

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **13 March 2017**

Report of: **Head of Finance and Audit**

Subject: **INTERNAL AUDIT PARTNERSHIP**

SUMMARY

This report proposes that the Council enters into a partnership with Portsmouth City Council, using a shared service agreement, for the provision of the Opinion audit work; the arrangement to be formally reviewed in 5 years.

RECOMMENDATION

That authority is delegated to the Head of Finance and Audit, in consultation with the Section 151 Officer, to enter into arrangements as are necessary, and on such terms as are reasonable to develop a partnership with Portsmouth City Council for the provision of Opinion audit work.

INTRODUCTION

1. Under the Accounts and Audit Regulations 2015, the Council has a statutory requirement "*to undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance*". However, this service does not have to be provided by an in-house team.
2. In April 2015 members approved the latest Audit Strategy setting out the level and nature of the work that will be delivered in order to deliver the annual Head of Audit's opinion required under the *public sector internal auditing standards*. This strategy recognised 3 streams of work underpinning the annual opinion: **Opinion work** (assignments leading to individual opinions), **Wider work** (assignments targeted at working with services to review risks and/or implement solutions), and **External Assurances** (gathering assurances available from third parties).
3. Since 2005 the "**Opinion work**" element of the internal audit service has been delivered by a number of external contractors, following the completion of a tender exercise. The current contractor is Mazars LLP. The rest of the service including counter fraud, investigation and governance work has been delivered by in-house auditors.
4. It is now proposed that the Council enters into a partnership with Portsmouth City Council, for the provision of the Opinion work part of the audit service.

BENEFITS OF PARTNERSHIP

5. The reasons that the original decision to externalise part of the audit service was taken in 2005 were:
 - To stabilise the resources available to deliver the planned audits and hence reduce the risk of an unfavourable external audit opinion of the audit service (which at that time affected the Council's Use of Resources scoring).
 - To eliminate the cost of using agency staff including officer time spent recruiting and training agency staff.
 - To increase the range of services being provided by the audit and assurance service and stabilise the in-house Council resource available for other services such as risk management support.
6. These objectives have been met with the arrangements that have been place since 2005. However, there are now additional reasons why a partnership model with Portsmouth City Council is recommended, as discussed below.
7. **Independence:** Having the opinion work delivered by a third party helps maintain independence from the in-house audit team who are becoming more involved in helping devise and implement solutions to weaknesses found. The external auditors have also highlighted that since the Head of Audit now also has responsibilities for the Finance service there is an increased need for independence in some of the audit work. Therefore the Chief Internal Auditor at Portsmouth City Council would also be available to the Council and would have direct access to the Section 151 Officer and Chairman of the Audit and Governance Committee if she felt an issue needed escalating.

8. **Cultural Fit:** The latest Audit Strategy seeks to embrace a number of the principles of “Systems Thinking” into how the audit service is delivered; as the service needs to adapt to the changing culture of the organisation as the learning from the Vanguard reviews is embedded. This is a different approach to the traditional auditing style and can be difficult for auditors from other cultures to understand. Portsmouth City Council have also been introducing “Systems Thinking” into its culture and so their auditors are familiar with the audit requirements under this model.

In the past 2 years we have been piloting the use of auditors from Portsmouth City Council in a number of different types of assignment and we have found that their approach fits well with the FBC culture.

9. **Savings:** Unlike in a tender arrangement, under a shared service agreement neither of the parties involved are able to generate profits from the arrangement. The rates that FBC will be required to pay will be contributing to the overheads of Portsmouth City Council and these are likely to come down if other councils enter into shared service agreements with them. We are aware of 2 other large councils who are also considering entering into a shared service agreement with Portsmouth City Council.

There will also be savings for FBC by not needing to undertake a procurement exercise to select a new contractor for the work.

10. **Additional Service Provision:** There are audit services that both Councils may be developing that would be of mutual benefit to each other, as we have common objectives. In particular we are aware of the work Portsmouth City Council are doing on data analytics which would be useful for inclusion into the FBC audit plan. In addition we are working to strengthen the horizon scanning element of our service, which could benefit from both Councils working together to capture new risks and opportunities arising. There are also areas of governance, risk and fraud work where the Councils will benefit from sharing learning through the partnership.

ALTERNATIVE OPTION TO CONTINUE WITH CONTRACTORS

11. Continuing with the current contractor in 2017/18 is not an option as we have already extended the current contract up to the maximum allowed. Given the value of the work, we would therefore be required under the Public Contract Regulations 2015 to retender this contract.
12. Retendering the work is an available option, as is joining a framework agreement with a number of London authorities when their agreement is retendered in 2018/19. The current contractor used by FBC previously won that contract so if they were successful again the service would be similar to that already experienced. The daily rates are likely to be a little lower than current due to economies of scale, but the last rates quoted would still be higher than those that would be expected under the arrangements with Portsmouth City Council.
13. These options are not favoured mainly due to the problems with the cultural fit with the big accountancy firms and the direction the Council's audit service is going in. As the nature of the relationship is purely contractual we would also lose the potential for the two services to co-operative and develop the service with a common objective which can be obtained from a partnership relationship.

14. We are also aware that one of the weaknesses in the current audit service is the time taken to issue the draft reports once a piece of work has been completed. One of the factors contributing to this is the quality assurance framework that the big accountancy firms have in place as a means to manage potential risks to their reputation and litigation action. For this reason it is anticipated that performance in this area will improve under the partnership arrangement with another Council.

TERMS OF THE SHARED SERVICE AGREEMENT

15. The following arrangements are proposed as the basis of the shared service agreement with Portsmouth City Council:
 - (a) The period of the agreement will be five years from April 2017 until March 2023, with an option to extend for a further five years to March 2028. A clause will be included within the agreement specifying the period of notice that either party can give to trigger termination of the agreement.
 - (b) Portsmouth City Council will manage and provide the Opinion audit work with a guaranteed minimum number of chargeable days per year, in line with the FBC Audit Strategy, unless a lower figure is agreed by both parties.
 - (c) Fareham Borough Council will pay the agreed annual charge in quarterly instalments in advance.
 - (d) The annual charge will be reviewed on the 1 April each year.
 - (e) Management of the arrangement will be the responsibility of the Head of Finance and Audit who will meet regularly with the Chief Internal Auditor at Portsmouth City Council. Performance will be monitored against an agreed Internal Audit Quality Assurance and Improvement Programme.

FINANCIAL IMPLICATIONS

16. The rates to be paid under the agreement will result in a saving to the Council as laid out in Appendix A.

LEGAL IMPLICATIONS

17. We are working with the legal services in Portsmouth and Southampton to ensure that the partnership is set up in a way that it does not conflict with the Public Procurement Regulations.
18. We will be entering into a shared service agreement for 5 years with option to extend for a further 5 years.
19. This arrangement would be considered a significant partnership for the Council as it involves a statutory service *which has a risk to the council if there is under performance in this area*. Under Financial Regulation 21, therefore the decision to enter into the partnership needs to be approved by an appropriate committee. This is considered to be the Audit and Governance Committee as they are required to approve the Annual Audit Plan and the resourcing of the Plan.

Background Papers: None

Reference Papers:

Report to the Executive 8 March 2010 – Internal Audit Services Supplier

Report to the Executive Member for Policy and Resources 9 June 2015 – Internal Audit Services Supplier 2015/16

Report to the Audit and Governance Committee 16 April 2015 – Internal Audit Strategy and Annual Plan

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext: 4344)