

# Governance, Risk and Best Value

9am, Thursday 10<sup>th</sup> October 2013

## Internal audit co-source update

Item number	8.2
Report number	
Wards	

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Coalition pledges	<a href="#">P30</a>
Council outcomes	<a href="#">CO25</a>
Single Outcome Agreement	<a href="#">All</a>

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# Executive summary

## Internal audit co-source update

### Summary

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On 22 November 2012, Council approved the appointment of PwC as co-source partners in the delivery of internal audit and risk management services for a three-year period. The contract incorporating the agreed service delivery plan was signed in early April, with an effective date of 1 April 2013 to coincide with the beginning of the financial year. As part of the approval at Council, it was agreed to bring a report to GRBV within 6 months on the exit strategy for the end of the contract.

The agreed service delivery plan with PwC highlights the key phases of the 3 year contract and the services that PwC will deliver to transform the internal audit function. This report sets out details of the three key phases of the transformation program which are intended to allow the internal audit function to be taken forward by an in-house team at the end of the contract period.

### Recommendations

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Committee is requested to note:

1. the progress made with by the co-sourced internal audit team and the exit strategy for the end of the contract with PwC; and
2. that further reports will be presented to Committee on progress and relevant performance matters.

### Measures of success

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Over the three-year co-source period, PwC will provide services to ensure that the Council's internal audit and risk management function undergoes a transformation. The internal audit function will be repositioned to have a direct focus on mitigating the Council's key risks. By 1 April 2014 a new risk-based audit plan will be in place. By October 2015, a full exit strategy will be presented to Committee.

### Financial impact

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The cost of the co-source contract has been largely met by savings from the restructuring of the existing internal audit function.

## Equalities impact

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There are no direct equalities impacts as a result of this report.

## Sustainability impact

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There is no direct sustainability impact arising from the report's contents.

## Consultation and engagement

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The finalised co-source service delivery plan reflects extensive engagement and discussion between the Council and PwC and draws as appropriate upon earlier comments raised by the staff group.

## Background reading / external references

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- [Internal Audit and Risk Management Service Delivery, City of Edinburgh Council, 23 November 2012](#)
- [Internal Audit Co-Source Update, Governance, Risk and Best Value Committee, 23 May 2013](#)

## Internal audit co-source update

### 1. Background

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- 1.1 On 22 November 2012, Council approved the appointment of PwC as co-source partners in the delivery of internal audit and risk management services for a three-year period. The contract incorporating the agreed service delivery plan was signed in early April, with an effective date of 1 April 2013 to coincide with the beginning of the financial year. The service delivery plan highlights the services that PwC will deliver during that period to progressively move towards a state which allows the service to be taken forward by an internal Council team at the end of the contract.
- 1.2 As part of the approval at Council, it was agreed to bring an update report to GRBV within 6 months on the exit strategy for the function being taken forward internally.

### 2. Main report

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- 2.1 The internal audit function is undertaking a transformation over the next 3 years to ensure the Council has a leading edge internal audit function at the end of the co-source period. The Council internal audit function previously had a fairly narrow focus on financial controls with a need to increase productivity, capacity and capability. A requirement to increase the authority and influence of the function was also identified. In recognition of this transformation, internal audit will evolve and change over the 3 year co-source period. The transformation program is split into 3 key stages:
  - Stabilise and improve – 1 April 2013 to 30 September 2013
  - Design and build – 1 October 2013 to 31 March 2014
  - Implement and embed – 1 April 2014 to 31 March 2016
- 2.2 The 'stabilise and improve' phase of the transformation project is now complete. This phase has focused on initial steps towards improving the authority and influence of internal audit and ensuring management and elected members have greater visibility of assurance in key risk areas. This has included the development of an audit plan which focuses on scrutinising the high risk areas of the Council. Following consultation with senior management and elected members, this risk based audit plan was approved at Committee on 25 September 2013.
- 2.3 Over the initial 6 month period, internal capacity has been supplemented and strengthened by the new resource provided by PwC. The close 'one team' approach, with internal staff working closely with PwC colleagues, is intended to

facilitate a transfer of skills to build our in-house capability. Key service improvements and deliverables that have been achieved by the combined team include:

- In line with the increased focus on a risk based approach, risk and control matrices for planning and management of audits have been introduced. This tool allows the internal auditor to focus on the key risk areas under review and assess whether the management controls are adequate to mitigate these. Where management controls are adequate, it allows for effective testing of these controls. This improves the focus and efficiency of the audit thereby increasing productivity of the team.
- Appropriate definitions for risk findings as 'critical', 'high', 'medium' and 'low' have been developed to ensure clarity, consistency and transparency to management.
- Defined procedures have been developed for escalation of critical and high risk issues to CMT and GRBV, to improve authority and influence of internal audit.
- Defined procedures have been developed for escalation of issues to CMT and GRBV where no follow-up actions have been taken by management, to allow effective oversight and assurance of risks.
- A new audit charter has been introduced to define roles and responsibilities in relation to internal audit across the Council and to set management expectations. This document replaces the existing outdated charter.
- The audit year has been realigned with the Council financial year and a 6 month audit program has been developed which links with risk management to improve the effectiveness of internal audit.
- Upgraded audit management software has been installed to allow for more efficient processes.
- A challenging risk based audit plan for the year has been delivered, with some 45 internal audit reviews completed, an improvement of 50% on the prior year.

2.4 In addition to the skills transfer through the one team approach, a personal 3-year training program has been developed for each internal audit team member to ensure that each team member is appropriately trained in internal audit best practice in order to provide the best service to the Council. This journey of personal development for all staff has started through delivery of a number of classroom sessions on effective internal auditing including planning, completion and follow-ups.

2.5 During this time we have also started to look at developing a risk management function as a second line of defence, (audit performing the third line of defence).

Whilst that is not part of this report and it may well take a longer period of time to resolve, the services can be drawn down under the same contract.

2.6 The design and build phase of the transformation program is now underway. This phase includes the delivery of the risk based audit program that was approved by Committee in September. Throughout this phase the productivity and capacity within the team will be challenged with an increased focus on output of risk based internal audits rather than input days. Within this phase the key service improvements and deliverables that will be achieved include:

- Enhancement of an Internal Audit methodology for CEC, including the development of an internal audit quality manual which details the exact procedures and review requirements for each audit job. This will ensure consistency, quality and efficiency in audit approach.
- Development of a robust quality control framework for Council internal audit, including self-assessment program.
- Development of tailored, compliant work programmes, with the effect of reducing the time taken to scope and plan audits and understand the risks of the service area, allowing for time to focus on the key risks
- Enhanced linkage with risk management to ensure the audit program is tailored to high risk areas of the Council.
- Training delivered for each team member on new internal audit methodology and framework, to embed efficiency savings in the program.
- Roll-out and full integration including training for team members on audit management software to reduce non-productive time and to enhance reporting.
- Updated reporting format for internal audit reports to improve communication of internal audit findings which allow for better management oversight of risks.
- Enhancing reporting templates to meet the needs of stakeholders which will improve the efficiency of the reporting process and improve the assurance and scrutiny by senior management and elected members.

2.7 The implementation phase of the program will continue to embed the improvements to the internal audit section and ensure that by the end of the co-source contract, internal audit is an effective and efficient service. The internal audit program will be fully aligned to risk management and ultimately will be value enhancing, scrutinising and providing assurance for the Council on key risk areas. By the end of the co-sourcing contract the following will be in place:

- Full and transparent reporting to CMT and GRBV which will allow senior management and elected members to gain assurance that the Council is managing its risks effectively.
- Regular engagement with senior management and elected members to ensure concerns are raised early and internal audit can provide scrutiny on a timely basis.
- Value enhancement reviews and value adding performance which will allow internal audit to focus on review and scrutiny of wider areas of Council risk and can assist the Council to improve its governance framework.
- Effective and efficient structure of the internal audit department to ensure it is fit for purpose for the future.
- Fully trained and up-skilled internal audit staff which will allow the Council to run internally a leading edge internal audit function.

2.8 Within 6 months of the end date of the contract, the Council will need to begin recruitment activity to allow the in-house section to operate effectively under the improved framework and structure. PwC will assist the Council in the competencies required for candidates and in the recruitment and selection process.

### 3. Recommendations

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3.1 Committee is requested to note:

- (a) the progress made by the co-sourced internal audit team and the exit strategy for the end of the contract with PwC; and
- (b) that further reports will be presented to Committee on progress and relevant performance matters

**Alastair Maclean**

Director of Corporate Governance

## Links

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<b>Coalition pledges</b>	<b>P30</b> Continue to maintain a sound financial position including long-term financial planning
<b>Council outcomes</b>	<b>CO25</b> – The Council has efficient and effective services that deliver on objectives
<b>Single Outcome Agreement</b>	Our public services are high quality, continually improving, efficient and responsive to local people's needs