



**CABINET**  
16 June 2014

**Report from the Chief Finance  
Officer**

For Action

Wards Affected:  
ALL

**AUTHORITY TO TENDER CONTRACT FOR INTERNAL  
AUDIT SERVICES**

Appendix 1 is Not for Publication

**1. Summary**

- 1.1 This report concerns the provision of outsourced internal audit services from 1<sup>st</sup> April 2015. This report requests approval to invite tenders in respect of internal audit services as required by Contract Standing Orders 88 and 89.

**2. Recommendations**

- 2.1 The Cabinet to approve inviting tenders for internal audit services on the basis of the pre - tender considerations set out in paragraph 3.29 of the report.
- 2.2 The Cabinet to give approval to officers to evaluate the tenders referred to in 2.1 above on the basis of the evaluation criteria set out in paragraph 3.29 of the report.

**3. Detail**

**Purpose**

- 3.1 The purpose of this report is to seek approval to invite tenders for the provision of a four year contract for internal audit services to the council from the 1<sup>st</sup> April 2015. This follows expiry of the current contract with the London Borough of Croydon on 31<sup>st</sup> March 2015.
- 3.2 The services to be provided are core internal audit services, including the audit of schools, establishments, key financial systems and specialist audit areas including IT and contract audits.

**Current Provision**

- 3.3 The current provision is via a contract with the London Borough of Croydon. This

contract was approved by the Executive at its meeting on the 11<sup>th</sup> February 2013<sup>1</sup> and runs from 1<sup>st</sup> April 2013 to 31<sup>st</sup> March 2015. The gross cost of the existing contract over the two year period is estimated to be £604,000. The council recovers some £120,000 over the two year period from Brent Housing Partnership relating to planned audit work purchased under the contract.

- 3.4 The council had previously contracted with the London Borough of Croydon for the period 1<sup>st</sup> April 2011 to 31<sup>st</sup> March 2013. In both instances the council entered into a two year contract in order that it could review its position should the market or the council's requirements change.
- 3.5 The London Borough of Croydon entered into a framework agreement (the "Croydon Framework") with Deloitte and Touche Public Sector Internal Audit Ltd ("Deloitte") and are able to call off from the Croydon Framework a variable number of days per annum, in order to service the contract with Brent. Deloitte and Touche Public Sector Internal Audit were sold to Mazars on 3<sup>rd</sup> February 2014. The name has since been changed to Mazars Public Sector Internal Audit (Mazars).
- 3.6 The Croydon Framework commenced in April 2008 with an initial term to expire on 31 March 2015. There was however an option to extend the term of the Croydon Framework and it now runs until 31<sup>st</sup> March 2018. There are currently 25 local authorities buying into the Croydon contract, including 12 in London. Approximately 12,000 days were called off in 2013/14.
- 3.7 The rationale for entering into this contract in 2013 was documented in the earlier report to the Executive<sup>1</sup>. The decision in 2013 followed an earlier decision to contract with Croydon in 2011. On both occasions, when entering the contract, there was an option to contract for a period of four years. There was no financial advantage in doing so and the Executive agreed to a two year contract on the basis that it would provide an opportunity to review the situation over a shorter time frame.
- 3.8 The contract has been delivered using staff from Deloitte, now Mazars. This has provided a degree of continuity and has enabled senior staff to become familiar with the systems and structures within the council.
- 3.9 An audit plan is established for each year. This is drafted in conjunction with Departmental Directors and is approved by CMT and the Audit Committee. For 2014/15 this has been set at 1,200 days. The council uses a mix of a small in-house resource to deliver 295 days with 905 days delivered by the contractor. The contract price is based upon daily rates for different types of audit work.
- 3.10 The day rates within the current contract vary slightly depending upon the volumes called off the whole contract and are adjusted annually for inflation although there has been no increase for the year 2014/15. The current contract allows for flexibility in the number of days procured. The contractor only receives payment for completed audit work.
- 3.11 The in-house team and Mazars' staff are co-located within the Civic Centre and service provision is relatively seamless with a common approach to audit and reporting. Mazars have a manager based on-site who manages the output of Mazars' staff. The council's Internal Audit Manager has day to day oversight of the contract, manages the sole in-house internal auditor and conducts a number of individual audit assignments, delivering 95 chargeable days. The Internal Audit Manager reports to the Head of Audit and Investigation.

### **Options for 2015 onwards**

- 3.12 Given the Croydon contract has been renewed on two occasions with a view to considering market conditions after each 2 year period, officers consider that it is an appropriate time to test the market to establish whether a reduced price / increased effectiveness can be achieved. This is due to a perception that there may be increased interest from the private sector audit in delivering services to local government and that audit techniques, such as continuous auditing methodologies, may present options for efficiency savings.
- 3.13 There are a number of options for the provision from the 1<sup>st</sup> April 2015. Under the existing model of provision, the key determinant of the cost of the contract is the number of days being procured. Under current arrangements, the council determines the audit plan and procures the relevant number of days from the contractor. An alternate model is to ask the contractor to provide a single price to develop and deliver an audit plan to provide adequate coverage to give assurance to the council that internal controls are effective and operating. Under such a model the council has less control over the audit plan or the level of resource devoted to the plan but might receive a lower price.
- 3.14 Under any outsourced option the mix of in-house and outsourced resource could be varied from no in-house provision to minimal outsourcing (necessary to cover computer / contract or other specialist audit). Whilst it is cheaper to deliver core audit services using in-house staff, the council would carry the risk of non-delivery of the audit plan if there were any unforeseen sickness or performance issues and would be less able to flex the service to reflect changing council structures without incurring redundancy and recruitment costs. Therefore, the proposal is to continue with an outsourced service as a replacement of the element of the service currently provided through the Croydon contract.
- 3.15 Given the pressure to reduce support service costs, it is likely that the council will seek a lower level of audit provision in future years. Given the council's expenditure and, potentially range of services, is shrinking it is considered appropriate, to assume that plan days will reduce for 2015/16 and future years. Any contract needs to provide flexibility regarding the number of audit days procured, although these normally need to be agreed at the commencement of the year with the contractor. For the purposes of cost calculations, coverage has been set at 1,000 days per annum, although this should not be seen as a guaranteed minimum or maximum level.
- 3.16 Tendering a new contract will provide an opportunity for the council to test the market for new methodologies. Officers are mindful of the need to adapt audit techniques and there may be opportunities to achieve cost saving or increased effectiveness through the use of new techniques.

### **Option 1 - Extend Croydon Framework**

- 3.17 The council could renew its contract with Croydon for 1, 2 or 3 years. The shorter the period, the more flexibility the council would have should the market change or contractor performance become an issue. The market has remained relatively stable for the past four years and, although there is no material financial benefit in opting for a longer period, a three year commitment would give an indication of stability to Mazars. As a new player in the local authority internal audit market, this may reap some rewards in terms of new approach or products being offered, such as the use of data analytics. The council would only commit annually to a contractual number of planned audit days and would be able to adjust its plans according to need. Costs

would, therefore, be known.

- 3.18 However, there is also no compelling reason not to re-procure the service. Performance has been on the whole, but not always, of a broadly acceptable standard, rather than consistently good. Mazars may improve upon this but the council can have no assurances of this. Conducting a tendering process will help to provide assurance about the quality of future services.

#### **Option 2 - Full in-house service, outsourced IT audit**

- 3.19 Reverting to a full in house service is an option. This would require recruiting to four Internal Audit posts. There is little research available as to the state of the current market for local government internal audit staff as most authorities provide these services through a model broadly similar to Brent's. Experience of recruitment is mixed across London although no one has attempted a large scale exercise. However, given the economic climate and likely downsizing of some internal audit teams, there may be a pool of talented staff available in the run up to April 2015.
- 3.20 However, it is unlikely that the council would be able to attract or retain an in-house computer audit specialist. Therefore, continued outsourcing of IT audit would be required and could be purchased as a separate item from the Croydon Framework. Full in-house provision would result in cost savings of some £40,000 per annum or 16% of the cost at current prices, assuming performance levels and deliverable days are maintained. Although there are no performance issues with the current in house team, the risks of non-delivery increasingly fall on the council as the in-house capacity is increased.
- 3.21 The risks associated with in-house provision are principally non-delivery of the audit plan. If the contractor fails to deliver, they do not get paid and non-delivery could in theory be recovered via temporary internal resource. With an in-house service, sickness, performance or project overrun issues are all risks which are borne by the council and any savings can be quickly eroded. This option has, therefore, been rejected. The other significant issues are flexibility and specialism. Under the current arrangements the council can adjust audit days relatively easily, or pursue shared service arrangements if appropriate. With its own directly employed staff this flexibility is harder to maintain. In addition, private sector providers in this field can usually offer staff more attractive career structures, and in turn can provide purchasers with ready access to specialist skills.
- 3.22 This option has, therefore, been rejected.

#### **Option 3 – Tender for replacement for current outsourced element of service**

- 3.23 Given the short time frame until expiry of the current contract, it is considered unlikely that there would be sufficient time to enter negotiations with other authorities and agree specification and evaluation criteria to enter into any joint procurement arrangements. In addition, eleven other London councils are already in the Croydon framework and at least two, up to a possible seven, are about to procure another framework contract. Therefore, the council will need to conduct a full re-tendering exercise as a sole party either for a similar level of provision to the current contract or for a fully outsourced service as mentioned above.
- 3.24 The advantages of a re-tender are possible cost savings, a change in internal audit approach, new providers possibly in the market by 2015 with some of the second tier firms attempting to obtain business. Disadvantages include the cost and time

associated with tendering and potential disruption and loss of accumulated on-site experience within the existing contractor should they be unsuccessful.

#### **Option 4 - Join another existing framework**

- 3.25 Officers understand that the London borough of Camden and Islington has indicated that they are about to award a framework contract for four years from 1<sup>st</sup> June 2014 on behalf of seven councils. Others will be free to procure from the framework. The results of this exercise will be known shortly. Brent, on publication of this framework, could therefore consider whether this would be a more advantageous route.
- 3.26 Other shared service options may be pursued. The London boroughs of Havering and Newham have recently established a Joint Committee with a staffing structure under it – entitled OneSource – which exists to provide back office support services to local authorities. Their offer includes internal audit and so this may be a potential way forward, as might other shared service arrangements.

#### **Other factors**

- 3.27 The audit market is somewhat competitive, with firms such as Grant Thorntons, Mazars and BDO recently showing interest in winning more local authority work. The only firm excluded from tendering are the council's current external audit provider, KPMG.
- 3.28 This market has become much more fast moving in the last year and the options of sharing services have yet to be fully explored. However, the council will always need some internal audit provision, and this report has shown that tendering for this is the route considered most likely to secure better value. This will not preclude joining other frameworks that may become available, or pursuing other shared service options. At this time Members are therefore recommended to approve the pre-tender considerations below so that a procurement can be commenced, which will not preclude other options being explored.
- 3.29 In accordance with Contract Standing Orders 88 and 89, pre-tender considerations have been set out below for the approval of the Cabinet.

<b>Ref.</b>	<b>Requirement</b>	<b>Response</b>	
(i)	The nature of the service.	Internal Audit Services	
(ii)	The estimated value.	£ 1,000,000	
(iii)	The contract term.	1 <sup>st</sup> April 2015 to 31 <sup>st</sup> March 2019	
(iv)	The tender procedure to be adopted.	Open Procedure	
v)	The procurement timetable.	<b>Indicative dates are:</b>	
		Adverts placed	12/09/14

Ref.	Requirement	Response	
		Deadline for tender submissions	24/10/14
		Panel evaluation and shortlist for interview	14/11/14
		Interviews and contract decision	21/11/14
		Report recommending Contract award circulated internally for comment	01/12/14
		Cabinet approval	14/01/15 (Indicative)
		Minimum 10 calendar day standstill period – notification issued to all tenderers and additional debriefing of unsuccessful tenderers (as the contract is covered by the full EU Regulations)	27/01/15
		Contract Mobilisation	28/01/15
		Contract start date	01/04/15
(vi)	The evaluation criteria and process.	<ol style="list-style-type: none"> <li>1. At selection (qualification stage) shortlists are to be drawn up in accordance with the Council's Contract Procurement and Management Guidelines namely the qualification questionnaire and thereby meeting the Council's financial standing requirements, technical capacity and technical expertise.</li> <li>2. At tender evaluation stage, the panel will evaluate the tenders against the following criteria: Price 60%, Quality 40%, with Quality criteria consisting of: <ul style="list-style-type: none"> <li>• Strategic and Operational Approach</li> <li>• Systems and working methods</li> <li>• Indicative resources, staff mix and management</li> <li>• Innovative solutions</li> <li>• Benchmarking</li> </ul> </li> </ol>	

Ref.	Requirement	Response
		<ul style="list-style-type: none"> <li>• Collaborative approach</li> </ul>
(vii)	Any business risks associated with entering the contract.	No Specific business risks are considered to be associated with entering into the proposed contract.
(viii)	The Council's Best Value duties.	This procurement process and on-going contractual requirement will ensure that the Council's Best Value obligations are met.
(ix)	Consideration of Public Services (Social Value) Act 2012	See Section 8 below
(x)	Any staffing implications, including TUPE and pensions.	See section 7 below
(xi)	The relevant financial, legal and other considerations.	See sections 4 and 5 below.

3.30 The Cabinet is asked to give its approval to these proposals as set out in the recommendations and in accordance with Standing Order 89.

#### **4. Financial Implications**

- 4.1 The current service (Option 1) costs the council approximately £300,000 per annum for 900 days of contracted work. The exact cost of a new outsourced element of the service would be dependent upon the changes to the number of contracted days and the secured cost per day that is agreed.
- 4.2 Section 3 of this report explains the potential costs and benefits to the council of each of the options to be considered. As set out in paragraph 3.28 officers will continue to explore developing opportunities to identify a solution that provides best value.
- 4.3 Owing to market uncertainty and likely changes to the number of days contracted the potential savings of the various options will be quantified as part of the tendering exercise
- 4.4 Any decision altering the in-house audit provision would likely have financial implications for the council in terms of redundancy costs. These will be quantified as part of the tendering exercise.
- 4.5 The cost of this contract would be funded from the existing Audit & Investigation budget allocation.

## **5. Legal Implications**

- 5.1 The estimated value of an outsourced contract over its lifetime is in excess of the current EU threshold for services and the nature of these services means they fall within Part A of Schedule 3 of the Public Contracts Regulations 2006 (“the EU Regulations”). The tendering of the services is therefore governed in full by the EU Regulations. As the estimated value of the contract over its lifetime is in excess of £250k, the procurement and award of the contract is subject to the council’s own Standing Orders in respect of High Value.
- 5.2 For High Value Contracts, the Cabinet must approve the pre-tender considerations set out in paragraph 3.29 above (Standing Order 89) and the inviting of tenders (Standing Order 88).
- 5.3 Once the tendering process is undertaken Officers will report back to the Cabinet in accordance with Contract Standing Orders, explaining the process undertaken in tendering the contract and recommending award.
- 5.4 As this procurement is subject to the full application of the EU Regulations, the council must observe the requirements of the mandatory minimum 10 calendar standstill period imposed by the EU Regulations before the contract can be awarded. The requirements include notifying all tenderers in writing of the council’s decision to award and providing additional debrief information to unsuccessful tenderers on receipt of a written request. The standstill period provides unsuccessful tenderers with an opportunity to challenge the council’s award decision if such a challenge is justifiable. However if no challenge or successful challenge is brought during the period, at the end of the standstill period the council can issue a letter of acceptance to the successful tenderer and the contract may commence.
- 5.5 As indicated in Section 7, the intention is to retain the in-house provision and therefore council staff will not transfer pursuant to the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”). There may however be a transfer of staff currently employed by Mazars to any new provider pursuant to TUPE.

## **6. Diversity Implications**

- 6.1 The proposals in this report have been subject to screening and officers believe that there are no diversity implications.

## **7. Staffing Implications**

- 7.1 Internal audit services are currently provided by a combination of Mazars’ staff and staff employed by the council. As it is intended to retain the in-house provision, there will be no staffing implications for council staff.

## **8. Public Services (Social Value) Act 2012**

- 8.1 Since 31<sup>st</sup> January 2013, the council, in common with all public authorities subject to the EU Regulations, has been under duty pursuant to the Public Services (Social Value) Act 2012 to consider how the services being procured might improve the economic, social and environmental well-being of its area; how, in conducting the procurement process, the council might act with a view to securing that improvement; and whether the council should undertake consultation. This duty applies to the procurement of the proposed contract as Services over the threshold for application



of the EU Regulations are subject to the requirements of the Public Services (Social Value) Act 2012.

- 8.2 Given the nature of the services being delivered under the contract and the limited market for the delivery of these services, Officers have concluded that it is not appropriate to undertake any consultation and that the only measures appropriate to meeting the requirements of the Public Services (Social Value) Act 2012 are to operate the Council's usual procurement processes.

## **9. Background Papers**

1. Report from the Deputy Director of Finance to the Executive 11<sup>th</sup> February 2013 – Internal Audit Contract 2013-2015

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