

Report to: Governance and Audit Committee

Date: 30 July 2018

Subject: **Delivery of the Internal Audit Function**

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1. Purpose of this report

- 1.1 To consider the outcome of a soft market testing exercise conducted for the provision of internal audit to the Combined Authority.
- 1.2 To consider a preferred model for the delivery of internal audit.

2. Information

- 2.1 This report provides information concerning a soft market testing exercise undertaken and seeks approval to commence the implementation of a preferred model for the delivery of the internal audit function.
- 2.2 Members will recall that a report was provided to the March 2018 meeting of the Governance and Audit committee which evaluated the weaknesses and benefits of a range of models for the provision of internal audit. The Committee requested that officers undertake a 'soft' market testing exercise to establish indicative costs for each of these options.
- 2.3 A range of local authority service providers along with a number of audit/accountancy firms were contacted and asked to submit costed proposals for providing a fully outsourced option and day rates for specialist audit services which could be provided as part of a co-sourcing arrangement. In addition, further work was undertaken to develop the effectiveness of the internal service offer, identifying improvements to the structure along with an assessment of anticipated costs.
- 2.4 Responses to this request were generally disappointing. There was some initial interest received from local authority service providers, however, none of the five authorities contacted were able to provide any formally costed proposals. There was slightly more interest provided from the accountancy/audit firms. Two of the five organisations contacted provided information for both a fully outsourced service and day rates for audit

specialisms. This information is commercially sensitive, however, it can be disclosed that both proposals for an outsource provision were competitive when compared with the costs of the existing internal service provision but provided fewer audit days than those identified within the approved audit plan. Their approach was to undertake the minimum level of audit work which would enable them to provide an annual opinion on the Combined Authority's control, governance and risk management arrangements. Other work including grant certification, the provision of advice and consultation, value for money reviews and counter-fraud activities were outside of their proposals.

Preferred option

- 2.5 It is proposed that a model which provides a depth of understanding of organisationally operations, the ability to respond quickly to provide consultation/ad-hoc advice and insight into organisational risk management activity, including the early identification of emerging risks and how this informs the assurance process, coupled with a degree of audit specialisms, is the most effective means of service delivery.
- 2.6 A hybrid co-sourcing model enables the Combined Authority to retain control over the internal audit function while at the same time leveraging the internal audit resources of the third party service provider, which provides access to valuable and diverse specialised skills as needed. The model includes the establishment of a core internal audit team, led by the Head of Internal Audit. Members of this team are essentially audit generalists with a partner providing subject matter specialists under the direction of the Head of Internal Audit.
- 2.7 This will provide a unified internal audit plan and an agreed audit methodology and, if need be, discussion and decisions can be made quickly to adapt the plan. Having an internal team gives internal audit a clear identity and profile and it is part of the organisation's culture. It allows the building and retention of knowledge relating to the Combined Authority which enables internal audit to be valued by the business areas. Finally, the annual budget is part of the organisation's costs and means that people who want advice and guidance on a consultancy basis do not have to be afraid to ask for it on the grounds of cost. This helps to reinforce the message that risk management and control are important.
- 2.8 It is necessary to provide improvements to the structure of the internal delivery team to allow increased emphasis and focus on strategy, planning, delivery, reporting and performance whilst providing greater flexibility and resilience within the function.
- 2.9 To achieve these objectives it is proposed that the post of the Head of Internal Audit be redefined. The key responsibilities of this role would be for setting and delivering strategic objectives and plans, developing and leading the service, developing policies, monitoring and ensuring the adequate resourcing of the function, liaising with key stakeholders including the Governance and Audit Committee and the Combined Authority's Leadership Team and providing commentary on the status of the organisation's control environment,

risk management and governance arrangements. The post will also lead on counter-fraud initiatives and investigations and meet statutory requirements by being the Combined Authority's Responsible Officer - this is the person, appointed with overall responsibility for maintaining and operating the whistleblowing policy nominated contact for reported incidents and money laundering reporting officer.

- 2.10 A post of Principal Auditor will allow the day to day supervision of work undertaken within the audit plan to be undertaken and allow capacity to undertake a number of more complex reviews within the plan. In addition, this post would be responsible for ensuring the implementation and operation of internal audit quality processes, determining the scope of audit assignments, liaising on audit findings, monitoring the progress of management in implementing audit recommendations and deputising for the Head of Internal Audit when necessary.
- 2.11 Internal auditor posts will perform the bulk of audit testing under the direction of the Principal Auditor. These are audit generalist roles and would include participation in the audit planning process, performing audit testing, participating in audit closures and the completion of internal audit reports to draft stage.
- 2.12 The exact audit activities to be provided by external specialist are identified under the following headings;
- IT systems including network penetration testing and cyber security.
 - Governance – consider and compare against other local authorities.
 - Data Analytics – embedding systems to enable continuous audit capabilities and to support fraud detection.
 - Local Assurance Framework –Review processes around investment appraisal and monitoring benefits realisation.

Initial indications are that this could require an input of around 50 audit days per annum. Further work will be required in working up detailed specifications and service level requirements for this work prior to undertaking any procurement of these services.

3. Financial Implications

- 3.1 The costs of resourcing the current internal audit establishment are identified at £151,483. These include on-costs for employers National Insurance and pension contributions and are set at the top of current grading bands.
- 3.2 Costs will need to be established for any requirement to develop the internal audit structure and for the procurement of third-party audit specialisms.

4. Legal Implications

- 4.1 The Accounts & Audit Regulations require the West Yorkshire Combined Authority to maintain an adequate and effective internal audit.

5. Staffing Implications

- 5.1 The preferred option would require the reappraisal of the internal audit structure and roles. Full consultation would take place with any affected staff.

6. External Consultees

- 6.1 As described in section 2.3 and 2.4 of this report.

7. Recommendations

- 7.1 That the Committee note the outcomes of the market testing exercise undertaken.
- 7.2 That the Committee approve the preferred model for the delivery of internal audit to the Combined Authority.
- 7.3 That the Committee support the development of the internal audit team structure through the Combined Authority's organisational development programme.

8. Background Documents

None.