

**MANCHESTER CITY COUNCIL**

**REPORT FOR INFORMATION / RESOLUTION**

**COMMITTEE**            **Audit Committee**

**DATE:**                            1 June 2006

**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 2006/7.

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 it's 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. 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 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 2006/7.

## **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 and other Senior Managers
  - Members.
- 2.2 The process was overseen by the Head of Financial Management, the Assistant Chief Executive (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 at the meeting of the Strategic Management Team (SMT) held on 23 May.

## **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 2005/6 these arrangements have been improved. A review of the Community Strategy has created a new vision and aims for Manchester for the period up to 2015. This has been underpinned by the development of a Local Area Agreement and the signing of a Local Public Service Agreement for the city. The Community Strategy has within it a framework of "State of the City" performance indicators. The arrangements have also been supplemented by the development of the Manchester Improvement Programme establishing clear priorities for the improvement of Council services. The objectives for the city, for the improvement of Council services and for improving the capacity of the Council to deliver the objectives have been brought together into a new Corporate Plan.
- 4.4 At its meeting on 23 March 2006 Audit Sub Committee commented that the various forms of monitoring, as described, did not give the clearest view of how this is achieved. Previous analysis had also omitted the role of scrutiny committees in the consideration of objectives.
- 4.5 While it is clear that monitoring of objectives takes place in terms of the role of Executive and Scrutiny Committees and through SMT, these arrangements could be better articulated and further developed with reference to monitoring of performance.
- 4.6 There are considered to be no issues warranting disclosure in relation to this aspect of control but to improve arrangements still further it is intended to review the functions and structure of the Manchester Partnership, start to report on the "State of the City" Indicators, review the Corporate Plan in the light of Members' priorities following the elections and strengthen the role of all managers in providing leadership on the achievement of the Council's objectives through work to develop a wider leadership team.
- 4.7 The way in which these arrangements are described and articulated will be taken into account in further developing arrangements.

## **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. Overview and Scrutiny Committees have started to look at how they can improve the effectiveness of their role assisted by performance management information and this work will continue this year.
- 5.3 The current reorganisation of the Council, in particular to create Children Services and Neighbourhood Services together with the extensive programme of change associated with the Manchester Improvement Programme and working in partnership with others, often in new ways, (for example district governance models) means that it is important to ensure clarity in accountability and decision making is maintained.
- 5.4 Whilst the Constitution is updated on an annual basis to reflect change and the Council was assessed as performing well in relation to "*promoting and ensuring probity and propriety in the conduct of its business*" (Use of Resources Assessment), it would be prudent to undertake a programme of internal audit review during 2006/7 to provide additional assurance about compliance with agreed arrangements. In this context Internal Audit, in conjunction with the City Solicitor, will develop a programme of review covering the period July 2006 – March 2007

## **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

- 6.4 Audit Sub Committee was established during 2005/6 and operated effectively bringing increased member scrutiny to audit matters. Subsequently, Council approved the creation of an Audit Committee reporting directly to Council in accordance with professional guidance.
- 6.5 In considering this aspect of control CIPFA/SOLACE guidance recommends formal acceptance of a Code of Corporate governance covering community focus, service delivery arrangements, structures and processes, risk management and internal control and standards of conduct. While the Council follows the principles incorporated in the guidance, it has not formally been adopted. The Code, which was published in 2001, is currently under review and a revised Code is expected to be published in July 2006.
- 6.6 As a result SMT agreed that The City Solicitor in conjunction with the Assistant Chief Executive (Performance) will oversee a review of the Revised Code and bring forward recommendations about its adoption.
- 6.7 In relation to school governance, the support given to and monitoring arrangements adopted for schools in providing increased assurance to the Council that the Governance of schools is effective was highlighted last year and disclosed as a significant control issue.
- 6.8 The terms of reference of the agreed review recognised the need to undertake this in two stages. Firstly to address the issues raised by the District Auditor in his Public Interest Report issued in October 2005. Secondly, to consider the more wide-ranging governance issues associated with the development of new structures of governance for individual schools and for new models of district service coordination and delivery across the City.
- 6.9 The outcome of the first stage of the review will be reported to a future meeting of the Audit Committee. The report will detail actions already taken and those being implemented to improve support and monitoring. However, a number of proposed improvements are not yet in place and as a result SMT have recommended that the Council again discloses this matter as a significant control issue within the Statement of Internal Control. Subject to further consideration by the Audit Committee, the resultant Action Plan will concern the implementation of the agreed recommendations.
- 6.10 The likely Clawback of £2.7m of grant funding for one ERDF scheme has arisen from the failure, in the eyes of the European Union Auditors, that the Council did not properly follow procurement rules. Given the magnitude of this potential recovery and that it is related to a failure (albeit by a particular ex employee) to comply with the Council's agreed procedures, SMT recommend that this item is disclosed within the Statement. The Deputy Chief Executive, in conjunction with Internal Audit, will review the arrangements for ensuring compliance with grant conditions to consider whether any additional measures are required.

## **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 newly constituted Audit Committee includes the responsibility to “*oversee the effectiveness of the council’s risk management arrangements*” within its Terms of Reference.
- 7.2 Planning methodologies have continued to emphasise the need to identify risks and the Performance and Risk Management Group was established in January 2006 to assist in the development of the corporate risk register and to further consider planning methodologies
- 7.3 The development of the Corporate Risk Register owned and monitored by SMT, the formal adoption of an Audit Committee with a remit to review risk management, key registers in Children Services and Adult Social Care and the establishment of the Performance and Risk Management Group comprised of senior managers, drawn from across the Council and representing all departments, represent important steps forward in this area.
- 7.4 Risk management was declared in the 2005/6 Statement of Internal Control as a significant control issue and was also scored as inadequate in the 2005 Use of Resources assessment, However, progress over the last six months has been significant. While there is still progress to be made in further embedding risk management at all levels of management planning and more consistently across the Council it is the view of SMT that this matter does not now require disclosure. Nevertheless, Risk Management needs to continue to receive close scrutiny by SMT and the Audit Committee to ensure methodologies are further embedded and stabilise
- 7.5 A further report on risk management will be available for the 29 June meeting.

## **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 The Use of Resources Assessment undertaken by the Audit Commission in 2005 scored VFM as “adequate performance” but feedback highlighted that the Council is unable to demonstrate how it is consistently achieving VFM in

its services or compared to others. While there has been a focus on identifying areas of high spending, in the opinion of the Audit Commission some services are not providing VFM.

- 8.4 From this year the Audit Commission, as our external auditors, are required to form an opinion about whether or not the Council delivers VFM. This decision is based upon 12 criteria and a decision that the Council does not deliver VFM would clearly be a significant issue for consideration. However, this assessment will not be available until September 2006.
- 8.5 The Council believes that it does deliver value for money and is delivering efficiencies which are demonstrated by the ability to set below inflation Council tax rises for the last seven years.
- 8.6 While it is not considered that this is a matter for disclosure, nevertheless it is recognised that more can be done to develop a better understanding of relative costs and to more effectively build in VFM considerations when considering how resources are allocated and deployed.
- 8.7 Following receipt of "VFM profiles" from the Audit Commission, work is ongoing to examine unit costs across the Council with the intention of developing a methodology to use the analysis of costs in a more systematic way
- 8.8 The Manchester Improvement Programme is now well underway and is the key driver in delivering significant efficiencies and service improvements. The Programme Board is monitoring the delivery of efficiency savings. The scale of these savings and the successful delivery of them will provide powerful evidence for the VFM key lines of enquiry within the 2006 Use of Resources assessment and beyond
- 8.9 The recent implementation of new financial systems will now deliver increased rigour in procurement and much improved management information to help develop procurement strategies during 2006/7 and beyond. During 2006/7 a Service Improvement Project is being undertaken which will configure the procurement function for the future and it is also anticipated that an additional senior level resource will be added during the year to oversee and further strengthen the function.
- 8.10 As well as completing the Service Improvement Project actions to improve arrangements in relation to procurement will need to include the design of a programme of monitoring to ensure the efficiencies delivered through the introduction of new financial systems are being realised.

## **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 will 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 Service Improvement Projects (SIP's) are underway or planned for key resource management areas. These SIP's will reconfigure services to deliver, amongst other things, necessary improvements in service delivery and the management of resources. In particular, this will be an opportunity for the Financial Management function to review operations to deliver improvements to the control environment and address issues highlighted in the CPA "Use of Resources" assessment.
- 9.5 The use of resources assessment, which assesses financial management through judgements about financial reporting, financial standing, financial management and internal control was assessed overall as "adequate performance" but two particular areas scored as inadequate (in addition to risk management outlined above).
- 9.6 In relation to financial reporting the Audit Commission highlighted two material errors in the accounts presented for audit and deficiencies in key working papers. While steps have been taken to improve quality control during this years production of the Accounts, it is also true to say that key resources have needed to be deployed in implementing the new financial systems operating from April 2006 which has significantly stretched resources in a year when the statutory timescale for preparing the accounts has been reduced from 4 months to 3 months and significant additional reporting requirements have been added (e.g. preparation of full group accounts for the first time). New systems implemented for Housing Benefits and Council Tax early in the new year also impact on the closedown of the 2005/6 Accounts
- 9.7 These factors are likely to have increased the risk of material error. The outcome of the Audit of the 2005/6 Accounts will not be known until later in the year and as a result SMT recommend that this matter is disclosed within the SIC. Associated actions are already in train to mitigate the risk.
- 9.8 In relation to the management of Assets the Audit Commission highlighted the need to develop an effective Asset Management Plan and report performance to members, to ensure the corporate property function has sufficient capacity to operate effectively and to update the backlog maintenance figures and ensure these are a focus of attention.

- 9.9 Significant work has been undertaken to produce a new Asset Management Plan which was published in March 2006 and the Plan outlines significant change to the management of assets. The repairs programme has been consolidated and the Service Improvements Project for Valuation and Property commenced in 2005/6 is well underway which will address the resourcing issues associated with the management of the Council's asset portfolio.
- 9.10 These intensive actions represent a significant step forward in the management of assets and, as a result, SMT consider that this matter does not need to be disclosed.
- 9.11 Nevertheless it is important to continue to make progress. The Asset Management Plan Board (which includes member representation) will oversee the Implementation of the agreed approach to Asset Management and the Service Improvement Project will be brought to fruition during 2006/7.
- 9.12 Last year the Council declared problems with the Education Budget relating to cumulative overspends. While measures have been taken to address this, at the same time increasing numbers of schools are recording budget deficits so in overall terms budgetary control of education spending remains a difficulty.
- 9.13 Extensive work has been undertaken to understand the nature of budget pressures and to set realistic budgets at cost centre level, Nevertheless challenges remain including the delivery of savings from the review of the Manchester Education Partnership whilst at the same time the pressure to improve on poor performance would tend to drive up spending.
- 9.14 Under these circumstances SMT recommends that Education Spending is again disclosed in the SIC and that the position continues to be subject to close review overseen by the Education Budget Group (which includes member representation).
- 9.15 The implementation of new financial systems whilst designed to deliver significant improvements in the financial management of the council, represents a very significant change in processing transactions and controlling budgets.
- 9.16 There is a risk that serious problems could ensue because of an initial lack of familiarity with the new systems or because controls do not work as intended. While the Project Board is overseeing the stabilisation of the system and Internal Audit are undertaking focused work in key areas there is a significant risk of difficulties emerging given the scale of change undertaken.
- 9.17 At this stage and based on reports to the Project Board it is reasonable to be optimistic that the systems will stabilise without causing significant problems but it will be important during 2006/7 for the City Treasurer and the Project Board to keep this matter under review.

## **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 scrutinize 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 In terms of monitoring performance in partnerships the LSP Management Group submits quarterly performance reports on all Community Strategy objectives and national and local PSA targets to the Board of the Manchester Partnership. The Board also provides focused challenges of specific objectives. The LSP Monitoring Group provides a similar focussed challenge on specific targets as well as monitoring performance across the LPSA.
- 10.4 The LAA is subject to six monthly performance monitoring by GONW and the Manchester Partnership is subject to annual performance appraisal.
- 10.5 Each of the Strategic Regeneration Frameworks are performance managed through Public Agency Forums at district level.
- 10.6 During 2005/6 the Audit Commission undertook a review of the Council's performance management arrangements. This highlighted that a number of building blocks are in place to provide a comprehensive performance management framework but that more needed to be done to ensure consistency across the Council, to use performance management to drive improvement and to embed the culture of performance management at all levels.
- 10.7 As a result of the review, an Action Plan has been drawn up to systematically address the issues raised and work is ongoing to develop planning arrangements, guidance and procedures and monitoring arrangements across the Council.
- 10.8 The Audit Commission review is positive but it is anticipated that performance management will feature in the Corporate Assessment currently underway
- 10.9 The Performance and Risk Management Group has been established to help develop performance management methodologies across the Council and

within partnership. It will be important to pick up any specific issues or feedback arising from the Corporate Assessment over the coming months

10.10 In addition, the Corporate Performance Group within Chief Executives Department will review the management arrangements for data quality to comply with new Audit Commission requirements on data quality

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

11.1 The above section has outlined the component elements of the control environment and specifically highlighted four areas where disclosure within the Statement of Internal Control is recommended. These are-

- support and monitoring of school governance
- compliance with procedures which govern the conditions attached to the receipt of external grants
- closure of the Accounts
- education spending.

11.2 For reference, the criteria used to decide whether to disclose are:-

- The issue has seriously prejudiced or prevented achievement of a principal objective
- The issue has resulted in the need to seek additional funding to allow it to be resolved, or has resulted in significant diversion of resources from another aspect of the business
- The issue has led to a material impact on the accounts
- The Audit Committee or equivalent has advised that it should be considered significant for this purpose
- The Head of Audit has reported on its significance, for this purpose, in the annual opinion of the internal control environment
- The issue, or its impact, has attracted significant public interest or has seriously damaged the reputation of the organisation
- The issue has resulted in formal action being taken by the Chief Financial Officer and/or the Monitoring Officer

11.3 Members are requested to consider whether or not they wish to give further and specific consideration to these disclosure matters or to refer as appropriate to other scrutiny committees.