

ARGYLL & BUTE COUNCIL

Internal Audit Section

INTERNAL AUDIT REPORT

CUSTOMER DEPARTMENT	CHIEF EXECUTIVE'S UNIT
AUDIT DESCRIPTION	RISK BASED AUDIT
AUDIT TITLE	STRATEGIC FINANCE – DEPARTMENTAL SUPPORT
AUDIT DATE	AUGUST 2016

2016/2017



1. BACKGROUND

A review of Accounting and Budgeting - Departmental Support within Chief Executive Unit/Strategic Finance Service has been planned as part of the 2016/17 Internal Audit programme.

It is a requirement of the Local Government Scotland Act (1973) that “every local Authority shall make arrangements for the proper administration of their financial affairs and shall secure that the proper officer of the Authority has responsibility for the administration of those affairs”. If a budget cannot demonstrate that the appropriate level of balances are attained at the end of an agreed financial planning period the budget may not meet the requirements of the act. The budget papers and minutes, presented for Council approval, should therefore provide a clear trail to both elected members and the public.

The budget monitoring and setting process is a vital part of the Councils financial management arrangements and should be clear, transparent and open to scrutiny.

The Finance section within the Council has been split into 2 separate teams namely a departmental support team and a corporate support team. The role of the departmental team is aligned to the specific requirements of the service departments in regard to budget monitoring and budget setting. The corporate support team’s area of responsibility includes treasury management, capital budgeting and completion of year end accounts. The Finance section has a total of 37.5 full time equivalent staff of which some are qualified and non-qualified staff, the split being 17 qualified, 6 part qualified and 14.5 non-qualified.

The Council’s revenue budget for financial year 2016/17 is approx. £242 million.

2. AUDIT SCOPE AND OBJECTIVES

The main objectives of the audit were:

- To provide assurance that the financial management framework is adequate and effectively supports relevant and timely financial planning, budgeting and monitoring activities.
- To assess the adequacy of the process used to develop annual budgets which appropriately reflect strategic/business priorities and financial requirements.
- To assess whether reporting arrangements are adequate in respect of being timely, consistent and transparent.

Controls will include:

- Authority – Roles and delegated responsibilities are documented in policies and procedures and are operating well in practice
- Occurrence – Sufficient documentation exists to evidence compliance with policies and procedures
- Completeness – Policies and procedures are aligned and all required documentation is accurately and fully maintained
- Measurement – Policies and procedures are in line with requirements of relevant legislation
- Timeliness – Policies and procedures are regularly reviewed and updated as necessary

3. RISKS CONSIDERED

- Roles and Responsibilities for budget monitoring and setting are not clearly defined
- Procedures for both budget monitoring and budget setting are not documented
- Reporting information to managers and members does not support decision making
- Financial monitoring and forecasting is not accurate, robust or timely

4. AUDIT OPINION

The level of assurance given for this report is Reasonable

Level of Assurance	Reason for the level of Assurance given
High	Internal Control, Governance and the Management of Risk are at a high standard with only marginal elements of residual risk, which are either being accepted or dealt with. A sound system of control is in place designed to achieve the system objectives and the controls are being consistently applied.
Substantial	Internal Control, Governance and management of risk is sound, however, there are minor areas of weakness which put some system objectives at risk and where specific elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
Reasonable	Internal Control, Governance and management of risk are broadly reliable, however although not displaying a general trend there are a number of areas of concern which have been

	identified where elements of residual risk or weakness with some of the controls may put some of the system objectives at risk.
Limited	Internal Control, Governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and system objectives are at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.
No Assurance	Internal Control, Governance and management of risk is poor, significant residual risk exists and/ or significant non-compliance with basic controls leaves the system open to error, loss or abuse. Residual risk must be addressed immediately with management allocating appropriate resources to the issues.

This framework for internal audit ratings has been developed and agreed with Council management for prioritising internal audit findings according to their relative significance depending on their impact to the process. The individual internal audit findings contained in this report have been discussed and rated with management.

A system of grading audit findings, which have resulted in an action, has been adopted in order that the significance of the findings can be ascertained. Each finding is classified as High, Medium or Low. The definitions of each classification are set out below:-

High - major observations on high level controls and other important internal controls. Significant matters relating to factors critical to the success of the objectives of the system. The weakness may therefore give rise to loss or error;

Medium - observations on less important internal controls, improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system and items which could be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified;

Low - minor recommendations to improve the efficiency and effectiveness of controls, one-off items subsequently corrected. The weakness does not appear to affect the ability of the system to meet its objectives in any significant way.

5. FINDINGS

The following findings were generated by the audit:

Per Scope: To provide assurance that financial management framework is adequate and effectively supports relevant and timely financial planning, budgeting and monitoring activities.

- A financial framework is in place and is shown via the Financial and Security regulations, included at section D within the council's constitution. These regulations were found to be consistent with good practice with clearly defined roles and responsibilities, documented procedures and reference to relevant legislation. The Financial and Security regulations are updated on a regular basis as part of the annual Constitution review. The Constitution is available on the Councils website.

Budget Monitoring

- Strategic Finance has a financial monitoring framework in place that covers the various stages of the budget monitoring process including; engagement with budget holders, roles and responsibilities and the reporting timetable. Budget monitoring performance reports produced were found to be accurate and were provided on a regular basis to budget holders as per requirements. Guidance has been issued to budget holders, although information remains current, this not been reviewed since 2013/14.
- A timetable is in place in respect of budget monitoring requirements and this has been distributed to relevant stakeholders. Budget monitoring information is provided in the form of a trial balance and is supported via individual payroll reports and detailed transaction information.
- Strategic finance adopt a risk based approach to budget monitoring in order to focus on the key areas, whereby key monitoring activity is on identified risk areas. In order to ascertain the level of risk a matrix has been developed and has a number of criteria such as cost centre value, proportion of fixed employee costs and income volatility which is used to determine the frequency of reporting. The risk matrix is currently under review.

- The budget monitoring framework states that the engagement process with budget holders should cover a number of areas including explanation of variances against year to date budget and expected cost or demand pressures that may impact the final outturn for the year. A sample of engagement records were reviewed across departments and it was noted there was an inconsistent approach in terms of completion e.g. the issue of cost or demand pressures was not recorded in a number of engagement logs and similarly a projected forecast outturn position was not available.
- The council has defined budget holders as 3rd tier managers and above and all cost centres are assigned a designated budget holder. In addition, a finance contact within strategic finance is also assigned to individual cost centres and, where appropriate, an operational contact. Budget holder information is reviewed on an ongoing basis and was found to be accurate and comprehensive.
- As noted above, budget holders are supported by a dedicated finance contact and there is an e-learning module which has been developed by Strategic Finance providing advice and guidance for budget holders.
- Strategic Finance have carried out a customer service performance satisfaction questionnaire, the results of which have yet to be collated. Consequently, a sample of 12 budget holders were contacted to ascertain whether they were satisfied with the quality of budget monitoring information, the engagement process and what, if any, improvements they would recommend. The replies received indicate that budget holders were satisfied with the level of support from Strategic Finance and that the reports provided were timely, accurate and relevant.
- There was no evidence of a mechanism in place which incorporates planned earmarking within Budget Monitoring & Forecasting protocols.
- The scheme of integration states that “any potential deviation from the planned outturn should be reported to Argyll and Bute Integration Joint Board, The Council, and NHS Highland at the earliest opportunity”. Arrangements currently in place do not support timely flow of information.

- Control accounts are also administered by Strategic Finance. Recent scrutiny and audit activity has identified weaknesses in relation to monitoring protocols and clearly defined roles and responsibilities whereby Control accounts are not subject to robust monitoring protocols. This is an area which is currently under review and a procedure / process is being drafted.

Budget Preparation

- Budgets are required to be prepared on an annual basis and follow a standard process; however elements of this process are not formally documented. Strategic Finance staff and budget holders are aware of the generic tasks and these are completed on an ongoing basis with budget holders receiving instructions from the finance contacts as part of the engagement process.
- Strategic Finance adopts an incremental form of budgeting where the base budget for the previous year is rolled forward into the following year. The base budget is then subject to change via agreed cost and demand pressures, inflation assumptions, pay awards and fees and charges assumptions. The key stages in the budget preparation involve:
 - Roll forward of previous year's budget
 - Salary templates being populated
 - Identification of Cost/Demand pressures and Inflation assumptions
 - Fees and Charges inflation assumptions
 - Savings Proposals

To support these processes Strategic Finance has a budget timetable in place which states the actions to be carried out, the responsible person and the key dates. It was noted that the budget timetable reviewed was not specific to budget setting actions but also included budget monitoring actions.

- In order to mitigate the risks associated with incremental budgeting Strategic Finance previously implemented a budget challenge where budget holders had to provide justification and, where appropriate, evidence as to the requirement for resources. It was noted that this exercise has not taken place over the last few years however plans are in place to re-introduce a revised challenge process as part of the 17/18 budget process.

- Where services have adopted unit costing for budget monitoring processes there was no demonstrable linkage to the budget preparation process. Additionally, where services have identified a trend of demand and cost pressures against their services via budget monitoring there is no evidence of a link to the budget preparation process.
- Approximately 54% of Service costs relate to employee expenses. Strategic Finance have a procedural document in place which sets out the requirements for completion of the salary templates regarding checks required as to accuracy, responsible person and a timetable of when tasks should be finalised. Appropriate review and authorisation of completed templates was evidenced as being in place and a reconciliation report is submitted to Strategic Management Team (SMT).

Per Scope: To assess the adequacy of the process used to develop annual budgets which appropriately reflect strategic/business priorities and financial requirements

- A one year budget has been agreed as a consequence of the Scottish Government only being able to confirm the financial settlement for the year 2016/17. Budget Outlook reports provide a longer term view.
- Service plans support the management planning process and include financial analysis including base budget, inflation, success measures, target timescales and relevant benchmarking. In addition, service plans are linked to service outcomes which are, in some cases, linked to strategic objectives. Strategic Finance has recognised that the link between financial planning and the Council's strategic aims, targets and priorities requires to be improved and in mitigation has prepared a strategy entitled "Planning our future". Included within this strategy is an outline of service choices which outlines the following:
 - Adopt a longer term structured means to identify members' priorities in terms of service and changes to the budget
 - Members would be involved in stages where decisions were required in relation to options review, sign off of business plan for the revised service
 - Align budgets with Council priorities and for delivering on the Local Outcome Improvement Plan (LOIP)
- Assumptions underpinning the budget such as pay award increases, inflation adjustments and increases to fees and charges were reviewed and the methodology for preparing these assumptions was found to be adequate. Governance

arrangements were also found to be adequate with a review process via SMT, budget working group and relevant committee.

- Strategic Finance prepare an annual budget pack which is available to members and external stakeholders which summarises the overall revenue budget position covering funding, expenditure and savings. It also sets out the proposals around non pay inflation and the cost and demand pressures for inclusion in the revenue budget.
- Strategic Finance prepares a budget in consultation with members of the Ruling Group/ Administration. Support is given in terms of a dedicated finance resource, ordinarily from the Head of Strategic Finance and/or Principal Accountant. The same level of support is available for other groups who may wish to present an alternative / amended budget and there is clear segregation of duties in place. It was noted that although all base information is made available to all groups there is no formal template or standard approach to budget presentation.
- Audit Scotland reviewed the 2015/16 budget setting process and identified 3 areas for improvement and an action plan has been agreed.
- The Council has agreed to hold a contingency balance equivalent to 2% of the Council budget for 2016/17. This contingency is held to provide a working balance to mitigate the impact of uneven cash flows and unexpected events.

Per Scope: To assess whether reporting arrangements are adequate in respect of being timely, consistent and transparent

- Reporting is undertaken at various levels including; budget holders receiving reports at cost centre level, consolidation of cost centres into service expenditure, consolidation of service expenditure into departmental classification and into council wide reporting.
- Cost centre level reporting was found to be timely, consistent and transparent with clearly defined roles and responsibilities and was subject to a detailed timetable.

- It was evidenced that Strategic Finance staff regularly attend SMT meetings and provide an update on the financial position including year to date, variance analysis and projected outturn. Strategic Finance staff also attend Departmental Management Team meetings and provide a consolidated position covering the same criteria noted above.
- The Head of Strategic Finance provides a report to the SMT on a monthly basis giving an overview of the Council position.
- Committee reporting is undertaken via updates to the Policy & Resources (P&R) committee. The P&R Committee papers specified the reporting arrangements for 2016/17 and covered the following areas :
 - Financial monitoring pack summary
 - Revenue budget monitoring
 - Monitoring of Service choice savings
 - Monitoring of Financial risks
 - Capital Plan monitoring
 - Treasury monitoring
 - Reserves and Balances

As required Strategic Finance provide these reports on a bi-monthly basis and a review of the reporting requirements outlined above showed that they are being fully adhered to.

- Strategic Finance produce a budget outlook report which covers all key areas of the budget namely:
 - Pay Awards
 - Key assumptions noting any changes from previous assumptions
 - Income from fees and charges
 - Cost and Demand pressures
 - Funding
 - Savings updates
 - Scenario analysis

The latest budget outlook paper for 2016/17 was presented to the P&R committee in August 2016. The report covered the period from 2017/18 to 2019/20 and was found to be comprehensive with emphasis on the emerging financial issues. It was confirmed by the Head of Strategic Finance that updates to the Budget outlook report will be presented to the P&R Committee when assumptions previously made require to be updated in light of new information received such as Government funding.

- Strategic Finance prepares a bi-monthly summary report to SMT on savings that are out with the Service choices process. This savings report was found to be comprehensive and transparent. The report summarises those savings which have been delivered and the mechanism adopted to deliver them. For those savings which are still being addressed, such as vacancy savings, the report summarises savings achieved to date and what remains outstanding with a statement stating whether the savings will be met within the timeline agreed.
- External reporting includes an annual audit report by Audit Scotland on the accounts of Argyll and Bute council. This report makes reference to areas such as financial management and over the last 3 years has concluded that generally sound arrangements are in place. From 2016 this annual audit report will focus on 4 areas namely: financial sustainability, financial management, governance and transparency and value for money.

6. CONCLUSION

This audit has provided a Reasonable level of assurance. There were a number of recommendations for improvement identified as part of the audit and these are set out in Appendix 1 and 2. There were 4 high and 3 medium recommendations set out in Appendix 1 which will be reported to the Audit Committee. There is 1 low recommendation which is not reported to the Audit Committee. Progress with implementation of actions will be monitored by Internal Audit and reported to management and the Audit Committee.

Thanks are due to the Strategic Finance staff and management for their co-operation and assistance during the Audit and the preparation of the report and action plan.

APPENDIX 1 ACTION PLAN

Findings	Risk Impact	Rating	Agreed Action	Responsible person agreed implementation date
1. Engagement Logs		High/ Medium or Low		
Cost and demand pressures are not recorded in a number of engagement logs and similarly a projected forecast outturn position was not always recorded.	Failure to record key information or projected outturn may lead to misreporting resulting in ineffective decision making.	High	Instruction to be issued to all Finance contacts reminding them of requirement to adhere to agreed protocol.	Finance Manager Departmental Support 31st October 2016
2. Earmarking				
There was no evidence of a mechanism in place which incorporates planned earmarking within Budget Monitoring /Forecasting protocols.	Failure to provide timely information leads to ineffective decision making.	High	Consideration will be given how to incorporate earmarking into monitoring or forecasting protocols.	Head of Strategic Finance 31st December 2016

3. Integrated Joint Board		High/ Medium or Low		
Arrangements currently in place do not support timely flow of information relating to financial position.	Arrangements do support the early identification of material deviation from planned outturn.	High	IJB's monitoring report will be appended to the Councils financial risk report.	Head of Strategic Finance 31st October 2016
4. Control Accounts				
Control Accounts are not subject to robust monitoring protocols.	Failure to have robust monitoring protocols in place may lead to financial loss.	High	This is an area which is currently under review and a procedure / process is being drafted.	Finance Manager Departmental Support 31st October 2016
5. Budget Preparation procedures				
Elements of the budget preparation process are not formally documented.	Failure to formally document budget processes may lead to loss of skill and/or knowledge when staff members leave resulting in inefficient service delivery.	Medium	A budget preparation guidance documentation will be prepared which incorporates existing individual guidance	Finance Manager Departmental Support 31st March 2017

6. Budget challenge		High/ Medium or Low		
Budget challenge process has not taken place over the last 2 years.	Failure to have appropriate mitigation in place in respect of incremental budgeting.	Medium	A revised challenge process will be introduced for the 17/18 Budget setting exercise.	Head of Strategic Finance 28th February 2017
7. Unit Costing and Trend analysis				
Trend analysis and unit costing are not commonly used in the budget monitoring and budget preparation process.	Failure to link unit costs and or trend analysis in budget preparation may lead to ineffective use of resources resulting in missed opportunities.	Medium	Where appropriate Unit Costing and Trend analysis will be incorporated into routine processes	Finance Manager Departmental Support 31st March 2017



Contact Details

Name David Sullivan

Address Whitegates, Lochgilphead, Argyll, PA31 8RT

Telephone 01546 604125

Email David.Sullivan@argyll-bute.gov.uk

www.argyll-bute.gov.uk

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