INTERNAL AUDIT, RISK & COMPLIANCE SERVICES

Argyll & Bute Council

Internal audit report – Budgetary preparation

18 June 2009

Report Number 002

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Margaret Moncur	Finance Manager, Operational Services.	Bruce West	Head of Strategic Finance
		Ian Nisbet	Internal Audit Manager

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Executive summary

Summary of objective and scope

As part of the 2008-09 internal audit plan, as approved by the audit committee of Argyll and Bute Council ("the Council"), an internal audit review of budget preparation was performed in February and March 2009.

The overall objective of this review was to consider the processes and controls to manage budget preparation between corporate (i.e. senior management team) and departmental level. This review focused on the operational services directorate, but the findings may be equally applicable across other areas of the Council's operations. The review's focus was the revenue budgeting process.

The specific objective, scope and approach are detailed in Appendix 1.

Background

An effective system of budgetary control is the cornerstone of sound financial management. It is therefore important that senior management and the audit committee have assurance that budgetary controls are both designed and operating effectively.

The Council's annual resources is based on an allocation from the Scottish Government, along with the expected revenue from other sources, key elements of which are from council tax and rent. For 2009-10 the overall approved budget for the operational services directorate is £32.7 million.

Historically, on an annual basis, each directorate is allocated a budget based upon the previous year, plus an incremental increase. The 2009-10 budgeting process the Council has adopted is a similar approach, however a greater emphasis has been placed upon directorates basing budget submissions on risks and opportunities, which in turn supports the allocation process. The budget setting process for directorates begins in August with final budgets submitted to corporate by January. Directorates build their budgets around the services within each directorate and use a defined cost centre structure to allocate expenditure. Heads of services within each directorate are responsible for individual budgets, with delegated budget responsibility assigned for specific cost centre level budgets. The operational services directorate consists of two areas, roads and amenity services and facility services which between them have 775 cost centres. The February Council meeting approves the individual directorate budgets and overall budget for the forthcoming financial year.

During the financial year individual directorates manage their own budgets. Variances to approved budgets are monitored on a monthly basis, with reports issued to all budget holders detailing actual spend to date compared to budgeted. Budget holders are required to submit explanations to finance for any overspend and how it will be rectified in future periods. A traffic light system is used to grade variances.

Best Value review of strategic finance

During the course of our review we identified some weaknesses based on testing and discussions with management. A number of these matters had also been identified as part of the Best Value review of strategic finance which was completed in February 2008. The Best Value review identified a number of specific actions that were categorised under three themes:

- theme 1 – improved financial management;
- theme 2 – actions to support improved financial management; and
- theme 3 – performance within strategic finance.

We reviewed these individual themes and identified detailed actions contained against all three. These actions included clear explanations of the main features that will be addressed by management. A consolidated action plan for all three themes and actions has been developed defining timetables and individuals responsible. At present a dedicated resource has been allocated to drive and

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monitor progress against this consolidated action plan. Additional resource has been identified to support delivery from within the finance functions in each of the directorates.

The three issues identified from our project were confirmed to be included within the consolidated action plan and referred to in detail within the key features of the relevant individual actions. The specific issues identified are described within the following sections.

Ownership and financial awareness

Our discussions with management found that in many instances the finance teams are actively managing the budgets on the budget holders' behalf and notifying the budget holder of changes to budgets. Management also indicated that many budget holders are not 'financially-minded' and therefore do not fully understand the financial information that is regularly presented to them.

This could result in budget holders not assuming full responsibility for their budget or understanding where variances within their budgets are arising. By performing budgetary duties on behalf of the budget holders, the finance team may be removing any incentive for budget holders to understand or manage their budgets.

It was also noted that there is no formal documentation to evidence that budget holders have accepted the budgets that they have been assigned responsibility for a specific budget. Budget holders should be required to formally accept the budget they have been allocated at the start of the year. This will ensure that responsibility and ownership is clearly evidenced and more importantly allows engagement with any new budget holders to ensure clear understanding of their roles, responsibilities and accountabilities.

Management are looking to develop a series of initiatives including a program of basic financial training which will be rolled out to budget holders across the Council. This should ensure that all budget holders have a minimum level of financial knowledge to accurately interpret and manage their own cost centre budgets, rather than them being managed by the finance teams.

Commitment accounting

Discussion with finance at both corporate and divisional level identified that there is no consistent and robust process to identify commitments. Therefore when variance analysis is performed between actual and budgeted spend, no account is taken of any future commitments entered into. There is a risk that budget holders interpret reports in error believing their cost centre to be in a better financial position due to the commitments not being included.

Management have acknowledged this and are considering, as part of the budget monitoring and reporting process, incorporating commitments. This will allow budget holders to obtain a more up to date understanding of the financial position and of the level of resources or available spend remaining.

Budget reporting

Discussions with management found that budget monitoring reports are issued for every cost centre within the Council. Within operational services alone, 775 reports are being issued on a monthly basis, and across the Council an estimated 2,000-3,000 reports are issued.

This process of analysing and producing reports is time consuming and results in finance teams spending long periods analysing, collating and issuing reports, time which may be required by the finance teams in other operational areas. There is a risk that staff and office resources in the finance teams are being used inefficiently.

Management have committed, within the consolidated action plan, to implement a more streamlined financial reporting process to provide budget holders with more responsive financial management information and to ensure efficient use of financial and function resources. The Best Value report identified that the current reporting process was inflexible, resource intensive, bureaucratic and costly. In terms of cost saving a target of around £177,000 was identified by management as achievable with clearer roles and responsibilities and wider access to financial information to budget holders.

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Key findings and recommendations

The findings identified during the course of this internal audit are summarised below. A full list of the findings and recommendations are included in this report. Classification of internal audit findings are detailed in Appendix 2.

	High	Medium	Low
Number of internal audit findings	-	2	1

These findings and recommendations relate directly to the operational services directorate and were discussed with management who have accepted the findings and have agreed actions to address the recommendations. The applicability of these recommendations should be considered across other areas of the Council's operations.

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Executive summary

Summary of internal audit findings

Ref #	Description of internal audit findings	Rating of internal audit findings			Target date
		High	Medium	Low	
1	**Virement approval:** Testing identified a number of exceptions where virements within and between cost centres were not being formally approved.				30 September 2009
2	**Budget variance reporting:** Inconsistent reporting of budget variances was identified leading to variances not being documented or captured. The current triggers for variance reporting may not always be appropriate for smaller budgets.				1. 31 December 2009 2. 30 September 2009
3	**Budget cut off process:** Operational services does not have a documented timetable to ensure that their budget submissions to corporate are achieved on time.				31 October 2009

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Internal audit findings to be actioned

1. Virement approval		Rating of internal audit finding: Medium
Finding(s) and impact	**Recommendation(s)**	**Agreed Management action(s)**
An essential activity of managing budgets is the need to make changes to agreed budgets during the course of a financial year. We considered virements at two levels: • virements within a cost centre budget; and • virements between cost centre budgets. Our testing confirmed that no documented procedures were available for virements within cost centre budgets. Management rely on the bottom line budget number remaining unchanged on a day to day basis as assurance that budgets have not been adjusted incorrectly. There is a risk that funds could be moved within budgets and variances analysis could be distorted without the 'bottom line' changing. The Council's financial regulations require that virements between cost centres must be approved by the head of service up to £25,000 and above this level must be approved by the relevant director. Testing found that this approval process is not being consistently applied when virements are made between cost centres. The changes are regarding by management as 'copy budget changes' and management do not seek approval. This is not in line with the Council's procedures. The virements process between head of services budgets within the operational services directorate could not be examined due to the organisational restructuring exercise that took place during the year.	Management should review the Council's financial regulations, ensuring that all staff are aware of the requirements. Particular focus should be upon ensuring the following controls are implemented and adhered to: 1) Virements within a cost centre budget should be reviewed on a regular basis by senior management and all virements should be signed off as authorised by the budget holder and by the accountant that processes the virement. 2) Virements between cost centre budgets should adhere to an authorised approval process, which at present requires the approval by the head of service.	**Action:** Agreed. Introduce a sign off procedure, whereby the head of service will sign off virements processed within a budget monitoring month. The accountant who processes the virement will also authorise that the virement has been processed. **Responsibility:** Bruce West **Target Date:** 30 September 2009

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2. Budget variance reporting:

Rating of internal audit finding: Medium

Finding(s) and impact	Recommendation(s)	Agreed Management action(s)
Variations from budget should be communicated and explained to the finance teams on a monthly basis. Variances only need to be reported to the senior management team if actual spend exceeds +/- £25,000 of budgeted spend. However, this fixed monetary amount could lead to large variances within small budgets (e.g. a £5,000 variance in a £10,000 budget) not being required to be reported. This could lead to key issues within smaller budgets not being recognised, which may have a significant cumulative effect. Our discussion with management confirmed that the process for discussing variances below £25,000 was being inconsistently completed by budget holders. Budget holders are required to explain variations on a monthly basis by emailing a variance return to the finance teams. Our testing found that this process is not being used, with most explanations being given verbally, either over the telephone or in person. Instances were found where these explanations, although known by the finance teams, were not documented. This results in a break in the audit trail and a risk that the explanation for some variances may not be fully understood and documented. Discussions with management identified that there is no formalised or documented process throughout the year to assess the risk profile of significant items of revenue and capital expenditure. A detailed risk assessment process was identified during the budget preparation process to create the budgets as well as to determine a reserve policy for the Council. This proactive and continuous consideration of risks linked to income and expenditure is critical, particularly in the current economic climate. In addition, this could have a significant effect on budgets where they rely on income received in order to fund expenditure and therefore the service plans may not be achieved.	1) Management should consider reviewing the budget variance reporting trigger mechanisms. A percentage system along the same lines as the overall service budgets reporting mechanism (i.e. 5% variance or greater than £100,000) should be considered by the Council whereby where any budget variances over a set percentage, including an appropriate diminimus limit require an explanation of the variance from the budget holder. The variance reported should be in terms of projected outrun at the end of year. 2) Explanation of variations should be in a written format and documented on the appropriate return by the budget holder. The pro forma for budget variance should be completed by finance to ensure that all required information to explain and deal with the variances are consistently recorded.	**Action:** 1. Agreed. Management will review the budget variance reporting trigger mechanism in line with timescale alongside reviewing budget monitoring within the Best Value review of strategic finance. **Responsibility:** Bruce West **Target Date:** 31 December 2009 2. Agreed. Ensure that budget variance pro-forma's are being used consistently by departments. A record of discussions with budget holders regarding variances should be kept with the variance report. **Responsibility:** Bruce West **Target Date:** 30 September 2009

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3. Budget cut off process		Rating of internal audit finding: Low
Finding(s) and impact	**Recommendation(s)**	**Agreed Management action(s)**
We identified from discussions with management that a corporate budget preparation timetable exists that encapsulates all the directorates within the Council. However, within operational services this review found there is no documented timetable to ensure that the budget submissions due to corporate are submitted on a timely basis. This has led, during the year, to the information being submitted late holding up the Council's budget setting process. There is a risk that staff could be unaware of deadlines for budget submissions due to a lack of a defined timetable. Any functional budget preparation timetable should be synchronised with the corporate budget preparation timetable.	Management should retain a single corporate timetable for budget preparation however this should incorporate the critical dates that are relevant to each functional budget preparation timetable. These may differ for each directorate by nature of there differing levels of complexity. This should be issued to all staff within departments detailing deadlines to be met, submissions to be prepared and responsibility for preparing the information.	**Action:** Agreed. Corporate timetable for budget process should include critical dates relevant to each service. **Responsibility:** Bruce West **Target Date:** 31 October 2009

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Appendix 1 – Objective, scope and approach

In accordance with the 2008-09 internal audit plan of Argyll & Bute Council ("the Council"), as approved by the audit committee, an internal audit of the budget preparation and monitoring cycle is to be performed.

Objective

To consider the processes and controls in place to manage the budget preparation and monitoring process within the corporate and departmental level entities.

Scope

Based on the objective outlined above, the scope of the review was to:

- consider whether a budget cycle was established to ensure that budgets were promptly prepared;
- consider the controls and processes established to ensure that virements and other amendments to budgets are authorised by the appropriate level of authority;
- consider the controls and processes established to ensure that budget variances were highlighted and reported on a timely basis;
- consider the controls and processes established to ensure the budgets are recorded on the FIS accurate;
- identify the processes adopted to communicate budgetary responsibility to budget holders; and
- on a sample basis, tested compliance with the identified policies and procedures.

Exclusions

The project did not consider the capital budgeting process.

The project will be completed from the Manse Brae Office in conjunction with visits to the Kilmory Office and focus upon the operational services function.

Approach

The internal audit will be conducted by holding discussions with key members of Council staff, considering available documentation and performing test procedures as appropriate.

Key staff members with whom we will hold discussions include:

- Moira Miller, Corporate Accounting Manager;
- Margaret Moncur, Finance Manager Operational Services; and
- Morag Cupples, Senior Accountant.

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Appendix 2 – Classification of internal audit findings

The following 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 graded with management

Rating	Definition
High	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 it if were rectified.
Low	Observations 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.

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