

Wolverhampton City Council

OPEN INFORMATION ITEM

Audit Committee

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Originating Service Group(s)

DELIVERY

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Title/Subject Matter

CIPFA AUDIT COMMITTEE UPDATE

SUMMARY

That the latest CIPFA Audit Committee Update, Issue 8 – helping audit committees to be effective, be received and noted.

1. PURPOSE AND BACKGROUND

- 1.1 CIPFA issue regular briefings for audit committee members in public sector bodies. Their aim is to provide members of audit committees with direct access to relevant and topical information that will support them in their role.

2. DETAILS

- 2.1 The latest edition of these briefings covers, amongst other topics, commissioning, procurement and contracting risks. A copy of the briefing accompanies this report for Members reference.

3. FINANCIAL IMPLICATIONS

- 3.1 There are no direct financial implications arising from this report. [GE/17072012/D]

4. LEGAL IMPLICATIONS

- 4.1 There are no direct legal implications arising from this report. [MW/17072012/X]

5. EQUAL OPPORTUNITIES IMPLICATIONS

- 5.1 There are no direct equal opportunities implications arising from this report.

6. ENVIRONMENTAL IMPLICATIONS

- 6.1 There are no direct environmental implications arising from this report.

7. SCHEDULE OF BACKGROUND PAPERS

CIPFA Audit Committee Update – Issue 8 (June 2012)

CIPFA Better Governance Forum briefing paper

Audit Committee Update

– helping audit committees to be effective

Issue 8

Commissioning, procurement and contracting risks

June 2012

Introduction

Dear audit committee member,

This issue of Audit Committee Update focuses on some of the risk and control issues arising from commissioning, procurement and contracting. To undertake these essential processes effectively public sector organisation should ensure that they have appropriate governance, risk management and internal control arrangements in place. The article highlights the key risk areas and controls and examines some of the questions the audit committee might wish to raise. We also feature an article on some of the current challenges affecting procurement and commissioning in public bodies by Mohamed Hans of CIPFA's Procurement and Commissioning Network.

As usual we also feature a round-up of legislation, reports and developments that may be of interest to audit committee members. Whenever I put these issues together I am reminded just how much there is for audit committee members to consider in their role. I hope these briefings help to make that role a little easier!

We have included links to resources and further information on our website. To access these all you need to do is register. Further details on how to do this are at the bottom of the page.

We welcome feedback on these briefing and also any suggestions for future topics. Feel free to contact me and let me know.

Kind regards

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Receive our briefings directly

This briefing will be sent to all key contacts of organisations that subscribe to the CIPFA Better Governance Forum with a request that it be forwarded to all audit committee members.

If you have an organisational email address (for example jsmith@mycouncil.gov.uk) then you will also be able to register on our website. This will give you access to governance material, guidance documents and you can receive these briefings directly.

Visit our website www.cipfanetworks.net/governance or register today.

Workshops and training for audit committee members in 2012 from CIPFA

The Influential Audit Committee

This new audit committee workshop will address how the audit committee can improve its influence and impact on good governance. Featuring sessions on assurance planning, effective public reporting, improving accountability and evaluating the provision of audit services, the workshop will offer opportunities for discussion, self-evaluation and networking with other public sector audit committee members.

18th July Birmingham, 4th October Edinburgh

Further dates & locations will be available in 2013.

<http://www.cipfanetworks.net/governance/events/>

Advanced Audit Committees

Have you cracked the basics? This workshop examines the audit committee role in strategic risk management, value for money, counter fraud and treasury management.

26 September Leeds, 22 November London

Essential Skills for Board Members

The role of a board member in a public sector body, featuring sessions on corporate governance, decision making, accountability and evaluating board performance.

23 October London

<http://www.cipfanetworks.net/training/events/#3>

In-house training

We have many years' experience in delivering training in-house for Audit Committees. A range of options are available including:

- Key roles & responsibilities
- Effective chairing & support for the committee
- Working with internal and external auditors
- Corporate governance
- Strategic risk management
- Value for money
- Counter fraud
- Reviewing the financial statements
- Treasury management
- Assurance arrangements
- Partnership assurance

We can also develop bespoke training to meet your needs.

For more information please contact Claire.Simmons@cipfa.org.uk or speak to Diana Melville.

Commissioning, procurement and contracting risks – what does the audit committee need to know?

The public sector spends a huge amount of money on goods and services. The range is vast from the routine and relatively simple, such as fuel & equipment, to major construction contracts and complex service contracts for social care. The processes of commissioning, procurement and contracting form a major part of service planning and delivery and often involve specialist input from professional advisors.

From the audit committee's point of view it is worth understanding some of the key risks associated with this area. The audit committee is unlikely to be involved in the commissioning and procurement processes directly, but has an important role to play in reviewing the management of the risks and ensuring there are appropriate arrangements in place for assurance.

Commissioning – key risks

Ensuring a strategic approach

Commissioning of services arises from the strategic planning process and should reflect the vision for the development and delivery of services. Depending on the service the commissioning strategy could be long term and depend on a number of variables outside the direct control of the organisation. For example, commissioning adult social care services will need to take account of likely future demand.

Shared services and partnerships

A number of organisations are investigating alternatives to procurement on the open market. Establishing a new form of service delivery involves a number of risks which need careful planning. Sharing the Gain is a CIPFA guide that highlights key areas.

De-commissioning

Changes in legislation, in service needs or the end of partnership could result in the need to de-commission a service. Often how this will be achieved is not considered in advance which could result in additional costs.

Procurement – key risks

Value for money

There isn't always an obvious answer to the question of value for money. Should you go for the cheapest cost now or should you consider the whole life of the asset / service being procured? Having a clear objective at the start is very important so that the procurement process can be developed accordingly. Identifying key deliverables and stakeholders' expectations, and assessing the extent to which these are likely to be achieved by the procurement process at a reasonable cost, is not often undertaken. The end result being a focus on the immediate 'savings' realised at the contract award stage, rather than on whether the contract is actually going to deliver throughout its term.

Legal compliance

One of the major areas of risk concerns legal compliance. Major procurements will usually require compliance with EU procurement rules. Failure to follow the rules can result in costly legal action and could even result in the contract award being set aside. To avoid this, major procurements should involve appropriate professional advice at an early stage.

Procurement process

A number of risks can arise from the procurement process itself. For example a decentralised system could mean that economies of scale are not realised or that procurement is undertaken by

inexperienced staff. On the other hand a very centralised system may be inflexible and unresponsive to service needs. Few organisations measure the true cost of procurement.

Fraud

There are a number of fraud risks in the procurement process. These could include:

- bribery of staff to award a contract or disclose advantageous information;
- collusion between 'competing' contractors
- Invoice fraud to secure payments for goods or services not provided
- Payment fraud to divert genuine payments to contractors to fraudulent bank accounts.

The Annual Fraud Indicator 2012 compiled by the National Fraud Authority estimates that procurement fraud in the public sector amounts to £2.29 billion. A fraud loss tool, developed by the National Fraud Authority, is available on the CIPFA TISONline website to allow English local authorities to estimate their exposure to procurement fraud. CIPFA has produced guidance documents on procurement fraud which can help identify the risks and take appropriate action. Further details are provided in the resource list.

Contracting – key risks

Due diligence and contractor vetting

During the contractor evaluation process a proper due diligence process should be undertaken to evaluate the contractor's suitability for the service. Advice on suitable financial and other checks is available in a CIPFA guide produced in association with Grant Thornton. It is also important to be aware of risks during the lifetime of the contract, for example is a key contractor experiencing financial difficulties and likely to go out of business?

Contract Management

Effective management of the contract and monitoring of performance is essential to ensure that:

- The service is delivered to the standards expected.
- Payments are made only for services / goods supplied.
- Opportunities for improvement are identified.

This can be a weak area and the reasons for this could be a lack of suitably experienced staff to properly assess the contractor's performance. Ensuring that adequate and accurate data is collected and evaluated is a key part of the contract management process. There are also risks of collusion between contractor and contract management staff.

Contingency planning

In the event of service failure, whether temporary or longer-term, organisations should have contingency plans for the delivery of essential services. This can be difficult if the specialist equipment, knowledge or expertise is not readily available.

Audit Committee Role

There are a number of ways in which the audit committee is likely to review the effectiveness of the organisation's management of its commissioning & procurement risks.

- Oversight of the control framework. For example whether the organisation has up to date and effective strategies and policies in place.
- Review of risk registers and major commissioning and procurement risks.
- Review of governance arrangements over partnerships and shared services.
- Review of the governance and assurance arrangements for major projects that involve procurement.
- Review of the internal audit plan and reports. The audit committee should consider the extent to which they cover these risks.
- The assurances that underpin the Annual Governance Statement are likely to cover commissioning and procurement activity.

Wherever procurement and commissioning appears on the audit committee agenda, members of the committee should be seeking assurance that the risks have been fully identified, that controls are in place to manage the risk and that they are effective in practice.

Key questions to ask:

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|---|
| 1. Have the major areas of procurement spend been identified and what assurance do we have over those areas? |
| 2. Are policies and strategies to ensure compliance and value for money in place? How effectively do they work in practice? |
| 3. What is the risk from procurement fraud? What steps have we taken to prevent and detect fraud of this type? |
| 4. Are there plans to establish new partnerships, shared services or projects that will involve commissioning or procurement of services? Have the risks been identified and how will we get assurance? |
| 5. Do we have effective arrangements to carry out due diligence checks and monitoring during the lifetime of a contract? |

Sources of further information:

[Procurement Fraud briefing](#)

[Reducing the risks of procurement fraud briefing](#)

[Annual Fraud Indicator](#), from the National Fraud Authority

[Due Diligence – A guide to Pre-Qualification Questionnaires](#)

[Procurement and Contract Audit Forum](#), has audit programmes and information to support the audit of procurement. The forum is supported by CIPFA's Audit Panel and the Better Governance Forum.

[CIPFA Procurement and Commissioning Network](#) have resources for procurement professionals.

Diana Melville
Governance Advisor
CIPFA Better Governance Forum

Current developments in procurement & commissioning

The landscape of procurement and commissioning is constantly changing in response to government policy, case law, emerging good practice, risks and service needs. The following areas reflect some of the current developments that public bodies are currently dealing with.

Public Services (Social Value) Act 2012

The Public Services (Social Value) Act became law on 8th March 2012. Under the Act, for the first time, all public bodies in England and Wales are required to consider how the services they commission and procure might improve the economic, social and environmental well-being of the area.

It applies to all English and some Welsh bodies who will have to comply with the new law, including local authorities, government departments, NHS Trusts, PCTs, fire and rescue services, and housing associations.

The provisions will apply to all public services contracts and those public services contracts with only an element of goods or works. It will not apply to public work contracts or public supply (goods) contracts. However, there is widespread approval for public bodies considering social value in all forms of contracts including support from Nick Hurd, Minister for the Cabinet Office. It is expected that the Act will come into force from January 2013.

Community Right To Challenge

On 17 May 2012, in exercise of powers conferred by sections 81 and 235 of the Localism Act 2011, the Secretary of State made the Community Right to Challenge (Expressions of Interest and Excluded Services) (England) Regulations 2012, SI 2012/1313.

They came into force on 27 June 2012. Regulation 3 and Schedule 1 specify requirements for expressions of interest for the purposes of Section 81(1)(b). Regulation 4 and Schedule 2 specify services that are to be excluded for the purposes of Section 81(5), in some cases only until 1 April 2014. The Secretary of State has also issued Statutory Guidance on the Community Right to Challenge.

Abnormally Low Tenders – Your contracts are at risk!

The tough economic climate has led to an upsurge in suicide bidding – tendering at silly prices. This worrying practice is demonstrated in the construction industry: a RICS survey of nearly 400 quantity surveyors has shown contractors putting in bids below cost. 20% of tenders submitted during 2010 – 2011 were priced at a “sub-economic level”. Most suicide bids were 10% below cost but some were 40% under!

The findings also show that more than 50% have seen a client accepting a “sub-economic tender” in the full knowledge it was “potentially unviable”. Construction industry tender prices have fallen by about 15% since the start of the recession and suicide bidding has already caused some contractors to go bust.

Therefore tender with caution and be aware of recent ECJ case law which requires contracting authorities to investigate Abnormally Low Tenders. Failing to do so may put your contract in peril!

For detailed information on these areas contact the Procurement & Commissioning Network.

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Developments you may need to know about:

Local Government (Wales) Measure 2011 – statutory guidance

The Welsh Government undertook consultation earlier this year on the statutory guidance to support the implementation of this legislation, including guidance on audit committees (section 85.1). The statutory guidance has now been published.

Welsh authorities are required to establish an audit committee and the statutory guidance advises authorities to review the guidance contained in the CIPFA publications "*Audit Committees: Practical Guidance for Local Authorities*" and "*A toolkit for Local Authority Audit Committees*" as complimentary to the statutory guidance. The Toolkit is available on the [Audit Committee page](#) of the Better Governance Forum website

Welsh audit committees must appoint at least one lay member and up to a third may be lay members. The chair of the committee must not be from the same political group as the executive. The authority should adopt a Statement of Purpose for its audit committee ensuring that the committee is given a prime role in ensuring that effective corporate governance is central to the organisation. [Statutory Guidance](#)

National Fraud Indicator

The National Fraud Authority publishes an annual indicator of the level of fraud in the UK. The assessment breaks down the total fraud by sector and by major types of fraud. It estimates that the loss to the public sector from fraud is £20.3 billion, of which £14 billion is loss to the tax system.

Fraud loss in central government is estimated to be £2.5 billion and the loss to local government £2.2 billion. In addition there is a further loss of £1.6 billion on benefit and tax credit fraud. In local government the areas of the greatest fraud are estimated to be housing tenancy fraud (£900 million) and procurement fraud (£890 million).

[National Fraud Indicator 2012](#)

Fighting Fraud Locally

The National Fraud Authority launched the strategy for local government in April. Its aim is to help local authorities to better protect themselves from fraud and to have in place a more effective fraud response. To improve a local authority's strategic approach to fraud the National Fraud Authority (NFA) recommends that there should be an annual report to the audit committee on all matters relating to fraud. This should include an assessment of the effectiveness of the authority's fraud response. The NFA wrote to the chairs of all local authority audit committees to make them aware of the strategy.

CIPFA has been working with the NFA to develop and extend resources and guidance for counter fraud practitioners and also for those charged with governance. On the [Audit Committee page](#) of our website you will find links to the Counter Fraud Standards Managing the Risk of Fraud ([Red Book](#)) and a checklist for those charged with governance. On CIPFA's TISonline website there are further resources available in the [fraud risk management](#) section.

[Issue 3](#) of Audit Committee Update (October 2010) featured articles on counter fraud and the role of the audit committee. It includes two case studies of how local authority audit committees contribute to the fight against fraud.

Review of Good Governance Guidance Note

A steering group made up of CIPFA, Solace and practitioners is currently updating the Guidance Note that accompanied the Good Governance Framework in 2007. A draft for English local authorities will be released for consultation later this summer with publication due in December 2012. A separate publication is also being developed to support police bodies and reflect the changes happening in that sector.

The guidance note will feature new guidance on addressing governance issues that local authorities are facing. Since the governance framework is principles based it can be adapted to reflect changing circumstances and the updated guidance note will facilitate this.

Localism Act – code of conduct

Under the Localism Act local authorities are required to put in place new arrangements by 1st July to fulfil their responsibilities for ethical standards. Two templates have been produced by the DCLG and LGA to guide the development of a local code of conduct. A [briefing](#) on the Localism Act is available on the Better Governance Forum website. [Example formats for Local Code](#)

Internal Audit Standards Advisory Board and new professional standards for internal audit

CIPFA is collaborating with the Chartered Institute of Internal Auditors on a number of professional developments. A new Board was established in March this year to develop new public sector internal audit professional standards. The standards will be published for consultation soon and following the consultation they will be finalised at the end of 2012. The new standards will come into force from April 2013 and will be mandatory for all public sector bodies. It is proposed that a 'comply or explain' requirement will be introduced. Audit committees will have an important role to play in monitoring the compliance of the internal audit service against the professional standards and supporting improvement.

Details of the consultation will be published on the CIPFA website. An article outlining the work of the Board appeared in [Public Finance](#) a few weeks ago.

Appointment of external auditors

The Audit Commission concluded the outsourcing of external audits for local government, health, police and other bodies recently. The appointments are all for a five year period. Further details are available on the [Audit Commission website](#).

In the Queen's Speech a bill was announced to take forward the Government's objective of local appointment of external auditors. The draft bill is expected to be published for pre-legislative scrutiny later this summer.

Audit Quality Review Programme

The Audit Commission publish an annual report of the appointed external auditors for health and local government. The review covers the quality of the audits performed and compliance with regulatory requirements. [Audit Quality Review](#)

Local Government Governance Review, Grant Thornton

External auditors Grant Thornton have issued a major research report, High Pressure System, reviewing governance arrangements and Annual Governance Statements (AGS) in local authorities. The research included a desktop review of 200 councils' 2010/11 AGS comparing them to their best practice criteria. The review found that more could be done to make the AGS more accessible to the public and more effective as an assessment. Areas for improvement included demonstrating what assurance is needed to support the AGS and concluding explicitly where they have received sufficient assurance.

The review also includes sections on the contribution of the audit committee to governance, risk management, scrutiny arrangements and counter fraud. Other key documents for public reporting, including the explanatory foreword to the accounts are also assessed. Again a range of practice and quality was identified and there are opportunities to improve the usefulness of the document to the public. [High Pressure System](#)

Internal Audit in Central Government

The National Audit Office has published a value for money review of internal audit in central government. They conclude that Government is not getting the most out of the £70 million it spends on internal audit because the service does not always focus on the right issues and it is often not of sufficient quality to be useful in decision-making. The report identifies the NAO's key characteristics of an effective internal audit service. Audit committee members in central government bodies should consider the report and its recommendations. [Effectiveness of Internal Audit](#)

Value for money from shared services

The National Audit Office (NAO) published a report in March 'Efficiency and reform in government corporate functions through shared service centres'. The report focused on shared service arrangements in central government but the key messages are important for any public body planning the implementation of shared service arrangements. [NAO report](#)

UK Code of Governance and Audit Committee consultations

The Financial Reporting Council has issued consultations on the UK code of governance and on the role of the audit committee. The consultations are not applicable for the public sector but for governance and audit committee practitioners they will be of general interest. Of particular note is the proposal that the audit committee should advise the board on whether the annual report is fair, balanced and understandable and provides the information necessary for users to assess the company's performance, business model and strategy. [Financial Reporting Council](#)

The audit committee cycle

Review of Annual Governance Statements & Financial Statements

Prior to the end of September local authorities must approve their accounts and annual governance statements (AGS). Audit Committees usually play a significant role in reviewing not just the final documents, but reviewing supporting assurances and contributing to the development of the draft documents.

[Issue 2](#) of Audit Committee Update included an article on the audit committee role in reviewing the AGS. For 2011/12 it will now be a requirement to 'comply or explain' in the AGS against the CIPFA Statement on the Role of the Chief Financial Officer. Guidance on this is provided in the [Application Note](#).

A [webinar](#) is available to view covering the 2011/12 AGS.

Audit annual reports and review of effectiveness

The annual report of the Head of Internal Audit, including the opinion on the control environment, is a key document to support the AGS. The report should include:

- An opinion on the overall adequacy and effectiveness of the organisation's control environment.

- Disclose any qualifications to that opinion, together with reasons for the qualification.
- Present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies.
- Draw attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the AGS.
- Compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and targets.
- Comment on compliance with these (CIPFA code of Practice) standards and communicate the results of the internal audit quality assurance programme.

Code of Practice for Internal Audit in Local Government, CIPFA

Professional standards for internal audit (IIA and CIPFA) require appropriate quality review arrangements to be in place and the results of these reviews should help the audit committee to assess the assurances it receives from internal audit. In addition, the [Accounts and Audit Regulations](#) 2011 require local authorities to assess annually the effectiveness of internal audit.

Audit Committee Annual Reports

Many audit committees prepare an annual report to demonstrate how they have fulfilled their terms of reference and to account for their performance. Key aspects to consider including are:

- Committee membership
- Summary of activity, including key topics, decisions and recommendations.
- Review of the committee's effectiveness, including any external assessment results.
- Development activity undertaken. For example training, networking with other audit committees or peer reviews.

Annual reports should be publically available and care should be taken to make them readable and accessible.

We are keen to share good examples of annual reports so please send a copy to Diana.Melville@cipfa.org.uk and we will feature it on our website.

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