

Grant Thornton

Manchester City Council

Interim Accounts Audit Report 2009/10

25 May 2010

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1 Executive Summary

Introduction

- 1.1 This report sets out the findings of our interim accounts audit carried out in accordance with our agreed Audit Plan dated December 2009. The scope of our interim accounts audit covered:
- updated review of the Council's control environment, including the work of Internal Audit on core financial systems
 - review of the presentation of the accounts and early work on accounting issues
 - update on the arrangements for implementation of International Financial Reporting Standards
 - updated review of arrangements to compile the Annual Governance Statement
 - responding to a query relating to the Council's decision making process
 - review of the Council's information and communication technology systems
 - progress on prior year recommendations

Key findings

- 1.2 We have 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.
- 1.3 The Council has an accounts closedown timetable in place and is on course to produce the 2009/10 Statement of Accounts prior to the statutory deadline of 30 June 2010. Key areas for the Council to conclude it's work on include:
- finalisation of accounting disclosures for the recognition of PFI schemes on the Council's balance sheet
 - completion of the review of other service concession arrangements and finalisation of accounting disclosures
 - consideration of recommendations following our review of the presentation of 2008/09 Statement of Accounts and Annual Report against best practice.
- 1.4 The Council is preparing for the transition to International Financial Reporting Standards (IFRS) from 2010/11 and has a timetable in place to restate balances under IFRS. The council is making progress, however, there has been some slippage against the timetable due to the volume of work required, which is in line with our observations nationally. Significant areas which the Council needs to complete are:
- assessment of accounting for property leases
 - review of contracts for embedded leases.
- 1.5 The Council has good arrangements for producing the Annual Governance Statement and has implemented some important developments during the year. Initial findings from our Use

of Resources assessment noted positive progress on schools partnership governance arrangements, however, we raised concerns over progress with IT governance arrangements, which are detailed in a separate report to the Council, which will be received by the Audit Committee at the 3 June 2010 meeting.

- 1.6 Our review of the general information technology control environment did not identify any material weaknesses within the IT arrangements that could adversely impact on our audit of the accounts, however, we did identify a number of areas for improvement, principally relating to further security improvements to the SAP system.
- 1.7 Recommendations arising from our interim accounts review are included at Appendix A.

Use of this report

- 1.8 Our report is part of a continuing dialogue between the Council and ourselves and should not be relied upon to detect all errors, systems or control weaknesses or opportunities for improvements in management arrangements that might exist. The Council should assess the wider implications of our conclusions and recommendations before deciding whether to accept or implement them, seeking specialist advice as appropriate.
- 1.9 We accept no responsibility in the event that any third party incurs claims, or liabilities, or sustains loss, or damage, as a result of their having relied on anything contained within this report.

The way forward

- 1.10 We have set out our findings and recommendations in Appendix A to this report, which has been discussed and agreed with the City Treasurer.

Acknowledgements

- 1.11 We would like to record our appreciation for the assistance and co-operation provided to us during our interim accounts audit by the Council's staff.

Grant Thornton UK LLP

25 May 2010

Introduction

2 Detailed Findings

2.1 As part of the interim accounts audit, and in accordance with our Audit Plan dated December 2009, we considered:

- the effectiveness of Internal Audit
- the work of Internal Audit on the Council's fundamental financial systems
- a review of closedown procedures in preparation for the final accounts
- review of the presentation of the accounts and comparison to best practice
- review of emerging accounting issues
- updated review of arrangements to compile the Annual Governance Statement
- review of decision making processes in response to a query received by External Audit
- review of the Council's information and communication technology systems.

The Internal Audit function

2.2 We undertake a detailed review of Internal Audit every three years, with an interim review in intervening years. The last detailed review was completed in 2007/08 and has been updated as part of our planned programme of work for 2009/10. A full review will be undertaken next year.

2.3 Our review of Internal Audit considered the quality of work performed on twelve core system reviews included within the 2009/10 Internal Audit plan. This included four full system audits and eight compliance audits. At the time of our interim audit these had all been completed, with the exception of the asset management review, which is to be undertaken following the financial year end, when all transactions will be updated in the fixed asset register. Overall, we have concluded that Internal Audit is performing well.

2.4 The National Fraud Initiative (NFI) matches electronic data within and between audited bodies to prevent and detect fraud and is operated by the Audit Commission. As part of our planned programme of work for 2009/10, we reviewed the procurement matches identified by the 2008/09 NFI exercise. Our review did not identify any significant matters and we have passed the findings to Internal Audit in order to undertake a full follow up of the matches.

Review of Internal Audit work

2.5 Where possible we seek to place reliance on the Council's fundamental financial systems and the operation of controls in planning our programme of audit work to obtain assurance for the accounts audit. In preparation for our accounts audit, we sought to review Internal Audit work on the Council's financial systems.

2.6 Internal Audit's work on these systems has been carried out as late in the year as possible, in order to provide assurance over the full financial year. The fundamental systems we planned to review during our interim accounts audit visit are detailed in Exhibit One.

Exhibit One: Planned systems review

Fundamental System	Assurance placed on Internal Audit's work?
General Ledger	✓
Revenue Budget Setting	✓
Payroll	✓
Treasury Management	✓
Debtors	✓
Creditors	✓
Housing and Council Tax Benefits	✓
Council Tax	✓
Cash Receipting	✓
Revenue Budget Monitoring	✓
National Non Domestic Rates	✓
Asset Management	✓

2.7 In assessing the effectiveness of Internal Audit work, we reviewed Internal Audit's files to ensure that:

- systems were adequately documented
- key controls had been identified and evaluated
- key controls had been tested
- weaknesses had been reported to management.

2.8 We are pleased to report that we will be placing reliance on the work of Internal Audit and on the operation of the Council's fundamental financial systems.

Closedown procedures

2.9 Our review considered the Council's timetable for closedown, and the arrangements for preparing the Statement of Accounts, including guidance provided on working papers to be made available as part of the closedown process. The Council continues to closely monitor the timetable and expects to meet the statutory deadline of 30 June 2010, and also expects to provide detailed working papers to support the accounts at the start of our final accounts audit visit, using the electronic working paper database identified as good practice in prior years.

2.10 As part of the Council's preparations for compilation of the Statement of Accounts, we gave a presentation to service financial managers detailing the role of external audit and key requirements for the Council to assist in delivery of an effective audit, identifying some improvement opportunities for the Council in preparing working papers. We have issued a working papers arrangements list detailing supporting information required during our audit.

2.11 In 2008/09 and previous years, the Council has not met the deadline for providing Whole of Government Accounts (WGA) consolidation packs for audit. This has been due primarily to

complexities of the Council's group accounts structure and reporting issues within the SAP ledger. Our Audit Plan identified a risk that the WGA deadlines would continue to be missed, which could prevent the Council from improving its Use of Resources assessment for KLoE 1.3.

- 2.12 The Council has implemented system improvements, which will enable additional reports to be produced to aid compilation of the WGA return. We also arranged for the Council to discuss the compilation of the WGA return with another local authority. These discussions confirmed that the Council's arrangements, following the improvements, are adequate to enable the Council to meet the WGA deadlines and the Council has incorporated the compilation of the WGA return into its closedown timetable.

Presentation of the accounts

- 2.13 The Council's accounts are amongst the most complex in local government and are likely to become lengthier and more complex with the introduction of IFRS. It is a challenge to meet statutory requirements but present the financial statements in an accessible and user friendly format for local taxpayers and other stakeholders to understand.
- 2.14 As part of our Audit Plan we agreed to review last year's audited Statement of Accounts and Annual Report with a view to identifying opportunities to improve the presentation and usefulness of the documents for key stakeholders.
- 2.15 Our review included producing and sending a questionnaire to Council members seeking views on the presentation and usefulness of Statement of Accounts and Annual Report. Unfortunately we received few responses to the questionnaires and a key challenge for the Council is engaging members in the production and presentation of the Statement of Accounts.
- 2.16 We discussed the findings of our review with the Council's finance team, in advance of preparation of the Statement of Accounts and Annual Report. The team had already identified a number of areas for review and shared many of our observations. Key areas discussed include:
- improved presentation of information in the explanatory foreword, and signposting to other sources of useful information
 - some enhancement to accounting policies disclosures, although the Council has significantly improved these in the last two years
 - explanation of core financial statements and disclosure notes in 'plain English'
 - logical ordering of notes and cross references
 - explanation of significant 'other' items in disclosure notes.
- 2.17 Last year the Council produced an Annual Report for the first time. Following our review and discussions with officers the following improvement opportunities were identified:
- improved use of a foreword to the Annual Report
 - explanation of how the Council fits in to the hierarchy of local partnerships and key area strategies
 - explanation of the Council's key priorities and how it has performed against these in the year

- commentary on the Council's strengths and improvement opportunities (for example, Use of Resources assessment, corporate health indicators and results of inspections)
- additional commentary on residents' satisfaction, including trend and comparative data.

Emerging accounting issues

Private Finance Initiative (PFI) and service concession arrangements

- 2.18 The 2009 SoRP requires PFI contracts to be accounted for in accordance with the government's Financial Reporting Manual (FReM) to bring local authority accounting in line with central government bodies. This assessment is based on tests of control and will result in the Council recording an asset and a liability within the accounts and the restatement of assets on the balance sheet.
- 2.19 We have had several meetings with the Council and its advisers to discuss the proposed treatment and accounting disclosures within the accounts and are satisfied that the Council should account for the PFI schemes as on balance sheet. We are continuing discussions on how to determine the split of the unitary charge for accounting which will be necessary to determine the amounts to be recorded for initial asset capitalisation, finance charges, service charges and lifecycle maintenance costs. Appropriate accounting treatment is to be determined before the end of June.
- 2.20 The 2009 SoRP also requires local authorities to consider the accounting for any other service concession arrangements. The Council continues to undertake a review to identify any other arrangements and we will consider the outcomes prior to the end of June.

Accounting for Council Tax and NNDR

- 2.21 The other major change in the 2009 SoRP relates to the way in which Council Tax and National Non Domestic Rates are accounted for. The changes require the Council to:
- disclose council tax balances net of any amounts that relate to other preceptors (Police and Fire)
 - only recognise NNDR cash collected in excess of the Council's cost of collection allowance.
- 2.22 The changes require the Council to restate the prior year comparatives. The Council has completed the work required to restate the balances in accordance with the 2009 SoRP and we will review the work undertaken during our final accounts audit.

International Financial Reporting Standards (IFRS)

- 2.23 The Council is required to prepare its accounts in accordance with IFRS from 2010/11. Whilst the Council continues to undertake work in order to restate the accounts under IFRS and is making progress, there has been some slippage in the Council's timetable for completion due to the amount of work required, which is in line with our observations nationally. We have agreed to undertake a review of the restatement exercise following completion by the Council. Significant areas which the Council needs to complete are:
- assessment of the accounting for property leases
 - review of contracts for embedded leases.

Arrangements to compile the Annual Governance Statement

- 2.24 In previous years we have reported on the Council's good arrangements for producing the Annual Governance Statement (AGS). The 2008/09 AGS provided a comprehensive assessment of how the Council has put in place arrangements for the governance of its affairs. Discussion with officers and review of action plans for 2009/10 show that the Council is planning a similar approach and output to the previous year, with some important developments noted during the year, including:
- development of a 'programme of improvement for significant governance arrangements' which provides an action plan for improvement of the most significant issues identified in the 2008/09 AGS. This programme for improvement has been regularly reported on and monitored during the year
 - establishment of a separate SMT Governance sub-group, which has responsibility for the development of governance arrangements across the Council and its partners and the production of the AGS. We have reviewed the minutes of the sub-group and it is clear that key governance issues such as risk management, partnership governance and monitoring the Council's programme of governance improvement are regularly discussed
 - improvement of training arrangements for officers in key areas such as risk management and formation of a 'Learning and Development Group' to co-ordinate members' training and development.
- 2.25 Our Use of Resources assessment has considered the Council's progress against the programme of improvement for significant governance arrangements. Our initial findings submitted to the Audit Commission in April noted positive progress on schools and partnership governance arrangements. However, we raised concerns over the progress with IT governance arrangements, detailed in a separate report to the Council, which will be received by the Audit Committee at the 3 June 2010 meeting.
- 2.26 We will review the Council's draft AGS as part of our annual accounts audit to ensure that the information included is consistent with our knowledge of the Council and that key improvement areas are appropriately reflected.

Review of decision making processes

- 2.27 During the interim audit we received a query relating to a delegated decision to not recoup a £420,000 overpayment to the Association of Greater Manchester Authorities (AGMA) which had built up over a period of five years due to an administration error relating to the percentage split of Marketing Manchester costs between the constituent authorities. Through discussion with officers and review of relevant documentation we examined the circumstances of this error and the appropriateness of the Council's decision making process deal with the error once identified.
- 2.28 Our review did not raise any concerns over the reasonableness of the decision, based on the explanations provided. However, the Council had not produced appropriate documentation to support the decision. We recommend that for all significant delegated decisions, the Council should document:
- the basis of delegating the decision under the Council's constitution

- the background to the decision, and key factors to be considered, including financial and value for money considerations
- details of relevant legal advice supporting the decision
- formal 'sign off' by appropriate statutory officers.

Information Technology Control Environment

2.29 As part of our interim accounts audit we undertook a review of the information systems controls as part of the overall review of the internal control system. Our review did not identify any material weaknesses within the IT arrangements that could adversely impact on our audit of the accounts.

2.30 Our work did however identify a number of areas for improvement. The Council needs to:

- address weaknesses identified by Internal Audit's November 2009 penetration test, implement agreed actions and establish a project team to administer the purchase of a vulnerability scanning tool to enable compliance with the Government Code of Connection
- document a SAP security policy and appoint a dedicated security team lead to perform periodic reviews over the SAP system security configuration
- review SAP user access to reduce the high number of inactive accounts on both the network and the SAP system, which will minimise licensing costs and reduce the risk of unauthorised access to the Council's system
- review SAP user privileges to reduce the risk of unauthorised transactions being performed by users with full privilege rights
- review system security settings for both Active Directory and SAP systems to reduce the risk of unauthorised access and consider:
 - implementation of screensaver passwords to reduce the vulnerability of unattended workstations
 - configuration of the SAP portal security settings to require password complexity in accordance with the Council's password rules.

2.31 Detailed findings have been separately reported to IT management and we have issued three further reports to the Council, which will be received by the Audit Committee on 3 June 2010, as follows:

- SAP System Utilisation and Effectiveness Review
- Review of IT Governance
- Information Security Management.

2.32 As part of our review we followed up previous recommendations raised in our 2008/09 SAP and 2009 follow up reports. Whilst the Council has made some progress in implementing recommendations raised, our review identified four recommendations which have not been fully implemented as follows:

- reviewing access rights to critical transactions and ensuring only authorised individuals have access to those transactions
- reviewing user administrative privileges and evaluating the need for multiple administrator accounts

- reviewing remote access authorisation
- populating and regularly reviewing the table of common passwords for SAP access.

Follow up of prior year recommendations

2.33 As part of our planned programme of work, we followed up the recommendations made in our annual accounts report last year. Our work indicates that the Council has made some progress, fully implementing 3 of the 6 recommendations, with work continuing to be undertaken on the remaining 3 recommendations in accordance with the accounts closedown timetable. The Council expects to fully implement these recommendations prior to preparing the Statement of Accounts by 30 June 2010. We will follow up the implementation of these recommendations during our final accounts audit.

A Action Plan - Interim Accounts Audit

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
1	2.19	The Council should finalise PFI related disclosures to be incorporated in the Statement of Accounts in advance of 30 June 2010 statutory deadline.	M	The finalised disclosures will be incorporated in the Statement of Accounts submitted to Audit Committee in advance of the 30 June 2010 statutory deadline.	June 2010 Karen Gilfoy
2	2.20	The Council should conclude its review of service concession arrangements and ensure SoRP compliance disclosure in advance of the 30 June 2010 statutory deadline.	M	The review of service concessions arrangements and the disclosures will be completed prior to the 30 June 2010 statutory deadline.	June 2010 Karen Gilfoy
3	2.23	The Council should continue to prepare for 2010/11 IFRS restatement. Significant areas which the Council needs to complete are: <ul style="list-style-type: none"> assessment of the accounting for property leases review of contracts for embedded leases. 	M	The Council is continuing its preparations for 2010/11 IFRS implementation. The 2009/10 re-statement should be completed by the end of December 2010 and the first IFRS compliant accounts will be submitted to Audit Committee in June 2011.	June 2011 Karen Gilfoy
4	2.28	For all significant delegated decisions, the Council should document: <ul style="list-style-type: none"> the basis of delegating the decision under the Council's constitution the background to the decision, and key factors to be considered including financial and value for money considerations details of relevant legal advice supporting the 	M	The City Treasurer and City Solicitor will document the basis of delegating significant decisions under the Council's constitution. A process will be put in place to document the background to significant decisions and the key factors taken into account together with details of relevant legal advice and formal sign off.	August 2010 Richard Paver Susan Orrell

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
		<p>decision</p> <ul style="list-style-type: none"> formal 'sign off' by appropriate statutory officers. 			
5	2.30	<p>Following the Penetration Test review the Internal Audit in November 2009, the Council should:</p> <ul style="list-style-type: none"> follow up the agreed actions reported and resolve the weaknesses identified purchase a vulnerability scanning tool to enable regular penetration testing. 	H	<p>A suitably qualified external provider will be appointed to undertake regular Penetration testing.</p> <p>Vulnerability scanning tool will not be required as this will be an externally provided service.</p>	<p>Keith Traverse DMZ – June 2010 Internal – Aug 2010 Network – Nov 2010</p>
6	2.30	<p>The Council should produce and document a SAP Security Policy and appoint a SAP team lead to ensure all risks are appropriately managed and controlled.</p>	M	<p>In line with the Audit recommendation, a framework Security Policy has been commissioned from the Council's SAP software partner (HCL-Axon). The document has recently been delivered and is presently being internally reviewed. Some further work (running up to August 2010) is anticipated to make the framework Policy a fully implemented, working document for MCC.</p> <p>As a consequence of recent reorganisations within the ICT Service the post of SAP Security team lead no longer exists on the structure. However, in its absence the Security & Access Working Group (established in response to a previous audit recommendation) has</p>	<p>August 2010 - Phil Burke</p>

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
				sought to manage and/or minimise any security risks associated with SAP. The Security and Access Working Group has been meeting since July 2009.	
7	2.30	Management should review user access within the network to ensure any unused access is revoked. This will minimise licensing costs and reduce the risk of unauthorised access to the Council's systems.	M	Business Support have already carried out many reviews of who has access to live SAP systems as part of reviewing the SAP roles and access requirements of the Finance and HR Shared Service Centre creation. We have been carrying out a number of exercises as part of Security and Access Working Group to validate SAP users and their roles. An exercise has recently been undertaken in March 2010 to remove the SAP access of users who have not logged on to the ECC, SRM and CRM systems in SAP in 90 days. A program has been developed in house to remove the SAP access of employees processed as leavers in the HR module of SAP.	Implemented (SAP Users) - Alastair Cumming
8	2.30	The Council should review SAP user privileges to reduce the risk of unauthorised transactions being performed by users with full privilege rights.	M	With the exception of the MCC Basis team, no Dialog users are assigned any of the specified SAP standard profiles that give "full privilege rights" in Production environments. Privileged access has been	Implemented - Phil Burke

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
				<p>removed from the BASIS team's day-to-day SAP logins. In conjunction with this, additional logins (Emergency logins) have been created which, in line with new working practices, are available for use by the BASIS team but strictly in emergency circumstances only. To complement this measure, any SAP activity recorded against an Emergency login will automatically generate an entry on a Management report which is monitored by senior staff to ensure that there is no abuse of privileged access.</p>	
9	2.30	<p>The Council should consider the following improvements to system security settings to reduce risks:</p> <ul style="list-style-type: none"> • enable screensaver passwords to enforce valid log in after 15 to 20 minutes of inactivity • the SAP portal security settings should be configured to require Council's password rules. 	L	<p>SAP Portal security settings have been configured to match the Citrix / Network password complexity settings as closely as possible. The SAP Portal password now requires the following:</p> <ul style="list-style-type: none"> • 1 uppercase character • 1 lowercase character • 1 special character (such as !, \$, #, %) • Be 8 characters in length • User ID cannot be part of password. • Old password cannot be part of new password. 	Implemented - Phil Burke

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
				Implementation of Screensaver passwords on Citrix and PC is currently in final test and progressing through formal change control.	Screensaver responsibility - Keith Traverse June 2010 implementation
10	2.32	The Council should implement actions to address previous recommendations raised in our 2008/09 SAP report and November 2009 follow up review.	M	<p>It is accepted that there are still a number of users with access to sensitive SAP transactions but this anomaly is purposefully being addressed through an initiative (currently underway) to re-design SAP Support roles. Once complete, this exercise will ensure that access to sensitive transactions is appropriately restricted to just those users who require them to undertake specialist support roles. The scale of work involved in re-designing /creating / testing / implementing new support roles is significant, but demonstrable progress has been made and continues to be made in removing inappropriate access.</p> <p>For practicality, some ICT users outside of the SAP Security team have limited SAP user administration access. However, their access is restricted to specific functionality such as locking / unlocking users, assigning printers and does not include</p>	<p>August 2010 - Phil Burke</p> <p>N/A - Phil Burke</p>

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
				<p>the facility to add or remove SAP roles or profiles. This access will be monitored and reviewed on an ongoing basis.</p> <p>Clarification is currently being sought from authorised sources with regards to establishing an acceptable policy for remote access to ICT systems which will be compliant with CoCo standards. This dialogue may result in the use of dual-factor token authentication and / or restricted access through MCC supplied access devices only ; however, a policy has not yet been agreed.</p> <p>MCC SAP users access the system via the SAP Enterprise Portal and a Single Sign-on (SSO) regime is in place between the Portal and the backend SAP systems. As such, backend system passwords are effectively 'unused' as end-users only authenticate themselves to the Portal. The facility SAP provides to check password content against a table of 'common words' does not apply to Portal passwords. However, portal password strength has been increased by forcing special characters and content within the portal</p>	<p>Date TBC - Martin Turner</p> <p>N/A – Phil Burke</p> <p>(TRIBAL</p>

Rec. No.	Para Ref	Recommendation	Priority H/M/L	Council response	Implementation date and responsibility
				<p>password. SAP Single Sign On authentication against Active Directory Services (ADS) at some future point will equally address the requirement of this audit objective.</p> <p>E-recruitment users do not use the portal to sign in. MCC is due to move to an externally hosted E-recruitment solution (TRIBAL) within the next three months, at which point SAP E-recruitment user access can be removed.</p>	<p>implementation date) August 2010 – Stephen Forrest project manager</p>