

## MANCHESTER CITY COUNCIL

### REPORT FOR INFORMATION / RESOLUTION

**COMMITTEE**            **Audit Committee**

**DATE:**                            1 June 2007

**SUBJECT:**                    **Annual Review of Internal Control**

**REPORT OF:**            **The City Treasurer**

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#### **PURPOSE OF REPORT**

To report on the findings of the annual review of internal control, undertaken in accordance with the Accounts and Audit Regulations 2006.

#### **RECOMMENDATIONS**

To note the findings of the review of internal control and the actions proposed to further develop or strengthen elements of the control environment during 2007/8.

To note the requirement to approve the Annual Statement of Internal control at the meeting to be held on 29 June.

To request members to identify any matters arising from the review which require further, more detailed consideration by the Audit Committee, including in particular those matters which will be subject to disclosure within the Statement of Internal Control.

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

None directly from this report

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#### **BACKGROUND DOCUMENTS**

The Statement on Internal Control in Local Government: Meeting the Requirements of the Accounts and Audit Regulations 2003 - CIPFA 2004.

**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

## **1. Introduction**

- 1.1 The Accounts and Audit Regulation (2006) require that the Council undertakes, at least annually, a review of its system of internal control and publish a Statement on Internal Control (SIC) signed by the Leader and Chief Executive within its Accounts. The Accounts are, subsequently, subject to approval by the Audit Committee.
- 1.2 From April 2006, the Regulations have been amended to require that the outcome of this review is considered by (in effect) the Audit Committee. This report, in detailing the results of the review, briefly outlines the process adopted to undertake the review, provides analysis of each of the issues identified in assessing these controls and provides information about the associated actions required to improve control where necessary.
- 1.3 Some of the issues identified as a result of the review warrant disclosure in the Statement of Internal Control which will be published with the Accounts. It should be noted that it is recognised by the Audit Commission that internal control arrangements within Councils are under a constant state of change and that it is expected to be the norm to have to disclose issues in this way.
- 1.4 Members are requested to comment on the outcome of the review and indicate if there are any matters which, in their view, require further consideration by Strategic Management Team (SMT). In addition Members may wish to indicate whether or not any of the issues raised need to be the subject of more detailed consideration by the Audit Committee as part of its programme of work for 2007/8.

## **2. The Review Process**

- 2.1 The annual review of internal control draws upon evidence about the control arrangements within the City Council from a number of sources including:-
  - The Chief Executive
  - The City Treasurer
  - The City Solicitor
  - The Head of Audit and Risk Management
  - External Audit
  - External Inspectorates
  - Strategic Directors, Heads of Service and other Senior Managers
  - Members.
- 2.2 The process was overseen by the Head of Financial Management, the Assistant Chief Executive (Performance), the Head of Corporate Performance and the Head of Internal Audit and Risk Management and involved assessment and analysis gathered from an array of sources which culminated in formal consideration of the outcome of the review by members of the Strategic Management Team at their meeting of 22 May 2007.

### **3. The Results of the Review**

- 3.1 The Internal Control environment covers seven areas which follow the definitions outlined by CIPFA. The following section outlines the findings for each element

### **4 How Objectives are Established and Monitored.**

- 4.1 The Council has set out its objectives in its Corporate Plan. More detailed departmental service plans and management action plans, integrated with financial planning and budgeting, are in place to outline objectives within services.
- 4.2 Achievement of objectives are monitored by the Executive, the Strategic Management Team (SMT) and other senior managers. A comprehensive set of performance indicators underpin these monitoring arrangements which are overseen and monitored by the Chief Executive's Performance Division who provide feedback to Members and SMT.
- 4.3 During 2006/7 these arrangements have been improved. The structure of the Manchester Partnership has been revised to provide greater clarity between governance and delivery structures. A new Manchester Partnership Board has been constituted and is chaired by the Leader of the Council. It provides oversight and scrutiny on activity within the Partnership and the delivery of the Community Strategy for Manchester.
- 4.4 Reporting to the Manchester Partnership Board, a new Public Service Board for Manchester has been created with membership limited to the main public service bodies within the city. Its role is to direct the sub partnerships within the city towards the delivery of the Community Strategy and Local Area Agreement and align the activities of individual bodies to enhance their contribution to the city.
- 4.5 The Centre Management Group has been established (comprising members of SMT responsible for corporate functions) and the role of the Manchester Improvement Programme Board has been strengthened to provide focused senior management review over the internal management of the Council to ensure it is more effective in the delivery of the Council's objectives.
- 4.6 Establishing and monitoring objectives has also been enhanced by the development of new business planning methodologies structured at Heads of Service level which links corporate objectives to service objectives.
- 4.7 A Corporate Support Team (made up of cross functional senior managers), sponsored by the Chief Executive and chaired by the Assistant Chief

Executive (Performance) has been established to integrate the corporate functions that support improvement and the Manchester Improvement Programme. The Team will provide focused challenge and support by being a gateway for business plans and by ensuring that Heads of Service and the Wider Leadership Team get consistent communication and involvement in corporate work on improvement. The Team reports on the key risks to the delivery of the Council's financial strategy to the Centre Management Group.

- 4.8 The Audit Commission undertook a Corporate Assessment of the council in August 2006 which concluded that "*the Council has clear, high level priorities which are well understood by partners, reflect the needs of Manchester residents and provide a good fit with national priorities*". This conclusion confirms that objective setting is soundly based.
- 4.9 As anticipated, new methodologies for Business Planning will take time to develop so the articulation of objectives and the way these are monitored by management teams are not as robust as they need to be. Nevertheless the arrangements are a major step forward.
- 4.10 The work of the Corporate Support Team will lead to further refinement of the Business Planning process during 2007/8. It will also improve sharing of learning from improvement activity and improve financial monitoring and reporting within the Council.
- 4.11 There are considered to be no issues warranting disclosure in relation to this aspect of control but to improve arrangements still further these activities will be supported by the publication of a new Corporate Plan which will provide greater clarity on organisational priorities and assist with business planning. The publication of "State of the City" and "State of the Ward" reports which outline trends in key quality of life and performance metrics will provide an enhanced evidence base to support the development and revision of service priorities.
- 4.12 Actions planned for the coming year also include the development of a new Local Area Agreement and a review of regeneration activity and the future strategy for East Manchester. This will include a review of the Strategic Regeneration Framework for the area and the organisational structure of New East Manchester.

## **5 How Decisions are Made and Recorded**

- 5.1 Responsibility for decision making in relation to the functions of the Council is clearly set out in the Council's Constitution. Council sets the policy and framework within which the Executive makes decisions or decisions are delegated to Chief Officers. Key decisions are published in the Forward Plan. The framework also provides for other committees to deal with non executive functions.

- 5.2 Six Overview and Scrutiny Committees operate to review various aspects of policy and have the facility to “call in” matters for scrutiny and to report back to Council.
- 5.3 During 2006/7 Overview and Scrutiny Committees have looked at how they can improve the effectiveness of their role, assisted by performance management information, particularly in relation to the impending introduction of more wide-ranging responsibilities to review partner organisations who are contributing to the delivery of the Community Strategy. A range of measures have been agreed to improve the scrutiny function from the start of the municipal year to ensure that this significantly enhanced role is delivered effectively.
- 5.4 Following the identification of potential clawback of ERDF funding, last years SIC outlined the intention to review the arrangements for ensuring compliance with grant conditions to consider whether any additional control measures were required.
- 5.5 As reported to Audit Committee on 22 March 2007 that review concluded that documentation to support decision making within externally funded schemes was not as robust as it needs to be to ensure that this documentation is available in the future for European Commission audit purposes. Separately, documentation relating to European Social Fund grant for the Youth College has been called into question.
- 5.6 A programme of work is in progress to rectify any shortfalls in documentation but until this is complete it is not possible to complete the process of providing assurance through internal audit review that the Council is not exposed to further Clawback. Audit Committee will consider further reports on progress but given the position is not yet resolved is it recommended that external funding is again disclosed in the SIC.

## **6 How Laws, Rules and Procedures are complied with**

- 6.1 Procedures are covered by the Council’s constitution, together with associated guidance including financial regulations, contract and procurement rules, subject specific guidance (issued corporately) and service specific guidance held in departments.
- 6.2 The Monitoring Officer has overall responsibility for legal issues and her staff work closely with departments to provide advice where appropriate. All reports to the Council, the Executive and Committees are considered from a legal perspective.
- 6.3 The City Treasurer carries overall responsibility for financial issues via his own staff and departmental finance staff. All reports to Council and its Committees require commentary about the financial implications. The Audit Committee

reviews the activity of Internal and External Audit as a contribution to providing assurance about the operation of controls

- 6.4 Last years review highlighted the intention to review the Council's arrangement in the light of the intended publication of a revised Code of Corporate Governance produced by CIPFA/SOLACE. However, the publication of this Code has been delayed so the proposed review by the City Solicitor could not be undertaken.
- 6.5 However, a Working Group of officers has identified the need to undertake a systematic and fundamental review of Governance arrangements during 2007/8 to align the Council's arrangements with four significant developments which will redefine Governance.
- The CIPFA/SOLACE Code should finally be published in the spring and the Accounts and Audit Regulations are expected to be amended to require an annual assessment against this Code.
  - Changes to the way the Council is operated democratically are likely to arise from new legislation during 2007/8.
  - The Financial Management Service Improvement Project will significantly change and enhance the finance function and financial procedures need to be fundamentally reviewed as part of the process and in the light of the implementation of SAP.
  - Similarly, the Corporate Procurement Service Improvement Project will significantly change procurement arrangements and procurement rules will need to be updated accordingly.
- 6.6 In addition to fundamentally reviewing the majority of the Constitution and associated guidance it is intended to develop simplified guidance for staff to ensure they are more readily accessible.
- 6.7 During 2006/7 work continued to strengthen governance arrangement in schools. Events with Headteachers and Chairs of Governors coupled with the changing configuration of Children's Services highlighted the need to increase resources to support governance in schools. Proposals, considered by Finance and General Purpose Scrutiny Committee in February 2007, included measures to raise the quality of governance through:-
- A significantly enhanced training programme for Governors
  - A significantly improved flow of information to governors on current educational issues
  - Better organisation and operation of the strategic and day to day work of governing bodies within a clearly understood ethical and regulatory framework
  - Easy access to high quality support, advice and guidance from the Council.

- 6.8 The delivery of these improvements required the development of enhanced support in relation to technical advice and support, training and communication and Clerking of Governing bodies. Structures have now been developed and consultation is underway on the operation of these support services.
- 6.9 The introduction of the Financial Management Standard in Schools (FMSiS) has offered the Council an opportunity to assess the effectiveness of Governance in the Council's High Schools during 2006/07. There is clearly an increased engagement by the majority of Head Teachers and Governors in terms of positive steps they have taken including undertaking FMSiS training, recognising the need to demonstrate transparent governance, carrying out self assessments and the compilation of evidence files for review by Internal Audit.
- 6.10 As FMSiS continues to be rolled out to all schools this will afford the opportunity to further assess whether or not governance in schools is improving. However, because of this and because the additional resources identified to strengthen support for Governance are not fully operational, SMT recommends that governance in schools should again be disclosed in the SIC.

## **7 How Risks are Managed**

- 7.1 The City Treasurer has overall responsibility for the Risk Management function through the Head of Audit and Risk Management. During 2005/6 the Audit Sub Committee considered a Risk Management Policy and Strategy and reviewed the initial Corporate Risk Register. The Audit Committee includes the responsibility to "*oversee the effectiveness of the council's risk management arrangements*" within its Terms of Reference.
- 7.2 The new Business Planning methodology introduced during 2006/7 incorporated risk assessment at a Head of Service level to continue the process of embedding risk management across the Council
- 7.3 The Use of Resources Assessment for 2006 increased the score for risk management from a one to a two reflecting the progress which has been made. A recent Audit Commission follow up review of progress to embed risk management concluded that "*Manchester City Council has made good improvements in implementing its risk management arrangements*".
- 7.4 However, feedback from risk management workshops and assessment of risks registers in business plans indicates that there is variable understanding of the Councils methodology for managing risks. As part of the work of the Corporate Support Team emphasis will be placed on developing the skills of managers in utilising the methodology.
- 7.5 Audit Committee received a report on the Corporate Risk Register in March 2007 which highlighted the need to review the register and the associated methodology for keeping it current and an active management tool. As part

of the developing business planning methodology work is ongoing to further develop the maintenance and use of the CRR. Given the progress being made there is no requirement to disclose any issues relating to risk management.

## **8 How Value For Money is Demonstrated**

- 8.1 The Council has reviewed and continues to review its services to identify efficiencies and the main focus for this process is through the Manchester Improvement Programme which is overseeing a systematic review of all services. Medium term financial planning is integrated with service planning to direct resources to priority areas. The Budget provides dedicated funds for service improvements.
- 8.2 Formal project management methodologies are in place together with a comprehensive approvals process to ensure capital investments are soundly based and the Councils corporate procurement arrangements seek to obtain value for money through procurement processes.
- 8.3 During 2006/7 Business planning methodologies have been introduced which emphasise scrutiny of VFM at a service level and a programme of reviews is underway, overseen by the Head of Financial Management, to establish, evaluate and challenge unit costs and other VFM benchmarks in all services.
- 8.4 The Manchester Improvement programme continues to systematically review services and has set ambitious efficiency targets which are crucial to the Council's budget assumptions. A recent review of the programme by the Audit Commission concluded that "*overall the MIP is being managed effectively to deliver economy efficiency and effectiveness*". However, concern remains about the capacity to deliver the significant levels of savings required.
- 8.5 The Manchester Improvement Programme Board and the Corporate Support Team overseen by the Centre Management Group has made the oversight of the achievement of these efficiencies the number one priority during 2007/8
- 8.6 The Council has appointed a Head of Corporate Procurement to oversee the implementation of the Councils procurement strategy. This work (supported by the implementation of new financial systems which provide improved management information) has assisted in making significant savings in relation to renewed contracts.
- 8.7 VFM workshops have been run in each Business Plan area, and have been well attended by Heads of Service and senior service managers. The workshops have been useful in identifying key areas where consideration of VFM issues needs further development, in particular in relation to the lack of understanding around current costs and outcomes and how these compare to others.

- 8.8 Heads of Service will be further supported in developing effective consideration of VFM issues as part of the ongoing Business Planning Process. The Corporate Support Team will challenge business plans to ensure that high cost/ low performance areas identified in the corporate VFM analysis are addressed effectively.
- 8.9 The VFM judgment associated with the closure of the 2005/6 Accounts was qualified in relation to Asset Management, however, good progress continues to be made in developing these arrangements and the Use of Resources assessment in 2006 increased the score to a two in this area. This should ensure that the VFM opinion in the 2006/7 accounts is not qualified in relation to asset management.

## **9 How Finances are Managed**

- 9.1 The system of financial management is based on a framework of regular management information, financial regulations within the Council's constitution and a system of delegation and accountability.
- 9.2 In particular, the system includes forecasting and monitoring budgets on a periodic basis, setting targets to measure financial and other performance, the preparation of regular financial reports which indicate actual and projected expenditure against the budget, clearly defined capital expenditure guidelines and, as appropriate, formal project management disciplines.
- 9.3 New financial systems came on stream from April 2006. These integrated systems provide, in particular, better management information, improved transparency of information (including audit trails) and accountability, including enforcing standardised procedures across the Council which will be particularly relevant to budgetary control, staffing and procurement.
- 9.4 However, these new financial systems suffered from some difficulties during the initial months of implementation but are now starting to deliver improved management information and control. Finance and General Purposes Overview and Scrutiny Committee at its meeting of 8 March 2007 considered the implementation process following concerns raised to Audit Committee by the Head of Audit in September 2006.
- 9.5 During 2006/7 projected overspending on some budgets coupled with indications of budget pressures during 2007/8 required significant management attention to bring budgets under control. Many of these issues relate to pressures arising from demand lead services but the interventions highlighted the need for improved monitoring of budgets and particularly the achievement of planned saving during 2007/8. Budgetary control will be the subject of close scrutiny during 2007/8 via the MIP board and Centre Management Group. This includes publishing the recently refreshed rules for budgetary control developed by the Corporate Support Team on behalf of CMG

- 9.6 In last years SIC, budget overspends in Education were declared as a significant control issues but SMT consider that the implementation of new financial systems coupled with increased scrutiny by Strategic Directors, further enhanced by the work of the Corporate Support Team has established robust budget monitoring arrangements which provide effective control over budgets and do not now require disclosure.
- 9.7 Closure of the Accounts received a score of one in the 2005 Use of Resources assessment and this matter was also disclosed last year. The completion of the external audit of the accounts in September was much more straightforward and the subsequent use of resources score was increased to a two in the 2006 assessment. There is a risk, however, that closedown for the first time using SAP may reverse this improvement if material errors are identified during the Audit process. Work on closedown of SAP, while understandably challenging does not, however, at this stage, indicate any need for disclosure,
- 9.8 The amounts paid in relation to equal pay settlements have been proposed as a potential disclosure item, however, this issue represents a risk rather than a control weakness. The risk was identified in the Corporate Risk Register and the settlements represent the effective management of the risk. The underlying issues which lead to the exposure to this risk have already been eliminated within the system of internal control.
- 9.9 In January 2007 In view of the importance of safeguarding care services in the city and in the interests of the financial position of the Council and the residents of Manchester, the City Council agreed to provide financial assistance to Manchester Care. A recovery plan has been established in relation to Manchester Care and the Social Strategy Overview and Scrutiny Committee is monitoring the implementation of the plan on a six monthly basis.

## **10 How performance is managed**

- 10.1 The Council has a range of performance indicators and targets incorporated in its plans which are used to measure performance at a corporate, departmental and ward level together with performance management arrangements to monitor the activities of the Manchester Partnership (LSP). Executive Members receive regular performance reports from Strategic Directors on all objectives relevant to their portfolios and there are specific officer member groups which scrutinise budget monitoring for Children's Services and Adults.
- 10.2 Performance management is also a component element within sectional business plans and within individual performance appraisal arrangements for the workforce. The Council was awarded Corporate Investors in People Status in 2005 which reflects the commitment to staff appraisal and development as part of the process of driving up performance.

- 10.3 A monthly report on progress in relation to the city's second Local Public Service Agreement (LPSA) is provided to the Executive Member for Finance and Human Resources.
- 10.4 Newly introduced business planning methodologies now incorporate "Critical Success factors" at a service level which underpin strategic indicators of performance with those necessary to demonstrate operational performance. These are supplemented by detailed risk registers within the business plans referred to earlier.
- 10.5 Detailed performance reporting against the Local Area Agreement also takes place on six monthly basis to Government Office for the North West. This performance review also evaluates delivery arrangements and risk management measures in relation to the Local Area Agreement.
- 10.6 Considerable work has taken place with Chairs of Overview and Scrutiny Committees to review of the role of Overview and Scrutiny in the Performance Management of the Council. New procedures to make members aware of performance issues for consideration will be implemented following the Local Government elections in May 2007.
- 10.7 As referred to earlier, new annual publications of the "State of the City" and "State of the Wards" reports highlight relevant performance trends will enhance the evidence base for policy development within the city.
- 10.8 Performance monitoring and management arrangements are appropriate for the nature and complexity of the Council. However, there is always the need for continuous improvement. Improved business planning and procedures for corporate performance monitoring and reporting will be led by the Corporate Support Team, and the Chief Executive's Corporate Performance Group are leading on the procurement of Informational Technology solution(s) to enhance the Council's performance reporting capability.
- 10.9 Measures to improve "people" performance are also in development through the Council's new "People Strategy". The immediate priority within the People Strategy has been the development of a new "Wider Leadership Team" consisting of the 70 most senior managers within the organisation and the implementation of the Council's senior management leadership programme. Programmes to role out leadership training to other management tiers are currently underway.

## **11. Significant Internal Control Issues**

- 11.1 The above section has outlined the component elements of the control environment and specifically highlighted two areas where disclosure within the Statement of Internal Control is recommended. These are-
  - compliance with procedures which govern the conditions attached to the receipt of external grants (paragraph 5.6)

➤ support and monitoring of school governance (paragraph 6.10)

11.2 Members are requested to consider whether or not they wish to give further and specific consideration to these disclosure matters or any other areas highlighted in the review or to refer, as appropriate, to other scrutiny committees for consideration in relation to their work programmes.