

MANCHESTER CITY COUNCIL

REPORT FOR INFORMATION / RESOLUTION

COMMITTEE Audit Committee
DATE: 14 March 2008
SUBJECT: Internal Audit Annual Assurance Statement
REPORT OF: Head of Audit

PURPOSE OF REPORT

To provide a statement of assurance based on Internal Audit activity over the last year and to outline the broad implications for audit work in the coming months.

RECOMMENDATIONS

To note internal audit assurance opinion and priorities for future work.

FINANCIAL CONSEQUENCES FOR THE CAPITAL AND REVENUE BUDGETS:

None.

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BACKGROUND DOCUMENTS

N/A

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

Head of Audit Assurance Statement April 2007 - March 2008

1. Introduction

- 1.1 This report provides the Head of Internal Audit's assurance opinion on the adequacy and effectiveness of Manchester City Council's internal control arrangements for the year April 2007 to March 2008.
- 1.2 The Annual Assurance Statement contributes to the annual review of internal control required by the Accounts and Audit Regulations 2006 and to the completion of the Annual Governance Statement. It is specifically timed to be considered by the Audit Committee in March at the start of the process of the Council's annual review of governance and internal control.
- 1.3 The report provides a summary of the work of Internal Audit over the last 12 months (which necessarily spans two planning years for Internal Audit). It highlights matters for consideration and refers to audit plans for ongoing activity in areas of concern. The report is broken down into an overall opinion and a summary of assurance for each functional area of audit work. The extent and direction of audit coverage is driven by assessment of risk and, by necessity, available resources. A detailed report on the effectiveness of Internal Audit will be reported to the Audit Committee in the form of the Annual Review of Internal Audit in June to fulfil the requirements of the Accounts and Audit Regulations (2006). For the purposes of this report there are no matters which have affected the provision of the assurance statement.
- 1.4 A key issue affecting the provision of assurance is the reduction in planned audit coverage arising from resource shortfalls and increased levels of demand-led work in year. This work included increasingly complex investigations, work for other business areas and advice and support and has limited the extent of planned assurance activity. Action is being taken to fill vacancies. Three additional staff have been recruited, though as two are trainees there is an inevitable lead time before full productivity can be expected. Two principal auditor posts are currently being advertised.

2. Overall Opinion

- 2.1 Based on the programme of audit work undertaken during the year assurance can be given that the Council's systems of internal control are generally sound and operate reasonably consistently across departments to ensure effective, economic and efficient management.
- 2.2 In a Council of Manchester's size and complexity, with its significant change agenda, there is a heightened risk of breakdown of control particularly where roles and systems are changing. Where audit work has highlighted areas for improvement recommendations have been made to address the risk and management action plans agreed. The key elements of this are detailed below.

3. Internal Audit Activity

Corporate Services

- 3.1 Internal Audit has continued to offer advice and support as SAP processes and procedures embed, maintaining close relationships with key officers and play an active role on the Business Support Board. Liaison with the Financial Management SIP MIP team is continuing, mapping key systems and giving assurance over the effectiveness of internal controls in proposed “to be” processes. The planned audit of SAP Basis will focus on technical risks around the confidentiality, integrity and availability of SAP Back Office solution and system data.
- 3.2 Assurance was provided from the work on Housing Benefits that management information was operated and administered efficiently and that controls over subsidy were substantially effective, making a few recommendations for improvement. Further audit activity found that the Academy system, used by Benefits, Council Tax and NNDR, was operating effectively. An audit of Recruitment provided limited assurance of compliance with guidelines and legislation but acknowledged that e-Recruitment has continued to be developed and improved and facilitates effective recruitment if used correctly. Work on Payroll provided assurance over the overall processing environment but found that the control environment could be improved as SAP functionality is developed.
- 3.3 Internal Audit work on the production of the 2006/07 final accounts reported slippage in timescales and some errors. Following the consequent 2006/07 Use of Resources score of 1 for Financial Reporting Internal Audit plan to review draft 2007/08 accounts to give assurance that any errors are corrected prior to finalisation. The Revenue Budget Monitoring audit found significant development since the score of 2 for Financial Management and provides assurance that budget monitoring and control is improving. There are some concerns over the extent of compliance by managers and Internal Audit supports work to refresh training and to review budget monitoring activity.
- 3.4 Internal Audit’s work on Miscellaneous Debt Recovery concluded, with management, that current SAP processes are not yet as functional as the system it replaced and supports managers views that the current recovery process should be improved. Audit carried out work on Audit Commission concerns over approval of unsupported invoices on SAP. This provided assurance that there was no evidence that payments were not legitimate and that risk of material error was minimal. Managers had also taken action to improve controls over the number of payments passed without dual approval. Internal Audit supports proposed changes to the purchase card operation in SAP (annual expenditure £60M) which should improve controls. The impact of these proposals will be monitored and evaluated.

- 3.5 The Departmental Information Security audit could not provide assurance that information security was delivered consistently and effectively and reflected managers' concerns over the low level of awareness of IT security standards. Some assurance has been taken from the plans for an Information Security Management System (ISMS) but there are concerns over delays in the development and roll out of plans. The proposal to create a Chief Information Officer post should also improve controls in some key areas.

Regeneration (including procurement and capital programme)

- 3.6 Internal Audit has provided ongoing advice, support and guidance for managers on the application of procurement and project management policy. Overall, assurance can be given that the Council has robust policies and procedures in place and that, while there has been some inconsistent application, concerns are being addressed within the Regeneration, Procurement and Capital teams. Senior managers accept and are addressing the need for improvement to reduce exposure to risk, particularly in respect of ownership, management controls, formal protocols, guidance and training. Managers are also working with Internal Audit to strengthen controls over compliance with grant funding conditions to minimise the risk of repayment.
- 3.7 Internal Audit has carried out a range of audits in the Regeneration area to support its view. As a result of the Section's work on external funding arrangements, particularly European Regional Development and European Social Funds, senior managers have actively engaged to implement recommendations on completeness of information, which should significantly reduce the risk of repayment. We support the actions taken. Limited assurance can be given on Capital Programme Monitoring that the Gateway system contributes effectively towards a robust, deliverable capital budget. An action plan is expected from senior managers to set out activities and timescales to address the need for improvement.
- 3.8 Extensive work by Internal Audit to reconstruct evidence submitted to GONW by Manchester Youth College in respect of European Social Funding was successful in preventing a repayment of £1.8m.
- 3.9 Audit work on the use of Open Book contractual arrangements to deliver Framework contracts provided limited assurance that activity delivered best practice and value for money. However, senior managers recognise the need to develop arrangements and implementation of recommendations should contribute to improvements in an efficient and economic Open Book process. Changes in best practice, methodologies and regulations over Competition Rules mean limited assurance can be given that the Rules are fit for purpose and support current working practices. The City Solicitor is currently revising them, as recommended by Internal Audit, and once formally adopted they should better support the Council's working practices.

- 3.10 The Use of Consultants audit provided limited assurance over appointment and retention of consultants in line with Financial Regulations. While this report is still being finalised with managers assurance can be given that its recommendations are being implemented which should ensure that appointments provide better value for money, reduce the risk of grant repayment and improve appropriateness of appointments.
- 3.11 Some assurance can be provided over planning appeals and enforcement processes. Internal Audit found some areas where effectiveness and efficiency could be improved by more effective management controls. Managers are currently implementing recommendations to ensure that finished work complies with planning consent approved.

Children's Services

- 3.12 Internal Audit has completed the preliminary assessment of primary schools against the Financial Management Standard in Schools (FMSiS). Of 59 schools selected 50 have been assessed and early indications are that at least 30 will achieve the Standard. The actual position will be determined following receipt and evaluation of additional evidence requested and moderation. Key areas of concern include the variable quality of information, such as budget monitoring reports submitted to school governors; inadequate evidence of the application of key controls, such as procurement; and limited evidence of Governing Body involvement and impact. Nine schools withdrew from the process and will be included in 2008/09 assessment. A overall report of findings will be prepared on completion of the work for discussion with Education.
- 3.13 51 schools were audited between April 2007 and March 2008 and a further 11 will be audited on the current audit programme. Assurance can be given that most schools understand and operate governance and financial management controls satisfactorily. While in most cases some improvement was needed, a few schools demonstrated the need for significant change. Audit findings focused on the need for better evidence that key controls were operating; improved budget monitoring and cashflow forecasting; more effective segregation of duties and authorisations in procurement.
- 3.14 School budgetary control and financial planning was adequate overall but varied considerably in quality. Assurance has been taken from Education's work with schools to manage budget deficits but this will be further informed by the current Schools Budget Management audit, which will focus on the schools with largest deficits. The findings from a number of investigations at schools have given rise to concerns over the accuracy of financial reporting and the ability of some governing bodies to monitor and challenge effectively. Internal Audit propose to take an active role in the developing School Governance Project, the purpose of which is to improve support for school governors. Further audit work due for completion shortly include the annual pupil census

and IT security in schools, which aim to provide an opinion on management and assurance activities both at the Council and at individual schools.

- 3.15 A number of Education services have been audited during the year. The audit of school recruitment and Criminal Records Bureau checks provided assurance that school recruitment procedures comply with statutory requirements and support appointment of the best candidate. CRB requirements are particularly well understood. Assurance is qualified by concerns over document retention, evidencing decision-making and the use of non-standard forms and selection interviews. Controls over the procurement of out-of-city placements for children with special educational needs required improvement but audit work recognised the action being taken by managers. Work on Youth Services concluded that controls were partially effective in facilitating delivery of key outcomes, identifying areas for development including management of performance against key objectives and planning.
- 3.16 Controls over Children's Services external funding are operating effectively in most cases and there was evidence of good practice. Recommendations have been made where instances were found of lack of compliance with grant conditions which could leave the Council with a liability to funding clawback. This issue continues to cause concern where external funding is involved and the need for audits of other funding streams will be considered for the 2008/09 audit plan and in light of external audit activity. An audit of the Council's management of the Sure Start programme gave some assurance over its operation but found room for improvement in the areas of risk and performance management and quality of data.

Neighbourhood Services

- 3.17 Internal Audit conducted a number of audits to give assurance over the effectiveness of specific service areas or teams. Common themes included the need for improvement in data quality, the effectiveness of internal controls and compliance with grant funding conditions.
- 3.18 An audit of the Asylum Seekers Consortium found that its structure and procedures delivered effective partnership governance, while recommending that a risk management framework be developed. A review of the Council's statistics on bulky waste was unable to provide assurance that the figures reported were accurate and complete and action was being taken by managers to address concerns. For Client Financial Service Unit (CFSU) Internal Audit gave limited assurance that controls operate effectively, identifying a lack of strategic direction and the need to improve the handling of service users' monies. An audit of Resident Payment Section identified that controls were operating satisfactorily over the creation and assessment of service user accounts, making recommendations for improvements in the treatment of deferred debts and arrears.
- 3.19 Internal Audit's contribution to the redesign and development of the Council's business planning process provides assurance that

improvements in planning, performance and risk management are being delivered. Further planned audit work will assess how well the process is embedding by evaluating the quality of 2008/09 plans and the experiences of managers.

Performance and Governance

- 3.20 Internal Audit's work on Local Public Service Agreement 2 (LPSA) gives assurance that measurement, reporting and action planning systems for targets are fit for purpose. The review identified a need to improve both central management and performance against specific targets and advice has been provided to help managers define how indicators should be calculated. More work on LPSA2 will be undertaken in April 2008. Work on KPIs provided limited assurance over effectiveness leading to recommendations to assist management in assessing and improving data quality and consistency. Internal Audit has also contributed to Corporate Performance's new guidance on Data Quality, which should clarify and simplify processes and procedures for managers, and will continue to monitor development of the performance management framework.
- 3.21 Assurance can be given that the Council's Governance Working Group is effectively improving corporate governance arrangements. Internal Audit have contributed to delivering the associated work-plan, which identifies specific tasks, and a communications strategy is being developed to steer the process of embedding new arrangements. The Employee Code of Conduct and Financial Regulations are being reviewed and revised; a pocket guide to decision-making has been produced; a Code of Corporate Governance has been developed and a framework and supporting processes established to assess and improve partnership governance. Assurance can be taken from External Audit's recent partnership governance review that, subject to some qualification, the developing partnership governance arrangements are fit for purpose. The audit of New East Manchester, a significant partnership, provided assurance over delivery against its high-level objectives while raising concerns over programme and project management and the protection of accountable body interests.
- 3.22 Internal Audit is working closely with senior managers in Financial Management to develop and implement a procedure for the new requirement to produce an Annual Governance Statement for 2007/08. This replaces the Statement of Internal Control. New processes have been developed, including a requirement for Heads of Service and other senior managers to provide a certificate of assurance over governance arrangements. There is still work to be done to embed these processes within Council systems and this will need to be supported by sufficient dedicated resource.
- 3.23 To inform an opinion on key governance policies an initial review of Hospitality and Gifts was undertaken, resulting in the development by City Solicitor's of additional procedural guidance for managers. This will be followed shortly by a full compliance audit. An audit of the Scheme of Delegation provided assurance that Chief Officers were

largely aware of their powers and exercised them appropriately, although there were some concerns over recording decisions and allocating responsibility.

Investigations

- 3.24 No organisation can guarantee that it will be free from fraud or financial irregularity, the extent of which can be a measure of the effectiveness of internal controls. Internal Audit has carried out a number of investigations referred during the year, either independently or by offering advice and support to managers and investigating officers. The work included examination of potential fraud and corruption, theft of money and poor management practice. Where appropriate internal disciplinary action has been taken to address issues and referral made to the police if required. Reports have been provided to relevant managers and recommendations for action and system improvements made as necessary.
- 3.25 The National Fraud Initiative (NFI) data matching exercise has been a primary source of proactive fraud work and a report on key findings is being finalised. Overall it has been a success, providing a reasonable contribution to the assurance given on the detection of some internal fraud. The considerable resource required to evaluate the 47 reports and more than 11,000 data items was used to target cases to examine further based on risk. The Audit Commission subsequently reviewed the results and gave positive assurance on the Council's work.
- 3.26 The most significant NFI outcomes relate to three cases of 'right to buy' of Council properties where tenants were foreign nationals without a valid UK Visa and therefore no entitlement to a discounted purchase. Two Council employees, found to be without UK Visas and consequently no entitlement to work, have had their jobs terminated and Internal Audit are reviewing the issues arising with personnel. The exercise uncovered six cases of continued payments to deceased care home residents and eight of continued pension payments to deceased teachers. These cases involve the potential recovery of around £155k.
- 3.27 Internal Audit completed 25 investigations (including 3 whistle-blowing cases) and seven are ongoing or require further follow up. This is a higher level of fraud related activity than last year. Significantly 15 fraudulent Council cheques have been presented for payment in recent months. The Council's positive payment system successfully identified the cheques presented and no financial losses were incurred. The latest cheque for £198K was significantly larger than the others and was referred to the Council by the receiving bank. Internal Audit has asked the Council's bank to follow up with the referring bank due to the large amount on the cheque and await an update.
- 3.28 A further unrelated fraudulent cheque for almost £19K was successfully cleared through a Council account and Internal Audit is waiting for further information from the bank to explore any system risk

in this case. The money has subsequently been repaid to the Council by the Bank.

- 3.29 A number of investigations have been conducted at schools supporting Education, concerning issues such as theft, adequacy of financial management arrangements and probity.

4. Recommendation Monitoring and Implementation

- 4.1 As part of Internal Audit's development of its approach to monitoring managers' implementation of recommendations, a report on progress to implementation of outstanding high risk recommendations has been submitted to the Senior Management Team for consideration.

- 4.2 Overall Internal Audit considers that many managers are responding positively to recommendations with agreed action plans issued in the audit report and to follow up requests. Internal Audit is also getting more pro-active reporting of progress. However, implementation rates vary and the number of recommendations outstanding passed the due dates needs further evaluation. There are a variety of reasons including some unrealistic implementation timetables and lack of resource capacity to deliver planned solutions. Some implementation has been affected by service improvement work and changes to planned timescales. Agreement has been reached to extend implementation dates in some cases due, for example, to personnel changes. Implementation of a large number of school audit recommendations is being followed up as part of the Section's external assessment of Financial Management Standard in Schools.

- 4.3 Internal Audit will continue to follow up on implementation with business leads for each audit. Where necessary, escalate to senior managers, conduct further audit work and refer highest risk recommendations to the City Treasurer and to the Audit Committee.

5. Conclusion

- 5.1 This summary opinion follows audit activity over the last year and highlights some of the work remaining on the current audit programme for 2007/08. Members are requested to note the assurance opinion and activity, and to consider whether or not there are any matters which have been raised which require more specific consideration by the Committee or referral to the appropriate Scrutiny Committee.