

Review of Internal Audit

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Cabinet Member: Cllr David Hall, Cabinet Member for Resources

Division and Local Member: All

1. Summary/link to the Annual Plan

- 1.1. A professional, independent and objective internal audit service is one of the key elements of good governance in local government. Internal audit forms a part of the governance that provides assurance on delivering all areas of the County Vision and Plan. In our assurance framework, based on CIPFA and ALARM, internal audit is the third (and last) “line of defence” on assurance matters.
- 1.2. In addition, there is an obligation under various pieces of legislation for the County Council to ensure that it has an effective internal audit function.
- 1.3. To ensure that our internal audit function (as provided by the South West Audit Partnership) remains “adequate and effective”, officers carry out an annual review of SWAP’s performance and bring the results to Audit Committee.

2. Issues for consideration

- 2.1. Members are asked to consider the presentation from the Chief Executive of SWAP, and the review carried out by Somerset County Council officers into the effectiveness of the internal audit function from SWAP in 2017/2018.

3. Background

3.1. Statutory requirements

The statutory requirements for internal audit have not changed:-

- The Accounts and Audit (England) Regulations state that “A relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control.”
- Section 151 of the Local Government Act 1972 states that every local authority in England and Wales should “make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the proper administration of those affairs.” CIPFA has defined “proper administration” in that it should include “compliance with the statutory requirements for accounting and internal audit”.

3.2. Chartered Institute of Public Finance and Accounting requirements (CIPFA)

The CIPFA Statement on the Role of the Chief Finance Officer in Local Government states that the Chief Finance Officer (CFO) must:

- Ensure an effective internal audit function is resourced and maintained;
- Ensure that the authority has put in place effective arrangements for internal audit of the control environment;
- Support the authority's internal audit arrangements: and;
- Ensure that the Audit Committee receives the necessary advice and information, so that both functions can operate effectively.

3.3. Public Sector Internal Audit Standards (PSIAS)

These Standards have been in force since 1st April 2013 and were updated and applied from 1st April 2016, applying the Institute of Internal Auditors (IIA's) International Standards to the UK public sector.

The objectives of the PSIAS are to define the nature of internal auditing, and to set **basic principles for carrying out internal audit in the UK public sector**, i.e. what we should automatically expect from our internal audit function.

They establish a framework for providing internal audit services, which add value to the organisation, leading to improved organisational processes and operations, and establish the basis for the evaluation of internal audit performance and to drive improvement planning.

The Standards apply to all internal audit service providers, whether in-house, shared services or outsourced. They also set out the expected behaviour with a Code of Ethics. These provide a ready checklist for us to consider our Internal Audit functions against.

During 2017, SCC officers have previously considered how SWAP conforms with these Standards. For completeness, these are set out again in Appendix B to this report, together with some examples of how SWAP complies.

The very nature of SWAP is very helpful in meeting these Standards – for example, it immediately has Independence and Objectivity by being a separate legal entity, with its own management structure. Additionally, as a separate legal entity it has a number of requirements, such as being audited itself, that give additional assurance.

The officers' own internal review of the Standards concludes that SWAP complies with the Public Sector Internal Audit Standards in all significant respects.

3.4. External Validation and Awards

Officers take assurance from a number of third parties who are required to review SWAP for a variety of statutory reasons, some of which have been brought to Audit Committee before but are included for completeness:-

- i) SWAP is reviewed by the Devon Audit Partnership to ensure that they comply with the applicable Standards. The last review was March 2016, and although reviews are only required every 5 years, SWAP has committed to being reviewed every 3 years and this will next take place in March 2019. The review was very wide ranging and involved speaking with a wide variety of partners who use SWAP's services, as well as staff at all levels to confirm that SWAP's documented practices were actually being carried out in practice.

Devon Audit Partnership concluded that "SWAP is a well-established provider of professional internal audit services to a number of public sector organisations. The internal audit activity meets the Standards and SWAP management regularly look to ways to improve the service they provide (e.g. by developing the "healthy organisation" approach) and add value to all of their partners and clients. A well-developed Quality Assurance Improvement Plan is in place that captures areas for development and provides a good record of progress against targets. Consequently, our comments and recommendations are intended to build on an already efficient and effective internal audit provider."

As a result, Devon Audit Partnership's "overall opinion that the internal audit activity **generally conforms** with the Standards and Code of Ethics". (Generally conforms is the highest level of opinion that it could have offered).

- ii) The Devon Audit Partnership has also acted as the internal auditor to SWAP, and their last report (May 2017) on the accounting arrangements for SWAP was very positive. Their next report will be reviewed by SCC officers when it is due shortly.
- iii) PKF Francis Clark is the external auditor for SWAP. Their last audit (on the 2016/2017 financial year) concluded that there were no issues to report and that the accounts gave a "true and fair view".
- iv) Grant Thornton's current progress report states that "Overall, we have concluded that the internal audit service provides an independent and satisfactory service to the County and Pension Fund and that internal audit work contributes to an effective internal control environment. Our review of internal audit work has not identified any weaknesses which impact on our audit approach".

- v) The Audit Committee has previously heard that SWAP won the innovation in audit award at Public Finance event. This was the first time that CIPFA have held such an event and this is excellent public recognition. The judges commented "*We really liked the Healthy Organisation themed reviews and behavioural model, which tackled important issues around assurance fatigue and systemic failure. It also demonstrated the benefits of a partnership, but firmly grounded in each organisations governance approach.*" Since then, SWAP was a finalist in the Municipal Journal Achievement Awards for Excellence in Governance and Scrutiny, and more recently is again a finalist are Finalists for the PFI Awards this year. This latest recognition is for the work SWAP do with "Audit Together", which is a Collaboration Group that they have started.
- vi) SWAP continues to attract more partners and business from a wider number of clients (see below). Each partner will have examined SWAP before taking a decision to join through their own governance process, and clearly see SWAP as the best provider. In part, this is due to strong testimonials and praise.

3.5. Development within SWAP

As a company, SWAP continues to grow since it became operational on 1st April 2013. With Powys, Cheltenham, Cotswolds and West Oxfordshire having joined from April 2017; this brings the number of current partners to 24, with an additional 13 other clients also receiving its services. SWAP has two new Partners for next year – Gloucester Police and the Office of the Police and Crime Commissioner (OPCC).

SWAP and its Directors have continued to focus on marketing opportunities in the last few financial years, to look at how it can continue to increase both partner and non-partner services and income. This is particularly important as some partner organisations, including SCC, have cut the number of audit days that they have commissioned in recent years.

The Board of Directors meets regularly and agendas include a maintained risk register and a Quality Assessment Improvement Plan (QAIP). This plan captures all actions arising from peer reviews and progress to achieve the agreed management actions.

The Board of Directors also review a large number of performance indicators in addition to those listed in Appendix A in what is termed a Balanced Scorecard, including timeliness and delivery, customer feedback questionnaires, financial issues and staff sickness levels. Performance levels remain encouraging.

Directors receive regular training about their roles, and about the responsibilities of being a Director.

3.6. Review Process

The review process was undertaken by the Strategic Manager – Financial Governance, and overseen by the Director of Finance and Performance. It considered the statutory obligations, the governance arrangements for SWAP, our experiences on the ground, and also looked at the key performance indicators on the Audit Partnership's delivery (set out in Appendix A).

There are further notable positives that have arisen from this review:-

- The team that supports Somerset County Council are increasingly knowledgeable about the services they audit, and increasingly able to help officers to identify risks and management actions as a result. Their increased contribution to the draft Internal Audit Plan and our risk profile behind it is acknowledged and appreciated.
- There continues to be a high level of requirement for SWAP work from the Chief Executive and from Senior Leadership Team members. This is a positive because it demonstrates that SWAP work is valued amongst key officers within the County Council, and improves our ownership. The Chief Executive will be the audit sponsor for the Healthy Organisation audit work in 2018/2019.
- Somerset County Council has access to specialist audit and related services through SWAP, which continue to be of a uniformly high standard, such as IT audit and anti-fraud expertise. The staffing risk has effectively been outsourced.
- SWAP has remained highly responsive in responding to changing circumstances at Somerset County Council, and has been very flexible in how they deploy resources to meet necessary changes in the audit plan.
- SWAP has been particularly responsive when fraud and corruption allegations have needed to be audited in 2017/2018, deploying specialist resources to investigate, reporting back to the Chief Internal Auditor and rearranging work to meet our immediate needs.
- SWAP has been extremely helpful in running and monitoring the progress of "Partial" audits through the Audit Committee review process and through JCAD.
- Despite a generally higher level of Partial audits as we specifically seek to audit high-risk areas, the level of satisfaction with the audit work has actually remained very high (despite any adverse findings that the manager has had to respond to).

3.7. Day Rates

- SWAP has maintained its average day rate at £244 for at least the previous decade. (The number of audit days purchased was reduced from 1,701 to 1,533 in 2015/2016 and to 1,400 days in 2016/2017, hence the reduction in the overall charge to the County Council).
- Somerset County Council no longer participates in the CIPFA Audit Benchmarking process, but previous information shows that this day rate was £75 below the national average of £319 as far back as 2013/2014. The CCAN survey in 2015/2016 suggested an average of £278 per day, but this was from a smaller sample of only 16 respondents.

- A number of cost pressures have inevitably arisen within SWAP, in particular the difficult issue of rising pension costs and addressing the pensions deficit. SWAP has therefore reluctantly decided (with general partner acceptance) that there has to be an increase in our day rate to £288 per day from 2018/2019. This is essential for SWAP to maintain its financial position and resilience. The total cost for 2018/2019 will therefore be £378,000.
- There is no suggestion from SWAP that this will become a regular occurrence and that day rates will continue to rise by a large percentage. This is much more about a one-off re-establishing of the base rate that will allow SWAP to meet costs and plan for the future.
- SWAP is still (at least) comparable with benchmarked rates.

3.8. Conclusion

The officer conclusion is that the South West Audit Partnership continues to provide an adequate and effective internal audit function for Somerset County Council, and can demonstrate good value for money.

4. Consultations undertaken

- 4.1. Informal discussions are had regularly with some other client officers and members of the Board of Directors of the South West Audit Partnership.

5. Implications

- 5.1. All contained within the report.

6. Background papers

- 6.1. "Public Sector Internal Audit Standards – Applying the IIA International Standards to the UK Public Sector"
- 6.2. "South West Audit Partnership (SWAP) - External Quality Assessment of SWAP Internal Audit Activity"
- 6.3. Previous internal audit reports to the Audit Committee, including the Internal Audit Plan and Charter.

Note For sight of individual background papers please contact the report author.