Local Authorities Chief Internal Auditors' Group which helps bring current issues to the Section's attention. Inevitably, some staff display certain skills in relation to specialist audits and these are shared throughout the team.

The Council's external auditors have consistently stated that they have been able to place reliance on the work of Internal Audit.

Internal Audit Resourcing

Aberdeenshire Council's Internal Audit Section currently has an establishment of eleven posts comprising the Chief Internal Auditor, two Senior Auditors and eight Assistant Auditors. The Section is currently two Assistant Auditors short of full establishment with one vacancy being advertised at present and one member of staff on a short-term secondment.

It is proposed that the Section be brought up to establishment and, if the proposal for a shared service is agreed, to recruit two further Assistant Auditors. The revised structure is planned to produce around 2,400 audit days which would initially be split between Aberdeenshire and Aberdeen City Councils in the ratio of 1,600:800. Aberdeenshire Council currently receives 1,900 Internal Audit days per annum whilst Aberdeen City Council has, for 2014/15, 608 days plus Chief Internal Auditor input. The reduction in days for Aberdeenshire Council will be achieved, without impacting on the level of assurance provided, through developments currently being worked on within the Team.

Aberdeen City Council's officials believe that, should current arrangements with PWC continue, their Internal Audit costs will decrease. However, it is anticipated that a shared Internal Audit service will reduce the cost of Internal Audit between the two Council's by £270,000 per annum (Aberdeen City Council £217,000, Aberdeenshire Council £53,000). However, it may be prudent not to take the full amount of these anticipated savings in year one of the new arrangements. The costs are based on staffing and incidental costs, and do not include any on-costs or central administration recharge which, in the spirit of partnership working through a shared service, are not intended to be included.

As with any Council Service, there may be challenges with recruitment and retention. Aberdeenshire has been successful in maintaining an Internal Audit resource which has enabled improvements to be made and for an annual opinion on the Council's control environment to be adequately supported. Should challenges with recruitment and retention arise in future, this will impact on the levels of planned work that can be undertaken and completed.

Internal Audit Planning

The proposal is that a shared Internal Audit Service commence with effect from 1 April 2015. In order to achieve this, there are some vital steps that need to be completed. The first is to obtain agreement from each Council's senior management and relevant Council Committees. Subject to senior management approval, it is planned that reports requesting approval of the arrangements will be submitted to appropriate Committees in September 2014.

Assuming that approval is given to progress, there are a number of other stages that need to be completed including agreement of an Internal Audit plan for Aberdeen City Council, and ensuring that adequate resources are in place to undertake the work.

Aberdeenshire Council has a rolling three year plan in place which is reviewed annually through consultation with senior management. The plan is agreed by the Council's Scrutiny and Audit Committee around the end of each financial year so that the impact of

the previous year's work can, as far as possible, be taken into account. Aberdeen City Council has an annual plan that is determined through consultation with senior management and approved by the Audit and Risk Committee. It is proposed that, in the first instance, a one year plan for Aberdeen City Council will be developed by Internal Audit, with consultation with appropriate senior management, and that this be submitted to the Audit and Risk Committee in February 2015 for agreement. The results of the work contained therein would assist in informing future three year rolling plans which would be presented to Committee for agreement around the end of each financial year.

There will be differences between the two Councils in terms of governance and control arrangements, and the expectations of senior management and elected members. Aberdeenshire Council's Internal Audit Section would have to gain an early understanding of Aberdeen City Council's control environment and governance arrangements and it is proposed that this commence prior to the formal start of any shared arrangements.

In order to achieve this, and to inform the first year's Internal Audit plan, Internal Audit would engage with specific officers of Aberdeen City Council including the Chief Executive, Directors, Head of Finance, and Risk Manager. Discussions would also be held with Audit Scotland, the Council's current external auditor, and with the Council's current Internal Audit provider, PWC. Whilst such consultation is vital in forming the plan, it is important that the plan is that of the Chief Internal Auditor in order to comply with Public Sector Internal Audit Standards which require that the 'Chief Audit Executive' report on any limitations to the scope of his or her work.

Discussions with PWC would include reviewing their progress against the current Internal Audit plan and determining, in consultation with management, how and by whom any work that may not be commenced or complete by the end of the 2014/15 financial year should be progressed.

The above process will assist in identifying the areas of risk over which Internal Audit will need to review and provide assurance regarding the systems in place to control and mitigate risk, along with those areas where Internal Audit will need to gain an understanding and satisfy itself that they are working adequately.

The draft plan would be produced by Internal Audit and would cover the Council's General Fund, Common Good, HRA, Pension Fund and a small amount of assurance work over the group structure (i.e. ALEOs). This would be circulated for discussion to the Chief Executive, Directors, and Head of Finance before being submitted to the Audit and Risk Committee for approval. Although such discussions have not yet taken place, Internal Audit currently anticipates that the plan would include the audit of some of the Council's main financial systems, to establish and evaluate the controls in place, and also to assist Internal Audit gain a better understanding of the Council's control environment, along with some cross cutting reviews of the main transactional data streams (payments, payroll, etc) to determine the level of compliance with policies and procedures, achievement of best value, and assist in identifying areas that would justify more detailed examination in future.

Aberdeen City Council's current Internal Audit plan includes commencement and completion dates. It is not anticipated that future plans would include dates for each

assignment as this can be impacted on by factors outwith the control of Internal Audit. This will assist with Internal Audit being flexible and being able, as far as is practicable, to work around issues which may prevent the commencement or conclusion of work to a pre-planned timetable.

The level of planned input for each audit will be based on a risk based approach and assume that systems are adequately documented, detailing the controls put in place by management, and that testing identifies that these controls are being complied with. If this is not the case, there will be an impact on the time taken to review a given area, and this will impact on the achievability of the plan.

It is usual in any given year for additional work to be required, either within the planned work, as additional work requests due to issues arising during the year, or specific investigations into, for example, suspected financial irregularities. Although a contingency element will be built into the Internal Audit plan for each Council, it is possible that this allowance may not be sufficient. The Internal Audit Section has always planned at a high level within the available resources in the past to ensure that should additional work through planned work, additional work requests, or investigations does not materialise, then there is sufficient planned work agreed.

It will be for the Chief Internal Auditor to manage the competing demands between planned and additional works, between both Councils, and to report as appropriate to management and relevant Committees. This may mean that, as has regularly been the case in the past, agreed planned work may move from one year to the next, and that the allocation of resources and costs between the two Councils may change.

A copy of the most recent report to Aberdeenshire's Scrutiny and Audit Committee seeking approval of the current three year Internal Audit plan is attached for information. This provides further details on how the plan was developed but it should be noted that this plan is based on approximately 1,900 audit days per annum.

Audit Methodology

Aberdeenshire Council's Internal Audit Section has an Internal Audit Charter, approved by the Council's Scrutiny and Audit Committee. There are some differences between this and that approved by and for Aberdeen City Council. It is seen as essential to the efficient provision of a service that Internal Audit operates in the same way, as far as practically possible, within both Councils, and that any differences do not impact on this. In view of this, it is proposed that Aberdeenshire's Charter be presented to Aberdeen City Council's Audit and Risk Committee for approval in February 2015. A copy of Aberdeenshire's Internal Audit Charter is attached for information.

Aberdeenshire's Internal Audit methodology is designed to comply with the requirements of the Public Sector Internal Audit Standards. At the commencement of each planned audit, contact is made with the appropriate Service's nominated officer for that audit in order to establish whether there are any particular issues that they are aware of that need to be specifically covered and to advise of Internal Audit's scope and objective for the audit. Although this will be detailed in the Internal Audit plan, and will be discussed at the commencement of each review, if issues are identified during Internal Audit work that

are outwith the originally planned scope, that Internal Audit believes should be included in its work, this will be the case.

Systems of control under review will be documented either by flowcharting or narrative description. Ideally, Services will have such documentation in place and the planned level of Internal Audit resource assumes that this is the case. The controls that management have put in place are then evaluated to determine if they are sufficient. Specific testing of these controls is then undertaken to ensure compliance and, where appropriate, determine whether best value is being achieved.

Internal Audit Outputs

The results of testing will be discussed with management during the course of the review and at the conclusion of testing. A draft report will then be prepared and issued detailing relevant findings and any recommendations for improvement. Aberdeenshire Council's Financial Regulations require Services to provide a full response to draft Internal Audit reports within one calendar month, and it is proposed that this be adopted in relation to Aberdeen City Council. Final reports would be issued to the responsible Service Director, Head of Service, and Service Manager, the Head of Finance, External Auditor, and Risk Manager, and any others as appropriate.

The results of each planned assignment will be reported, in summary, to the next available Committee. Currently, Aberdeenshire's Internal Audit reports are submitted to the relevant Policy Committee and then the Scrutiny and Audit Committee. It is proposed that this arrangement, believed to be unique in Scotland, is reviewed. Internal Audit output relating to Aberdeen City Council would be reported as soon as is practically possible to the Audit and Risk Committee.

The Chief Internal Auditor will report, independently, in his or her own name.

The agreed recommendations from each report will have an implementation date agreed with the responsible Service. These will be followed up by Internal Audit and progress with implementation included in reports to the Audit and Risk Committee.

Internal Audit currently reports progress against the plan to the Scrutiny and Audit Committee twice each year; once in December and then following the year end. It is proposed that this be the case for Aberdeen City Council. A number of performance measures are in place within Aberdeenshire's Internal Audit Section and these will be reported as required.

All of the planned work undertaken, along with any additional work and the work of other assurance providers will be considered in completing Internal Audit's annual Internal Financial Control Statement which will feed into the Head of Finance's Governance Statement in the Council's Accounts. Internal Audit's annual report to Committee will include the annual Internal Financial Control Statement.

Sample reports to Aberdeenshire's Scrutiny and Audit Committee relating to Internal Audit's regular output, and presentation of Internal Audit's annual report, including performance data, are attached for information.

Reports to the Scrutiny and Audit Committee have resulted in the Committee holding specific Workshops to further investigate matters arising from Internal Audit work. These workshops supplement the Committee's own review and investigation process and helps ensure close working between those Members and Officers charged with scrutiny responsibilities.

As mentioned above, the Council's external auditors have consistently stated that they have placed reliance on Internal Audit's work. Recommendations made by the Team for improvements in systems, controls and compliance have, in part, helped the Council maintain a record of having an 'unmodified' audit certificate from external audit.

In addition to the assurance work undertaken by Internal Audit, there have been many improvements made over the years as a direct result of Internal Audit work. These include:

- Significant improvements in the management of Housing stocks which had a history of requiring material adjustments at each year end.
- Introduction of a Corporate Travel Team to help standardise procedures and drive down costs through creation of a centre of excellence.
- Introduction of hire and pool cars to drive down travel costs achieved through recommendations and trialling a hire car scheme.
- Changes in the way mileage can be claimed by staff using their own vehicles on Council business which will save around £250,000 per annum when introduced.
- Improvements in the timing and procurement methodology for ICT equipment in schools resulting in better planning and the ending of 'year-end spend'.
- Raising awareness of the requirements of Financial Regulations and procurement related legislation through a number of audits which has led to an on-going review of the Regulations and enhanced training for management which should result in improved compliance.
- Raising awareness of the requirement to demonstrate transformational project success factors through an appropriate benefits realisation tool which is now being implemented.

Quality Review

The Public Sector Internal Audit Standards require that each Internal Audit Section undertake an annual self-assessment of its compliance with the Standards. CIPFA has produced a detailed checklist to assist in this being done and Aberdeenshire's Internal Audit Section undertook such a review in relation to 2013/14. This can be made available if required.

A further requirement of the Standards is that an external assessment be undertaken on a five yearly cycle. Aberdeenshire's Scrutiny and Audit Committee has approved Internal Audit's involvement in a national scheme being devised by the Scottish Local Authorities Chief Internal Auditors' Group whereby an external assessment would be undertaken on a four yearly cycle by another Council's Chief Internal Auditor. Accreditation of this scheme is being sought from CIPFA.

Councils with outsourced Internal Audit arrangements are excluded from these arrangements due to the potential for commercial conflict arising. A shared Internal Audit service would be able to take advantage of the arrangements.

David Hughes,
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Aberdeenshire Council.
17 July 2014