

London Borough of Hammersmith & Fulham

# Cabinet Agenda

## Background document

27 April 2015

**Item**

**Pages**

4. INTERNAL AUDIT CONTRACT RE-TENDER

1 - 15



London Borough of Hammersmith and Fulham | The Royal Borough of Kensington and Chelsea | Westminster City Council

# Tri-Borough Audit, Fraud, Risk and Insurance

## Options Appraisal – May 2014



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## **1. Introduction**

- 1.1 Internal audit is a statutory function: there is no option but to deliver the service to comply with Section 151 of the Local Government Finance Act 1972. Internal audit is fully outsourced at both H&F and WCC, through the Croydon framework and Baker Tilly, respectively. RBKC operates with an in-house audit team supplemented by a call off contract through the Croydon framework. The WCC contract with Baker Tilly will expire on 31 March 2015. The contract for the delivery of internal audit at Hammersmith and Fulham (H&F) is due to expire on 15 June 2015 and is co-terminus with the RBKC expiry date. There is therefore an immediate requirement to decide on an appropriate service delivery model for April 2015 onwards.
- 1.2 The fraud service at WCC is fully outsourced to Baker Tilly and provides an investigation service for housing benefit fraud as well as housing, parking and corporate fraud. The fraud service at both H&F and RBKC is provided by an in-house team. The contract at WCC will expire on 31 March 2015. The employees/contract staff currently providing the housing benefits fraud resource will transfer under TUPE to the Single Fraud Investigations Service (SFIS) within the DWP. The date of transfer of staff to SFIS has now been confirmed as 1 March 2015 for all three Councils.
- 1.3 In view of the end dates of the internal audit contracts at all three Councils, the end date for the WCC fraud contract, and the implication of SFIS, this paper provides details of options and recommendations for both Internal Audit and the remaining non-benefit fraud service after 1 March 2015.
- 1.4 As all three Councils are going through a substantial period of organisational change, risks of fraud and misuse of resources are much higher and so having full flexibility and control of audit and fraud resources throughout at least a two year period has been a key consideration in reviewing all appropriate options. This paper is not looking at this exercise to save cost as during a period of substantial change a decrease in audit resources is considered a false economy. There will however be a significant reduction in staff due to the benefit fraud teams transferring to the DWP under to SFIS (which may or may not be a saving to the Councils depending on any consequences for grant). A full review of the team structures and requirements going forward will be a requirement for 2015 onwards.

## **2. Background**

- 2.1 The three Councils have taken the decision to provide as many services as is feasible through either bi or tri-borough arrangements. The provision of Children's Services, Adult Social Care, Public Health and Libraries is now delivered on a tri-borough basis. The implementation of Managed Services across all three Councils and the proposed tri-borough Corporate Service department further validates the requirement for a tri-borough audit and fraud service operating as one unit, whilst making provision for sovereign reviews to be commissioned, as appropriate.
- 2.2 Prior to July 2013 there were three separate and discreet internal audit and fraud services operating independently at each Council, although the audit teams have co-operated to deliver both a tri and bi borough internal audit plan since 2012.
- 2.3 In July 2013 a bi-borough internal audit, fraud and risk management service was formally implemented under the direction of a shared Director of Audit, Fraud, Risk and Insurance. The insurance service was incorporated as a tri-borough service in

2012. In late 2013, agreement was reached to provide a tri-borough audit and fraud service. The tri-borough audit, fraud and insurance service formally commenced in April 2014. The strategic risk management support role, comprising 1fte, remains a bi-borough service, but with minimal collaboration with WCC. The contribution of the Bi-borough risk manager has however considerably exceeded the original resourcing allocated to deliver Tri-borough risk management objectives. It is increasingly difficult to divorce Bi-borough risk management from WCC as the Bi-borough risk role provides cover in other areas of business assurance for example working with WCC on the Annual Governance Statement.

- 2.4 The audit and fraud service contract at WCC expires on 31 March 2015 having commenced in 2007. The framework contract for internal audit at RBKC and H&F is in place until June 2015, but there is the possibility that this can be extended to 2018, when the Croydon framework has to be subject to retender. The Croydon framework uses Mazars (formerly Deloitte) to deliver the audit service. Both H&F and RBKC have used the framework since 2008.
- 2.5 As part of the evaluation of options, and in view of the changes planned under the SFIS proposals, this report has been split into two sections. Section 3 provides a summary of the options and initial recommendations in respect of the corporate fraud arrangements and section 4 summarises the options and initial recommendations for the internal audit service.
- 2.6 The initial recommendations made are based on the data available at the time of the review and will be subject to procurement, legal and risk management advice. The data used for the options analysis have been prepared based on data supplied by both contractors, Baker Tilly and Croydon/Mazars.
- 2.7 The move towards tri-borough services will eventually enable staffing levels to be reduced across all three Councils. However, this is reliant on the tri-borough services operating consistent systems and procedures as well as sharing the same IT systems. The consistent service provision arrangements are not yet in place but it is expected that this will be delivered over the next two years.

### 3. Options Appraisal – Corporate Fraud

Table 1 provides an overview of the fraud service arrangements at each Council.

**Table 1**

Service	H&F	RBKC	WCC
<b>Corporate Fraud Service Delivery</b>	In house team	In-house team	Fully outsourced to Baker Tilly. Contract expires March 2015.
<b>Day to day management</b>	Fraud Manager	Fraud Manager	3 x Fraud Managers plus Audit Manager and Head of Internal Audit. ( All employees of Baker Tilly)
<b>Oversight</b>	Head of Shared Services (WCC), Tri-borough Head of Fraud, Tri-borough Director of Audit and Fraud.		

### ***Westminster***

- 3.1 The corporate fraud service is fully out-sourced to Baker Tilly, the original contract being with Bentley Jenison who transferred to RSM Tenon and subsequently to Baker Tilly. The original tender for the service was procured in 2007 for five years, with the option to extend for a further two years. There have been a number of extensions to the contract and the last and final extension was in 2014. However, due to the programmed changes as a result of SFIS, the contract was extended under specific powers to enable the contract to continue to 31 March 2015.
- 3.2 The main focus of the corporate fraud team is investigations in respect of housing benefit fraud; the budget for this service is currently £395k plus a further £44k in respect of authorising sanctions. General fraud investigations accounts for a further £177k. Social housing fraud work is directly charged on a day rate basis. This is outside the contract sum and is funded through a DCLG grant via City West Homes. The DCLG grant is only available for one more year, until March 2015. The day rate for this work is £333 per day with a budget cap of £60,500 per annum.
- 3.3 The fraud service contract is managed by three managers from Baker Tilly, two of whom are responsible for housing benefit fraud and one for other fraud work. The contract management arrangements are overseen by the Head of Shared Services, although the Tri Borough Head of Fraud will take more responsibility for delivery during 2014/15. A further nine members of staff work as fraud investigators on the contract. The service delivery is managed by a Senior Audit Manager and the Head of Audit, both of whom are direct employees of Baker Tilly.

### ***Hammersmith & Fulham***

- 3.4 The corporate fraud service comprises an in-house team with one manager and 8.6fte. All staff are responsible for undertaking investigations into fraud, irrespective of the type of fraud and includes housing fraud, corporate fraud and housing benefit fraud investigations. The fraud service budget is currently £373K per annum, plus the shared cost of £33K for the tri borough Head of Fraud.
- 3.5 Disabled parking fraud investigations are currently the subject of outsourced contract arrangements with an annual contract value of £100k. There is currently no direct relationship between parking fraud and the in-house team. The parking fraud contract will be reviewed during 2014/15 to evaluate whether or not consideration should be given to undertaking this work through the in-house service.

### ***Kensington and Chelsea***

- 3.6 The corporate fraud service comprises an in-house team with one manager and 10fte. All staff are responsible for undertaking investigations into fraud irrespective of the type of fraud including housing fraud, corporate fraud and housing benefit fraud investigations. The fraud service budget is currently £365K per annum, plus shared cost of £33K for the tri borough Head of Fraud. Disabled parking fraud investigations are currently undertaken by one member of the team on a full time basis.

## Summary of Current Arrangements – Fraud Service

- 3.7 Table 2 provides a summary of staffing numbers and costs for the current fraud service at each Council. The impact of the SFIS is likely to reduce the fraud staff and associated expenditure budgets by approximately 50% overall. It is likely therefore that there will remain between three and six members of staff at each Council available to undertake non-housing benefit investigations

**Table 2: Staffing Numbers and Costs- Corporate Fraud**

Detail	H&F FTE	RBKC FTE	WCC FTE
Housing Benefits Investigators and admin/intelligence plus managers. Likely reductions due to transfer of staff from each Council to the DWP under SFIS.	3	4.5	7
Non-Housing Benefit Investigators including parking, corporate fraud and housing fraud.	5.6	5.5	2
Fraud Managers	1	1	3
<b>Total</b>	<b>9.6</b>	<b>11</b>	<b>12</b>
Expenditure Budget	H&F £	RBKC £	WCC* £
Housing Benefits Investigators and Managers	£111,704	£86,694	£439,659
Non-Housing Benefit Investigators including parking, corporate fraud and housing fraud.	£261,455	£278,495	£177,100**
<b>Total</b>	<b>£373,159</b>	<b>£365,189</b>	<b>£616,759</b>
Tri Borough Head of Fraud Service (1FTE)	£33,806	£33,806	£15,000

Note: Baker Tilly currently pay WCC £100k per annum for rental of premises

\*\* A separate budget of £60,500 for housing fraud investigations is excluded from the above figures

- 3.8 Table 2 above demonstrates the potential reduction in terms of fraud resources as a direct result of SFIS, of approximately 17 staff. The figures provided are provisional and are therefore subject to adjudication between each Council and the DWP. It is clear from the table above that the potential reduction in staffing levels is much higher at WCC.

- 3.9 Table 3 provides a summary of comparable performance information in respect of the outputs from the fraud services at each Council, for information.

**Table 3: Performance Information for year ending 31 March 2014**

Detail	H&F	RBKC	WCC
Housing Benefit Prosecutions 2013/14	12	14	10
Benefits Administration Penalties	4	54	49
Housing Benefit Cautions	2	7	33
Housing Fraud – Properties Recovered	26	46	6
Other Investigations Completed	67	40	7
Parking investigations resulting in prosecution or removal of badge/permit	N/A	28	39

### Conclusions

- 3.10 In view of the potential implications of SFIS in reducing the number of fraud investigators at each Council on 1 March 2015, the number of realistic options for a future fraud service is significantly reduced. It is however essential that each Council has full access to an experienced fraud resource to deal with investigations which fall outside the benefits fraud service.
- 3.11 The full implications of SFIS have not yet been determined in terms of the number of staff at each Council that will transfer. It is clear however that the number of fraud staff required at each Council will be significantly reduced, by approximately 50%. Senior management at both RBKC and H&F are keen to retain a fraud service in-house.
- 3.12 The WCC contract for fraud, as previously stated, is currently outsourced with the contract end date of 31 March 2015. Given that only three staff will probably remain, it would be most appropriate to seek a TUPE transfer of the remaining non benefits fraud staff to work with the current in-house teams at RBKC and H&F. It is currently unknown as to how many fraud staff will be available to transfer as it is understood that a number of investigators at WCC are planning to leave or have left.
- 3.13 The scale of future tri-borough services will inevitably mean that the majority of internal fraud will be perpetrated by staff employed within a tri-borough service as opposed to a sovereign service. It will therefore be appropriate to have an investigative resource operating as a tri-borough service. It is expected that during the next two months that an analysis of resources will be undertaken to confirm the resources required to respond to the future investigations, based on historical data..
- 3.14 At the current time the three fraud teams undertake a mixture of investigations and include Housing Fraud, Parking Fraud, and Corporate Fraud etc. There are also other pro-active and targeted fraud exercises undertaken in conjunction with other services such as the Police and the Home Office.



- 3.15 A future consideration is the requirement to ensure that policies, procedures and fraud training are consistent across all three Councils to accommodate the increasing number of tri-borough services.

### Recommendations

- 3.16 Given the uncertainties over the establishment of SFIS and the current disposition of resources, it would be appropriate at least in the short term to set up an in-house tri-borough fraud service . The team would comprise staff from RBKC and H&F who do not transfer to SFIS, together with [up to three] staff who choose to TUPE transfer from the WCC contract with Baker Tilly.
- 3.17 This recommendation is subject to confirmation that there are sufficient fraud investigation staff remaining at Baker Tilly on 1 March 2015, and that agreement is reached as to which Council the TUPE staff will transfer.
- 3.18 A full review of the future resource requirements of each Council will need to be undertaken during 2014/15 for implementation by 1 March 2015.

## 4 Options Appraisal – Internal Audit

- 4.1 The current service delivery model in respect of Internal Audit is summarised in Table 4 below, and summarised information on each Council follows from point 4.2.

**Table 4: Current Service Delivery Model – Internal Audit**

Service	H&F	RBKC	WCC
<b>Internal Audit Service Delivery</b>	Fully outsourced to Mazars via the Croydon Framework. Contract expires June 2015. Framework expires March 2018.	In-house service (4.5fte). Croydon Framework provides additional days as required. Contract expires June 2015. Framework expires March 2018.	Fully outsourced to Baker Tilly. Contract expires March 2015.
<b>Day to day management</b>	Senior Audit Manager (In-house). Contract Audit Manager (Mazars)	Senior Audit Manager (In-house)	Senior Audit Manager, Audit Manager and Head of Internal Audit (All contracted out to Baker Tilly)
<b>Overall service direction</b>	Tri-Borough Director for Audit, Fraud, Risk and Insurance		Head of Internal Audit (Baker Tilly) and Client monitoring by Tri-Borough Director for Audit Fraud Risk and Insurance.

### ***Hammersmith & Fulham***

- 4.2 The internal audit service is currently fully outsourced through the framework agreement with Croydon Council to Mazars (formerly Deloitte). The framework provides for a minimum of 1 day contracted work per annum, with no maximum. The framework contract came into effect in 2008 and will expire in March 2018. The current contract agreement between H&F and Croydon is in place until June 2015 following an extension in 2013.
- 4.3 The audit service is managed by the Senior Audit Manager at H&F, reporting directly to the Director of Audit, Fraud Risk and Insurance. The Senior Audit Manager takes responsibility for overseeing the delivery of the plan including agreement on making payments for the delivery of the contract. Payments are made to Croydon Council based on a fixed monthly payment with an annual year end adjustment. The contract sum for 2014/15 is currently £295k per annum. A full time Audit Contract Manager employed by Mazars oversees the day to day delivery of the contract and quality reviews of audit work.

### ***Westminster***

- 4.4 The internal audit service is fully out-sourced to Baker Tilly, formerly RSM Tenon and the original tender for the service was procured in 2007. There have been a number of extensions to the contract and the last extension and final extension was in 2013. However, due to the programmed changes as a result of SFIS, the contract was extended under specific powers to enable the contract to continue to March 2015. The contract sum is £366k per annum.
- 4.5 The contract provides for a fixed sum to be payable over 12 monthly payments, with an adjustment at the end of March. The contract provides for the role of the Head of Internal Audit to be provided by the contractor. The contract in the main is provided by a Senior Audit Manager and an Assistant Audit Manager who have confirmed they both work full time on the audit contract. Baker Tilly have further confirmed that there are five members of staff who work on the contract for more than 50% of their time. This figure is subject to confirmation.
- 4.6 The internal audit contract management arrangements involve an oversight by the Interim Section 151 officer, and payments are made via the Head of Shared Services. The Tri-borough Director of Audit has taken responsibility for oversight of the quality of the service from April 2014, however as the Head of Audit is currently a contractor role, the audit plan and assurance requirements for the Council remain with the contractor.

### ***Royal Borough of Kensington and Chelsea***

- 4.7 The internal audit service is primarily an in-house service with 4.5 members of staff providing audit reviews. The remaining requirements for specialist audits are sourced through the Croydon framework under the same arrangements as H&F. The contract has an expiry date of 15 June 2015; however it may be possible, subject to legal advice, to extend the contract to 2018.
- 4.8 The audit service is managed by the Senior Audit Manager at RBKC. The audit manager takes responsibility for staff management, overseeing the delivery of the plan and the quality of the work undertaken, well as making payments for the delivery

of the contract. The projected spend on the contract for 2014/15 is currently £70K. The current staffing cost, excluding the audit manager is £197k, for 4.5ftes.

- 4.9 The key performance indicators for the Internal Audit Services are summarised below, for information:

**Table 5: Key Performance Indicators**

Details	H&F	RBKC	WCC
Target date for completion of plan	95% by 31 March 2014	95% by 31 March 2014	Target unknown, presumed 95% by 31 March
Actual performance as at 31 March 2014	83%	81%	61%
Target for quality questionnaire responses	3+	3+	3+
Average quality scores from auditees *	3.6	4.2	4.1

\*5 being outstanding 1 being poor

- 4.10 There is commonality between both H&F and WCC in terms of the fully outsourced internal audit service provision. The contractual arrangements however are different such that the H&F and RBKC arrangements allow for any number of days to be commissioned on an annual basis. The WCC contract provides for a full audit service to be delivered within a set budget which is agreed each year.
- 4.11 Table 6 below provides an extract of comparative costs and budgets for each Council.

**Table 6: Summary of Audit Budgets/ Daily Rates at each Council**

Internal Audit			
Details	H&F £	RBKC £	WCC £
2014/15 Audit Costs for staffing/Contract Sum	295,000	273,000	366,400
Senior Audit Manager Costs incl. Overheads	80,000	80,000	0*
Total Cost	375,000	353,000	366,400
Daily contract rate for standard audit reviews (non IT) – Fixed Contract Rates	307.50	307.50	334.69
In house daily rate for auditors/senior auditors	N/A	309	N/A
Total Audit days provided per annum	960	1029	1024

\*Included in costs of contract for fraud and audit contract

\*\* Baker Tilly currently pay £100k annual rental for premises provided by WCC for fraud and audit staff.

\*\*\* Costs charged by each Contractor for IT audit work is not included in the above tables.

## **5 Options Appraisal Conclusions - Internal Audit**

5.1 There were a number of key considerations taken into account when reviewing the options available, post March 2015, including the following:

- Significance of tri and bi borough services on the audit and fraud service.
- Current performance and costs.
- Ability to deliver tri-borough services as well as sovereign and bi-borough services
- Effect of SFIS on the fraud service at each Council
- Contract end dates.
- Requirement for consistency and co-ordination of approach to internal audit reviews.
- Reduction in available resources to undertake fraud investigations.
- Costs associated with implementing various options identified.

5.2 The current contract through the Croydon framework, which provides a full audit service to H&F and a flexible resource to supplement the RBKC in-house team provides a cost effective resource. The daily rate of £307.50 is a competitive rate and is cheaper than that currently charged by Baker Tilly to WCC. The likelihood of achieving a lower daily rate from an alternative audit provider is low.

5.3 The Senior Manager at WCC has been working on the WCC contract for at least 15 years and has an excellent knowledge of the organisation. The number of staff employed for over 50% of their time on the WCC has been recorded as 5 however it is likely that this number is significantly lower. There may therefore be only 2/3 staff who would be eligible to transfer to an in-house team from Baker Tilly. There is a need for clarification on the costs of TUPE transfer of the Baker Tilly audit staff and consideration will be required as to which Council will take the TUPE'd staff.

5.4 There has been no critical issues with the quality of the audit resource provided by either Baker Tilly and Mazars. However the performance in terms of delivery has been lower at WCC during the past year. The performance in terms of quality questionnaire responses records a slightly better score from Baker Tilly than Mazars.

5.5 As a result of the appraisal exercise, five options were identified for consideration, the results of which are summarised below. Detailed evaluations of the options considered are attached at Appendix 1 for information.

## **6. Recommendation – Internal Audit – Mixed Economy**

**6.1 It is recommended that the staff who meet TUPE transfer requirements at Baker Tilly/WCC are transferred to an in-house team and the internal audit service is supplemented with the existing framework contract with Croydon Council/Mazars.**

- 6.2 A review of the requirements in terms of the in-house resource should be undertaken to formulate a revised structure.**
- 6.3 Arrangements should be put in place to authorise an extension to the framework contract with Croydon Council (Mazars), to provide a flexible resource to all three Councils. This should be undertaken on a 2+1 basis from 2015 to 2018, when the framework contract will be re-tendered by Croydon Council.**
- 7. Risk Management**
- 7.1 It is recommended that a review is undertaken to assess extending the benefits of having a strategic tri-borough risk manager, some of which are already emerging and being delivered from the existing bi-borough role.**

**Moyra Mc Garvey  
May 2014**

## Options Appraisal – Internal Audit

### Option 1 - Do nothing

This option has been discounted for the following reasons:

- There are no extensions available to WCC under the current contract.
- A waiver to the procurement code would not be justified.
- There is a need to re-align audit provision with the current ambition for extended tri-borough services.

### Option 2 – Outsource the whole service for all three Councils

Delivery of service would be provided by an external provider with all in-house staff being transferred under TUPE. A designated contract manager/s would act as a liaison point reporting to the in-house client team.

It is estimated that if this option was chosen the process would take between 6 and 9 months to implement, dependent upon the value of the contract and compliance to the Council's Financial Standing Orders and procurement process. The OJEU procurement timetable takes a minimum of 6 months. Procurement via competitive tendering carries related advertising and staff costs.

The TUPE implications of staff who would transfer may however present a high risk that the procurement process will not deliver best value for money. In the short-term there could be cost advantages however this is unlikely.

The three Councils are currently undergoing significant changes and this will continue over the foreseeable future. It is considered imperative that there is a robust internal audit team with sufficient knowledge of the organisation audit systems and processes to deliver a quality service to the departments.

This option was discounted for the reasons identified above.

### Option 3 – Bring the whole service in-house

This option has been discounted for the audit service as the current flexible arrangements fulfill the requirements of the organisations as a whole. The current arrangements provide sufficient flexibility for audit as well as providing technical audit skills as appropriate. There is difficulty in recruiting appropriately skilled staff to provide an in-house service and technical expertise would still be required from outside providers to supplement the in-house skills, specifically in respect of IT audit.

In order to provide a full in-house service there would be a requirement to recruit at least eight staff to the service. This would be difficult to achieve without paying a market supplement and the cost of the recruitment and training would outweigh any financial benefits.

#### **Option 4 – Tender the audit contract separately at WCC**

This option would entail a full tender exercise being undertaken for the internal audit service and the remaining staff transferred to a new provider. This option has been discounted primarily due to the fact that there would potentially be two different contractors providing the audit service with a split in management responsibilities which is not conducive to a streamlined service delivery model.

The WCC contract was a more lucrative contract when it involved tendering both the audit and fraud service, however as SFIS is being implemented, the tender value will be significantly reduced, potentially increasing the date rate and management costs.

It is estimated that if this option was chosen the process would take between 6 and 9 months to implement, dependent upon the value of the contract and compliance to the Council's Financial Standing Orders and procurement process. The OJEU procurement timetable takes a minimum of 6 months. Procurement via competitive tendering carries related advertising and staff costs.

The TUPE implications for staff who would transfer may however present a high risk that the procurement process will not deliver best value for money. In the short-term there could be cost advantages however this is unlikely. The current daily rates provided through the Croydon contract are extremely competitive.

The three Councils are currently undergoing significant changes and this will continue over the foreseeable future. It is considered imperative that there is a robust internal audit team with sufficient knowledge of the organisation to deliver a quality service to the departments.

#### **Option 5 – Mixed Economy**

This option would provide for the transfer of the remaining 3 members of the fraud staff, post SFIS, to a tri-borough team. The existing WCC internal audit staff would transfer to the in-house team and a tri-borough team would be set up. There exists the option to continue to utilise the Croydon framework to make up any shortfall in days required.

There has been a degree of variation in respect of the staff provided on the H&F and RBKC contract; however the key staff providing the WCC service have been relatively consistent over the last year. The loss of the key managerial staff at WCC would be a large disadvantage in continuity of service bearing in mind their detailed understanding of the organisation. This is the primary reason for suggesting that the staff are brought in-house to maintain the current service delivery.

Both RBKC and H&F use the same external contractor, fully outsourced at H&F and as a supplement to the RBKC in-house team. All three Councils undertake tri-borough reviews; H&F and RBKC also undertake sovereign reviews at each Council. The current contractual

arrangements do not allow either contractor to undertake a sovereign audit at another Council. Consequently RBKC can undertake audits at all Councils, H&F contractors can undertake reviews at both RBKC and H&F and WCC cannot undertake any sovereign audits except those at WCC. In order to move to a state where each auditor can undertake any audit at any Council requires the current arrangements to be re-structured.

It is for the reasons highlighted above that this solution is recommended as the option to take forward for further consideration.