

**Report to: Cabinet Member for Resources Portfolio For: 13 November 2008**

**Report by: Head of Audit & Performance Improvement**

**Title: Internal Audit Resources**

## **1. Purpose of Report**

The purpose of this report is to make the Cabinet Member aware that the programme of planned audit work for 2008/2009 will not be completed within existing resources, which exposes the Council to significant risk. Additional funding is sought, both in the short and longer term, to enable the Audit Plan to be completed for 2008/2009 and future years.

## **2. Recommendations**

The Cabinet Member is recommended to:

- (i) Note current progress on the Audit Plan for 2008/2009 and the associated risks with not completing the Plan
- (ii) Support a request to the Cabinet to authorise the Section 151 Officer to transfer £60,000 from the contingency provision in 2008/09 to provide additional resource within the Internal Audit team in the current financial year
- (iii) Acknowledge that from 2009/10 onwards the base budget for Internal Audit needs to be increased by £60,000 per annum in order to increase the permanent establishment of the team and therefore a budget pressure in the sum of £60,000 is recommended for endorsement by the Cabinet for consideration by the City Council at its Annual Budget Meeting in February 2009

## **3. Background**

3.1 The annual Audit Plan is drawn up in accordance with the agreed Audit Strategy and Audit Charter and Terms of Reference, which are updated each year and approved by Governance & Audit Committee

3.2 For a number of years, the Audit Plan has not been completed, mainly due to the level of unplanned work that the Audit Team is required to deal with. For the current financial year it is estimated that only 64% of the Audit Plan will be completed. Failure to complete the Audit Plan has the following impacts:

- (i) The Internal Audit Manager has a statutory duty (Accounts and Audit Regulations 2006) to provide an annual opinion on the effectiveness of internal control to support the s151 Officers responsibilities. By not completing the Audit Plan she has insufficient information available on which to form an opinion.
- (ii) The Council is open to criticism from its external auditors, who have indicated that the Use of Resources score is likely to be adversely affected.
- (iii) The Council may be unaware of significant risks that exist within key systems

- (iv) External Audit are allowed to rely on the work of Internal Audit, as an alternative to carrying out the work themselves. Therefore, if the Audit Plan is not completed additional external audit work is required, which is considerably more expensive for the Council.

3.3 In the short-term, additional funding is required to “buy in” extra resource to complete the 2008/2009 Audit Plan. It is estimated that 150 days of additional resource is required, at an inclusive cost of £400 per day.

3.4 In the longer-term, it seems unlikely that the resource requirement will diminish for some time. There are no indications that the level of unplanned work is reducing, and the demands on the Audit Plan are increasing each year. Therefore, better value for money would be achieved by increasing the permanent establishment of the Audit Team to ensure that the Audit Plan can be completed each year without the need to buy in external resource at considerably higher cost.

#### **4. Appraisal of Options**

##### **4.1 Review of Productivity**

The establishment of the Internal Audit team has reduced from 12 FTE in 1997 to 8.3 FTE in the current team, without any significant reduction in work volume. The current establishment represents approx 1 FTE auditor per 1000 employees. This compares to an average of 1 FTE auditor per 600-700 employees amongst other unitary councils in the region. Although like-for-like comparisons are difficult, this benchmarking suggests that the Council’s Internal Audit team is relatively small in relation to the size of the council.

##### **4.2 Content of Audit Plan**

The Audit Plan has been thoroughly reviewed and all non-essential audit work has been removed. Further reductions to the Plan would result in a significant increase in risk to the Council. It is also likely that the Council’s external auditors would consider that the Plan would not provide an adequate level of assurance.

##### **4.3 Quantity of unplanned work**

The level of unplanned work is considered to be the biggest obstacle to completing the Audit Plan. Unplanned work includes:

- (i) Special investigations, where it is believed that criminal activity or a significant breach of Financial Rules or Standing Orders has occurred
- (ii) Investigating complaints under the whistle-blowing procedure
- (iii) Carrying out additional work where significant issues have arisen as a result of planned audit work or work by external auditors
- (iv) Advice to managers on systems controls, changes in systems, financial rules and other delegations to officers
- (v) Financial Rule Waivers

Current staffing levels assume that 70% of available annual audit time is allocated to planned audit work, with the remaining 30% available for dealing with unplanned work. However, over the last 3 years the level of unplanned work has averaged 40%, and the trend is increasing year on year (49% in 2007/8).

By its nature, unplanned work tends to be time-consuming and requires the close involvement of the most experienced staff within the Audit team. Special investigations in particular must be carried out extremely thoroughly and with great sensitivity as they often result in criminal or disciplinary proceedings.

#### 4.4 Outsourcing all or part of Internal Audit service

An external market exists for audit work, and a number of councils have outsourced all or part of their internal audit function. This council has also made frequent use of contractors to provide specialist expertise or increase capacity.

The Cabinet Member may wish to consider the viability of externalising more of the Internal Audit function by either:

- (i) Reducing the permanent establishment of the team and buying in more resource on a contractor basis
- (ii) Outsourcing the entire service

Option (i) provides greater flexibility but is unlikely to represent value for money in the longer term as contracted rates tend to be higher than the costs of internal resources (typically £300 or more per day compared to £219 for the internal audit team).

Option (ii) would require a full business case to quantify whether or not there would be any cost reductions without loss of quality over time. A full tendering exercise would also be necessary, meaning that the lead-in time to pursue this option would be 12-18 months. Although this option might be perceived to offer cost savings, initial research has shown that there are also a number of significant down-sides that would need to be considered:

- a reduction in the level of control and flexibility of the service
- the requirement to maintain sufficient in-house resource to provide effective client-side management
- the sensitivity of special investigations may require that this area of work is retained in-house
- probable loss to the Council of skills and organisational knowledge that have been developed within the existing Internal Audit team. Knowledge of local systems is critical to the quality of audit work and the impact on audit clients
- although an external provider may be able to deliver planned audit work more cheaply, unplanned work is likely to be more expensive.
- quality will be dependent on the contractor staff involved and can be very mixed.

## 5. **Conclusions**

It will not be possible to complete the Annual Audit Plan for 2008/2009 within existing resources, which exposes the Council to considerable risk. This problem has existed for some years and is likely to persist for future years. Additional funding is required in the short-term to “buy in” additional capacity to complete the 2008/2009 Audit Plan, and in the longer-term to increase the permanent establishment of the Internal Audit team.

It is therefore recommended that agreement of the Cabinet be sought to:-

- (i) authorise the Section 151 Officer to transfer £60,000 from the contingency provision in 2008/09 to provide additional resource within the Internal Audit Team in the current financial year, and
- (ii) endorse a budget pressure in the sum of £60,000 for consideration by the City Council at its Annual Budget Meeting in February 2009 in order to increase the permanent establishment of the team

Externalising all or part of the Internal Audit function may be an option to consider in the future, but a full business case would be necessary to establish whether this would be viable, and there are a number of notable downsides to this approach.

**6. Equalities Impact Assessment**

The Annual Audit Plan is subject to an Equalities Impact Assessment

**7. City Solicitor’s Comments**

The City Solicitor is satisfied that it is within the Council's powers to approve the recommendations in this report

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 Jon Bell  
 Head of Audit and Performance Improvement

**Background List of Documents**  
**Section 100D of the Local Government Act 1972**

**The following documents disclose facts or matters which have been relied upon to a material extent by the author in preparing this report –**

| <i>Title of document</i> | <i>Location</i> |
|--------------------------|-----------------|
| None                     |                 |

The recommendations set out above were  
 approved/ approved as amended/ deferred/ rejected  
 by the Cabinet Member for Resources on 13 November 2008

Signed: -----