

ARGYLL & BUTE COUNCIL

Internal Audit Section

INTERNAL AUDIT REPORT

CUSTOMER DEPARTMENT	DEVELOPMENT AND INFRASTRUCTURE SERVICES
AUDIT DESCRIPTION	RISK BASED AUDIT
AUDIT TITLE	TAX INCREMENTAL FINANCING
AUDIT DATE	NOVEMBER 2016

2016/2017



1. BACKGROUND

This report has been prepared as a result of the Internal Audit review of Tax Incremental Financing as part of the 2016/17 Internal Audit programme.

Tax Incremental Financing (TIF) was introduced by the Scottish Government and the Scottish Futures Trust to allow Councils to borrow capital to fund infrastructure to enable economic growth. This investment allows Councils to borrow funds based on the strength of estimated future revenues raised on additional non-domestic rates and will be geared to specific projects that will allow support employment developments and encourage employment generation.

An initial proposal for developing a TIF business case for the Oban Lorn area was submitted to the Scottish government in August 2013 as part of the pilot TIF programme identification case. The Argyll and Bute proposal was chosen to progress as one of 6 pilot projects and proceeded to the next stage to develop a supporting business case.

The full business case for the TIF project, named Lorn Arc TIF, outlines the proposal package for the delivery of a capital spend of £18.9m on infrastructure improvements which in partnership with external funders will lead to circa £41m of investment in local infrastructure. The package is aimed at improving access to the Scottish Association for Marine Science/European Marine Science Park, measures to improve port and marine facilities within the Oban area and other business related infrastructure which will support the delivery of the Local Area Development plan.

The Lorn Arc TIF initiative has been geared to align closely with delivery of the Council's outcomes 1 and 2 of the Local Outcome Improvement Plan (LOIP) namely that the economy is diverse and thriving and we have infrastructure that supports sustainable growth.

There are currently 7 projects in progress at various stages of development within the Lorn Arc programme.

2. AUDIT SCOPE AND OBJECTIVES

- Review Governance arrangements
- Review monitoring procedures and reporting arrangements
- Review financial management arrangements including modelling, budgeting and general controls
- Identify and mitigate against known risks.

Controls included:

- Authority – Roles and delegated responsibilities are documented in policies and procedures
- Occurrence – Sufficient documentation exists to evidence procedures
- Completeness – Policies and procedures are aligned to contractual agreements in place
- Measurement – Risk registers are in place and regularly updated and mitigation actions are in place
- Timeliness – Policies and procedures are regularly reviewed and updated as necessary
- Regularity – Documentation is complete, accurate, not excessive and is compliant with data retention policy. It is stored securely and made available only to appropriate members of staff.

3. RISKS CONSIDERED

- Reputational risk to the Council in not delivering programme
- Inappropriate governance arrangements.
- Insufficient external funding
- Insufficient capacity/skills for dealing with number of projects
- Delivery timeline
- Inadequate monitoring of projects;
- Failure to report progress and performance.

4. AUDIT OPINION

The level of assurance given for this report is Substantial

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:

Scope 1: Review Governance arrangements

- It was evidenced that the Council received approval to proceed with the Lorn Arc TIF from the Scottish Government in May 2014. The approval letter stated “After due consideration, The Scottish Ministers approve the project set out in the Business Case as a ‘TIF project’”.
- A Project Initiation Document (PID) is evidenced as being in place and amongst other things sets out the arrangements for governance and management of risks, issues and dependencies:
- The PID specifies both the internal and external governance reporting committees namely:
 - Policy and Resources Committee - Internal
 - Oban Lorn and Isles Area Committee -Internal
 - Lorn Arc Programme Board -Internal
 - Lorn Arc TIF Executive -External

The PID clearly defines the roles and responsibilities of the various committee’s including their delegated responsibility for decision making, the frequency of meetings and the membership required of both the Lorn Arc Program Board and the Lorn Arc TIF executive. A review of the relevant minutes confirms appropriate representation and compliance with the agreed timetable.

- Roles and responsibilities in relation to delivery of the programme have been clearly set out within the PID, as also have the roles and responsibilities of Argyll and Bute Council, the Scottish Futures Trust and the Scottish Government.
- The PID was approved by Argyll and Bute Council in January 2015 and included the following significant areas:
 - Approval to borrow under the TIF regime for Lorn Arc programme capital costs
 - Approval of the governance arrangements for the Lorn Arc programme, including the roles of the Policy and

- Resources Committee and Oban, Lorn and the Isles Area Committee
 - Approval of a 6 year revenue budget for the Lorn Arc programme team/office utilising the balance on the General Fund earmarked to support the Single Outcome Agreement (SOA)
 - Approval of the process for individual project start-ups, including the borrowing required for feasibility work and Full Business Cases for each project
 - Approval to delegate delivery of the projects to the Executive Director of Development and Infrastructure, in conjunction with the Head of Strategic Finance and the Head of Customer and Support Services, following Policy and Resources Committee approval of the individual Full Business Cases
 - Approval to nominate the Executive Director of Development and Infrastructure to be the Council's nominated representative on the TIF Executive
- The PID sets out the primary tasks of the Councils internal committees relating to governance namely to:
 - Monitor performance of the Lorn Arc programme
 - Consider resource allocation to ensure delivery of the Lorn Arc programme
 - Consider resource requests for start-up costs to enable preparation of Full Business Case (FBC) for each identified TIF Asset project
 - Consider detailed FBCs for the 7 specific TIF Asset projects

A review of the monitoring procedures as outlined within the PID is set out below in relation to scope 2 of the audit report.

- Resource allocation/issues have been addressed by each of the committees tasked with overseeing of the TIF projects and it was noted from the latest Policy and Resources (P&R) committee papers dated October 2016 that a full complement of staff is now in place. A review of previous committee minutes noted that project resources have been an ongoing issue and that this could have an impact on project completion dates. A comparison of project start dates between the original schedule as laid out in the PID and the latest start dates as presented to the P&R committee in March 2016 shows that that all 7 projects have been delayed by circa 18 months.
- The original PID initially referred to 9 projects being considered under the Lorn Arc TIF heading but subsequently this has been reduced to 7 as a result of the removal of 2 Barcaldine projects. It was evidenced that the removal of these 2 projects was approved by the P&R committee.

- Current status of the 7 projects includes 3 projects at start up stage and 1 project at FBC stage. Appropriate authorisation has been given by the P&R committee to reach these stages. A review of the FBC showed that documentation was complete and adhered to Prince 2 project principles.
- The Scottish Government award letter outlines key dates for the TIF project, one of which is December 2020 whereby all TIF projects should be practically complete unless otherwise agreed with the Scottish Government. It was noted from the project risk register that there is a high risk that all projects will not be completed by December 2020.
- A review of the PID documentation showed that it was broadly in line with Prince 2 management principles, which have been adopted by the Council in regard to large capital projects, although it was noted that there was no evidence of a programme chart (Gantt chart) showing each project's timeline having been prepared.

Scope 2: Review monitoring procedures and reporting arrangements

- It was evidenced that the PID sets out the monitoring arrangements in place for each of the committees, their roles and responsibilities and their reporting frequencies. An extract from the PID is as follows:

<u>Committee</u>	<u>Roles and responsibilities relating to Lorn Arc</u>	<u>Nature and frequency of reporting</u>
Policy and Resources Committee	Delegated policy and financial decision making powers. To agree resource / funding allocation to enable TIF Asset projects to be taken to Full Business Case through committee reports. To agree Full Business Cases for each subsidiary TIF Asset project. To agree draw down of funding for each TIF Asset project.	Update report required on quarterly basis TIF Asset project start-up cost request reports. TIF Asset project Full Business Case reports and associated delivery funding. TIF Asset Exception Reports

OLI Area Committee	<p>Power of influence to make recommendations to the Policy and Resources Committee.</p> <p>To be informed about what is happening/planned and to give member/local feedback.</p> <p>Public Place for giving out information to all sectors in addition to wider and targeted communications plan.</p> <p>To be given more detailed information about what is happening / planned in relation to the overall programme and specific TIF Asset projects as they emerge. By nature most of these would be exempt items due to private partner interests.</p>	<p>Reports to make recommendations to the Policy and Resources Committee</p> <p>Update report - frequency on quarterly basis</p> <p>TIF Asset project start-up cost request reports.</p> <p>TIF Asset project Full Business Case reports and associated delivery funding.</p> <p>TIF Asset Exception Reports</p> <p>TIF Asset project completion reports.</p>
Lorn Arc Programme Board	<p>Provide Steerage to program managers and report back to Committees as required.</p>	<p>Members to include Director of Development and Infrastructure, Head of Service for Customer Services, Head of Finance representatives.</p>
Lorn Arc TIF Executive	<p>To perform a monitoring and evaluation role.</p>	<p>Members to include Scottish Government, Scottish Futures trust and Argyll and Bute Council representatives.</p>

- A review of the documentation forwarded to both the P&R Committee and the OLI Area committee shows that both committees have been furnished with reports as stipulated within the PID. The reports were found to be comprehensive giving a summary of ongoing issues for each of the 7 projects included within the TIF programme. However, there was no evidence of a project programme detailing the start/end dates of each project as recommended within the PID

- The PID states that “a Programme Manager will be responsible for the day-to-day financial management of the Lorn Arc TIF programme, and the subsidiary TIF Asset projects, ensuring that it produces the required outcomes, to the required standard of quality and within the specified constraints of time and cost. The Programme Manager will be responsible for monitoring progress, controlling the budget, ensuring the necessary resources are secured to deliver the TIF Asset projects they are directly responsible for and will act as the primary point within the Council for the Programme.”

It was evidenced that a Programme Manager has been appointed and is undertaking the required reporting protocols. An example of which is outlined below;

- Update reports on each of the projects
 - Monitoring of revenue budget through liaison with Strategic Finance
 - Monitoring of capital budget through liaison with Strategic Finance
 - Employment of resources for delivery of programme
- Highlight reports should be submitted by the Programme Manager specifically for presentation at the Programme Board meetings. The reports should “highlight progress made versus plan, changed risks, deviation from plan, resources required and financial and budgetary matters.” The highlight reports reviewed cover the following areas and were found to include the required criteria. These reports cover both individual projects as well as an overarching programme report.
 - Key areas completed in period
 - Key areas outstanding
 - Revised delivery date for projects
 - Key areas to completed in next reporting period
 - Project delivery date
 - Risk register
 - Project cost spend to date
 - Revenue budget
 - Affordability model (with narrative explanations)
 - It was evidenced that update reports have been prepared and forwarded to each of the relevant committees for both revenue costs and capital costs; highlighting approved funds spent to date and outstanding balances. There was no evidence of a projection of final capital costs for projects currently underway.

- It was noted that the P&R committee agreed revised reporting tolerance levels i.e. the projects in February 2016 namely;
 - Project schedule +/- 2 months on agreed completion
 - Project budget +/- 5% on agreed budget subject to a minimum of £50,000

The governance arrangements state “If the timescales or cost of the programme is likely to exceed the agreed tolerance levels, the Programme Manager will produce an exception report which will be sent to the Programme Board to inform them.”

Scope 3: Review financial management arrangements including modelling, budgeting and general controls

- As stated above, the TIF investment allows Argyll and Bute Council to borrow funds of £18.9m based on the strength of future revenues raised on additional non-domestic rates (NDR) along with other revenues such as uplifts in leases, council tax and berthing dues across the entire Lorn Arc TIF Programme Area. Within the overall Lorn Arc programme sit the 7 specific projects. Each of these projects will have its own FBC which should include financial modelling both discretely for the project itself and on how this impacts on the wider programme. It was evidenced that financial modelling has been prepared to ascertain the affordability of each of the projects based on expected NDR and other revenue streams by project and also more importantly on how this impacts on the wider programme. The modelling includes the following criteria;
 - Expected NDR income till 2040
 - Sensitivity analysis on NDR fluctuations over period
 - Sensitivity on interest rate changes
 - Sensitivity on inflation changes
 - Sensitivities on project delay
 - Project cost sensitivity

Recent Committee minutes state that Commercial agents have been appointed to challenge the Economic model presented in the original 2013 Lorn Arc Programme FBC. Specifically the OLI Area Lorn Arc update report of October 2016 stated that “the TIF financial model was unlikely to generate the required increase in NDR to pay off the intended borrowing of £18.9m over 25 years.” It was noted that the Commercial agents report was completed in October 2016 and is currently under review by Council Officers to ascertain the impact on the financial model in regard to affordability of all projects.

- Project management cost centres have been created which cover the costs of the Lorn Arc Programme team. These cost centres are subject to periodic budget monitoring review in line with Strategic Finance reporting requirements. It was evidenced that the Programme Manager has presented budget monitoring reports at the appropriate Programme Board meeting.
- It was evidenced that a TIF asset capital cost centre has been created within the ledger for each of the 3 projects currently underway. These cost centres are subject to periodic budget monitoring review in line with Strategic Finance reporting requirements.

Scope 4: Risks have been identified and mitigated against

- It was evidenced that a risk register has been prepared for each of the projects currently underway and that an overarching TIF Programme register has also been prepared.
- Active risk management is in place for each of the risks identified within the various risk registers; although it was noted that mitigating actions are in place along with a designated risk lead for only 3 of the 4 risk registers. In addition, it was evidenced that scoring assessments have been carried out for each risk identified and the minutes from Programme Board meetings show that risks have been re-evaluated.
- Examples of risks detailed in the overall programme risk register are;

<u>Potential Risk</u>	<u>Risk</u>	<u>Mitigation Actions</u>
Construction cost projections increase leading to underestimate in the Financial Model	High	Regularly revisit costings.
That the financial regime for Local Authorities does not remain sufficiently stable to deliver the programme	Medium	Keep LA funding regime and Council finances under review
Insufficient capacity /skills for dealing with this number of projects simultaneously	Low	Appointed programme/ project managers have skills and proven experience in the delivery of multiple

		project programmes. Approved PID outlines the internal and external resources required, provision for these in the approved revenue budget.
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It was noted from a review of the risk registers that high risks were centred on the complexity of the funding model, delivery of the programme by 2020 and the increase in constructions costs and lack of private investment. It was evidenced that the risk registers are regularly monitored by Members, the TIF Executive and the Lorn Arc Programme Board.

6. CONCLUSION

This audit has provided a Substantial level of assurance as Internal Control, Governance and Management of risk is sound; however there are minor areas of weakness which put some system objectives at risk. There were a number of findings identified as part of the audit and these, together with agreed management actions, are set out in the attached action plan. There were 3 actions which will be 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 project 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. Program Chart		High/ Medium or Low		
No evidence of programme chart showing each projects timeline having been prepared.	Failure to adequately plan leads to potential project overrun resulting in loss.	High	Overarching programme chart will be prepared	Programme Manager 31 December 2016
2. Cost projections				
There was no evidence of a projection of final capital costs for projects currently underway.	Failure to provide ongoing capital cost projections for projects underway may lead to potential cost overruns.	Medium	Capital projection to be carried out	Programme Manager 31 December 2016
3. Risk Registers				
No mitigation actions in place in respect of 1 of the risk registers.	Failure to provide mitigation actions against risks may result in risks being realised leading to loss.	Medium	Mitigation to be inserted into risk register	Programme Manager 31 December 2016



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