



Argyll and Bute Council

Interim Management Report

June 2009

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Executive Summary

1.1 Introduction

Argyll and Bute Council (the Council) is required to have arrangements in place to ensure propriety, regularity and best value in its stewardship of public funds. It is the responsibility of management to have adequate systems of internal control in place to ensure that resources are applied to the activities intended, fraud is prevented and detected, and resources used economically, efficiently and effectively.

As part of our interim audit, we have reviewed:

- financial management and budgetary control
- core financial systems including fixed assets, treasury management, cash and bank and procedures for journals.

1.2 Findings

Core financial systems

Our overall conclusion is that the core financial systems continue to operate effectively. Our audit identified 7 performance improvement recommendations, none are categorised as high risk. Our key findings are outlined below:

- the fixed assets register is not updated or reconciled to the general ledger during the year, with all transactions processed at the year end. This increases the risk that errors or discrepancies will not be identified in a timely manner
- the Council should ensure all financial institutions that it is prepared to lend to are included on the counterparty list
- the Council has strong treasury managements to manage loans, borrowings and investments. The Council should review its treasury management policy to take account of interim CIPFA guidance following the collapse of the Icelandic banks

Financial management and budgetary control

Financial pressures within the sector will place an increasing premium on effective financial management, and it will be important that budgets are subject to robust challenge, remain affordable and reflect corporate priorities. As part of our 2008-09 audit, we followed up the Council's progress in implementing agreed recommendations from our 2007-08 audit report.

We found that the Council continues to have good arrangements in place for financial management and budgetary control and has significantly improved its arrangements for linking corporate priorities into the budget setting process. However, there remains scope for greater challenge within the budget setting process overall.

The Council has fully implemented agreed actions relating to our two high risk observations. Of the remaining five recommendations, three remain outstanding with two partially implemented. A summary of our follow up review findings is contained at Appendix B.

1.3 Way Forward

The findings and recommendations from our review are summarised in an Action Plan that accompanies this report. The Action Plan has been agreed with management and incorporates the management response to audit recommendations.

This report includes some specific recommendations to strengthen internal controls. It is the responsibility of management to decide the extent of the internal control system appropriate to the Council.

1.4 Acknowledgements

We would like to take this opportunity to thank Council staff who have been involved in this review for their assistance and co-operation.

This report is part of a continuing dialogue between the Council and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on it.

Grant Thornton UK LLP
June 2009

1 Core financial systems

1.1 Introduction

As part of our interim audit, we have reviewed the systems of internal control for the following core financial systems and accounting processes:

- fixed asset management
- treasury management
- cash and banking
- journal preparation and authorisation

We reviewed the work of internal audit for key controls tested covering the debtors system, expenditure and accounts payable, payroll, council tax and non domestic rates, and housing benefit. We are able to place reliance on the work of internal audit and have not raised any control weaknesses in these areas.

We have noted the following key points arising from our audit in the sections below.

1.2 Fixed assets management

Findings

The fixed asset register is not updated or reconciled with the ledger until the end of the financial year. This increases the risk that errors or discrepancies in the processing of capital transactions are not identified in a timely manner.

Action plan point 1

1.3 Treasury Management

Introduction

The Council's treasury management system is not only designed to ensure that sufficient cash is available on a day to day basis to support revenue and capital commitments it also ensures that the costs of borrowing are minimised within an appropriate risk based strategy, whilst optimising returns from investing surplus cash within risk constraints. The Council is expected to maintain appropriate key controls to ensure that the system is designed and operating effectively.

Following the collapse of the Icelandic Banks in Autumn 2008, treasury management at public bodies has come under increasing scrutiny. The Accounts Commission for Scotland undertook a high level review of treasury management arrangements at local authorities in Scotland, including Argyll and Bute during the financial year. This review raised no material matters in relation to the Council's arrangements.

Counterparty limits

The Council has monitoring arrangements in place to assess credit risk for banks and building societies that it is prepared to lend to. In addition a register of agreed counterparty limits is maintained for each approved bank and building society which sets out the

maximum amount that can be deposited by the Council in any single institution and the maximum term of any deposit. The register is based on advice provided to the Council by their treasury management advisors and is formally approved by the Head of Strategic Finance.

During our 2007-08 audit, we noted that a counterparty limit had not been set for the Council's bankers. The Council does not place a formal counterparty limit on its own bankers as they consider it difficult to estimate what the limit should be as it needs to be sufficient to allow for movement of cash when carrying out debt rescheduling exercises and large receipts in respect of central government funding. As part of the daily treasury management activities, the available cash is reviewed and sums are invested with other institutions to spread the risk as appropriate.

During our audit, we noted that the credit reference agencies have placed a 'negative watch' outlook on this institution. We consider that a counterparty limit should be established for deposits in investment accounts outwith the Council's main current accounts. This would contribute to the existing risk management systems employed by the Council to minimise counterparty risk for deposits exceeding overnight.

Action plan point 2

CIPFA guidance on treasury management arrangements

CIPFA issued an interim guidance note on treasury management arrangements, *Treasury Management in Local Authorities- Post Icelandic Bank collapse*, in March 2009. The guidance note provides advice to local authorities in updating their treasury management arrangements following the financial crisis in the banking sector and the collapse of the Icelandic banks.

As part of our audit we reviewed the Council's treasury management arrangements against the good practice guidelines set out by CIPFA. Our key findings are noted below:

Recommendations	Council position
Elected members should be involved in key decisions for the treasury management function	The Council has discussed with their treasury advisors how best to address this issue and a training session is being planned. Members continue to approve the treasury management strategy, and receive quarterly reports on treasury management.
The Council should report the difference between net debt and gross debt to members on a regular basis	A quarterly report is issued to members as part of treasury management monitoring procedures. The report highlights the net and gross debt positions.
The Council should formally review training requirements for key officers and members involved in treasury management	The Council has a team of experienced officers in the treasury management section, and training is provided on an ad-hoc basis by the Council's treasury advisors.
The Council should consider sector and country limits of financial institutions	The Council considers sector and country counterparty risks, but these are not formally

when setting counterparty limits	documented in the counterparty list.
All three credit rating agencies should be used to assess financial risk and the lowest rating should be used when making lending decisions	The Council currently use two of the three credit rating agencies, which provides adequate coverage of the institutions on the counterparty list.

Our review noted that the Council already incorporates elements of the interim guidance in their treasury management strategies but should consider formally incorporating suggested best practice when treasury management policies are next updated.

Action plan point 3

1.4 Cash and bank

Bank reconciliations

We found that the income bank account reconciliations for April and May 2008 had not been performed or reviewed in a timely manner, however, management have taken action to ensure all subsequent reconciliations are completed and reviewed on a timely basis.

The complicated manual process the Council employs to reconcile the income bank account has introduced additional complexity into the reconciliation process and resulted in un-reconciled items each month. A new automated bank reconciliation process has now been implemented which should correct this matter going forward and we will audit the new reconciliation arrangements as part of our 2009-10 audit.

Our audit also found that deposit bank account reconciliations are not always reviewed by an independent officer increasing the risk that fraud or error may go undetected.

Action plan point 4

Dormant bank accounts

In our 2006-07 and 2007-08 audits, we reported that several bank accounts were not recorded in the Council's ledger. During 2008-09, the Council carried out a review of its banking arrangements and identified a number of bank accounts as surplus to requirements. Arrangements have now been made to close these accounts.

CHAPS transfers

The Council process same day bank transfers using the CHAPS system on a regular basis. Procedures are in place to ensure CHAPS transfers are signed off by a member of the treasury management team and subject to independent review. We identified 2 weaknesses with the current arrangements:

- the system allows for the development finance manager to both prepare and authorise CHAPS transfers, although this has never happened in practice
- internal audit managers are included in the list of CHAPS authorisers and this may compromise their independence.

The Council plan to review CHAPs authorisation procedures when a new web based banking system is introduced during 2009-10.

Action plan point 5

2 Financial management and budgetary control

2.1 Introduction

Our 2007-08 audit found that there had been significant changes to the Council's approach to financial management and budgetary control driven mainly by the move to a three budget cycle. This was in response to the changes in the funding settlements implemented by the Scottish Government with the introduction of the Local Authority Concordat, and the Single Outcome Agreement.

Our 2007-08 audit made a number of recommendations to improve financial planning and control arrangements. As part of our 2008-09 audit, we followed up the Council's progress in implementing the agreed recommendations.

2.2 Budget setting

The Council have made progress in improving the transparency of the linkage between corporate priorities and budget setting. Budgetary requirements for strategic objectives are incorporated in the draft 2009-12 Corporate Plan and service department budgets are now more clearly linked to strategic objectives.

Best value improvement plan

In addition, a best value review of Strategic Finance was carried out during the year resulting in the creation of a 2 year action plan covering the period to June 2011. With regards to financial management and budgetary control, the Council plans to improve the quality and effectiveness of current arrangements and has set key tasks to achieve this, including:

- development of a long term financial model
- review of the current financial strategy
- review of the budget setting process, including the use of rolling forecasts and a challenge process for budget assumptions
- development of a new policy for year end flexibility for unspent budget allocations
- development of a policy on income generation

Achievement of the best value action plan represents an ambitious and challenging target for Strategic Finance, but should result in significant improvement in the Council's overall financial management arrangements.

We will continue to monitor the Council's progress of achievement during the 2009-10 audit year.

2009-10 Budget

Service departments were allocated their 2008-09 budget with a 1% uplift. Inflationary factors were analysed separately for key cost drivers such as salary and utility costs. Departments then drafted their budgets in line with their revised allocation. The draft budgets were reviewed by the senior management team (SMT), who considered the impact on the corporate plan and the strategic risk registers. In addition service department bids for new budget allocations were reviewed against the corporate priorities and risk registers by SMT prior to approval.

The revenue budget continues to be set on an historical basis uplifted for inflation or to take account of new expenditure commitments. A key task going forward for the Council will be to ensure existing budget assumptions are subject to rigorous review, continue to remain affordable, and reflect corporate priorities.

Action Plan Point 6

2.3 Budget virements

Our 2007-08 audit found a weakness in the audit trail supporting approval of budget virements by the Head of Strategic Finance. As part of our 2008-09 audit, we tested a sample of five virements and noted that only one had evidence of notification in line with the requirements of the virement policy.

We also noted that there are a significant amount of budget transfers within service departments processed throughout the year. These transfers are also covered by the virements policy and require authorisation by the Head of Service. However, in many cases the transfer form is signed off by the officer who processed the transfer with no evidence of authorisation or review. In addition, the paperwork for these transfers are retained in each department and there is no central record held in Strategic Finance.

Action plan point 7

2.4 Reserves

For the year ending 31 March 2008, the Council had a total general fund reserve balance of £31 million, of which £26.1 million was earmarked for specific purposes, and £4.9 million was unearmarked. Table 1 shows the breakdown of the main general fund balances at 31 March 2008.

Table 1: General Fund balances as at 31 March 2008

	Balance as at 31 March 2008 £'000
Total General Fund	31,006
of which: Earmarked	
PPP Smoothing Funds	11,719
Social Housing	4,916
Grant Income carried forward	1,951
Budget carried forward	5,915
Funding committed to 2007-08	1,597
Total Earmarked	26,098
Unearmarked	4,908

Source: Argyll and Bute Council

Our 2007-08 audit, found that:

- there is scope for greater transparency in the plans the Council has to utilise reserves currently earmarked within departmental budgets
- the decision to reduce the target for available un-earmarked reserves to 1.5% of net operating expenditure was not based on a full risk assessment of future financial requirements. The revised target is unlikely to be achieved for the 2008-09 financial year, which could present a risk to the achievement of corporate objectives.

During 2008-09, the Council revised its reserves policy and developed parameters for the general fund and a risk assessment for the determined level of unearmarked reserves held for contingencies. The risk assessment supported the proposal to set the level of unearmarked reserves at 1.5%.

A separate paper has been produced to increase the transparency of the plans to utilise earmarked reserves, and this will be presented with the draft financial statements in June 2009. We will review this paper and conclude on this audit point in our final report on the 2008-09 audit.

A Action plan

No	Finding	Risk	Recommendation	Management Response	Implementation Date
Core financial systems					
1	The fixed asset register is not updated and reconciled with the general ledger until the year end. This increases the risk that errors or discrepancies will not be identified in a timely manner.	Medium	The Council should consider updating the fixed asset register throughout the year.	The Council consider that its approach to updating the fixed asset register minimises the risk of discrepancies occurring as input to the system is done in a controlled manner after having checked the nature of the capital expenditure and the assets on which spend has taken place.	N/A
2	There is no counterparty limit established for the Council's banker. We consider that a counterparty limit should be established for investments placed with the bank for periods greater than overnight. Credit reference agencies have recently downgraded their outlook for this bank.	Medium	The Council should establish counterparty for sums invested with its banker. This reduces the risk of lending to risky financial institutions.	A limit of £30 million has been agreed for investment deposits with the Council's banker.	Immediate
3	CIPFA have recently introduced interim guidance on treasury management for local authorities.	Medium	The Council already incorporates elements of this best practice in their treasury management strategies but should consider formally incorporating suggested best practice when treasury	The Council constantly keeps its Treasury Management policies and practices under review and will update these to reflect best practice as appropriate.	Treasury Management policies are reviewed once each year. This will be picked up once formal guidance issued

No	Finding	Risk	Recommendation	Management Response	Implementation Date
4	We noted that bank reconciliations for deposit accounts are not always authorised by a senior officer.	Medium	All bank account reconciliations should be reviewed and signed off by a senior officer.	Agreed	Immediate
5	We noted minor weaknesses in the procedures for authorising CHAPS payments:	Low	The Council should consider amending its CHAPS procedures to ensure only appropriate officers can authorise payments.	Agreed	Immediate
Financial management and budgetary control					
6	The revenue budget continues to be set on an historical basis uplifted for inflation or to take account of new expenditure commitments.	Medium	The Council should review departmental budget assumptions to ensure they are subject to rigorous review, continue to remain affordable, and reflect corporate priorities.	The ongoing development of PPMF and in particular the programme of service reviews supported by a more structured challenge process for service plans and budgets will address this point. This will be commenced for 2010/11 budget but will be developed on an ongoing basis	February 2010
7	Transfers of budgets between departments are not currently subject to authorisation. In addition, there is no central list of budget virements processed by service departments.	Medium	The Council should introduce procedures to ensure all transfers between budgets in service departments. A central list of all virements should be retained by Strategic	Agreed	Immediate

No	Finding	Risk	Recommendation	Management Response	Implementation Date
			Finance to ensure there is corporate oversight over significant budgetary changes.		

B Progress in implementation of prior year recommendations

No	Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at May 2009
Financial management and budgetary control				
1	There is scope to make the linkage between corporate priorities and budget setting more transparent. Risk: Medium	The Council should undertake a further review of its budget setting arrangements to better demonstrate how corporate priorities are prioritized within the budget.	Planning and budgeting arrangements will be further developed in the coming planning and budgeting exercise. Head of Strategic Finance February 2009	Partially implemented The Council improved the process for linking budget setting to corporate priorities. The best value review highlighted actions to further improve budget setting arrangements.
2	Budget monitoring reports may not be fully effective in highlighting potential budget variances sufficiently early in the financial year for corrective action to be taken. Risk: Medium	The Council should adopt commitment accounting principles when preparing budget monitoring reports.	An approach to addressing this recommendation will be developed as part of the implementation of the Best Value review of Strategic Finance. Head of Strategic Finance Ongoing	Not yet implemented The best value review highlights action plans to address this recommendation. Budget monitoring arrangements will be reviewed by September 2009.
3	There was a lack of evidence of review of Budget virements by the Head of Strategic Finance as required by the Council's Financial and Security	The Council should ensure that all budget virements are authorised and reviewed in accordance with established procedures. A report of	A report of budget virements will be prepared each month and reviewed to ensure proper authorisation.	Partially implemented The Council is planning to implement a new system for

No	Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at May 2009
	<p>Regulations. Risk: Medium</p>	<p>budget virements processed should be prepared for review by the Head of Strategic Finance on a monthly basis to provide evidence that procedures are being followed.</p>	<p>October 2008</p>	<p>recording the authorisation of transfers and virements as noted in Appendix A, point 7.</p>
4	<p>There is scope to improve arrangements to provide greater transparency around departmental plans to apply all earmarked reserves. Risk: Medium</p>	<p>The Council should ensure there are clear plans to apply all earmarked reserves.</p>	<p>The report submitted to the Council with the unaudited accounts lists the department, description and reason for carry forward for each element of unspent grants, unspent contribution and budgetary underspends to be carried forward. Whilst consideration will be given to what form of challenge there should be on proposed carry forwards the Council should avoid a situation whereby it is setting the budget on a 3 year basis but enforcing annuality in terms of allowing the carry forward of underspends (or overspends). Further consideration will be given to how this recommendation might or might not be implemented. Head of Strategic Finance February 2009</p>	<p>Not yet implemented A separate paper will be brought before the Executive before the 2008/09 accounts will be finalised.</p>

No	Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at May 2009
5	<p>The revised target for unearmarked reserves has been calculated to reflect available funds as part of the budget setting process, rather than as part of a risk based assessment of the reserves balance required to be held to meet contingencies and respond to effectively to unforeseen events.</p> <p>Risk: High</p>	<p>The Council should develop a policy for determining the level of unearmarked reserves based on past experience and an evaluation of risk.</p>	<p>The current approach is based around general consideration of inflation and interest rate risk and historic budgetary performance and is laid out in a report to members as part of the budget pack each year. In view of the audit recommendation a more specific set of criteria will be developed for 2009-10.</p> <p>Head of Strategic Finance February 2009</p>	<p>Implemented</p>
6	<p>The Council has not yet set out how it will measure and report efficiency savings generated and performance systems are not yet in place to measure outputs and outcomes to support the measurement of efficiency.</p> <p>Risk: High</p>	<p>The Council should put in place mechanisms to record efficiency savings generated from the plan.</p> <p>Progress against the efficiency savings target should be reported on a regular basis to management and members.</p>	<p>This will be addressed</p> <p>Head of Strategic Finance December 2008</p>	<p>Implemented</p> <p>Service plans highlight efficiency savings and relevant success measures. These now feed into the Pyramid performance management system.</p>
7	<p>Efficiency savings targets are not yet linked to corporate priorities and incorporated within the budget setting process and this may not provide sufficient challenge to Council departments to achieve planned savings.</p>	<p>The Council should embed planned efficiency savings within budget setting arrangements.</p>	<p>Efficiency savings are currently budgeted in services but a review of the efficiency savings plan as part of the coming planning and budgeting round will review how it can be linked to corporate priorities.</p> <p>Head of Strategic Finance</p>	<p>Implemented</p> <p>Efficiency savings are now included in the Service plans. These are incorporated into the budget. As part of the budget setting process proposed efficiency plans are</p>

No	Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at May 2009
	Risk: Medium		February 2009	reviewed by the Executive and alternative saving/ funds identified if the efficiencies are not accepted.



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