

## Report for Information

**Report To:** Audit Committee - 3 June 2010

**Subject:** Annual Review of the System of Internal Audit 2009/10

**Report of:** City Treasurer

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### Summary

In accordance with the requirements of the Accounts and Audit Regulations 2003 (Amended 2006) the Council conducts an annual review of the effectiveness of its system of internal audit to be considered as part of its governance assurance processes, including the production of the Annual Governance Statement.

The report demonstrates that the Council has an effective system of internal audit including a policy framework, internal audit function, Audit Committee and effective management engagement.

### Recommendations

Members are requested to consider and comment on the Annual Review of the System of Internal Audit 2009/10.

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### Wards Affected:

None

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### Background documents (available for public inspection):

Documents used in the development of the plan include the Internal Audit Plan 2009/10, Emergent Audit Plan 2010/11, Annual Internal Audit Report 2009/10 and Annual Governance Statement 2009/10 presented to Audit Committee throughout 2009/10 and 2010/11.

## **Manchester City Council Annual Review of the System of Internal Audit 2009/10**

- 1.1 The Accounts and Audit Regulations 2003 (Amended 2006) require that “The relevant body (*the Council*) shall, at least once in each year, conduct a review of the effectiveness of its system of internal audit. The findings of the review shall be considered, as part of the consideration of the system of internal control”.
- 1.2 The system of Internal Audit is defined as the means by which the Council addresses its governance and assurance requirements, ensuring that an effective internal control system is in place. The process for the provision of Governance and Assurance for the Council is currently under active development. Outcomes from the current governance processes are being evaluated and reported in the Annual Governance Statement.
- 1.3 To address the Accounts and Audit Regulations requirement this report provides an assessment of the system of Internal Audit for consideration by those tasked with completion of the Annual Governance Statement and by the Audit Committee. It contains an opinion on the effectiveness of the Internal Audit Service including a self-assessment against the CIPFA Code of Practice, findings from recent External Audit reviews and analysis of key performance indicators for 2009/10.
- 1.4 The review was overseen by the City Treasurer and the report is attached for Members’ consideration and comment.

## **2 Current Arrangements for Internal Audit**

- 2.1 A dedicated Internal Audit Section forms part of the system of Internal Audit in the Council. Since July 2009 the section has been part of with the Internal Audit and Risk Management division of the Corporate Services Directorate and is led by the Head of Internal Audit and Risk Management. It has close links with the Risk Management and Insurance Sections within the division but has retained a clear identity as a distinct business unit. The Head of Internal Audit and Risk Management reports directly to the City Treasurer but also has direct access to the Chief Executive, Executive Member for Finance and Human Resources and the Audit Committee.
- 2.2 The in-house team comprises 26 approved posts plus the Head of Internal Audit and Risk. The Section is structured in client/service based teams which reflect the current organisation of the Council’s support and delivery directorates. These audit teams provide the opportunity for auditors to develop of a depth of knowledge and relationships with customers in relation to the work of their services and the challenges faced in achieving objectives. The structure also offers continuity to the customer who can regularly deal with the same auditors over a period of time.
- 2.3 The Section’s Vision and Terms of Reference (TOR) outline the status of the Section and define the principles of how it operates within the Council. It provides appropriate arrangements to ensure that the Internal Audit Section is sufficiently independent and objective and that there is access to all

information and people required to discharge its responsibilities. Internal Audit undertakes work in accordance with the CIPFA Code of Practice for Internal Audit in Local Government (2006) revised and issued in November 2006. This is best practice guidance for the discharge of an internal audit function.

- 2.4 To examine the effectiveness of the Internal Audit Section this review considered several key elements and assessed their contribution to enabling the Section to fulfil its responsibilities. These were:
- The structure and resourcing level, including qualifications and experience of the audit team.
  - The extent of compliance with the CIPFA Code of Practice in producing quality work.
  - Ensuring that the Section successfully audits the most appropriate areas on a prioritised (risk) basis.
  - The overall performance of the audit team.

### **3 Resourcing, Qualifications and Experience**

#### Resourcing

- 3.1 During 2009/10 the staffing position stabilised and there have been an average of 23 staff in post compared to the approved allocation of 26. With reduced hours working this has equates to 21.8 FTE at the end of the year. Despite successful recruitment to three posts in the year and the return of a member of staff from long term absence, three posts remain vacant. This has impacted on the ability to deliver some aspects of planned work within proposed timescales, particularly given a significant increase in the numbers of investigation referrals received in the year.
- 3.2 To supplement the in-house team, external resources have been used for specialist ICT audit work. This arrangement provides technical expertise that cannot be fully developed or retained in-house and complements the work of the Lead Auditor responsible for the Directorate of Transformation. External resources have also been used to support the delivery of Financial Management Standard in Schools (FMSiS) assessments and a member of agency staff was has been used to cover a vacant post for four months.
- 3.3 In addition the section has also benefited from the placement of three Corporate Services CIPFA trainees for part of the year who have worked in Internal Audit as part of their work-based training programme. This involved a programme of professional development and provided resources to support the delivery of audit work in the year.
- 3.4 To reduce reliance on agency and contract staff and address the resourcing pressures Internal Audit is examining other options. Having made two internal promotions within the career grade scheme in May 2010 there is a vacancy for an entry level career grade auditor that it is hoped can be filled by the end of July. Inward secondments and the restructuring of senior posts to allow for more entry level opportunities and career grade progression within the Section

are being considered as options to address the remaining vacancies and resource requirements.

### Structure

- 3.5 The structure of the Section is attached at appendix 1 and reflects the configuration of the Council at Strategic Director level and allows the senior members of the audit team in particular to continue to develop and build on customer relationships with senior managers. This structure has been in place for most of the year although sickness absence has meant some redistribution of responsibilities during the year and increased the amount of governance and performance work having to be done by senior managers. The structure for 2010/11 and proposed appointments to vacant posts will address this issue. Retaining client-facing teams enables auditors to maintain continuity in assessment and analysis of business plans, priorities, risk and current issues to inform the audit planning process. The portfolios of Audit Managers also reflect the allocation of responsibilities within the Risk Management Section and this helps to promote effective liaison and dialogue on directorate risk and audit issues.

### Audit and Risk Management

- 3.6 From July 2009 the Internal Audit Section, Risk Management and Insurance sections created the new Audit and Risk Management Division within Corporate Services. This arrangement has promoted closer working between the teams and there have been positive examples in the year where this arrangement has been beneficial. For example, the Insurance Section are made aware of thefts and losses and for significant matters they have been able to ensure that Internal Audit are made aware of the need for potential investigations and that the risk management section are aware of emerging risks. Similarly, when Internal Audit work has identified the need for auditees to further develop their risk management arrangements they have been better able to help facilitate access to and support from the risk management team. Schools in particular are one area where issues of security and safe limits identified during audits have resulted in referrals to the insurance team. Other benefits of closer working are continuing to be identified and explored.
- 3.7 In clarifying the position of Internal Audit as distinct from Financial Management the Council has also demonstrated the independence of the audit function and ensured improved lines of reporting to the City Treasurer, Executive Member for Finance and Human Resources and Audit Committee.
- 3.8 The creation of the Audit and Risk Management division has also meant that the objectives for internal audit are more clearly articulated through the business planning process. Key priorities, options for development and service delivery, business objectives, assessments of performance and workforce plans are clearly articulated through the Audit and Risk Management business plan and this is used to inform Section, team and personal objectives.

### Training and Experience

- 3.9 Training and development plans that have been in place since 2005 aim to encourage development through both the career grade scheme and continuing professional development. There were successes for a number of candidates in 2009/10 with passes achieved in the membership and practitioner level Institute of Internal Audit examinations (MIIA / PIIA). A part qualified MIIA and exam qualified ACCA joined the section in June 2009 and a part qualified ACCA joined in April 2010.
- 3.10 The following information about qualifications and experience of staff available for audit work demonstrates the significant experience and rich qualification mix in the Section.

### *Experience 2009/10 (2008/09)*

<b>Auditing Experience</b>	<b>All Auditing</b>	<b>%</b>	<b>In local government auditing</b>	<b>%</b>
Up to 1 year	1 (0)	4%	1 (0)	4%
1 to 2 years	0 (2)	0%	0 (2)	0%
2 to 5 years	8 (5)	35%	8 (9)	35%
5 to 10 years	8 (6)	35%	6 (6)	26%
Over 10 years	6 (7)	26%	8 (6)	35%
<b>Total Staff</b>	<b>23 (21)</b>	<b>100%</b>	<b>23 (21)</b>	<b>100%</b>
Includes Head of Internal Audit & Risk Management but excludes support post				

### *Qualifications*

Qualified Accountants (CIPFA, ACCA, ICAEW)	6
Institute of Internal Auditors - Fellow / Member (FIIA/MIIA)	9
Institute of Internal Auditors – Practitioner Level (PIIA)	2
Studying for PIIA	4
Audit diplomas (CIA)	2
<b>Total</b>	<b>23</b>

In addition three staff have finalised the course for the CIPFA Certificate in Investigative Practices

- 3.11 As planned, the experience of audit staff started to increase during the year, benefiting initially from some stability within audit teams and increased time on audit work. Rotation of staff for experience and for continuing professional development was undertaken where appropriate and this is continues based on operational need and the priority and timing of work. This approach provided increased flexibility to meet audit and investigation needs particularly in time specific and statutory areas.
- 3.12 Two staff have progressed through the career grade scheme on the basis of the completion of professional qualifications and three have completed their courses towards the CIPFA Certificate in Investigative Practices. This demonstrates the commitment to continuing professional development as well

as the targeting of training at areas of identified need in respect of fraud investigation.

- 3.13 At the 31 March 2010 the section has three vacancies and the equivalent of a full time post is also unresourced as a result of current members of the team working reduced hours. As noted above, options including recruitment at entry level grades and secondments are being explored to ensure there are sufficient resources to deliver the annual audit plan without the use of agency staff.

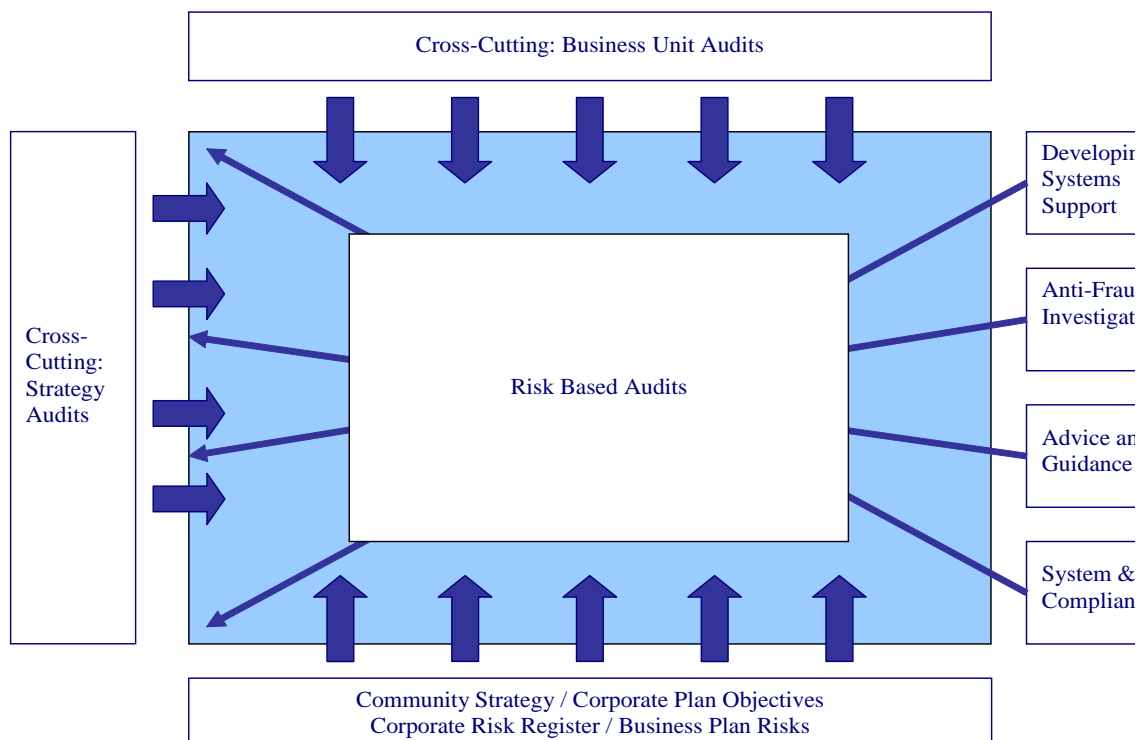
#### **4 Compliance with the Code of Practice for Internal Audit in Local Government**

- 4.1 Internal Audit carried out a self assessment against the key elements of the revised CIPFA Code. As in 2008/09 this demonstrated that that the Section was meeting 90% of the applicable Code requirements fully, 9% partially and 1% was not met. As reported last year the only criteria not met was that the results of the internal audit quality assurance programme were not included in the annual Internal Audit report. Reporting of quality assurance arrangements are being considered in the upgrade of the audit management system being implemented in July 2010 alongside the finalisation of the Internal Audit manual. The outcome of this work will inform how this aspect of the Code can be met for 2010/11.
- 4.2 As in 2008/09, External Audit have confirmed that they will be able to take assurance from the quality and extent of work done on the core financial systems and in other relevant areas of audit focus. The liaison with the external auditor has been embedded in the year and upgrading the audit management system offers further opportunities to simplify and standardise how Internal Audit provides them with their required assurance. Further refinements and improvements in the approach to auditing the core financial systems for example have been discussed and agreed, enabling Internal Audit to deliver work of increased value to the Council whilst ensuring that the needs of the external auditor are addressed.
- 4.3 Progress in the quality and delivery of Internal Audit work has also been acknowledged by the External Auditor. In the Use of Resources submission they “noted improvements in the Council's internal audit function with strategic audit plans based around key risk areas and the Council's corporate plans, aligned to the resources available”. Similarly their interim Accounts Report in June 2010 concluded “that Internal Audit is performing well and we are pleased to report that we will be placing reliance on the work of Internal Audit on the operation of the Council's fundamental financial systems”.
- 4.4 Positive progress has been made in the implementation of recommendations made by the Audit Commission and the current External Auditor, Grant Thornton, although target dates for the consolidation of working practices into a formal Audit Manual as a single reference point for the section have slipped in the year. Definitive dates are now set as the manual will be finalised alongside the upgrade of the Audit Management system in July 2010.

4.5 The overall conclusion from the self-assessment and with reference to the external audit opinions is that the majority of standards are complied with and there are no concerns raised in relation to the standard of audit and investigation work done. There has been further progress in the year in developing new approach to audit including the delivery of business unit and strategy audits as well as a programme of pro-active anti-fraud work. These developments and the continued improvement of the work of Internal Audit have contributed to the positive feedback from the External Auditor in respect of the Council's systems of Internal Control within the annual Use of Resources assessment.

## 5 Ensuring the Effective Prioritisation of Audit Work

5.1 Prioritisation of the work of the Audit Section is achieved by the development and delivery of an annual risk based Audit Plan. This describes the assurance plans for the Section and includes some capacity for flexibility to adjust to changing circumstances and for demand led and urgent work if appropriate. The plan is based on a mix of different types of audit and investigation work to ensure that assurance over the Council's systems of governance, risk management and internal control is obtained from a number of different directions and sources as illustrated below:



5.2 The Section's methodology for establishing audit priorities is aligned with the Council's developing governance and risk management systems. Audit plans are developed through an assessment of risk and assurance needs to support the Council's overall objectives. The Section reviews corporate and departmental risk registers, business plans and discusses Council objectives and priorities with Heads of Service and Strategic Directors to assess

assurance needs. Emergent plans are discussed with the Audit Committee and final plans show links to Corporate Plan objectives and Use of Resources assessment criteria to clearly demonstrate how work relates to the achievement of Council objectives. All planned work is defined including an assessment of the related business objective and key risks to delivery and prioritised on the basis of risk.

- 5.3 It is considered that the 2009/10 Audit Plan represented a reasonable view of critical areas for audit review and assurance needs when it was constructed and agreed with senior management and Audit Committee. It was based on reasonable estimates of available resources and despite higher than anticipated numbers of fraud investigations and referrals and some significant pieces of other work that arose in the year the plan was largely delivered as planned. Apart from 130 days of work completed in April and reports being finalised in May work was completed within the year.

## 6 Performance Measures

- 6.1 Performance management of the Section and for individuals focuses to a large degree on deployment of auditor time to best effect. This has three main elements related to how much time is spent auditing, completion of audits within set timescales, and effectiveness of time deployed. The key deliverable for 2009/10 and with the exception of 130 days of work carried forward into April and the finalisation of reports in May this has been achieved. The main reason for this slippage has been the higher than anticipated levels of fraud referrals, tight timescales for completion of some year end work particularly around ICT and changes in responsibilities within the section to cover a period of sickness absence that has now been resolved.
- 6.2 Performance and progress are monitored through specific key performance measures throughout the year. These performance indicators were originally shared and agreed with Core Cities but the data for 2009/10 is not currently available however comparisons of key performance measures over the last three years are as follows:

	Target	2009/10	2008/09*	2007/08
Days spent on audit work as % of available days	76%	91%	63%	81%
Audit reports and other outputs issued in year	140	206	109	172
Actual time on audits compared to original estimates	110%	120%	120%	116%
Customer satisfaction (satisfactory or better)	95%	100%	100%	100%
Customer satisfaction (good or better)	75%	70%	69%	68%

	Target	2009/10	2008/09*	2007/08
Draft reports issued within 3 months of audit start	90%	77%	84%	86%

\* Figures based on a nine month year

- 6.3 The key performance measures show that the days spent on audit work and numbers of audit reports and other outputs issued in the year were well above target. This reflects a very busy year in terms of reports and outputs as the service met the challenge of delivering a comprehensive and thorough audit plan.
- 6.4 The indicators show a higher than planned proportion of time spent on 'chargeable' audit work and whilst it can be an indicator of productivity it is also a consequence of spending more actual time on jobs than had been estimated in the annual plan. This is borne out by the indicator showing that on average 20% more time than original planned was spent on jobs. This is an area where improvement is required if annual and individual allocations of audit work are to be delivered effectively. For 2010/11 this is reflected in the service business plan, new competency framework and the annual performance appraisal objective setting process. Other steps to improve performance in this area include further development of planning and budgeting arrangements as well as the further standardisation and simplification of audit processes being introduced as part of the upgrade of the audit management system.
- 6.5 Client satisfaction is reasonable although there is scope to improve satisfaction being more than satisfactory as this indicator is below target. There is a broader issue that the indicator is based on the return of only 13 questionnaires which is too small to be a representative sample. The system upgrade will help simplify processes for the issue and collation of questionnaires but key to improving response rates is that the team chase returns from clients and this expectation is reflected in the new competency framework.
- 6.6 The final indicator measures elapsed time and it is of concern that only 77% of draft reports were issued within three months of audit start dates. This has been a consequence of competing priorities resulting in delays in the completion of work and issuing of reports and is a key area of focus for 2010/11.
- 6.7 There have been no formal complaints raised about Internal Audit work in 2009/10. The service receives requests feedback and management responses from audit clients within which there can be comments or concerns in relation to the audit work. Whilst these have been raised with the team as part of feedback there have been no instances where issues have been escalated to formal complaints and no areas of concern in relation to the application of professional standards.

#### Implementation of Recommendations

- 6.8 The processes for the active implementation of recommendations has been an area of further improvement in the year. Internal Audit is embedding a

quarterly reporting process linking to the workplan of the Audit Committee and this has helped ensure that the time spent by the service is targeted on key risks.

- 6.9 In March 2010 there were 75 of outstanding recommendations which had missed the implementation dates agreed. This is a significant improvement in the year and a reduction from 127 reported as outstanding in September and 88 outstanding at the beginning of the year.
- 6.10 There has been significant action taken to implement a large number of recommendations made in the audits carried out across the Council. Management responses and the level of evidence provided to confirm implementation continues to improve but the quality and timing of updates provided to Internal Audit is inconsistent. There is a need for Internal Audit to chase for updates in some areas and to ensure sufficient evidence is provided. Work continues with Heads of Service and Strategic Directors to ensure steps are being taken by management to manage the identified risks and implement recommendations and progress on implementing recommendations is one of the indicators that has been developed for a Corporate Dashboard report that is currently being developed for reporting to the Strategic Management Team. This reflects the Council commitment to ensure that the good progress made in reducing numbers of overdue recommendations is sustained.
- 6.11 The standard quarterly update report on the current status of recommendation implementation will be provided to the Audit Committee at the end June.

## **7 Audit Committee**

- 7.1 The system of Internal Audit includes the role of the Audit Committee and in particular its role in the receipt and evaluation of audit reports, both in terms of assurance opinions and in ensuring that appropriate arrangements are in place for the delivery of an effective service.
- 7.2 In 2008/09 External Audit reported on the operation of the Audit Committee and all of the agreed recommendations have since been implemented. As part of their 2010 Use of Resources assessment they have updated their understanding of the operation of the Committee and have confirmed the continued good practice the Committee represents. In their initial report to the Audit Commission in support of indicative Use of Resources judgements they commented as follows: "The Council's Audit Committee demonstrated notable practice, providing robust and appropriate challenge to support the system of internal control". They made particular reference to the Committee's programme of learning and development, the contributions of independent members and the robust scrutiny and challenge that the committee has provided provides, particularly by inviting officers to attend and present updates of progress against both internal and external audit recommendations.
- 7.3 The ongoing development of the Committee and the engagement of Members in matters of assurance and risk continues to make an important contribution to the operation of an effective system of internal audit.

## **8 Summary and key priorities**

8.1 The Section has completed a year of stabilisation and consolidation within the Audit and Risk Management Division with a new Head of Service. It has continued to build on the good service development progress made during 2008/09, delivered a comprehensive and well rounded plan for the year and has a sound base for carrying out audit activities and meets its overall objectives in providing audit assurance and advisory support to the Council. It operates in line with professional standards and ethics for the delivery of audit work. External Audit has confirmed that it can place assurance on the quality of work audit done and that the service is performing well. An assessment reflected in a positive direction of travel within the Use of Resources Assessment on Internal Control (KLOE2.4).

8.2 There are further opportunities for development and these are set out in the divisional business plan. Key priorities for 2009/10 include:

- finalisation of resourcing proposals to ensure that previous reliance on external agency and contract staff for non-specialist support work is reduced;
- maximising opportunities for effective liaison, coordination and joint working with Insurance, Risk Management, colleagues in Corporate Services and across the Council within the context of emerging Target Operating Models ;
- delivery of the annual audit plan to time and budget allocations;
- upgrading of the audit management system with standardisation and simplification of processes to further develop efficiency and effectiveness within the audit process;
- focusing on effective communication with clients to fully understand their requirements, delivering work to agreed timescales and acting positively on feedback to ensure that the work of the service meets and where possible exceeds the expectations of all stakeholders;
- strengthening performance and people management arrangements incusing a competency framework to support Section, team and personal objective setting and appraisal; and
- Investing further time and resource in the development of anti-fraud and investigation arrangements.

8.3 Within this context of development it is essential that the service delivers the 2010/11 Audit Plan and continues to engage officers and Members during the year on the provision of constructive, timely and valuable support in the operation of effective arrangements for governance, risk management and control.

## **9 Conclusions**

9.1 Members are asked to note the findings and conclusions of the 2009/10 review of the effectiveness of the system of internal audit.

**Appendix 1 – Structure, Roles and Responsibilities within the Internal Audit Section**

