Internal Audit Report

Cross Service

Shutdown of Non-Essential Spend

Issued to:
Steven Whyte, Director of Resources
Jonathan Belford, Chief Officer – Finance
Fraser Bell, Chief Officer – Governance
External Audit

EXECUTIVE SUMMARY

In 2018/19, the Council's year end position was a general fund surplus on provision of Services of £562,000. Finance had previously identified through the quarter 2 budget monitoring process for 2018/19 that cost pressures would lead to a general fund overspend for the Council in 2018/19 of £826,000 and if other demand led cost pressures and a higher pay award occurred, this could lead, in a worst case scenario, to a deficit of £7 million by the year end.

As a result, Finance issued a year end instruction in November 2018 to all budget holders stating that the last date for ordering goods and services, for 2018/19, would be Monday 14 January 2019, with the exception of certain consumables and perishable items, but that both should be kept to a minimum. It was also stated that *"expenditure should be incurred only because it is essential for business purposes, not just because there is unspent budget."* A similar memo was issued to non-housing capital project managers exempting them from this requirement.

The objective of this audit was to provide assurance that the shutdown of non-essential spend has been effective in achieving its objective and instructions were complied with. In general, this was found to be the case.

Budget holders were notified of the non-essential spend instruction timeously and the instruction was clear on what constituted essential spend (and therefore non-essential spend). Compliance with the instruction was monitored by Corporate Management Team via reported financial indicators and the Procurement Control Board was meeting to consider, and where appropriate approve, non-essential spend exceptions.

It was noted that, contrary to year end instructions, 80% of approved PECOS orders were being raised without justification, after the year end cut-off dates when orders were required to be adequately justified before being approved. Finance has agreed to remind staff and budget holders of their respective responsibilities to justify orders and obtain adequate justification prior to approval of orders.

Finance holds regular meetings with budget holders throughout the financial year. The numbers of meetings varied between Cluster and Function. A small percentage of meetings referred to non-essential spend after the instruction was issued, meaning expected cost reductions were not, generally, being discussed. Finance has agreed to address this in future by reducing budgets to address in-year budget pressures.

1. INTRODUCTION

1.1   As part of the 2018/19 budget setting process, the Strategic Transformation Committee agreed to save £6 million and Full Council agreed to save an additional £810,000 of "third party spend". The savings were removed from individual budget lines in 2 tranches during 2018/19. Subsequently, Finance identified through the quarter 2 budget monitoring process for 2018/19 that cost pressures would lead to a general fund overspend for the Council in 2018/19 of £826,000. It was also reported that other demand led cost pressures and a higher pay award could lead to a higher deficit of £7 million by the year end.

1.2   Finance issued a year end instruction in November 2018 which included a covering memo to all budget holders stating that the last date for ordering goods and services, for 2018/19, would be Monday 14 January 2019, with the exception of certain consumables and perishable items, but that both should be kept to a minimum. It was also stated that *"expenditure should be incurred only because it is essential for business purposes, not just because there is unspent budget."* A similar memo was issued to non-housing capital project managers exempting them from this requirement.

1.3   There are a number of other ordering processes in use throughout the Council along with payments that result from a contract or not instigated by any documented purchase order. The Council's revenue expenditure for the last two years is detailed below.

System	2018/19		2017/18	
E-Financials - Creditors System payments no PO	159,949,590	46.3%	173,008,330	54.0%
PECOS	64,008,351	18.5%	30,988,846	9.7%
Carefirst – Social Work Care Management System	78,179,738	22.6%	73,179,743	22.9%
Total Consilium – Roads, Landscape Services and Operational Buildings	22,229,493	6.4%	22,848,490	7.1%
Fostering – payments to foster carers	10,385,149	3.0%	9,373,642	3.0%
NDR – Business Rates refunds	5,846,335	1.7%	5,813,878	1.8%
Confirm – HRA repairs	1,968,508	0.6%	2,024,967	0.6%
Tranman – Council fleet management system	1,317,710	0.4%	1,327,913	0.4%
Fleet Hire – hire of operational vehicles	719,430	0.2%	1,012,300	0.3%
Library (Spydus) – library book ordering system	343,067	0.1%	384,736	0.1%
EMA / Clothing Grant	560,685	0.2%	399,350	0.1%
Revenue Total	**345,508,056**	**100.0%**	**320,362,195**	**100.0%**

1.4   The objective of this audit was to provide assurance that the shutdown of non-essential spend has been effective in achieving its objective and instructions were complied with.

1.5   The factual accuracy of this report and action to be taken regarding the recommendations made have been agreed with Jonathan Belford, Chief Officer – Finance.

2. FINDINGS AND RECOMMENDATIONS

2.1 **2018/19 Budget Pressures and Non-essential Expenditure**

2.1.1 Regular Council financial performance reviews carried out by Finance in quarters 1 and 2 indicated "*savings realisation and tracking at the half year point indicates significant progress being made towards achieving all the savings that were agreed, with over 75% so far captured.*" However additional cost and demand pressures arising during the opening periods of 2018/19, and those anticipated for the remainder of that financial year required additional savings to be achieved.

2.1.2 The Corporate Management Team (CMT) agreed to cap non-essential expenditure following discussions with the Chief Officer – Finance on 8 November 2018. This was also agreed with members of the Extended Corporate Management Team (ECMT).

2.1.3 On 31 October 2018, the City Growth and Resources Committee resolved "*to note the advice provided by the Chief Officer – Finance that the Council must continue to be proactive in its financial planning arrangements and to prepare for and respond to the range of cost pressures and uncertainties described in the report and appendices, and in respect of the Council's General Fund Revenue Budget, to instruct the Corporate Management Team to stop and reduce net expenditure wherever possible with immediate effect.*"

2.1.4 An email issued to all level 9 budget holders on 28 November 2019 stated "*Every month all budget holders are expected to actively review the financial information and to take appropriate action to achieve balanced budgets. From now to the end of the financial year CMT will be closely monitoring financial indicators and introduce measures to stop and reduce expenditure as a response to the City Growth and Resources Committee decision.*"

2.1.5 A budget monitoring PowerBI dashboard was developed by Finance and made available to Directors and Chief Officers for the purposes of monitoring non-essential expenditure. The dashboard was reported to CMT in February and March 2019.

2.1.6 The email to budget holders also provided a set of defined criteria for what constituted essential spend:

- Food and other perishables (including schools, care facilities, etc.);
- Life and limb expenditure (including essential social care);
- Health and safety (including essential building repairs);
- Fuel / energy required to deliver essential services and business continuity / emergency planning;
- External funds that ACC manage on behalf of others (e.g. Pupil Equity Fund and other specific grants, regional funding);
- Contracts to which the Council is legally committed to pay (e.g. school unitary charges, external leases for occupied properties).

All exceptions to the criteria, after discussion with a Director, needed to be approved by the new Procurement Control Board (PCB) prior to commencing the procurement. The PCB met regularly in December 2018 and January 2019 and agendas included business cases for non-essential expenditure for consideration by the Board.

2.1.7 Finance undertook an analysis of what potential savings could be achieved via the non-essential spend instruction, using the methodology applied to the second tranche of applied savings. This involved reviewing the actual expenditure against budget as at 31 October 2018 of those ledger codes which had been deemed to be in scope for the third party savings exercise (approximately £20 million of forecast expenditure yet to be

incurred against in-scope budgets). It was not confirmed what the value of the savings from restricting non-essential spend would be however it was not expected that it would amount to the entire £20 million of targetable spend.

2.1.8 The year-end procedures with covering memo were issued in November 2018 to all budget holders. These procedures covered the normal year end accounting timetable and processes including the last date goods could be ordered along with some general requirements:

- "It is acknowledged that certain consumables and perishable items will require to be ordered beyond this point, but this should be kept to a minimum."
- "Expenditure should be incurred only because it is essential for business purposes, not just because there is unspent budget."

2.2 **Compliance**

2.2.1 The 2018/19 cut-off date for ordering goods (except IT equipment) and services was 14 January 2019, while the last date for ordering IT equipment in 2018/19 was 14 December 2018. The year-end procedures stated in para 2.9.7 "*For any purchase orders processed after cut-off dates that are for 18/19 purchases the Comments Box in PECOS should be completed with full details to justify why the order had to be raised after the cut off dates.*" There was no reference as to what would happen should such justification be insufficient or omitted. There is also no mention of a justification requirement for any orders raised in the other systems used for purchasing e.g. Carefirst, Consilium, Tranman, etc.

2.2.2 Internal Audit requested an extract of all PECOS orders raised between the 14 January and 31 March 2019, including the comments field, in order to test this requirement. The Financial Systems team was unable to provide such a report as the comments field was not part of the reporting structure available from the system. Therefore, a sample of 40 orders raised and approved against non-essential expenditure codes was checked manually back to the PECOS system comments field. This found that 20% of the sample had comments justifying the order.

Recommendation
a) Staff should be reminded of the requirement to justify orders in PECOS which have been raised after the year-end instruction deadline.

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a) Staff should be reminded of the requirement to justify orders in PECOS which have been raised after the year-end instruction deadline.

b) Budget holders should be reminded, where required justification is not provided, the order should not be approved.

Service Response / Action
a) Agreed. A communication will be issued.

b) Agreed. A communication will be issued.

Implementation Date	**Responsible Officer**	**Grading**
a) February 2020	Chief Officer – Finance	Significant within audited area
b) February 2020		

2.2.3 Along with the orders raised, Internal Audit extracted all payments processed through the creditors system in February and March 2019 to establish any payments made without a purchase order being raised. The analysis found 2,103 invoices from 894 suppliers totalling £45 million without a purchase order. Of these, 1,503 totalling £41.9 million had an exemption under appendix A of Financial Regulations, leaving 600 totalling £3.1 million which did not. While orders being raised through PECOS had their approval process changed to a Chief Officer level, no such provision was made for payments without a

purchase order.

2.2.4   As all of these invoices had no supporting purchase order they are authorised for payment in manuscript on the invoice and submitted to Business Services for payment. Financial Regulation 5.12.3 paragraph 3 states *"The Council has adopted a "No Purchase Order No Pay" approach to managing procurement expenditure, and as a result invoices will not be paid unless a purchase order has been raised. A list of exemptions from the requirement for a purchase order is maintained by the Chief Officer - Finance and is included in this document as Appendix A."* and Appendix A states - *"All other purchases require a purchase order to be raised and quoted on the supplier's invoice. Invoices not containing the purchase order number will not be paid. No exceptions will be accepted unless specifically approved by the Chief Officer - Finance or their authorised representative."*

2.2.5   On discussing this requirement with the Business Services Team Leader it was noted that the No PO No Pay and approval by the Chief Officer – Finance was not being applied and that all invoices are paid, order or not, and the normal authorised signatory for that Cluster / Function is accepted as authority to make payment, with no subsequent corroborating approval from Finance. A similar finding was identified in audit report AC1914, Compliance with Procurement Legislation and Council Regulations with recommendations made and agreed to improve compliance.

2.3   **Budget Holder Meetings**

2.3.1   Finance hold regular meetings with budget holders throughout the financial year. The numbers of meetings varied between Cluster and Function. Finance had indicated that the non-essential expenditure requirements would form part of any such meetings and therefore a review of the minutes between June 2018 and February 2019 was undertaken to ascertain how this was being reported. Although all minutes were checked, the main focus of testing related to those minutes after the CG&R meeting of 31 October 2018, after which it became a requirement to stop and reduce expenditure wherever possible.

2.3.2   Of the eighty five meetings that were minuted, forty six were held after 31 October 2018. Of these, eighteen referred to non-essential spend. Where non-essential spend is minuted, only six (3 service areas - Roads & Infrastructure, Facilities, and Environment and Bereavement) indicated how this was being applied or had a financial value. The remainder simply stated their knowledge of the requirement. None of the minutes indicate that Finance was undertaking any monitoring of actual expected reductions in spend, or which non-essential areas related to the budget holders at the meetings.

2.3.3   Detailing expected cost reductions at a budget holder level and monitoring these with budget holders will increase the likelihood of non-essential spend cost reductions being achieved. Finance advised that the Council's commissioning led approach to structuring future budgets, provides the framework to build the appropriate level of budget for goods and services, that meets the service standards that will be delivered and this will enable the Council to adjust to changing resources in the future.

AUDITORS: D Hughes
              A Johnston
              G Flood

Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
Major at a Service Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited. Financial Regulations have been consistently breached.
Significant within audited area	Addressing this issue will enhance internal controls. An element of control is missing or only partial in nature. The existence of the weakness identified has an impact on a system's adequacy and effectiveness. Financial Regulations have been breached.
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.