

Report of the Chief Executive

## **Internal Audit**

### **Purpose of Report**

1. This report seeks approval for a new contract for internal audit and counter fraud services for the period 2020-30.

### **Recommendation**

2. Executive is asked to:
  - i. Agree to enter into a new 10 year contract with Veritau, with an option to extend for a further 5 years
  - ii. Agree the outline service specification as set out in annex 1

Reason for recommendation:

To provide a value for money internal audit and counter fraud function to the Council.

### **Background**

3. The Public Sector Internal Audit Standards (PSIAS) define internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.
4. The PSIAS go on further to outline a number of core principles that should be present in any internal audit function:
  - i. Demonstrates integrity.
  - ii. Demonstrates competence and due professional care.
  - iii. Is objective and free from undue influence (independent).
  - iv. Aligns with the strategies, objectives, and risks of the organisation.
  - v. Is appropriately positioned and adequately resourced.
  - vi. Demonstrates quality and continuous improvement.

- vii. Communicates effectively.
5. In 2009 the Council decided to deliver internal audit and related assurance services through a company, jointly owned with North Yorkshire County Council. Veritau Limited was formed in 2009 by both Councils to share internal audit, counter fraud and information governance services between the councils. The arrangement addressed a number of concerns around capacity for providing effective services in-house, including cost of services, ability to respond to changing service delivery models and recruitment and retention of high quality audit staff. It also delivered a number of other advantages, which are set out in the analysis section of the report. Each council has a 50% share in the company. The company established a subsidiary company in 2012, Veritau North Yorkshire (VNY). VNY is owned by Veritau and four of the North Yorkshire District Councils. The combined group operates as a single business.
6. The council no longer buys information governance services from Veritau, so the main services provided are internal audit and counter fraud. The original contract was for 10 years (with options to extend by a further five years) and was due to end on 31 March 2019. In March 2018 the Chief Executive made an officer decision to extend the contract by 1 year to take the Council through to 31 March 2020.
7. Veritau was formed for the primary purpose of delivering and enhancing assurance services provided to the shareholding councils. To fulfil this aim the council relies upon the Teckal exemption which enables us to procure these services directly from Veritau without tendering. This also enables control over the delivery of services. The new arrangement would continue to comply with Teckal arrangements as set out in the Public Contracts Regulations 2015.

## **Consultation**

8. This report has been considered by Audit and Governance Committee on 5<sup>th</sup> December 2018 and 6<sup>th</sup> February 2019. Members of the committee requested further information which is now included in this report. Specifically they requested further analysis of the following;
  - i. Costs and implications of alternative options
  - ii. Results of the external assessment of internal audit
  - iii. Management arrangements at other councils and
  - iv. Further justification and consideration of the proposed contract length.

9. Some Members still had concerns about the close relationship between Veritau and the S151 Officer. However it was explained that having a good working relationship with internal audit was crucially important to the S151 Officer in meeting their statutory obligations. Some Members also stated that they would be more comfortable with a shorter contract but on balance the Committee agreed that 10+5 was reasonable.
10. The Committee resolved that, with the inclusion of the additional information they requested to be in the report, they were content for the report to progress to Executive.

## **Analysis**

11. Proposals for sharing assurance services between City of York Council and North Yorkshire County Council were first suggested in 2007. A number of options for the delivery of a shared service were explored and in 2009 the Executive at each council approved the formation of Veritau Limited, and the transfer of services and staff to the company.
12. There were a number of drivers for the change, and benefits in sharing services. These included the following.
  - i. Increased security of service provision including resilience and capacity: the teams at both councils had experienced problems filling vacancies in professional assurance roles. Combining the services across a bigger team enabled resource pressures to be spread and the risks to be more effectively managed. The combined team is better placed to manage issues caused by staff vacancies and unexpected service demands. It also gives greater flexibility to respond to changing priorities, initiatives and new working practices dictated by professional standards. Reliance on key members of staff for the delivery of services had also been an issue and the new arrangement improved the scope to manage succession planning and mitigate risks around service continuity.
  - ii. Achievement of economies of scale by sharing overheads and reducing unproductive time: for example, through reducing overall management overheads, using a single audit management IT system and combining procedures. The councils recognised the need to improve the quality of services and making efficiency savings through sharing services and reinvesting this in the team was a way to achieve this. It also enabled effectiveness to be increased by sharing best practice and developing

expertise which could be shared across sites for example through the development of common approaches to audits.

- iii. Enhanced focus on service delivery and quality through the development of a dedicated professional services function with a separate identity, and a vision and brand linked to the delivery of high quality assurance services.
- iv. Greater staff satisfaction and retention as a result of enhanced career opportunities and the ability of staff to specialise and gain broader experience as part of a larger team.
- v. A greater opportunity to develop specialist knowledge within the company and reduce reliance on expensive bought-in services (for example IT audit). This was not possible within the smaller teams operated by each council.
- vi. A more innovative approach, which could generate improvements by being given greater flexibility in managing services.

13. The formation of a company controlled by the council was the preferred option as it achieved a number of key aims.

- i. It enabled each council to exercise a high degree of control and influence over the services in the future.
- ii. By maintaining control, it enabled them to be satisfied that the company would continue to provide sufficient and continuing access to the services.
- iii. It represented a genuinely equal partnership between the councils.

### **Success of company model**

14. The company model for sharing services has achieved the aims set out in the original business case and has delivered the expected benefits, as set out below.

15. Veritau was one of the first shared assurance services partnerships nationally. As financial pressures on councils have continued to grow over the last eight years, many in-house internal audit teams have faced reductions in their resources. In some cases, to levels which threaten their ability to deliver a service which meets statutory requirements - particularly at smaller councils. Nationally, more local authorities are joining shared service arrangements as a

way to manage this risk. This approach has also been replicated by central government which has established a single shared service for internal audit. Councils have also had their capacity to investigate fraud significantly reduced since the transfer of benefit investigation services to the DWP as part of the Single Fraud Investigation Service Initiative. In their 2016 Counter Fraud and Corruption Tracker, Cipfa reported that 10% of the public sector organisations they had surveyed (mainly local authorities) had no dedicated counter fraud resource.

16. Similar pressures faced by the shareholding councils have led to reductions in the level of service required from Veritau since it formed. For example, the level of service provided to NYCC and CYC by Veritau Limited has fallen by 25% since 2009, across the range of service areas. The company has been able to manage this reduction in demand whilst still maintaining professional standards and high levels of customer satisfaction. This is possible because as a larger entity it has been able to absorb the reductions through:
  - i. varying the numbers of employees engaged in service delivery across each client and targeting the mix of services most needed by the clients (for example to meet increases in demand for information governance and counter fraud services across a number of councils)
  - ii. selling services to external clients to maintain and expand the overall size of the business - this ensures that the overall infrastructure needed to maintain high quality services can continue to be supported.
  
17. As a larger entity, the group has also been able to manage short term fluctuations in demand and resource pressures. For example those caused by employee absences or requests for additional work. Veritau employees work across multiple sites and are moved around as needed to meet the demand for work.
  
18. The company model provides economies of scale across a range of areas. A number of examples are set out below.
  - i. A low ratio of management and administration overheads to direct costs compared to smaller in-house teams.
  - ii. Common IT audit and fraud management systems in use across all clients - the use of remote access means that systems can be accessed from any site.
  - iii. Unified procedures are in place for the delivery of services as far as possible. This means that employees can undertake work interchangeably at all sites. It also means that changes in practice can

be managed centrally - for example updates required to reflect changes in internal audit standards.

- iv. Common work programmes are used across clients where possible, which makes delivery of work more efficient.

19. Undertaking work across a number of organisations has also brought other benefits. For example auditors that have developed knowledge and expertise in a specific service area at one site are used to undertake work more effectively at other clients. Veritau is also able to support the sharing of knowledge and good practice across clients where appropriate.
20. Veritau has developed a strong and growing identity as a public sector assurance services provider. When first formed, the company inherited five contracts to provide internal audit services to external bodies. These organisations were all based in the North Yorkshire area. Veritau currently provides services to more than 20 public sector bodies, including work in the North West and the Midlands. Veritau is often approached by other councils to undertake audit assignments, often of a complex or sensitive nature.
21. In 2010, Veritau was awarded the Cliff Nicholson award for Excellence in Public Service Audit by Cipfa in recognition of its innovative approach to sharing services.
22. Since then, Veritau has also been shortlisted on a number of occasions for innovation and excellence awards by Public Finance and the Institute of Revenues Rating and Valuation (IRRV).
23. Recruitment and retention continues to be an issue across the range of Veritau services. As a Teckal company, pay structures are closely aligned to local government rates. This presents a challenge as pay rates in the wider private sector are often significantly higher for similar roles. To help address this, the company places a strong emphasis on being a good employer and uses the flexibility it has as a private company to make it attractive to current and prospective staff. For example:
  - i. The group has been accredited as an investor in people since June 2011.
  - ii. The company operates a performance related pay scheme which offers all employees an opportunity to earn additional pay as a reward for good performance.
  - iii. The company offers a high degree of flexibility around working patterns and home working.

- iv. The company offers a choice of pension provision.
- v. The client base and range of services offers staff the opportunity to gain wider experience in different organisations and areas.
- vi. The company invests a significant amount in training and development - professional training is a particular strength.

24. To address issues with recruiting qualified professional staff (one of the drivers for forming Veritau) the group has taken an innovative approach based on the recruitment and internal development of graduate trainees across each service area. Veritau makes a significant investment in professional training - an option not generally available to smaller in-house teams. Bringing in talented trainees on a regular basis helps to maintain a sufficient level of well trained professional staff able to meet the demand for services. As noted above, Veritau's approach to professional training has been recognised by Public Finance and the IRRV for its framework for training and developing staff. A number of former trainees have progressed into senior roles in the company. Veritau has also developed an aspiring manager programme, offering management development opportunities. The first new assistant manager was appointed under this programme in September 2018.

25. In addition to professional training, the company offers opportunities for staff to undertake training in specialist areas. Historically, reliance was placed on expensive bought in support to provide IT audit work at some clients. Over the last few years the company has targeted IT audit training internally and has been able to bring this work in-house. While retention of specialist staff is an issue (because they are attractive to other employers) the group is aiming to address this by increasing capacity and training. A specialist IT audit trainee was appointed in 2017 and training is being provided to a number of other employees.

26. Counter fraud is an area where the company has been particularly innovative. The counter fraud team inherited by Veritau from City of York Council in 2009 was principally a benefit fraud service. Since then the fraud team at Veritau has sought to diversify by broadening the range of investigations undertaken and transforming the service into a corporate fraud team. In its former role as a benefit fraud team, there was little scope to directly support councils through reducing losses - councils lost subsidy on benefit fraud overpayments and in most cases, customers were unable to pay overpayments identified.

27. Focussing on other types of fraud affecting councils has meant that the team can concentrate on cases which make real savings. The level of benefit fraud

investigated fell steadily between 2011 and March 2016, when responsibility for investigation transferred to the DWP. The change in focus has resulted in increases in real cash savings identified as a result of counter fraud work. In the last two years, counter fraud activity has yielded cash savings of £347k (2016/17) and £298k (2017/18) for the council. For 2018/19 (up to 30 September 2018) savings of £216k have been realised.

28. In accordance with the relevant auditing standards, the council must regularly review the effectiveness of its internal audit function. This review has recently been completed and the outcome reported to Audit & Governance Committee in February 2019. The review identified many positive observations and recommended some areas for further consideration. However, overall no concerns were raised regarding the performance of Veritau.

### **Value for Money**

29. Charges for services to the member councils are based on a day rate - which is industry wide practice for this type of work. Rates have remained competitive since the creation of the company. In 2009/10 (the first year of operation) the rate charged was £225 per day. For 2018/19, the rate is £249 per day - an increase of only £24 per day (10.7%). Over the same period, CPI has risen by 22.6%.

30. In the latest benchmarking information available from Cipfa, the average cost of internal audit per chargeable day for the local authorities taking part in the exercise was £300. In 2017/18 further benchmarking was undertaken with a number of other providers who are part of the Audit Together shared services network. This identified a range of costs from £265 up to £301 that were directly comparable to the £244 per day charged by Veritau last year.

### **The proposal**

31. Officers have reviewed the Councils requirements from its internal audit and counter fraud service and a draft specification is included as an annex to this report. The specification has been written to reflect the current operating context and the requirement for the Council to continue to improve and enhance the services concerned.

32. The key points in the service specification include:

- i. key performance indicators that can be monitored throughout the life of the contract



- ii. Ongoing delivery of efficiency savings
- iii. Maintaining a strong client relationship
- iv. Continued representation on the Veritau board.

33. Where appropriate, the targets to achieve have been increased from the current contractual arrangements to ensure the Council continues to receive timely and accurate reports that add real value.

34. The benchmarking with other councils included looking at management arrangements. Of the 70 councils examined, 26 had a shared service, 41 had an internal team and 3 used an external provider. Of the councils with a shared service they all had similar arrangements to the council in that they reported to the s151 officer, except 1 where the reporting line was direct to the Chief Executive.

35. It is proposed to agree a new 10 + 5 year contract with Veritau. Benchmarking with other shared services has identified that there is no particular standard or usual contract length. Of the 12 shared service models examined, 9 either had no time limit or were on rolling agreements and the remaining 3 had agreements for either 3, 5 or 6 years all with options to extend. The 10 + 5 agreement is therefore proposed both to be consistent with the other councils within the current shared service and to give Veritau, as a small local supplier, some certainty and to allow the company to plan business activity. It is worth noting that the council can withdraw from the service at any time by giving 12 months notice.

36. The company will continue to be held accountable by the Council Shareholder Committee, reporting the business plan and budget for the year ahead and the outturn position by presenting its accounts to the Committee.

## Options

37. A number of different options have been considered and are set out in the table below.

|   | Option  | Costs | Advantages / disadvantages   |
|---|---|-------|--|
| 1 | Continue with Veritau model – <b>recommended option</b> | £500k | <u>Advantages</u> <ul style="list-style-type: none"> <li>• Service resilience and capacity</li> <li>• Economies of scale</li> <li>• Quality of service delivery</li> </ul> |

|   |   |   |  |
|---|---|---|--|
|   |   |   | <ul style="list-style-type: none"> <li>• Access to wider / specialist resources</li> <li>• Control over service through shared ownership of company</li> </ul> <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> <li>• There is a view that the provision of internal audit through this delivery model may give rise to conflicts of interest</li> </ul>   |
| 2 | In house service – the problems originally sought to be addressed through the shared service will continue to exist. It would also not be possible for the council to maintain the same level and quality of service without increasing cost.   | Approx £650k plus implementation costs estimated at £250k | <p><u>Advantages</u></p> <ul style="list-style-type: none"> <li>• Quality of service delivery</li> <li>• Scope of service easily changed</li> </ul> <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> <li>• Increased cost</li> <li>• Lack of resilience</li> <li>• Likely to be more difficult to recruit &amp; retain staff in smaller team</li> <li>• Access to specialist resources limited</li> <li>• Reduced opportunity to share knowledge / experience with neighbouring councils</li> <li>• Cost of implementation (purchase of IT system, HR and legal costs, TUPE etc.)</li> </ul> |
| 3 | Seek another vehicle for delivery of shared service - The options for delivery of the service remain broadly the same as when Veritau was created and the arguments for maintaining the company model remain valid. The other member councils all remain committed to the Veritau model | £500k plus implementation costs estimated at £150k        | <p><u>Advantages</u></p> <ul style="list-style-type: none"> <li>• Service resilience and capacity</li> <li>• Economies of scale</li> <li>• Quality of service delivery</li> <li>• Access to wider / specialist resources</li> </ul> <p><u>Disadvantages</u></p>  |

|   |                                   |   |  |
|---|-----------------------------------|---|--|
|   |                                   |   | <ul style="list-style-type: none"> <li>• Risks to stability of current arrangements</li> <li>• Any changes in scope of service would require contractual negotiation</li> <li>• Continuity of staffing not guaranteed</li> <li>• Increased ongoing cost</li> <li>• Significant costs in winding up, negotiating and creating a new vehicle with the other member councils</li> <li>• Cost of implementation (HR, legal costs, TUPE etc.)</li> </ul>  |
| 4 | Procure external service provider | Approx £540k plus implementation costs estimated at £150k | <p><u>Advantages</u></p> <ul style="list-style-type: none"> <li>• Service resilience and capacity</li> <li>• Economies of scale</li> <li>• Quality of service delivery</li> <li>• Access to wider / specialist resources</li> </ul> <p><u>Disadvantages</u></p> <ul style="list-style-type: none"> <li>• Continuity of staffing not guaranteed</li> <li>• Increased ongoing cost</li> <li>• Cost of implementation (tendering, TUPE, etc)</li> <li>• Any changes in scope would require changes to contract</li> <li>• Less certainty over costs in longer term</li> <li>• Lack of control over service</li> </ul> |

38. Options 2, 3 and 4 have been discounted on the basis of additional cost (for which budget would need to be identified) and disruption to service. As outlined in paragraphs 27 to 28 the benchmarking of other audit services demonstrates that the charges from Veritau are already competitive. It is considered that any procurement exercise would not drive out further value.

## **Council Plan**

39. The work of internal audit and counter fraud helps to support our overall aims and priorities by promoting probity, integrity and accountability and by helping to make the council a more effective organisation.

## **Implications**

### **Financial Implications**

40. The annual budget for internal audit and fraud services is £500k and the service specification outlined in annex 1 can be delivered within this approved budget. This is less than the estimated cost of the alternative options outlined above.
41. It is difficult to accurately cost the alternative options outlined in paragraph 33, as there are many different factors and possible outcomes to consider. The costs are therefore broad estimates based on informal discussions with Councils who currently use external providers, knowledge of rates charged elsewhere and assuming a similar level of service to that currently received. In addition to the ongoing costs included in the table above, there would also need to be a period of dual running with an in house team and Veritau to allow for a proper handover, along with costs of buying an internal audit ICT system and other set up costs. Overall, it is difficult to see how this could be delivered within current resources and therefore additional budget would need to be identified to cover the set up and transition costs. In addition, there would be legal costs associated with the transfer arrangements of Veritau staff into the Council.
42. As outlined in paragraphs 27 and 28, the current arrangements are very cost effective. The average paid by other Councils is some 20% higher than our current costs. Therefore seeking an alternative service delivery vehicle is unlikely to deliver any cost savings but would have the added cost of re procurement.

### **Human Resources (HR)**

43. There are no HR implications if the recommended option is agreed. Under options 2, 3 and 4 TUPE would apply and this would result in uncertainty for staff and potential disruption to service delivery.

## Legal

44. The Council can make a direct award to Veritau Ltd without undergoing a procurement process while it remains a Teckal compliant company. This requires the Council to exercise similar control over the company as it does over its own departments, that at least 80% of the activities of the company are those entrusted to it by the shareholding Councils and that there is no direct capital participation from the private sector in Veritau. The alternative proposals would all require some legal resource to extract the council from the Veritau company structure along with support to procure a new supplier.

## Other

45. There are no other One Planet Council, equalities, crime and disorder, information technology, property or other implications.

## Risk Management

46. An assessment of risks has been completed and there are no significant risks to highlight.

## Contact Details

|   |  |   |                          |
|---|--|---|--------------------------|
| <b>Author:</b>  | <b>Chief Officer responsible for the report:</b> |   |                          |
| Debbie Mitchell<br>Finance & Procurement<br>Manager<br>Ext 4161               | Mary Weastell<br>Chief Executive                 |   |                          |
|   | <b>Report Approved</b>                           | ✓ | <b>Date</b> 4 March 2019 |
|   |  |   |                          |
| <b>Wards Affected:</b> All  |  |   |                          |
| <b><i>For further information please contact the author of the report</i></b> |  |   |                          |