

**MANCHESTER CITY COUNCIL**

**REPORT FOR INFORMATION / RESOLUTION**

**COMMITTEE**            Audit Committee  
**DATE:**                29 May 2008  
**SUBJECT:**            Annual Review of the System of Internal Audit  
**REPORT OF:**        The City Treasurer

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**PURPOSE OF REPORT**

To consider the outcome of the annual review of the system of internal audit in accordance with the Accounts and Audit Regulations.

**RECOMMENDATIONS**

Members are requested to note and comment on the results of the annual review of the system of internal audit.

**FINANCIAL CONSEQUENCES FOR THE CAPITAL AND REVENUE BUDGETS:**

None

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**BACKGROUND DOCUMENTS**

None.

**WARDS AFFECTED**

N/A

**IMPLICATIONS FOR KEY COUNCIL POLICIES**

<b><u>Anti-poverty</u></b>	<b><u>Equal Opportunities</u></b>	<b><u>Environment</u></b>	<b><u>Employment</u></b>
None	None	None	None

**Manchester City Council**  
**Annual Review of the System of Internal Audit 2008**

- 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 Regulation 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, analysis of key performance indicators and customer feedback and refers to findings recent External Audit reviews. Further analysis of the Internal Audit Service was provided by outcomes of the on-going Audit and Risk Management Service Improvement Project (SIP).
- 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. The in-house team is managed by the City Treasurer and Head of Financial Management and is within the Corporate Services department. The Section funds 26 posts plus the Head of Internal Audit position. The Section is structured in client/service based teams which reflect the current organisation of the Council. These audit teams provide the opportunity for auditors to develop a depth of knowledge and relationships with customers in relation to the work of the 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.
- 2.2 The Section's 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. The annual review of the Terms of Reference was carried out and reported to Audit Committee in June 2007 with minor amendments made to update it. 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.

2.3 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 There have been a significant number of vacancies in the Section during the year and in previous years. The resource availability ranged from a low of 16 and a high of 21 during the year against an FTE of 26 plus the Head of Internal Audit post. The Section's budget is approximately £1.2m with approx 85% of this related to salaries when fully staffed. The resource available during the year was less than planned for delivery of the annual assurance programme due to the number of vacancies which remained unfilled after poor responses to external recruitment exercises at senior levels. The resource pressures came from a secondment, two extended periods of sick leave and maternity leave, the resignations of two principal auditors and one newly qualified auditor (scale 6) and implementation of some reduced hours patterns. The leavers moved to private sector and voluntary sector posts for career development, increased salaries and in one case the opportunity for international travel.

3.2 To address significant resourcing pressures Internal Audit held successful recruitment exercises appointing three senior auditors S01/2 in December 2007. These were one external and two internal candidates from the career grade scheme. The promotion of the internal candidates demonstrated the success of some of the first career grade staff appointed in 2005 as part of a long term plan to increase the numbers of staff and skills within the Section. In addition three trainee auditors (scale 4) were appointed and started work in January 2008 although one resigned shortly afterward for personal reasons. Further resource was provided by the use of consultants, referred to in para 3.8.

3.3 There are currently five vacancies against the agreed FTE which are the posts of Head of Internal Audit, one Audit Manager (PO6), one lead Auditor (P04), two Principal Auditors (PO2/3) and one Senior Auditor (S01/2). The Head of

Internal Audit, Audit Manager and Lead Auditor posts have been filled throughout the year with staff on temporary appointment from the audit team. These posts will remain filled on a temporary basis until the outcome and implementation plans for the Audit and Risk Service Improvement Review (SIP) are confirmed.

### Structure

- 3.4 To address the impact of resource pressures on delivery the Section was reconfigured in an interim structure in 2007. This continued to reflect the configuration of the Council at Strategic Director level and allowed the senior auditors to continue to develop and build on customer relationships with senior managers across the Council albeit in increased numbers. Retaining client-facing teams enabled auditors to maintain continuity in assessment and analysis of business plans, priorities, risk and current issues to inform the audit planning process.
- 3.5 Reconfiguration of the Section included merging both the Finance and IT and the Governance and Performance audit teams under single Lead Auditors. The business development Lead Auditor post was retained to take forward some key development objectives. This structure remains in place although further staff reduction required governance audit work to be addressed by the Acting Head of Internal Audit and Acting Audit Manager with some support from the business development lead auditor. This led to a subsequent reduction in business improvement and development work during the year. The current, interim structure is shown at Appendix A.

### Audit and Risk Management SIP

- 3.6 The SIP started in July 2007 with an initially review of scope and coverage of the objectives. The work was split into two streams for audit and risk. An interim report was taken to Audit Committee in January 2008 and the project is expected to report on options at the end of June 2008. The SIP is examining the approach to Internal Audit, in particular the positioning and structure of the Section, expectations of customers, key deliverables and value added and the potential strategies for addressing recruitment and retention. Consideration is also given to any opportunities for joint working with other AGMA Audit Services.
- 3.7 The future shape, size and structure of the Internal Audit Section will be informed by the conclusions of the Audit and the Risk work-streams as these are interrelated and must reflect the developments in Corporate Governance arrangements across the Council. This will be influenced by the outcome of the discussion with Strategic Directors about their expectations and requirements of the Internal Audit function. This is seen as a critical element to the development of the Internal Audit Strategy.

### Alternative Resourcing

3.8 During the year the Financial Services Framework Contract was used to bring in additional resources to address specific gaps in the assurance programme based on an assessment of risk and technical skills required. Salford's Computer Audit Service also delivered some IT audit work. Skills transfer was part of the expectation of the use of external resources and this was achieved to limited degree with some job shadowing. The external resources used were managed by in-house staff to ensure consistency and in most cases the Section's working papers, systems and review processes were used. The experience demonstrated that while external resources can be used significant management time is required to ensure that external staff are properly briefed and engaged. There are lessons to learn on both sides of these contracted arrangements about approaches to audit work, effective management of work, and customer relationships but there were successful outcomes and positive feedback received.

### Training and Experience

3.9 Training and development plans operated 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 2007/08 with passes achieved in the practitioner level Institute of Internal Audit examinations (PIIA). Three career grade auditors were awarded the PIIA during the year and two of these have progressed to the next grade based on competency and qualification. Two trainees passed final PIIA exams January 2008. Two new trainees will start training with the IIA shortly.

3.10 As the trainees have developed and experienced more varied and complex audit work their individual productivity has increased. They are able to take on more work and self manage to a greater degree, though direction and support are still required. More complex audit work still requires more senior staff and this is the area of challenge for the Section due to the limited number of senior staff in post.

3.11 The following information about qualifications and experience of staff available for audit work during the period is provided as agreed, as a benchmark for future consideration. The level of senior audit experience in audit has reduced since reported in 2006 due to the turnover at those levels.

### **Experience 07/08 (06/07)**

<b>Auditing Experience</b>	<b>All Auditing</b>	<b>percentage</b>	<b>In local Government auditing</b>	<b>percentage</b>
Up to 1 year	2 (0)	10%	2 (0)	10%
1 to 2 years	0 (4)	0	0 (8)	0
2 to 5 years	5 (1)	25%	9 (4)	45%
5 to 10 years	6 (6)	30%	6 (4)	30%

Over 10 years	7 (11)	35%	3 (6)	15%
<b>Total Staff</b>	<b>20</b>			
Includes Acting Head of Internal Audit but excludes 1 support post				

### Qualifications

Qualified Accountants (CIPFA, ACCA, ICAEW)	3
Institute of Internal Auditors (FIIA/MIIA)	6
Institute of Internal Auditors (PIIA)	3
Studying for PIIA	4
Studying for audit diplomas (CIA)	4
<b>Total</b>	<b>20</b>

Includes newly appointed staff and excludes technical support

- 3.12 Is 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, linked to 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. However this increased level of experience and qualification was subsequently reduced by the resignations and moves during the year. This has an impact on the delivery of complex work and management.
- 3.13 The overall conclusion on structure and staffing is that the client based structure enables delivery of quality risk-based work and that the career development path is beginning to produce results. This takes time. Sufficient quality of work is achieved but is a gap in delivery of planned assurance because of the capacity issues. Consolidation of experience and knowledge is required for the increasingly more complex work and in order to meet client expectations for solution-based recommendations. It is recognised that the Section needs to build up its numbers, to recruit senior staff, and to allocate time to train and develop its staff. Consideration will be given through the SIP and Job Evaluation processes to additional options for increasing the effectiveness of recruitment and retention and for the resourcing of core work.

## 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. This identified that the Section was meeting 85% of the Code requirements fully, 14% partially and 1% was not met. This is a slight decrease on the previous year and is associated with specific improvement areas including the need for clarification of the position of the Section and expectations of it, agreement to an audit strategy and inclusion of Internal Audit in the review of the effectiveness of the Audit Committee. The

resourcing gap for the current audit programme has impacted on the delivery and is a concern raised by external audit.

- 4.2 The Audit Commission carried out an independent review in June 2007 which reported in January 2008 and a further External Audit review was carried out in February 2008 to be formally report to the June 2008 Audit Committee. The emerging findings from this work have been discussed with the Acting Head of Internal Audit, City Treasurer and Head of Financial Management and mirror the self-assessment. Key issues have been highlighted which affect achievement of the Code. An improvement plan to address issues from both reports is being prepared which should enable improvement to overall compliance with the Code and through engagement with Strategic Directors confirmation of the position and status of the Section and its role in the assurance framework.
- 4.3 External Audit have commented that they take assurance from the quality of work done but that there is not enough core work completed. Improvements in the management and control of work have been effective and are being embedded and adapted. These include refinements to planning of work and methods for active management of jobs. The process involves review and reporting of additional time requests and discussion and agreement to changes to scope to identify what impact it will have on the overall work plan. Improvement to the evaluation process has continued with the increased use of white-boarding sessions to engage audit teams and managers in active assessment of audit findings and conclusions. This has been expanded to planning sessions on more complex audit work and is helping to refine risk assessment and scoping. Further work has been done to improve the follow up processes for recommendations and to increase the active review and management of implementation by senior managers. There is more work to do in this area with consideration being given to risk rating of audit reports and alternative methods for reporting low level audit findings and recommendations. This will enable managers to focus on key risk areas and recommendations to better enable them to prioritise action required.
- 4.4 Progress on other areas of business development work for example agreeing a formal Internal Audit Strategy and provision of an Audit Manual to consolidate the audit processes in a single reference have been limited by resource availability. The delay in appointing and subsequent intermittent availability of a Business Development Manager to deliver improvements to procedures and processes, and reduced level of senior staff, has limited progress to refine the quality review process which is crucial for further Section development and will help address key findings from the Audit Commission report on Internal Audit.
- 4.5 The overall conclusion from the self-assessment and with reference to the external audit opinion 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. However there is the opportunity for improvement in key areas and the need to ensure all Code Standards are fully met. In particular senior management needs to clarify its expectations and the role of

Internal Audit. Resourcing constraints remain critical to future success and the resource gaps particularly at senior levels must be addressed. The completion of the audit stream of the SIP is a key element in taking this forward and action needs to be taken to ensure resources are available to do this. A report is to be provided to the next Audit Committee on progress in these matters.

## **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. There is also an allocation made for investigation and proactive fraud work.
- 5.2 The Section's methodology for establishing risk based priorities are being aligned with the Council's developing governance and risk management systems. The Audit Plan 2007/08 was - and 2008/09 is being - created by 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. All planned work is defined including an assessment of the related business objective and key risks to delivery and prioritised as high, medium and low.
- 5.3 It is considered that the 2007/08 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. However it was overly ambitious in terms of resourcing estimates. The plan was developed assuming a full staff compliment of 26 by mid year which was not achieved and delivery of the plan was significantly affected by vacancies, additional unplanned but significantly high risk and urgent work, and by the need to extend testing in some areas of audit activity. Changes were made during the year and audit work to be deferred was identified in a report to Audit Committee. The changes reflected an assessment of risk and, potential alternative means of gaining assurance. A full outturn report to Audit Committee will quantify the gap after the year end (June) but the most significant issue is the limited assurance provided on core financial systems. The current key performance measures are examined below.

## **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. These are monitored through specific key performance measures throughout the year. These performance indicators were originally shared and agreed with Core Cities and are currently under review. The impact of audit activity is

assessed on a variety of factors including the quality of audit work done and the level of acceptance of recommendations by management. This is monitored during the audit through compliance with audit standards and management review, and after the audit through implementation of recommendations. Internal Audit also considers customer feedback as a critical source of analysis which can help to identify strengths and areas for improvement. The performance measures are described in more detail below.

#### Time Spent Auditing.

- 6.2 This measures the percentage of time deployed on audit work (direct time) as opposed to indirect time spent on overhead requirements such as management, administration, training and sickness absence.
- 6.3 The target set is 76% and current performance is 82 % which is slightly higher than last year and up from 64% the year before. This is considered to be an indication of increasing effectiveness in targeting direct audit time and in how time used. The high level of available days demonstrates some improvement in the quality and effectiveness of individual audit planning and active management of the work by both auditors and their managers.

#### Time spent on each audit compared with time allocated.

- 6.4 This is a measure of the ability of individual auditors to manage and complete work in allocated time in agreement with customers. It is assessed on individual audit delivery and can be affected by a variety of factors some of which are outside the auditor's control. The measure allows for a degree of slippage to reflect this with a target of 110% of planned time. Current performance is 116% which is above the target but decreasing. Varying levels of experience can impact on this and it is expected that achievement will improve as auditor experience grows.

#### Time elapsed between work started and draft report issued.

- 6.5 This measures the level of service provided to auditees in completing the work and to some extent measures the complexity of the audit and the issues which may have been encountered in undertaking it. Clearly, reports which are significantly delayed from the time the work was undertaken can have reduced impact as the business and issues move on. The target is 90% of reports issued within 3 months of fieldwork starting. Current performance is at 91% which is an improvement on 81.6 in 2007 and 67.1 % in 2006. There has been active work undertaken to decrease the response time from customers by better planning of work, timing of testing and in encouraging the development of action plans during the emerging findings stage. There has been some difficulty in obtaining timely responses from management to enable some final reports to be issued in a timely way but these are followed up individually and escalated as required. Internal Audit has improved achievement levels through active management and application of internal quality procedures and by ensuring effective client communication and engagement throughout the process.

## Customer Satisfaction in the work undertaken

6.6 After each audit managers are asked to complete a questionnaire which asks 12 questions about the conduct of the audit, classifying responses as excellent, good, satisfactory, adequate or poor. The questionnaire was originally agreed with Core Cities. Additional written comments are requested to help identify best practice and any issues arising. Response rates are not high but sufficient to draw some conclusions and to address any areas of concern arising. The process is currently under review and it is planned to revise and re-launch the customer satisfaction process.

6.7 The results are amalgamated into an overall percentage score and are currently as follows:-

**Satisfactory or better      target 95%    performance 100%**

**Good or better                target 75%    performance 67.9%**

This, encouragingly, shows that customers continue to see the service delivered as valuable with an improvement on satisfactory or better to 100% but there is a decrease on good or better from 76.5% last year. The positive responses are judged to come from customers who have had the benefit of effective communication from the auditors and where the recommendations and comments made properly reflect and address the challenges the business faces in managing its risks.

6.8 Additional assessment of the impact and value of Internal Audit has been under review this year. There is work in hand to assess how the Section will contribute to the overall assurance and governance framework. In terms of direct impact value is added by the provision of the required function of Internal Audit for assurance and the provision of audit opinion on key systems and developments as well as advice and support. This is reported to Audit Committee by the Acting Head of Internal Audit. Large financial savings were made in some work where audit activity addressed concerns in the audit trails for project management. The risk of clawback was averted and monies recovered by the Council as a result.

6.9 Senior managers have been interviewed as part of the SIP process and have provided constructive comments which are being assessed as part of the SIP process. Some of the key areas of concern support the findings of external audit who have expressed concern about the positioning and status of the Internal Audit Section and the expectations of audit which are quite wide ranging. There is a need to clarify the role of Internal Audit and in taking action to re-launch the Service to the Council.

6.10 The Section continues to receive unsolicited and positive feedback from customers which refer to the professional approach of auditors and the supportive nature of work done to support managers in specific projects. This includes work in risk based audits, developing systems advice and support

and investigations. Several reward and recognition awards have been made to individual auditors for their contribution to key work areas.

- 6.11 There have been no formal complaints raised about Internal Audit in 2007/08 and there are no areas of concern in relation to the application of professional standards.

#### Implementation of Recommendations

- 6.12 The processes for the active implementation of recommendations is an area of development in the Council. Internal Audit is working with management to ensure appropriate and timely action is taken to address implementation of agreed recommendations and action plans to address risk. Recommendations are assessed as high, medium, and low to assist management in directing resources at the priority issues. A report on progress to implementation will be provided to the next Audit Committee meeting in June as agreed.

## **7 Conclusions**

- 7.1 The Section 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 taken assurance from the quality of work audit done and that it meets the majority of Code Standards. It considers however that there is work to do to address gaps in achievement of the Code in four key areas.
- 7.2 The Section has maintained productivity throughout the year but has not delivered all core system work planned. The impact of vacancies, level of demand led work, and some expanded scoping for some work to address key risks have affected the delivery and resourcing plans were considered optimistic. There is a need to ensure that the assurance from planned work is delivered in the coming year.
- 7.3 Performance management has improved in and the impact of this is, demonstrated by the increased achievement levels in most of the key performance indicators used by the Section. The KPIs are under review. External Audit has asked that output measures be reported more regularly to management and to Audit Committee.
- 7.4 There is a need for Service improvement in relation to provision of an Audit Strategy, the positioning of the Service and consolidation of quality processes and procedures. The External Audit's report on the Service along with previous recommendations form Audit Committee will be used as part of the Service Improvement plan.
- 7.5 The Audit and Risk SIP offers the opportunity to formally assess the requirements of the Service, confirm them and to set the framework required to deliver its objectives in the future.



Corporate Services Department  
Internal Audit Section

