

# Argyll and Bute Council

Interim Management Report

May 2010

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### 1

# 1 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 the effectiveness of the Council's core financial systems and financial management and budgetary control arrangements. In addition, we followed up the Council's progress in implementing recommendations agreed in our prior year interim report.

### 1.2 Findings

### **Core financial systems**

Our overall conclusion is that the core financial systems continue to operate effectively. Our audit identified 4 performance improvement recommendations, none are categorised as high risk.

### Financial management and budgetary control follow up

We reviewed the Council's progress in implementing agreed recommendations to improve financial planning and budgetary control arrangements. Overall, we concluded that the Council continues to closely monitor its finances and the impact of the deterioration of the wider public sector finances. The Council's efforts to improve the budgetary control environment are continuing and a three year cycle of service reviews in order to address a forecast annual funding deficit of £11m in 2011-13 has already commenced. Our audit found that the Council has identified several challenging issues in achieving its target:

- the need for service heads to identify 15% cost savings in their departments
- the impact of inflation, which has now increased above 3%
- the ongoing corporate restructure of the management team, directorates and services

As part of our audit, we will continue to monitor the Council's approach to budgetary control and consider the outturn for 2009-10.

### Implementation of 2008-09 action plan points

The Council has fully implemented agreed actions for 4 of our 6 prior year audit recommendations. Of the two remaining recommendations, one has been partially implemented, and the other is expected to be implemented in the first quarter of 2010-11, neither is considered high risk

### 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 May 2010

# 2 Core financial systems

### 2.1 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
- payroll
- expenditure and creditors
- treasury management
- journal preparation and authorisation

The key findings from our audit are detailed below:

### 2.2 Fixed asset management

We reviewed the operating controls for the fixed asset system, and confirmed that controls operate in accordance with the Council's policies and procedures. Key authorisation, monitoring, and IT security controls over the fixed asset system were found to be operating effectively. There are no new recommendations arising from our audit that we require to report to management.

### 2.3 Expenditure and creditors

We reviewed the operating controls for the purchasing system, and found that, in general controls, are designed and operating effectively. Two areas for improvement were found as a result of our testing:

### Verification of purchase invoice details

A control is in place whereby all invoices received by services departments should be stamped to evidence that details have been agreed to the relevant purchase order. Our testing has shown that this is not being used on all invoices, raising the risk that invoices are processed without being properly reviewed.

Action plan point 1

### E-procurement

The Council's e-procurement system (PECOS) holds information on the date goods or services have been received, however it is currently not possible for the creditors department to run a report showing all goods received where the invoice has not been matched to a purchase order. Such a report would act as a useful check on the completeness of the accruals process.

Action plan point 2

### 2.4 Payroll

We reviewed the operating controls for payroll system, and confirmed that controls operate in accordance with the Council's policies and procedures. There were no recommendations arising from our review.

### 2.5 Journal entry controls

Our audit of journal entries controls found that in general controls were operating effectively. We noted that current council policy requires a journal to be prepared by one individual, and posted by another to ensure an element of review, however, this check is not mandated by the financial system. We tested a sample of 25 journals and found one instance where the policy had not been adhered to. We would recommend that the Council consider introducing an IT control to prevent override of policy.

Action plan point 3

### 2.6 Treasury Management

### Introduction

The Council's treasury management system is designed to ensure that sufficient cash is available on a day to day basis to support revenue and capital commitments, and borrowing are minimised, whilst optimising returns from investing surplus cash within risk constraints.

The default of the Icelandic Banks in Autumn 2008 has led to increased scrutiny of treasury management at public bodies. CIPFA published updated treasury management guidance in 2009 (The CIPFA Treasury Management Code of Practice). The revised Code requires that authorities create and maintain, as the cornerstones for effective treasury management, a treasury management policy statement, suitable treasury management practices, and develop sound and structured internal reporting on treasury management policies, practices and activities. In addition the Code requires that responsibility for the implementation and regular monitoring of it treasury management policies and practices be delegated to the audit committee.

### **CIPFA** guidance on treasury management arrangements

At the time of our review the Council was in the processes of revising the treasury management policies to comply with the revised Code. The Council adopted the revised Code in June 2010.

We found that areas of the treasury management policy, in particular those covering service providers, had not been kept up to date. It is important that treasury management procedures continue to be reviewed and updated regularly to ensure continued compliance with best practice.

### **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.

Following recommendations made in our prior year report, a counterparty limit has now been introduced for deposits held with the Council's banker.

### **Deposit account reconciliations**

In our 2008-09 report we noted that deposit account reconciliations were not always reviewed by a senior member of staff. In our testing this year, we noted that whilst all account reconciliations are now reviewed, this was not done in a timely manner throughout the period.

Action plan point 4

# 3 Financial management and budgetary control

### 3.1 Introduction

The impact of the credit crunch on the global economy has led to a significant deterioration in the financial position of the UK government. This will translate into reduced public sector funding across all public services for the foreseeable future, with the likely impact taking effect on the Council's funding from 2011-12 onwards. As a result, there will be a greater premium on the effectiveness of the Council's financial management and budgetary control procedures.

The Council is aware of this challenge has responded by reviewing its cost base. A three year programme of service reviews has been put in place, in order to address the funding gap forecast for 2012-13 and 2013-14.

As part of our interim audit, we have reviewed the Council's progress in implementing agreed recommendations to improve financial planning and budgetary control arrangements. This will take into account the improvements to financial arrangements as a result of the best value review of Strategic Finance.

### 3.2 Budget setting

In our 2008-09 audit, we noted that the revenue budget continues to be set on an historic basis uplifted for inflation or to take account of new expenditure commitments. We recommended that the Council reviewed departmental budgets assumptions to ensure they continued to remain affordable and reflected corporate priorities. In response, the Council intended to use its ongoing programme of service reviews to adopt a more structured challenge process for service plans and budgets. As part of our audit, we reviewed the Council's progress in this area and noted the following:

- the Council has completed the first tranche of service reviews, covering one third of service departments. The remaining reviews will be carried out over the next two years. Service heads have been asked to identify 15% cost savings as part of the review process, and management consider savings identified to be achievable. However, it should be noted that identified savings include inflationary rises from the budget.
- the impact of inflation (particularly wage and energy inflation) remains a significant financial pressure. The Council has calculated that a 1% rise in inflation would result in a £2m increase in costs. The Consumer Price Index (CPI) as at March 2010 reached 3.4%, up 0.4% from the previous month. This may adversely impact the Councils ability to achieve targeted savings.
- service reviews have been carried out while a restructuring process is ongoing.
   There may be additional changes to service lines implemented by new heads of

service which have not been identified during this process. We will monitor the result of these in our 2010-11 report.

In the current period, the Council has reviewed the strategic risk register and
reflected strategic risks in its corporate and service planning process. Operational
risk registers are now formally reviewed each quarter. Service plans and budget have
been prepared to reflect risks identified, and are linked to strategic and operational
aims.

In the first year, some service reviews were performed on a less radical basis than others. Consistency is expected to be achieved through the introduction of the following new oversight processes agreed by the Executive:

- revised project management arrangements to be put in place for each service review
- arrangements will be scrutinised by the Transformation Board and reported to SMOG
- political implications will be reported to the Executive
- Councillors will discuss key developments at timely seminars
- seminars will be held well in advance of any decision making by the council.

Our audit has confirmed that the Council's current approach to financial management and budgetary control is robust, however, current uncertainty over the future of public sector finances continues to present a significant risk to future funding. We will continue to monitor the Council's progress in addressing this risk.

### 3.3 Reserves

For the year ending 31 March 2009, the Council had a total general fund reserve balance of £32.6 million, of which £28 million was earmarked for specific purposes, and £4.6 million was unearmarked. Table 1 shows the breakdown of the main general fund balances at 31 March 2009.

Table 1: General Fund balances as at 31 March 2009

	Balance as at 31 March 2009
	£'000
Total General Fund	32,627
of which: Earmarked	
PPP Smoothing Funds	14,639
Social housing	6,032
Grant Income carried forward	2,012
General earmarked sums	3,659
Funding committed to balance future	
years budget	1,673
Total Earmarked	28,015
Unearmarked	4,612

Source: Argyll and Bute Council

The Council continues to review the reserves policy on an annual basis. The February 2010 review has set the contingency level for the General Fund Reserve at £3.971m equivalent to

1.5% of the forecast budget in 2010-11. The Council's ability to achieve this target depends upon the redundancy and retirement costs arising from the senior management restructuring exercise.

As part of its review of financial management and reserves, the Council will no longer allow the automatic carry forward of unspent budget (except under the devolved scheme for schools). Instead unspent budget will be pooled, and the level of unspent budget reported to the Council as part of the annual accounts process. Unspent budget will be allocated with reference to the Council's priorities as set out in the corporate and service plans, and the overall financial outlook. This is considered to be a positive step in terms of ensuring efficiency and best value in relation to service level expenditure.

### 3.4 Budget virements

In our 2008-09 audit, we found that 80% of virements tested did not follow the notification procedures set out in the virement policy contained in the financial regulations. We also noted that budget transfers within service departments were often signed off with no evidence of authorisation or review. We have performed a follow up review in the current period, and found that the council has now satisfactorily addressed all issues identified.

Authorisation limits and guidance are included in the financial regulations and a new draft is being prepared to be effective from 2010-11. Testing performed indicated that these authorisation controls encountered some initial problems with heads of services continuing to authorise amounts over £25,000 in one department, but further investigation showed that this has been rectified and that the controls have been adhered to since August 2009.

# A Action plan

Finding	5	Risk	Recommendation	Management Response	Implementation Date
Core financial systems					
Verification of pure details  The creditors depart stamp to be used on into other departments basic checks have be testing has shown the used on all invoices.	Verification of purchase invoice details  The creditors department have created a stamp to be used on all invoices coming into other departments in order to show basic checks have been carried out. Our testing has shown that this is not being used on all invoices.	Low	Payments processing staff should be reminded of the need to stamp invoices as evidence that basis processing checks have been carried out.	The Creditors section issued stamps to payment processors a year or so ago for this purpose. The majority of invoices are stamped and the sections who process a lot of invoices use the payment stamp and base internal checks for duplicates etc around this. Other sections who don't pass as many invoices do not use a stamp and this is also not used in schools where separate checks are carried out. A decision would have to be made on whether the cost of more stamp pads and the time taken by cooks etc to stamp each invoice would be worth any real risk removed	n/a
PECOS		Low	The Council should investigate	In simple terms this report exists in Peros and can be menerated at any	n/a
ditors dep	The creditors department are unable to		report from PECOS to identify	time. It is run at year end and	
e a report	produce a report showing all purchase		goods or services received, but	departments base their accruals on	
in the Pec	orders in the Pecos system where goods		not yet processed to improve	this report However the report is	
ices have b	or services have been received but not yet		the accuracy of financial	far from perfect and requires	

No	Finding	Risk	Recommendation	Management Response	Implementation Date
	been matched with an invoice. This increases the risk that budget monitoring reports during the year will not capture all committed expenditure.		reporting, and reduce the risk that accruals may be missed.	interpretation on how part receipts are treated (Pecos treats receipts as a quantity and not a financial transaction) Reports on Pecos are not able to be run from within the Council's network but have to be run from an employee's home internet. This is a known issue but doesn't have a solution at this point in time.	
0	Journal Entry Controls  There is no control in place to prevent individuals both creating and posting journals	Low	The Council should incorporate an edit into the Oracle system to prevent someone posting a journal they have entered.	We will investigate this proposal to establish how if it is possible to do what is proposed.	31 July 2010
4	Deposit account reconciliations  Deposit account reconciliations are not reviewed on a timely basis. This increases the risk that errors or reconciling differences are not review and resolved timeously.	Low	All bank account reconciliations should be passed for review as soon as they are complete.	Agreed	30 June 2010

# B Progress in implementation of prior year recommendations

$ m N_{o}$	Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at March 2010
Core fi	Core financial systems			
1.	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  Risk: 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.  Implementation date:  Immediate	Implemented. Agreed to revised Treasury management practices published 26 August 2009.
5	CIPFA have recently introduced interim guidance on treasury management for local authorities. Risk: 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 management policies are next updated.	The Council constantly keeps its Treasury Management policies and practices under review and will update these to reflect best practice as appropriate. Implementation date	Not yet implemented.  CIPFA Code of Practice has been updated since the review of procedures performed in August 2009.  The adoption of the revised

$^{\circ}$ Z	Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at March 2010
			Treasury Management policies are reviewed once each year. This will be picked up once formal guidance issued	treasury code before the Council and the executive in April for approval. The Council are in the process of updating all the TMP's in light of changes to the code and changes to the investment regulations.
<i>.</i> .	We noted that bank reconciliations for deposit accounts are not always authorised by a senior officer.  Risk: Medium	All bank account reconciliations should be reviewed and signed off by a senior officer.	Agreed Implementation date: Immediate	Implemented.  Reconciliations were reviewed, however this was not found to have occurred in a timely fashion throughout the period. See action plan point 5 above.
4	We noted minor weaknesses in the procedures for authorising CHAPS payments:  • 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 should consider amending its CHAPS procedures to ensure only appropriate officers can authorise payments.	Agreed Implementation date: Immediate	Implemented  A list of those who are authorised signatories for the CHAPS payments has been obtained and confirmed that members of internal audit and the development finance manager have been removed.

Z	Orioinal Finding and Risk	Orioinal Recommendation	Management response and	Position at March 2010
	9		implementation date	
	Risk: Low			
Financ	Financial management and budgetary control			
5.	The revenue budget continues to be set on an historical basis uplifted for	The Council should review departmental budget assumptions to	The ongoing development of PPMF and in particular the programme of	Ongoing
	inflation or to take account of new expenditure commitments.	ensure they are subject to rigorous review, continue to remain affordable.	service reviews supported by a more structured challenge process for	
	Risk: Medium	and reflect corporate priorities.	service plans and budgets will address	
			the Point:	
			This will be commenced for 2010/11	
			budget but will be developed on an ongoing basis	
			Implementation date: February 2010	
6.	Transfers of budgets between departments are not currently subject	The Council should introduce	Agreed	Implemented.
	to authorisation. In addition, there is	between budgets in service	Implementation date:	Authorisation limits and
	no central list of budget virements	departments are authorised.	Immediate	guidance are included in the
	processed by service departments.	A central list of all virements should		financial regulations and a
		be retained by Strategic Finance to		new draft is being prepared
		ensure there is corporate oversight		to be effective from $2010/11$ .
		over significant budgetary changes.		Testing performed indicates
				that these authorisation
				controls had some initial
				problems with heads of
				services continuing to

Original Finding and Risk	Original Recommendation	Management response and implementation date	Position at March 2010
			authorise amounts over £25,000 in one department, but further investigation showed that this has been rectified and that the controls have been adhered to since August 2009.
			No central list of virements is maintained, however each department maintains their own. This is considered



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