

MANCHESTER CITY COUNCIL

REPORT FOR INFORMATION / RESOLUTION

COMMITTEE Audit Committee

DATE: 29 June 2006

SUBJECT: Annual Review of the System of Internal Control

REPORT OF: The City Treasurer

PURPOSE OF REPORT

To consider the outcome of the annual review of the system of internal control in accordance with the Accounts and Audit regulation

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

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

1. **The Annual Review of the system of Internal Control**

- 1.1 The Accounts and Audit Regulations were amended from April 2006 to 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”*. Consideration of the system of internal control is a matter for the Audit Committee
- 1.2 The outcome of the Review, which has been overseen by the City Treasurer, was considered by SMT at its meeting of 20 June 2006. The report is attached for Member consideration and comment.

Annual Review of the System of Internal Audit

- 1.1 The Accounts and Audit Regulations were amended from April 2006 to 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 This report represents an assessment of the System of Internal Audit for consideration by SMT and the Audit Committee. It highlights, amongst other things, key activity during 2006/7 which will provide additional assessments as a result of the planned Audit Commission review of the Section, the Service Improvement Project and the need to review and adopt any necessary changes arising from the intended revision to the audit Code of Practice.

2 Current Arrangements for Internal Audit

- 2.1 The system of Internal Audit is provided by a dedicated Internal Audit Section, which forms part of the Corporate Services Department, managed by the City Treasurer. The Section funds 26 posts, 4 of which are currently vacant (see Appendix 1). The Sections budget is approximately £1m and 85% of this relates to salaries.
- 2.2 Internal Audit Terms of Reference, approved by the previous Audit Sub Committee, outline the way in which the Section operates within the City Council. These provide appropriate arrangements to ensure independence and objectivity in the discharge of Internal Audit’s responsibilities. The Section undertakes work in accordance with the Code of Practice for Internal Audit in Local Government produce by CIPFA which is, in essence, best or proper practice guidance for the discharge of an audit function.
- 2.3 The last formal evaluation of the Section was undertaken by External Audit using the Code of Practice as the basis for the review and was reported to Finance and General Purposes Overview and Scrutiny Committee on 10 March 2005. This review concluded that *“Manchester has a satisfactory Internal Audit Function which generally produced high quality work the overall effectiveness of the Internal Audit function is only reduced by there being insufficient resources within the section to complete the planned work”*
- 2.4 Following on from this review, a number of issues were detailed in an Action Plan agreed with External Audit to improve the operation of the Section. The status of these actions are detailed in Appendix 2.
- 2.5 In now considering a review of the effectiveness of the Section in the context of the last review by External Audit and in the light of developments and changes in the interim, the following key issues are considered:-
 - The staffing levels, including qualifications and experience of the team
 - The extent of compliance with the Code of Practice in producing quality work

- Ensuring the Section successfully audits the most appropriate areas on a prioritised (risk) basis.
- The performance of the team

3 Staffing Levels, Qualifications and Experience

- 3.1 The Audit Commission report outlined above highlighted significant problems in the retention of staff within Internal Audit. As a result the structure of the Section was reviewed and new posts were configured. A significant level of recruitment was undertaken during 2005/6 which has significantly increased resources although the Section remains below Establishment (although work is supplemented by the purchase of 100 days specialist computer audit work undertaken by Salford as part of an AGMA agreement). The Audit Sub Committee considered reports about the resourcing of the Section at its meetings of 6 October 2005 and 23 March 2006.
- 3.2 During 2006/7 a Service Improvement Project will be undertaken (as part of the Manchester Improvement Programme). This will examine the structure of the Section and associated recruitment and retention issues.
- 3.3 One significant effect of the protracted period of high staff turnover and the recruitment of such a significant proportion of new staff, (especially in relation to the establishment of a career grade structure) is the overall loss of experience available to the team. While every effort is being made to minimise the impact of this (particularly by seeking to ensure all auditor become professionally qualified) there has inevitably been an impact during 2005/6. In future years a significantly greater proportion of the Team will be professionally qualified than before and provided staff can be retained, experience in Internal Audit and of local government will build. .
- 3.4 Because this is the first formal annual review of the Section under the Accounts and Audit Regulation, the following information about qualifications and experience are provided as a benchmark for future consideration. This information will also be used in the SIP.

Experience

Years of Auditing Experience	In auditing (numbers of staff)	Cumulative percentage	In local Government auditing (numbers of Staff)	Cumulative percentage
Up to 1 year	4	18.2%	7	31.8%
1 to 2 years	1	22.7%	1	36.4%
2 to 5 years	0	22.7%	5	59.1%
5 to 10 years	10	68.2%	3	72.7%
Over 10 years	7	100.0%	6	100.0%
Total	22		22	
Includes Head of Audit but excludes 1 support post				

Qualifications

Qualified Accountants	6
Institute of Internal Auditors (IIA)	6
Studying for IIA	6
Studying for audit diplomas	4
Total	22

The overall conclusion on staffing, therefore, is that levels are reasonable but the section needs to build up numbers, increase experience and the level of professional qualifications held.

4 Compliance with The Code of Practice

- 4.1 The Section was reviewed against the Code by the Audit Commission and Appendix 2, outlines those aspects of the Code where improvement was needed. There have been notable improvements with the establishment of formal terms of reference and the setting up of an Audit Committee. Progress has been limited in relation to other matters, largely as a result of low staffing levels until October 2005 and then because of the necessity to effectively induct significant numbers of new staff. The revised structure included the establishment of the post of Lead Auditor (business development) to provide, for the first time, a dedicated resource to deliver improvements to procedures and processes. When the post holder returns from maternity leave it is expected that significant progress can be made in this area.
- 4.2 In relation to the Code, there are two factors to consider. CIPFA are currently consulting on a revision of the Code which should be published in the Summer/Autumn period. This also co-incides with the next scheduled formal review of the Section by External Audit. It seems logical to focus on assessment of compliance with the new Code, when published and the results

of the impending review by the Audit Commission. This should be considered by the Audit Committee in due course.

- 4.3 The overall conclusion on compliance with the Code is that the majority of standards are complied with, but there are some improvements still to be made.

5 Ensuring the Effective Prioritisation of Audit Work

- 5.1 Prioritisation of audit activity is achieved by the development and delivery of a risk based Audit Plan, on an annual basis, which also includes some capacity for flexibility to adjust to changing circumstances.

- 5.2 Over recent years, the Section has sought to align the methodology adopted to establish risk based priorities with the emerging risk management systems being developed by the Council. In considering the effectiveness of these arrangements there are two areas which need particular comment.

- 5.3 As the Council's risk management arrangements are still developing, the extent to which the Plan fully reflects all issues is likely to be incomplete. The process of developing the Plan has been undertaken, largely with staff in new roles, many of which are becoming familiar with the Council (or indeed local government) and staff are in the process of developing working relationships with senior managers across the Council. Pressure to assist in key areas during the early part of the year and the lack of Audit Managers in post, until one was appointed from May 2006, has limited the ability to consult with senior managers across the Council as effectively as required. This is an area which will be further developed during 2006/7.

- 5.4 It is considered that the Plan represents a reasonable view of critical areas for audit review. The plan covering the period July 2006 to June 2007 is presented as a separate report.

- 5.5 The second issue to consider is delivery of the plan which is considered in the next section on performance.

6 Performance Measures

- 6.1 As outlined above 85% of the budget is expended on staffing. It follows, therefore, that performance management for the section and for individuals must focus on deployment of auditor time to best effect. This has three main elements.

- How much time is spent auditing
- When undertaking audits are these completed within set timescales, and
- How effective was the time deployed.

These issues are picked out through specific performance measures the results of which are detailed and context explained below.

Time Spent Auditing.

- 6.2 This measures the percentage of audit time actually deployed on audit work as opposed to (in the main) management, administration, training and sickness.
- 6.3 The target set is 76% and current performance is 64.9%. This invariably reflects additional time spent in the induction and coaching of significant numbers of new staff, several of which have embarked upon professional training as one cohort rather than this being staggered as would normally be the case in a mature structure.

Time spent on each audit compared with time allocated.

- 6.4 This measures if individual auditors (including also managerial review) complete work in the time allocated to each audit. 100% would represent perfection which is why the measure allows for a degree of slippage. The target set is 110% and the current performance is 122%. This, again, reflects current varying levels of experience in undertaking audits.

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 problems which may have been encountered in undertaking it. Clearly, reports which are significantly delayed from the time the work was undertaken are devalued. The target is 90% of reports issued within 3 months of commencement and current performance is 67.1%. Again this reflects the problems associated with such a large proportion of the section being new, either to auditing or the roles they have taken up, but there is also a degree of difficulty in obtaining timely assistances from auditees.

Customer Satisfaction in the work undertaken

- 6.6 Perhaps the most important measure is what is made of the work undertaken. Following every audit we ask auditees to return a questionnaire which asks 12 questions about the conduct of the audit, classifying responses as excellent, good, satisfactory, just adequate or poor. The results are amalgamated into an overall percentage score and are as follows:-

Satisfactory or better target 95% current performance 97.1%

Good or better target 75% current performance 76.5%

- 6.7 This, encouragingly, shows that while the usage of days has suffered (either in deployed time or in overspends on job) and audit reports are not being issued as promptly as desired, customers continue to see the service delivered as valuable. This suggests that we are able to ensure that work done (including by relatively inexperienced staff) is effectively quality controlled, albeit at the expense of additional time spent.

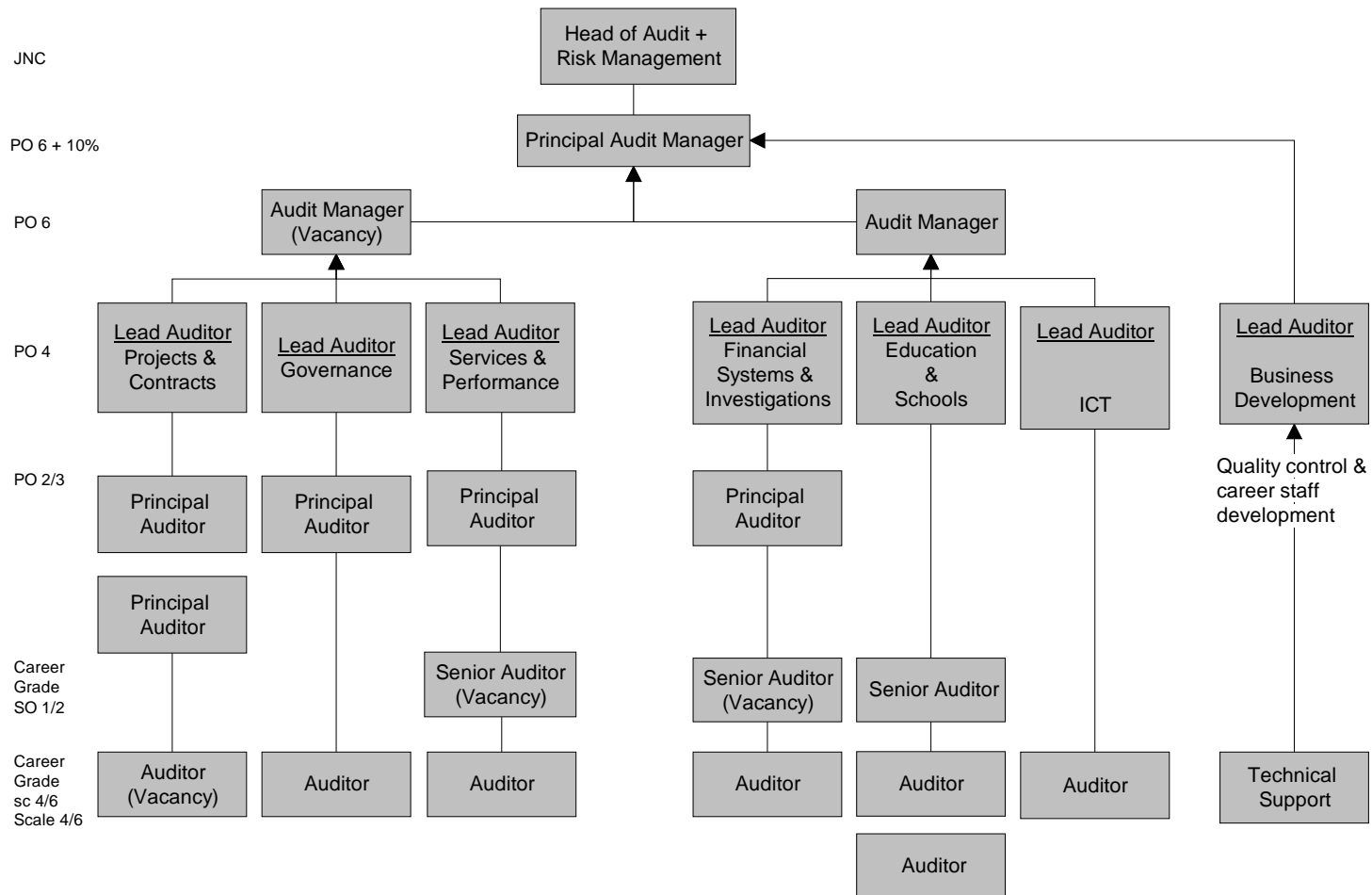
6.8 In overall terms these performance measures are as expected given where the section is but it will be important to see significant improvements in 2006/7 as experience builds.

7 Overall Conclusion

7.1 The Section has a sound base, as assessed by the Audit Commission last year, but has suffered from staff shortages. Whilst this has been largely addressed there has been an anticipated reduction in performance levels arising from the significant influx of new staff.

7.2 The establishment of Terms of Reference and the formal support of a dedicated Audit Committee are significant steps forward in further developing an effective system of internal audit. The need to review activity in the light of the impending new Code of Practice and the completion of the Service Improvement Project will provide further evidence and analysis to build on existing arrangements which will be subject to further formal review by the Audit Commission as part of their 2006/7 activity.

Corporate Services Department Internal Audit Section



Audit Commission Recommendation

Suggested Action	Current Position
Procedures should be put in place to ensure that working papers are appropriately referenced to give evidence of work carried out.	implemented
Procedures should be clarified to ensure that managers evidence review on the computer system.	implemented
Where the scope of the audit is limited to, for example, a small number of establishments, this should be clearly defined through the risk assessment process	Implemented
The Head of Internal Audit should seek to develop, as part of the new structure, internal quality reviews as recommended by CIPFA Code of Practice for IA 2003.	The post of Lead Auditor (business development) was created to oversee and coordinate this activity.
Review of resource requirements should be completed as soon as possible and appropriate action taken. This may result in a fundamental review of the packages being offered by MCC to attract and retain the appropriate calibre of staff.	The Section was restructured but difficulties still exist in recruiting to senior posts, This will be reviewed as part of the Service Improvement Project
Consider the introduction of a formal audit committee.	Implemented
The purpose, authority and responsibility of Internal Audit should be formally defined by the organisation in terms of reference	Implemented
Declarations of interests and auditor independence should be completed by all members of the Internal Audit section.	Not formally completed yet but staff are aware of the issues. It is understood that the revision to the Code of Practice will include a new Standard dealing with this matter
An up-to-date audit manual reflecting current procedures and systems should be produced, once the new CIPFA guidance is available	The post of Lead Auditor (business development) was created to oversee and coordinate this activity