

Audit Summary Report

January 2008



Review of Internal Audit

Manchester City Council

Audit 2006/07

External audit is an essential element in the process of accountability for public money and makes an important contribution to the stewardship of public resources and the corporate governance of public services.

Audit in the public sector is underpinned by three fundamental principles:

- auditors are appointed independently from the bodies being audited;
- the scope of auditors' work is extended to cover not only the audit of financial statements but also value for money and the conduct of public business; and
- auditors may report aspects of their work widely to the public and other key stakeholders.

The duties and powers of auditors appointed by the Audit Commission are set out in the Audit Commission Act 1998 and the Local Government Act 1999 and the Commission's statutory Code of Audit Practice. Under the Code of Audit Practice, appointed auditors are also required to comply with the current professional standards issued by the independent Auditing Practices Board.

Appointed auditors act quite separately from the Commission and in meeting their statutory responsibilities are required to exercise their professional judgement independently of both the Commission and the audited body.

Status of our reports

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors/members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

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Summary Report

Introduction

- 1 This report identifies the main findings from our triennial full assessment of Manchester City Council's system of internal audit.

Background

- 2 All local authorities have a statutory responsibility to maintain an adequate and effective system of internal audit of their accounting records and control systems. External auditors have a statutory responsibility under the Audit Commission's Code of Audit Practice to:
 - give an audit opinion on the Council's financial statements and statement on internal control; and
 - give a conclusion on whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.
- 3 Internal auditors provide officers and members with an independent assessment of the adequacy and effectiveness of the internal controls operating within the organisation. Therefore, some of the work internal audit carry out is directly relevant to the external auditor's statutory responsibilities.
- 4 Internal audit work is carried out to standards set out by CIPFA in their 'Code of practice for internal audit in local government in the United Kingdom' ('the Code'). This Code is periodically updated - the current version was issued in late 2006.
- 5 These Standards are as follows.
 - 1. Scope of internal audit.
 - 2. Independence.
 - 3. Ethics for internal auditors.
 - 4. Audit committees.
 - 5. Relationships.
 - 6. Staffing, training and continuing professional development.
 - 7. Audit strategy and planning.
 - 8. Undertaking audit work.
 - 9. Due professional care.
 - 10. Reporting.
 - 11. Performance, quality and effectiveness.

- 6 There are three parts to our review of IA.
 - We confirm that Internal Audit comply with the requirements of the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom. This gives us assurance that their work is to a standard that we can rely on to inform our conclusions.
 - We review whether IA is effective as a management control, as part of our control environment assessment.
 - We review, and seek to place reliance on, specific pieces of IA work, where that work covers areas relevant to our Code of Practice objectives.

Audit approach

- 7 We compared Internal Audit's approach and recent work with the Standards in the 2006 Code.
- 8 We have reached our conclusions on the internal audit service at Manchester by:
 - meeting with the Principal Audit Manager (now acting Head of Audit) and internal audit staff;
 - reviewing key internal audit documents; and
 - reviewing a sample of completed audits.

Main conclusions

- 9 The internal audit service in Manchester City Council sufficiently complies with the CIPFA Code of Practice to allow us to seek reliance on their work where appropriate. We have found some area for improvement and these have been summarised in an action plan to be completed separately from this report.
- 10 The Council has taken steps to improve its audit function and processes since our last full review by:
 - establishing an audit committee;
 - approving detailed terms of reference for Internal Audit; and
 - recruiting additional internal audit staff.
- 11 There are however some areas for improvement.

Scope of internal audit

- 12 The overall scope of Internal Audit should be formally defined by the organisation in terms of reference consistent with the CIPFA Code.

- 13 We found that the terms of reference in place at Manchester during 2006/07 broadly meets the requirements of the code, though there were some minor omissions relating to how Internal Audit's resource requirements will be assessed and confirmation that the terms of reference will be subject to periodic review. These have, or are in the process of, being reviewed. The terms of reference were considered at the 29 June 2007 Audit Committee, whilst a formal review of resources is being undertaken as part of the Service Improvement Programme.
- 14 The terms of reference currently do not fully consider partnership arrangements or consider how the section will obtain the necessary assurance for such arrangements. Given the range of partnerships in place at Manchester this could result in insufficient assurance being obtained for substantial areas of the Council's activities.

Recommendation

R1 The terms of reference should be amended to ensure that they fully meet the CIPFA code requirements, particularly in relation to partnerships.

Independence

- 15 The CIPFA Code states that Internal Audit should be independent of the activities that it audits to enable auditors to perform their duties in a way that allows them to make impartial and effective professional judgements and recommendations. Furthermore it stresses that internal auditors should not have any operational responsibilities.
- 16 Generally we found that Manchester has arrangements in place to ensure the independence of the audit team. There are some specific areas where internal audit review activity undertaken by the section. During 2006/07 officers within Internal Audit had responsibility for risk management and fraud investigation. Both of these areas were subject to review by Internal Audit.
- 17 Arrangements were put in place to ensure Internal Audit's independence including that the reports were issued under the now Acting Head of Internal Audit's name. We concluded that whilst this arrangement ensured independence other authorities have in place alternative arrangements for reviewing activity where there is internal audit involvement so independence can be more clearly demonstrated.
- 18 We also found that there are no arrangements in place to monitor contractor conflicts of interest. Whilst we do not view this as being a major issue, the risk remains that an auditor brought in to work for Internal Audit either individually, or as part of a wider contract for example the Salford IT Audit, may review an area where, due to personal relationships, the independence of the section could be questioned.

<i>Recommendations</i>
<i>R2 Ideally Internal Audit staff should have no other duties. If this is not possible arrangements should be in place for external review of these activities.</i>
<i>R3 Arrangements should be introduced to monitor contractor conflicts of interest.</i>

19 The code highlights four main ethical principles that should be observed by internal audit:

- integrity;
- objectivity;
- competence; and
- confidentiality.

20 The Internal Audit section broadly meets these principles, though some elements of good practice in relation to ethics are not documented in policies and procedures. This includes ensuring:

- auditors are not assigned to work areas where they have had operational involvement;
- rotation of audit responsibilities;
- staff have relevant knowledge of the organisation and relevant legislation / regulations; and
- staff are reminded of ethical responsibilities.

<i>Recommendation</i>
<i>R4 When policies and procedures are updated the items in paragraph 20 should be included.</i>

Audit committee

21 Early in 2006/07 the Council established an Audit Committee, whose role is outlined in the Council's constitution. Independent audit committees are CIPFA's preferred model for local authorities and are seen as best practice. CIPFA's 'Audit Committees: Practical Guidance for Local Authorities' outlines the principles of an effective audit committee. This includes practical separation from the scrutiny function and the executive.

22 The audit committee was previously a sub-committee of the Finance scrutiny committee. Although it is now technically independent from the scrutiny function it did not fully achieved this separation during 2006/07, with significant cross-membership between the audit committee and the finance and general purposes scrutiny committee. Furthermore we have noted that there are no 'independent' people on the Audit Committee; though acknowledge that the Council has attempted to recruit such individuals without success.

- 23** Given the changes in membership and the relatively recent introduction and development of the Audit Committee there is some uncertainty over whether the Committee meets all of the principles of an effective audit committee. We understand that this has been recognised by Manchester and the new external auditors for the Council and there is to be a review of the effectiveness of the Audit Committee to take place in 2007/08 as part of Grant Thornton's audit.

Staffing, training and continuing professional development

- 24** For staffing, the CIPFA code stresses that Internal Audit should be appropriately resourced to meet its objectives and have appropriate numbers of staff in terms of grades, qualifications, personal attributes and experience or have access to appropriate resources in order to meet its objectives and to comply with these standards.
- 25** Resourcing has been a key issue in previous reviews. Although significantly improved from our last full review, Internal Audit staffing level is below that assessed as necessary by the Head of Internal Audit. By the end of 2006/07 there were 4 vacancies and during 2007/08 there have been further reductions in staffing levels as experienced staff have moved to other posts or secondments within the authority.
- 26** Recruitment to remedy the lack of staff has led to a situation where Internal Audit staff lack experience and qualifications. In June 2006, a third of the staff had less than a year's experience of local government auditing, and almost half were studying for IIA or audit diplomas. Training commitments inevitably reduce time available for audit work. Furthermore the section has been running with 4 vacancies during the year, again placing additional pressure on the amount of work that can be completed.
- 27** These issues have arisen at a time when the Authority has introduced new financial systems, inevitably reducing the amount of assurance we have been able to take on internal audit's review of financial systems.
- 28** We recognise that resolving such issues can be difficult, but it is important that the audit committee is kept informed of potential changes to plans. The six monthly Internal Audit reports presented to the Audit Committee highlighted progress but did not specify which specific reviews would need to be dropped from the plans to address shortfalls in staffing numbers. This can result in Members not playing an active role in determining the appropriateness of changes to the audit programme.

Recommendations

<i>R5 The SIP review of staffing requirements needs to be completed to an appropriate timescale.</i>
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<i>R6 At each Audit Committee there should be a detailed report updating members on staffing issues and progress.</i>

Audit strategy and planning

- 29 The CIPFA code indicates that the Head of Internal Audit must produce an audit strategy which sets out at a high-level how the internal audit service will be delivered and developed in accordance with the terms of reference and how it links to the organisational objectives and priorities.
- 30 The strategy should communicate the contribution that Internal Audit makes to the organisation and should include:
- Internal Audit objectives and outcomes;
 - how the Head of Internal Audit will form and evidence his or her opinion on the control environment to support the annual Statement on Internal Control;
 - how Internal Audit's work will identify and address significant local and national issues and risks;
 - how the service will be provided, ie internally, externally, or a mix of the two; and
 - the resources and skills required to deliver the strategy.
- 31 At Manchester no overall internal audit strategy has been developed. A well developed strategy helps the Internal Audit function produce a plan which is clearly tailored to address key risks, and links addressing the risks to resources.

Recommendation

<i>R7 Produce an audit strategy in line with CIPFA guidance.</i>
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Reporting

- 32 The CIPFA code indicates that the primary purpose of Internal Audit reporting is to communicate to management within the organisation information that provides an independent and objective opinion on the control environment and risk exposure and to prompt management to implement agreed actions.
- 33 We found that the overall arrangements for reporting met the requirements of the CIPFA code. We did find that the arrangements for the follow-up of audit recommendations are not systematic. Whilst there are appropriate follow up mechanisms for school audits and parts of finance this was not the case for other areas.

- 34 The CIPFA code emphasises that management has responsibility for ensuring agreed actions are implemented. Internal Audit's role is therefore to obtain assurances that actions have been implemented, particularly those where risks are high, with the Head of Internal Audit expected to determine the need for, and the form of, follow-up action.

Recommendation

R8 A standard follow-up process should be set-up which includes reporting to the Audit Committee where key agreed recommendations are not actioned by the agreed date.

Undertaking audit work

- 35 The code highlights how the required standard of Internal Audit documentation and working papers should be clearly specified. It is important for managers within Internal Audit to have systems in place to ensure that auditors obtain and record sufficient evidence to support their conclusions, professional judgements and recommendations. Internal Audit working papers must always be sufficiently complete and detailed to enable an experienced internal auditor with no previous connection with the audit to ascertain what work was performed, to re-perform it if necessary and to support the conclusions reached.
- 36 Our overall conclusion on this area is that whilst we saw some good working papers there are areas where further development is required. We found that:
- the required standard of internal audit documentation and working papers have not been defined;
 - for some assignments the recording of testing was not of a sufficient standard to enable re-performance; and
 - for some work it was not always possible to see how the work supported the conclusion.
- 37 These issues can usually be addressed by having a Quality Manual in place which would set out required standards of documentation and how to record audit work. At Manchester there is currently no such audit manual, though we have noted that the use of Galileo to record and document audit work helps ensuring there is an overall framework in place.

Recommendation

R9 A Quality Manual, based on working with the Galileo system, should be prepared setting out how work is to be recorded and the expected standards of documentation.

Due professional care

38 Due professional care is defined within the code as:

- working with competence and diligence;
- the use of audit skills, knowledge and judgement based on appropriate experience, training (including Continuing Professional Development), ability, integrity and objectivity; and
- respecting and understanding confidentiality.

39 We found no evidence to suggest that any of these are an issue at the Authority. The code does indicate that the development of a monitoring and review programme to ensure that due professional care is achieved and maintained should take place. No such programme specifically exists, though there is a system of bi-monthly review sheets which addresses some of these issues, as does the use of the Galileo system.

Recommendation

R10 To be fully compliant with the code a monitoring and review programme to ensure that due professional care is achieved and maintained should be developed.

Performance, quality and effectiveness

40 The Code indicates that Internal Audit should establish policies and procedures in an audit manual to guide staff in performing their duties and complying with this Code. The manual should be regularly reviewed and updated to reflect changes in working practices and standards. As mentioned earlier, the Internal Audit section does not have such a manual, which could therefore result in inconsistencies in quality expectations across the section.

41 Furthermore, the code specifies that performance, quality and effectiveness should be assessed at both an individual audit level and for the service as a whole. The overall quality assurance process is currently under development at Manchester, though there are a number of ways that performance is assessed, for example:

- assessment of work at an individual audit level;
- customer questionnaires;
- canvassing of senior manager on the effectiveness of the section; and
- annual review of internal audit by the Audit Committee.

Recommendation

R11 The quality assurance process framework, building on the items set out in paragraph 41, should be finalised.