

Provision of Internal Audit Services

SUMMARY:

This report sets out a proposal to deliver the internal audit service using the Southern Internal Audit Partnership rather than resource internally to gain additional skills and independence.

RECOMMENDATIONS:

Members are requested to:

- (i) Review and agree the proposal to contract the Chief Internal Audit function to SIAP.

1. INTRODUCTION

- 1.1 The Councils Constitution sets out in Part 3, Section 6 (Roles and Responsibilities of Council Decision Making Bodies) that it is the CGAS committees' responsibility to:

"16. To review the risk-based internal audit plan, including internal audit's resource requirements, the approach to using other sources of assurance and any work required to place reliance upon those other sources.

17. To approve significant changes to the risk-based internal audit plan and resource requirements.

18. To make appropriate enquiries of both management and the Executive Head of Finance to determine if there are any inappropriate scope or resource limitations, in respect of carrying out internal audit work."

2. PURPOSE

- 2.1 This report sets out the proposal to move to an externally provided internal audit service.
- 2.2 The finance service review which is to be considered by Cabinet in November proposes a number of finance team changes of which the provision of audit is a part of.

Appendix 1 – Cabinet Report – 26th November 2024 – Finance Service Development

BACKGROUND

- 3.1 Internal audit is a statutory requirement and coded into the council's constitution as a key tenet of good governance. The service is currently led by the Service Manager - Audit, supported by two full time (vacant) auditor posts.

- 3.2 The Internal Audit service has been reviewed as part of the wider finance service review with a view to strengthen governance arrangements and service resilience.
- 3.3 Currently there are two vacant internal audit posts which have proven difficult to recruit to. To support the Service Manager – Audit to deliver the internal audit service, the council has been contracting some of the internal audits externally. In 2024/25 this is through SIAP (Southern Internal Audit Partnership) which is part of Hampshire County Council.
- 3.4 The current resourcing arrangement with SIAP has proven successful and a proposal has been developed for SIAP to deliver the full internal audit service as part of the finance capacity and capability review.
- 3.5 The proposal to move to SIAP gives the council access to a pool of staff. This provides benefits including:
- Increased independence from Council staff
 - Increased resilience
 - A wider skill base including IT and systems expertise
 - Wider experience of other council's processes and procedures

4 CONSULTATION

- 4.1 Internal Staff consultation has taken place regarding the change in structure.
- 4.2 The Head of Paid Service has been consulted on these proposals and is satisfied that this solution is acceptable to address the challenges outlined in this report, including the legal implications and mitigations of the SIAP SLA resulting in putting the Service Manager – Audit post at risk.

5 IMPLICATIONS

- 5.1 Risks have been documented above regarding the Internal Audit function. In addition, the attached Cabinet report gives the risks relating to the financial service.
- 5.2 Legal Comments have been included in the attached Cabinet report.
- 5.3 Financial and Resource
The initial service agreement will be for 5 years with break clauses based upon specific performance metrics.

Strong internal audit helps to ensure the council has appropriate processes and procedures in place to deliver services and consider value for money.

- 5.4 Equalities Impact

Consideration has been given to the protected characteristics. There do not appear to be any qualities implications arising in respect of the decisions being taken by Cabinet with regard this report.

5.5 Other
Not applicable.

8. CONCLUSIONS
The council must ensure it has adequate capacity and capability to enable strong internal audit and provide review of processes and governance.

BACKGROUND DOCUMENTS:

None

CONTACT DETAILS:

Head of Service: Peter Vickers – Executive Head of Finance, S151
peter.vickers@rushmoor.gov.uk

FINANCE SERVICE DEVELOPMENT

SUMMARY AND RECOMMENDATIONS:

This paper sets out the requirement for additional senior financial management and technical capacity and the functional re-alignment of existing accountancy capacity to ensure robust financial leadership and risk management of the Council's affairs.

Cabinet is requested to:

1. Approve the repurposing of the internal audit and financial services budgets in accordance with the Council's Financial Procedure Rules – Part 4, C10 virements: above £50,000 reserved for Cabinet, to achieve the finance service development plan proposed in this paper.
2. Approve the Council entering into an inter authority agreement for the provision of the internal audit service by Southern Internal Audit Partnership through a 5-year Service Level Agreement including the provision of the Chief Internal Audit function, in line with the Scheme of Delegation Part 3 Section 3 para 3.5.26: agreeing agency agreements with other local authorities for the delivery of services, subject to the agreement of the Corporate Governance, Audit and Standards Committee.

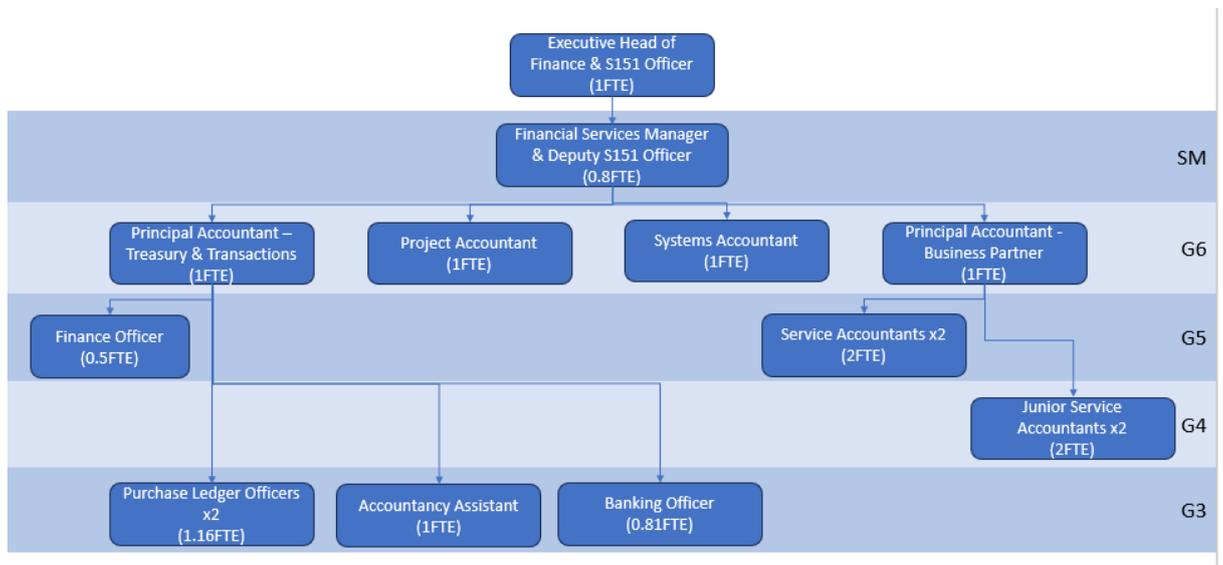
1. INTRODUCTION

- 1.1. The Council's finance team structure and capacity must be fit for purpose to address the full range of financial disciplines required to support the functioning of the Council, including strategic and operational financial leadership, financial management, financial risk management and professional supervision of the finance team. The 2024-25 budget report approved at February Budget Council identified a need to rebuild financial capability, capacity, and resilience within the Council, and specifically within the finance team. This was further detailed and supported by the CIPFA report, and the Corporate Peer Challenge commissioned to underpin the Financial Recovery Plan. This paper proposes a response to this challenge specifically focusing on improving financial management, governance and decision making.

2. Current structure

- 2.1. The finance team had been settled for a significant number of years (capacity and function), led by senior qualified local authority experienced accountants (i.e. Chartered, Certified – affiliated members of the Consultative Committee of Accounting Bodies - CCAB). The senior members of the team had a primary focus on technical accountancy and to a lesser extent on financial leadership and service development. The wider team consists of accounting technicians and administrators with varying degrees of experience and training. This was an appropriate structure and capacity for the Council after it had divested its housing stock (through LSVT) and contracted out refuse collection, street cleaning, leisure centre operations and parks and grounds maintenance, remaining with a much smaller and financially uncomplicated revenue funded low risk service offer, supported by a comfortable level of useable reserves.
- 2.2. The Council's financial affairs have rapidly become more complex in recent years (since 2017) due to its focus on significant regeneration projects and external partnerships, commercial asset acquisitions, and a housing company, all predominantly funded by borrowing. The change in focus evolved alongside a national context of increased complexity in central government regulation, rules-based grant funding, new and more complex accounting rules and regulations and statutory governance codes of compliance.
- 2.3. External audit scrutiny has become more demanding due to the Financial Reporting Council's (UK auditors and accounting institutes - CCAB governing body) response to several high-profile corporate failures (i.e. Patisserie Valerie, Sports Direct, Carillion, Credit Suisse and more recent ones). These failures were specifically attributed to issues pertaining to complex asset accounting, lease accounting, financing, and corporate governance, with the resulting additional audit regulations and higher auditing standards. The council is directly affected by these changes due to its significant asset base, technically complex commercial financial transactions and underlying financing, higher financial risk, and more challenging financial governance. Audit firms have struggled to resource the increased workload, in an ever-increasing difficult recruitment market resulting in a backlog of financial audits, which is a challenge for and a draw on the finance teams limited qualified capacity to resource.
- 2.4. The role of finance is central in identifying and managing strategic and operational financial risk and long-term financial planning. There are no aspects of council business isolated from financial risk, including areas such as treasury management compliance, borrowing, cashflow management, VAT and taxation compliance, contractual obligation, and procurement. The Council handles more than £150m of operational cashflow and £165m borrowing in any financial year, it makes long term high value financial commitments and is financially responsible and accountable to many different stakeholders. The council is always operating in a high-risk environment, with very limited reserves to mitigate the impact of any risk event materialising. Strategic and technical financial awareness is critical to ensure the council appropriately manages its risks and develops sustainable financial plans.

- 2.5. The Council has not secured sufficient appropriately skilled and experienced financial capacity to manage the council's financial affairs in response to the changes in its environment. In recent years, the team has experienced turnover of senior and experienced staff which has proven difficult to replace. The team has been partially resourced through internal recruitment and promotion of staff with insufficient experience (and not CCAB qualified) in financial management, technical accounting, and financial leadership, ultimately with an adverse impact on depth of knowledge, supervision and oversight, and effective financial management.
- 2.6. The current structure is shown in the diagram below.



- 2.7. The Head of Finance and Finance Manager are both CCAB qualified and experienced accountants, both new to the council in the last 12 months and currently the council's only senior strategic and operational technical capacity, as well as providing leadership, managerial support, and technical supervision for the wider team. It is crucial that the council has sufficient capacity to support strategic decision making, understand and analyse risk, identify, and advise on options, and understand implications of technical financial transactions and provide leadership to the council.
- 2.8. The balancing of the Council's revenue budget is challenging due to high inflation, contractual growth, a reduction in income and government funding, and high interest rates resulting in the need for several savings programs. Service managers have been responsible for managing their budgets, in accordance with the council's financial regulations and governance procedures, with limited business partnering support for service management. The limited financial leadership has resulted in an inability to provide timely and accurate financial management reporting and poor compliance with the financial regulations. Business partnering support from the finance team will require strengthening to effect improvement and enable effective ownership of service budgets.

- 2.9. Treasury management, cash flow and interest on borrowing are key risks due to the high level of short-term borrowing, and the uncertainty of interest rates. Managing this aspect of the council's cashflow and borrowing requires skill and experience to minimise interest cost, strategic treasury management oversight is limited without sufficient day to day treasury management capacity, this has resulted in significant unplanned interest costs. Treasury management requires experienced CCAB qualified finance capacity within the team.
- 2.10. The council has £235m of land and buildings across several hundred individual assets. Included within this are £134m of commercial assets (including over 100 tenants) generating £8m of lease income per year directly financing the revenue account and currently £48m of assets under construction (Union Yard and Civic Quarter). The asset base represents the biggest financial risk in the council's revenue account as identified in the February 2024-25 budget report to Full Council due to the high values of individual leases, rent free and void periods, service charges and maintenance costs, requiring much closer financial management. The council must develop, maintain, and manage a long term planned maintenance schedule including detailed financing plans. Significant expenditure on the asset base is effectively "investment" in the individual assets and should be appraised as such with clear reasons for the investment and appropriately identifying effective "best Value" affordable options for the council. The finance team does not have any dedicated capacity at present to cover off the technical accounting and financial management of the asset base and the council has yet to develop a long term planned maintenance programme or robust financial reporting to manage the commercial asset portfolio and necessary investment decisions.
- 2.11. Governance and compliance are the bedrock of sound financial administration and management, this has not been sufficiently addressed and therefore somewhat left behind. Financial governance is increasingly being codified into statute and requires external audit confirmation of compliance through our external auditors annual Value for Money reporting. Key financial aspects of the council's constitution require updating and to be maintained and promulgated across the council.
- 2.12. The council does not have in-house capacity to lead on technical year end accounting, production of the annual Statement of Accounts and external audit and a plethora of financial reporting returns to various government departments. Aside from being a statutory requirement, these reports are the basis of the governments assessment of financial support provided to the council. Production of the Statement of Accounts requires experience and up to date detailed knowledge of accounting standards, several CIPFA Codes of Practice, government directives and statutes. Information is required from across the whole council and external experts such as asset and financial instrument valuers and actuaries, in specified formats, must be accurate and verifiable. This is a logistical challenge that is constantly rolling from year to year without a break. This work has previously been resourced and lead by the Head of Finance and Finance Manager, at the expense of other priorities.

- 2.13. Over the last year, technical capacity has been secured by the engagement of an experienced qualified interim to lead on the 2023-24 financial year end accounts and audit, LGFutures engaged to provide the complex collection fund accounting and Arlingclose to assist with treasury management and capital financing, accounting, and reporting. This has been an effective stop gap strategy. It does come at a high financial cost and is not embedded within the finance team.
- 2.14. The adverse impact of all the above has resulted in the inability to produce accurate and timely in-year financial management reporting, reduced financial governance compliance (i.e. key control account reconciliations, compliance with financial regulations, codes of practice, develop and document best practice, comply with internal audit agreed actions), no in-house capacity to lead on technical year end accounting and production of the annual Statement of Account, over exposure to financial risk on the commercial asset portfolio, treasury management and the balance sheet, and under resourced strategic financial oversight and risk management.

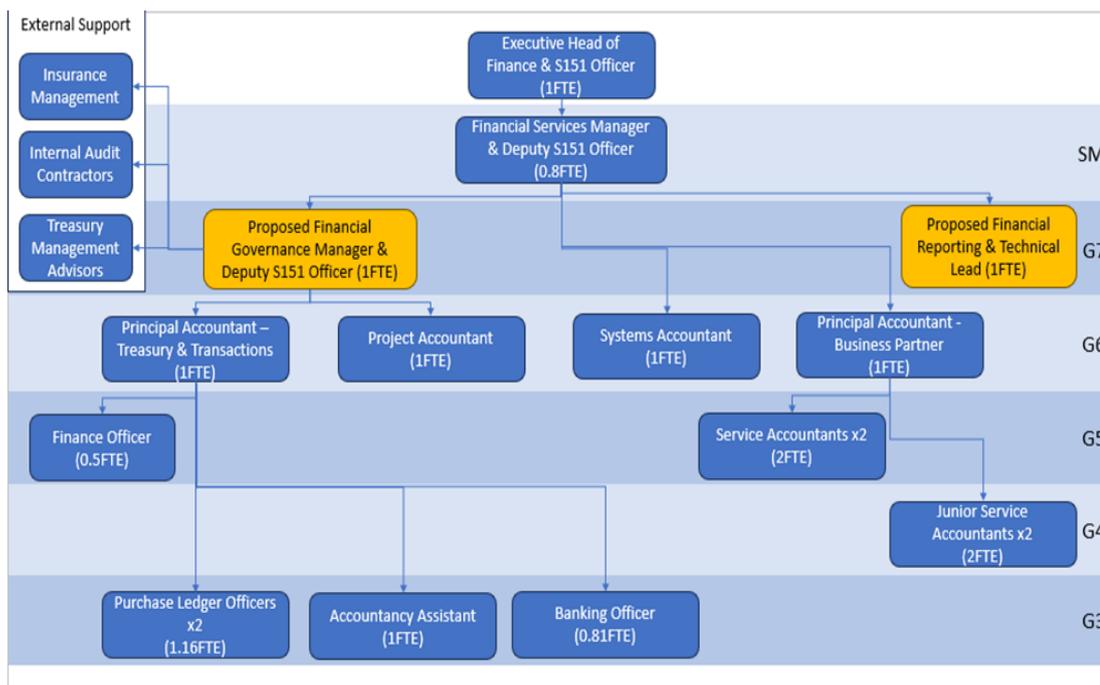
Internal Audit

- 2.15. Internal audit is a statutory requirement and coded into the council's constitution as a key tenet of good governance. The service is led by the Service Manager - Audit, supported by two full time (vacant) auditor posts.
- 2.16. The Service Manager – Audit is required to provide an annual assurance assessment to the Corporate Governance, Audit and Standards Committee on the soundness of the council's governance arrangements, based predominantly upon the audit evidence gathered through completion of the annual audit programme.
- 2.17. The two vacant internal audit posts have proven difficult to recruit to. Alternative audit capacity has been procured from several councils in the last two years with limited success due to their own resourcing priorities. In the last financial year, a robust service level agreement (SLA) has been negotiated with Southern Internal Audit Partnership (SIAP), part of Hampshire County Council. The council has been trialling an SLA with SIAP resourcing the 2024-25 audit programme and has proven to be successful, especially due to their significant and varied resource capacity and Cabinet is being asked to approve the partnership agreement with SIAP for a five-year SLA, with a recommendation from the Corporate Governance and Standards Committee.
- 2.18. The Service Manager - Audit's annual assurance assessment has highlighted that the council's governance arrangements are challenging, with significant improvements required. Factoring in the finance team resourcing situation, the underlying issues require a wider focus on governance and compliance to resolve the situation from within the senior finance capacity. The Service Manager - Audit role is a proactive part of the council's assurance and risk management system and must remain independent preventing the use of this professional capacity in an operational role without causing a conflict of interest. This can be resolved through engaging SIAP to provide the independent

assurance statement and fulfilling the statutory duties of the Service Manager - Audit. This will result in deletion of the Service Manager – Audit role from the council’s establishment as part of the wider finance team capacity and capability review proposals in the detail below.

Proposed capacity and capability changes

- 2.19. The council has a significant financial challenge, the required capacity and capability of the finance team must be resourced within exiting budget provision.
- 2.20. Additional senior finance capacity is required to provide the technical experience, knowledge and support for the finance team and services. The council must address the technical deficit as described above and as a top priority, re-establish and develop business partnering to support service managers and deliver robust and timely financial reporting.
- 2.21. The Internal Audit service has been reviewed to strengthen governance arrangements and service resilience. The current resourcing arrangement with SIAP has proven successful and a proposal has been developed for SIAP to deliver the full internal audit service as part of the finance capacity and capability review.
- 2.22. The Service Manager - Audit post will be at risk and therefore a meaningful consultation on the proposed service changes will be done in line with the council’s human resource policies, which includes ringfencing suitable vacant posts for at-risk posts to apply for. Cabinet is requested to approve the proposed SLA with SIAP to deliver the Internal Audit function.
- 2.23. The finance service will be strengthened by the addition of two senior accountant posts, one post will lead on managing financial governance, and the second post will lead on statutory and technical accounting.
- 2.24. The proposed structure is given in the diagram below:



2.25. The current internal audit budget is £197,901. SIAP have quoted £96,000 for the provision of audit services to cover the annual audit programme and the provision the Service Manager – Audit’s statutory duty. The balance of the internal audit budget is proposed to be vired to fund the changes in the finance service and £16,823 to fund investigation capacity (fly tipping) in the Environmental team. LGFutures have been engaged to support with the Collection Fund (local taxation) accounting, and the annual licence fee for the recently procured ledger budget management module. Cabinet is requested to approve the proposed virements.

	Budget 2024/25	Staff	LG SIAP Futures	Budget Investigation module	Revised budget
Finance Support Services					
Establishment	767,856	174,648	(8,000)	(4,500)	930,004
Integra budget module				4,500	4,500
Professional Consultancy	14,000		8,000		22,000
Staff - Temp	89,570	(89,570)			0
Internal Audit					0
Establishment	193,943	(81,120)	(96,000)		(16,823)
SIAP contract	0		96,000		96,000
Environmental Investigations					16,823
Staff non pay	3,958	(3,958)			0
Grand Total	1,069,327	0	0	0	0

2.26. Once the current management review is complete business partnering will be further developed with the objective of improving financial governance, accuracy, timeliness, and support services to be more confident in owning their financial responsibilities. This will entail a review and alignment of the existing finance team capacity to address this challenge.

- 2.27. The finance system has been in place for many years and has not been fully configured to support financial management. The council has embedded an experienced systems accountant into the finance team, enabling further development of the ledger system and implementation of a budget management module that is currently being rolled out to all services.

Alternative Options

- 2.28. This proposal has been developed utilising external expertise for insurance administration (London Borough of Sutton), internal audit (SIAP), collection fund accounting (LGFutures) and treasury management support (Arlingclose). The alternative will be to attempt to resource these skills through recruiting officer posts. This would be a challenge to achieve and less effective in managing these niche activities.

Consultation

- 2.29. The finance team and Service Manager - Audit will be formally consulted as part of the restructure process. Corporate Governance, Audit and Standards committee have been consulted on 21st November meeting including a presentation from SIAP.
- 2.30. The Head of Paid Service has been consulted on these proposals and is satisfied that this solution is acceptable to address the challenges outlined in this report, including the legal implications and mitigations of the SIAP SLA resulting in putting the Service Manager – Audit post at risk.

3. IMPLICATIONS

Risks

- 3.1. Risks have been documented in the narrative of this report. In addition, the Council engaged CIPFA to undertake a financial resilience review, their findings included the risks to the council of not establishing appropriate financial skills and capacity. The CIPFA report can be accessed on the July Council agenda.

Legal Implications

- 3.2. Section 151 of the Local Government Act 1972 states that every local authority must make arrangements for the proper administration of their financial affairs.
- 3.3. Pursuant to sections 9E, 9EA, 9EB of the Local Government Act 2000 the Secretary of State may make provision to permit local authorities to make arrangements for the discharge of their functions by another local authority and under Section 101(5) of the Local Government Act 1972 for the discharge of any of their functions jointly which are the responsibility of the Cabinet or Executive of a local authority. The Local Authorities (Arrangements for the Discharge of Functions) (England) Regulations 2012 permit such arrangements.

- 3.4. In accordance with sections 101 and 111 of the Local Government Act 1972, and section 3 of the Local Government Act 1999, a number of local authorities have already agreed to enter into a collaboration agreement to establish a relationship between the authorities in relation to the provision of an Internal Audit service.
- 3.5. The proposed structural changes may have TUPE implications (Transfer of Undertakings (Protection of Employment)) and external advice should be sought from an employment specialist and budgeted for accordingly.
- 3.6. The Procurement Act 2024 is due to come into effect from 24th February 2025, and until this date, the existing procurement rules as explained above will apply.

Comments approved by S Thorp, Corporate Manager, Legal Services.

Financial and Resource Implications

- 3.7. The initial service agreement will be for 5 years with break clauses based upon specific performance metrics.
- 3.8. The financial implications of the proposed structure changes are covered in the report.

Equalities Impact Implications

- 3.9. Consideration has been given to the protected characteristics. There do not appear to be any qualities implications arising in respect of the decisions being taken by Cabinet with regard this report.

4. CONCLUSIONS

- 4.1. The council must ensure it has adequate capacity and capability to enable the Chief Finance Officer to properly administer the Council's financial affairs. This paper sets out the requirement for additional senior financial management and technical capacity and the functional re-alignment of existing accountancy capacity to ensure robust financial leadership and risk management of the council's affairs.

LIST OF APPENDICES/ANNEXES:

none

BACKGROUND DOCUMENTS:

None

CONTACT DETAILS:

Report Author – Peter Vickers, Section 151, peter.vickers@rushmoor.gov.uk

Head of Service – as above.