



ABERDEEN CITY COUNCIL

Internal Audit Report

Finance

Budget Monitoring

Issued to:

Richard Ellis, Interim Director of Corporate Governance
Steven Whyte, Head of Finance
Sandra Buthlay, Accounting Manager
Carol Smith, Accounting Manager
Doris Wyness, Finance Projects Manager

EXECUTIVE SUMMARY

The Council budgeted General Fund net revenue expenditure of £443,627,000 for 2015/16.

Budget holders across each Service have been assigned responsibility for specific elements of income and expenditure under their control. Finance supports Service budget holders by providing access to budget monitoring information including actual expenditure to date, committed funds and forecast outturns and through regular budget holder meetings. Finance then prepare reports to Service Management, and Service Committees, highlighting spending patterns and forecast variations from budget in order to demonstrate performance and advise on any areas of risk and corresponding management action.

The objective of this audit was to review procedures used for monitoring the Council's budget. Although there are timetables in place, and individual Finance teams have their own guidance notes, there is no comprehensive corporate procedure document for budget monitoring. Some variation in practice, and in the quality of supporting records and report narrative, was therefore identified, and improvements have been recommended. Finance will review and incorporate these into new written procedures.

Committees scrutinise financial performance through Finance budget monitoring reports on a regular basis, however it was noted that the Chief Executive's Service and Corporate Budgets are presented for scrutiny to the same level of detail. In comparison to other budgets, these are smaller sums (amounting to 7.5% of the total Council budget), however it remains important that expenditure in these areas is accounted for transparently, including providing opportunity for scrutiny by the appropriate Committee. Finance does not consider that this is a significant risk since the budgets are reported at an overall level. Any exceptional matters at any time in the cycle would be escalated to the Director, CMT and relevant Committee Convenor.

1. INTRODUCTION

- 1.1 The Council budgeted General Fund net revenue expenditure of £443,627,000 for 2015/16.
- 1.2 Budget holders across each Service have been assigned responsibility for specific elements of income and expenditure under their control. Finance supports Service budget holders by providing access to budget monitoring information including actual expenditure to date, committed funds and forecast outturns. Finance, in consultation with relevant budget holders then prepare reports to Service Management, and Service Committees, highlighting spending patterns and forecast variations from budget in order to demonstrate performance and advise on any areas of risk and corresponding management action.
- 1.3 The objective of this audit was to review procedures used for monitoring the Council's budget.
- 1.4 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Steven Whyte, Head of Finance.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Procedures

- 2.1.1 Comprehensive written procedures which are easily accessible by all members of staff can reduce the risk of errors and inconsistency. They are beneficial for the training of current and new employees and provide management with assurance of correct and consistent practices being followed, especially in the event of an experienced employee being absent or leaving.
- 2.1.2 Documentation on the Zone shows the Finance and Service responsibilities in respect of budget monitoring but does not go into detail on how Finance should fulfil those requirements. Although the roles and responsibilities of Finance and Services are set out at a high level, there is limited information available to document responsibilities within Finance for producing, reviewing and reporting budget monitoring information. There are a number of procedures within Accounting teams setting out the process in more detail, but these have evolved over time and could benefit from being more accessible to budget holders.
- 2.1.3 There is a fixed timetable for production of budget monitoring data, and much of the process is driven by the financial system. Individual accounting teams have standing processes which are followed each monitoring period, however much of this relates to the detailed completion of specific tasks rather than setting out the principles and practices to be applied. Although there are similarities in the tasks performed, there is no 'corporate' comprehensive procedure for budget monitoring applied across Finance. Without this there is a risk of variation in practice which might lead to varying quality of budget monitoring information.

Recommendation

Finance should develop comprehensive budget monitoring procedures for Finance staff to follow, including documenting roles and responsibilities.

Service Response / Action

Agreed. The budget monitoring timetable sets out a clear, consistent method in practice to the significant processes of the budget monitoring approach. This includes budget reporting cycles and dates for reports to services, accruals and forecasting, reporting to SMT's, CMT and Committees, budget holder meetings. In addition, there are a number of procedures in place for specific elements of the process. It is recognised that there could be a corporate, comprehensive procedure document, and further that there could be a clearer document about roles and responsibilities. This will be put in place.

Implementation Date

April 2017

Responsible Officer

Accounting Manager

Grading

Important within audited area

- 2.1.4 There is no formal training for budget holders. Finance has stated it has recognised the need to instil ownership in Services, and is working on Councillors training. Budget holder training will be covered under phase two of the Finance Framework – which sets out a strategy for developing financial competency within the Council. Without clear guidance and training there is a risk that the requirements of their role will not have been communicated or understood by management, and budget monitoring information may be incomplete or inaccurate as a result.

Recommendation

Finance should develop and provide training for budget holders.

Service Response / Action

Agreed. There are a number of training programmes that have been developed for budget holders, and there was a formal training programme in 2013. It is recognised that this needs to be refreshed. Informal training is provided as part of the new budget holder induction and support is provided by their Finance contact through budget holder meetings. This allows training and support to be tailored to the budget holder's requirements.

The Reporting and Monitoring E&CS team are delivering a set of training sessions for Educational Establishment staff, which started in September 2016. Formal training and other resources are being developed as part of the Shaping Aberdeen Use of Resources Academy. This will start rolling out in November 2016. A dedicated training team is under consideration as part of the revised Accounting structure. Finance Framework training will be delivered to all budget holders by December 2017.

Implementation Date

December 2017

Responsible Officer

Accounting Manager

Grading

Important within audited area

2.2 Scheduling and Reporting

- 2.2.1 Budget monitoring is timetabled for presentation to Corporate Management Team (CMT). It is not specifically scheduled to meet individual Service and Policy Committee dates thereafter – it is a standing item on Committee agendas, and each will receive the most up to date figures available. Although each receives a report on an approximately quarterly basis, aligned with the Committee cycle, different Service Committees may therefore receive financial information for different periods. Committees may also not receive the same periods' monitoring reports in subsequent financial years.

	Budget monitoring reported to:			
	CH&I	E&CS	FP&R	IJB / E&CS
September 2015		June 2015	July 2015	
October 2015	July 2015			
November 2015		Cancelled		
December 2015			October 2015	
January 2016	October 2015	November 2015		October 2015
February 2016				
March 2016	December 2015	January 2016		January 2016
April 2016			February 2016	
May 2016	February 2016			
June 2016		March 2016	March 2016	
July 2016				
August 2016	May 2016			June 2016

- 2.2.2 Data is still produced in the intervening periods for CMT and management purposes, and therefore still informs management action. However, inconsistency in reporting periods could affect the ability of Committees to monitor trends in their Service's financial performance.

- 2.2.3 Although Committees are provided with information regularly, as can be seen in the above table, it is normally two months after the end of the period to which it relates. Depending on scheduling of Committee meetings, there may in some circumstances be limited opportunity to scrutinise financial performance, and direct appropriate action, in advance of the end of the financial year. However, Finance has stated that any exceptional important matters at any time in the cycle would be escalated to the Director, CMT and relevant Committee Convenor.
- 2.2.4 In contrast to other Service budgets, costs relating to the Chief Executive's Service budget (£3,241,000), and Corporate Budgets (£29,930,000), are not being reported to a Committee, except as a single line within quarterly overall Council General Fund monitoring reports to the Finance Policy and Resources Committee (FP&R).
- 2.2.5 The Chief Executive's Service budgets include expenses for the Chief Executive's Office, Civic Support, Media and Promotions. Corporate Budgets include Capital Financing Costs, Supplementary Pensions, Welfare Reform Grants, Councillors Expenses, Joint Boards, Contingencies, and Trading Operations.
- 2.2.6 According to the Council's Standing Orders, FP&R should monitor all Council budgets, but is specifically accountable for Corporate Governance and the Chief Executive's Service budgets and performance. No separate reports have been provided to FP&R regarding the latter, and these have not been included within the reports for Corporate Governance. It will be difficult for the Committee to manage the Chief Executive's Service budget and performance without separate budget monitoring detail.

Recommendation

Finance should ensure all budgets are monitored and reported to a standing Committee of the Council.

Service Response / Action

Not agreed. It is not considered that this is a significant risk since the budgets are reported at an overall level. Any exceptional matters at any time in the cycle would be escalated to the Director, CMT and relevant Committee Convenor. It is not felt that there is any risk to the financial performance as a result of this schedule.

Audit Position

Although in comparison to other budgets, these are smaller sums (amounting to 7.5% of the total Council budget), it remains important that expenditure in these areas is accounted for transparently, including providing opportunity for scrutiny by the appropriate Committee.

Grading

Major at a Service Level

- 2.2.7 CMT reports provide bottom line figures for Revenue and Capital budgets for the General Fund, Trading Services, Housing Revenue Account and Common Good. Trends and key risks are documented. There is minimal discussion of any individual Services or Directorates within the reports.
- 2.2.8 There is also limited evidence of discussion of performance and figures in CMT meeting minutes. Whilst there is general discussion of finance related issues, this does not often involve detailed review of the budget monitoring figures. However, as the monitoring is largely by exception and the periods reviewed were in surplus, and within 10% variance overall (which CMT includes as 'green' within a traffic light system), it is unlikely that much discussion would have been necessary. Finance has stated that new savings, cost pressure, and earmarked reserve, trackers are being presented regularly to CMT for the 2016/17 financial year: which will provide additional information regarding areas identified as at risk during the budget setting process.

- 2.2.9 Although there is a link between the CMT and Service Committee budget monitoring papers, the extent to which the data is summarised means that it is difficult to identify a clear link between items highlighted in individual Service papers, the Corporate General Fund monitoring paper presented to FP&R, and the CMT report.
- 2.2.10 Most of the Committee papers reviewed as part of this audit did not clearly state on the cover which period the monitoring figures apply to. Although in most cases this detail was included in the accompanying tables / appendices, it should be clear from the cover of the report. Not clearly identifying which period monitoring reports refer to could cause difficulty in interpreting the data – since spend to date, and accuracy of forecasts, will increase the further through the financial year they progress.
- 2.2.11 The majority of the figures presented in Committee papers are ‘bottom line’ only for each Service. Within Corporate Governance budget monitoring the bottom line figures for Finance are separately reported to those for HR, Legal and others, in a single table. In a separate table, the combined costs for all of these are then split by expenditure category. As a result, variations (e.g. underspends on Staffing and overspends on Transport costs) are not clearly attributable to any particular Service within Corporate Governance. Although significant variations at an individual Service level are discussed in the narrative section of the Committee report, there is no clear connection between the figures in the tables and the variances described in the narrative. Combining budgets at a summary level could mask variations between Services which may be of interest to Committees. As it is not possible to reconcile variance notes with the narrative, Committees will not have assurance that all variances have been appropriately explained.
- 2.2.12 This is not the case with CH&I and E&CS, which present both a summary and a separate analysis into account categories for each Head of Service. Variance notes are then provided, and separately calculated, for each Head of Service area. Although this is clearer, the headings do not clearly demonstrate which services fall under which Head of Service. For example it is not immediately clear what services come under ‘Public Infrastructure and Environment’ within CH&I, or ‘Lead Service Manager 2’ within Social Care. Providing clarity regarding which budgets are under the control of which Heads of Service would aid interpretation of the budget monitoring figures by putting them in context, and improve readers’ ability to match these with the accompanying notes. However, Finance does not consider that this would add value to the reports.
- 2.2.13 There is a standard format of Committee report, which is also used for presenting budget monitoring information. Sections on ‘Impact’ and ‘Management of Risk’ do not appear to be well used: in most cases these include generic statements about the usefulness of budget monitoring information rather than explaining the risks and impact on delivery of services resulting from variations in actual and forecast spend compared with the budget applying to that particular Service. Explanation of the risks and how they are being managed would provide additional assurance to Committees. Finance has stated that more recent reports do include additional detail, as they continue to develop through a process of continuous improvement.
- 2.2.14 Whilst it would not be appropriate to provide excessive detail on all operational issues, it is vital that the Committees are able to understand the nature of budget variances and have assurance over management’s actions. Committee papers could be improved to provide further assurance to Councillors that Service budgets are being managed appropriately.

Recommendation

Finance should review the content and format of budget monitoring Committee reports to ensure an adequate and consistent level of detail is presented to each Committee, with a clear link between each level of reporting.

Service Response / Action

Not Agreed. The Council has a strong recent history of financial management as evidenced through our external audit reports. There is a thorough approach to presenting reports to appropriate levels of management. There is a consistent source of data in the ledger that aligns to our statutory reporting information. The style of reports has been tailored to specific needs of our customers. Whilst it is recognised there are some minor inconsistencies in our reporting this is not perceived as a control risk for the organisation. It is recognised that it is important to consider the fitness for purpose of reports, particularly in light of the new challenges facing the City and Public Sector but this is something incorporated in our ongoing processes.

Implementation Date

N/A

Responsible Officer

N/A

Grading

Significant within audited area

- 2.2.15 Committee papers should contain enough detail to describe the circumstances surrounding budget variances, i.e. why they have occurred and what the implications are, as well as describing the actions being taken by management to address and mitigate these variations. In carrying out the audit, a number of committee reports were reviewed with varying detail found.
- 2.2.16 For example:
- “the underspend (£x) reflects lower than budget spending on staffing”;
 - “the adverse movement since the previous period is due to additional spend”;
 - “the adverse variance reflects shortfalls in recoveries”;
- 2.2.17 There is currently no set standard for budget variance notes, and as a result notes can be inconsistent. Other than those included in a high level summary which is presented quarterly to FP&R on the overall position, which provides more detail but only on major variances, the majority of notes simply state in which service or budget line the variance has occurred. Variance notes should do more than highlight that there has been a variance between budget and actual or forecast outturn. They should explain why there has been a variance, and provide assurance that action is being taken to resolve it.
- 2.2.18 The way in which reports are set out might also cause confusion, as often multiple variances are discussed within the same sentence, paragraph or bullet point. Prior and detailed knowledge of the Service and its functions are also assumed, as in addition to the points discussed at 2.2.12 above there is extensive use of acronyms and jargon.
- 2.2.19 Applying a standard which includes the following would improve the quality of budget monitoring variance information and provide additional assurance to management and Councillors:
- Requirement to provide information to management / Councillors on why a specific budget is under or overspent;
 - Sufficient detail to allow the reader to grasp the reason without having to ask further questions; explaining rather than noting the variance;
 - Whether or not it is recurring;
 - Whether the forecast has changed substantially from previous periods;
 - Whether it affects service delivery;

- How is it being dealt with;
- Avoiding jargon, unexplained abbreviations, and acronyms

2.2.20 For example:

- “the underspend (£x) reflects lower than budget spending on staffing. This is due to a combination of recruitment difficulties in area y, and vacancies in area z being held open pending completion of a service structure review. Management anticipates the review will be complete by the end of the financial year and has engaged with HR to develop new recruitment initiatives. In the interim agency staff are being utilised where necessary.”

Recommendation

Finance should develop a standard for budget variance notes, including the requirement for clear reference to why a variance has occurred and what action is being taken in response.

Service Response / Action

Agreed. It is recognised that the quality of explanations is variable in written documents and it is agreed that a standard guidance should be introduced.

Implementation Date

April 2017

Responsible Officer

Accounting Manager

Grading

Significant within audited area

2.2.21 Budget holders at all levels are provided with BOXI reports – summarised data available live or downloaded from the financial system. There is no narrative in these reports, but there is a traffic light system to indicate variances in excess of £10,000. Further detail is available to recipients who may use the reports to access the details of individual transactions which make up the summary balances.

2.2.22 Finance engages with budget holders through regular meetings, at which more relevant information is discussed, and used to review forecast outturns and prepare Highlights and Committee reports. Although minutes are typically retained, there is no formal reporting at this level. More formal analysis at a Head of Service or Manager level might yield benefits in terms of explaining to operational managers what they are spending and why, and allowing them to take relevant action as appropriate.

2.2.23 Service Management Teams are provided with Highlights reports on a monthly basis. These are in a similar format to the Committee reports, but contain additional detail which is more relevant to management. As with Committee reports, only larger variances are reported, and costs are typically grouped across different services or cost types, making it difficult to verify them back to the ledger directly.

Recommendation

Finance should consider whether management needs are being met by the existing complement of reports.

Service Response / Action

Not Agreed. The Service considers that management needs are being met effectively. Budget holders can review data at any point using BOXI reports, and will meet regularly with Finance through budget holder meetings and Finance Partner attendance at management team meetings. Highlights reports allow Service Management Teams to focus attention on high risk areas. Budget holders were consulted extensively on the reports and feedback is always welcome on the content of the reports.

Audit Comment

Service position noted.

Grading

Important within audited area

2.3 Data Processing and Output

- 2.3.1 Transaction data is held within the financial ledger system: e-financials. The system is regularly updated with new transactions, for example: invoices, payroll, and journal entries (financial adjustments). At the end of each month checks are carried out and the current period is closed for new transactions, balances are rolled forward, and all new transactions will be posted to the next period.
- 2.3.2 As noted at 2.1.3 above much of the work completed by Finance is driven by the need to process information through the financial system:
- Budgets and profiles are uploaded to the ledger.
 - Figures are downloaded each period to check actual costs and provide a baseline for adjustments.
 - BOXI reports are sent out to budget holders at various levels.
 - Journals are prepared and uploaded to update budgets.
 - Journals are prepared and uploaded to update accruals.
 - Journals are prepared and uploaded to update forecasts.
 - Figures are downloaded again, and reviewed to prepare Highlights reports.
 - Updated BOXI reports are sent out to budget holders at various levels.
 - Highlights reports are sent to / discussed with budget holders.
 - Figures are downloaded again, and reviewed to prepare Committee reports.
 - Committee reports are published.
- 2.3.3 Data can be extracted directly, via BOXI reports, or from Collaborative Planning – a system designed to provide access to financial data for budget holders, and to facilitate them updating forecasts and narrative explanations directly, without direct access to the financial system. It appears to have been the intention to use Collaborative Planning for all services and budget holders, in order to reinforce the role of services in monitoring their budgets, however use of this system varies.
- 2.3.4 In order to demonstrate the accuracy of budget monitoring data provided to Committee and CMT, Internal Audit sought to reconcile the figures presented in reports to data downloaded from the financial system. Although the majority of figures matched, there remained unreconciled differences. These have subsequently been explained as manual adjustments to the reported figures, which had not been applied to the ledger in the period concerned. Whilst there may be good reasons for doing so: in order to report a more accurate position; the audit trail becomes less clear.
- 2.3.5 Although Finance collates data in a spreadsheet, which could be used to reconcile ledger and reported figures, and explain the differences, it is not currently being populated with sufficient information to do so.

Recommendation

Finance should ensure it can demonstrate that all figures included in reports for management and committees can be reconciled to ledger data.

Service Response / Action

Not Agreed. There are a number of control checks in place to reconcile corporate level data to service data. The source of all financial information is the ledger system. If recent and significant changes need to be reported that supersedes the ledger information this may be adjusted.

Implementation Date

N/A

Responsible Officer

N/A

Grading

Significant within audited area

- 2.3.6 Variations were also evident between the budget, year to date variance, and forecast outturn figures depending on the point at which reports from the financial system were run. Further investigation revealed that changes had been made retrospectively to budgets at the end of the financial year, including: transfers from Capital to Revenue expenditure, adjustments for internal charges, and changes to reporting lines for staff costs. This meant that the reported results for prior periods could not be replicated at a later date. Adjustments should not have a backdated effect on prior periods' data, as it reduces the transparency of the audit trail.

Recommendation

Finance should ensure that journals do not have a backdated effect on prior ledger periods.

Service Response / Action

Not Agreed. There are a number of situations where retrospective adjustments are appropriate.

Implementation Date

N/A

Responsible Officer

N/A

Grading

Significant within audited area

- 2.3.7 An 'accrual' is an accounting term for including transactions completed to date but not yet recorded in the financial system, within the current period's results. Accruals may be processed for items which have been purchased and received, but not yet invoiced – in order to reflect the current level of expenditure. Similarly spend committed via Purchase Order may be accrued for in advance in order to demonstrate that the remaining budget has been reduced. It may also be appropriate in some instances to process a negative accrual (a prepayment) where expenditure has been incurred but the value is still to be received.

- 2.3.8 Finance regularly processes accruals to reflect such adjustments. In many cases it is apparent that accruals are being processed to make up the difference between actual year to date spend and the anticipated spend based on the number of months progressed into the financial year. This process is recommended in many of the Finance teams' guidance notes and is replicated across the majority of budget lines reviewed. However, this smooths the actual spend data and may mask the fact that expenditure is variable throughout the year, or whether it has or has not occurred in line with expectations.

- 2.3.9 Neither Highlights reports (for management) nor Committee reports contain details of the original actuals or the accruals – these are combined into a single ‘revised actual’ figure, though it is not declared as such: it is called “Actual Expenditure”. This could be misleading, as readers are likely to assume that these are actual costs incurred to date.
- 2.3.10 Although there is a record of the net value of accruals in the ledger system, there is generally only a limited audit trail supporting their calculation. Some accounting teams and individuals keep more records and notes than others.
- 2.3.11 Whilst it is appropriate that professional judgement is applied, which may not always be based on a specific detailed calculation, there is a risk that incorrect or unsupported revisions may be made and not identified, resulting in adjusted actual spend figures which are not reflective of service expenditure to date. If these figures are used to determine ongoing spending priorities, decisions may be made on the basis of inaccurate information. This is partly mitigated by the segregation of duties and review stages through which each set of monitoring figures passes, however these checks are at a summary level, and may miss smaller variations – which could have a cumulative effect or affect individual lower level budget holders’ actions.

Recommendation

Finance should ensure it can demonstrate that accruals have been appropriately calculated, and applied only where necessary.

Service Response / Action

Agreed. The current accruals methodology has been in place for a number of years and it is recognised that it needs to be reviewed for consistency and materiality across the service areas. The main focus of financial control in year is forecast outturn rather than the accrued in-year position. There should be a greater focus on looking at a high level of spending profiles as a predictor of forecast outturn rather than detailed focus on minor accruals. This will be incorporated in the new procedures in 2.1.3.

Implementation Date

April 2017

Responsible Officer

Accounting Manager

Grading

Significant within audited area

- 2.3.12 Accruals are entered into the financial system as a journal entry. However, journal line descriptions are not self-evident, therefore there is a reduced audit trail. For example:
- “Accrual P9 Dec Agency Staff”;
- 2.3.13 As accruals are applied only to one particular field in the financial system, a user will already know a journal to this part of the financial system is an accrual. The period and account code and their names are already in the system and linked to this record – therefore do not need to be duplicated in the line description. Re-stating these elements is not efficient and does not provide additional value. It would provide more valuable information if the need for the accrual was provided instead. This would also help demonstrate that accruals were for legitimate value received or obligations entered into but not yet paid, rather than adjusting the actual cost to date figures. For example:
- “Charges for agency provided at x location between y & z dates not yet invoiced.”

Recommendation

Finance should ensure that journal line descriptions are clear and meaningful.

Service Response / Action

Agreed. It is recognised that the quality of explanations is variable in written documents and it is agreed that a standard guidance should be introduced.

<u>Implementation Date</u> April 2017	<u>Responsible Officer</u> Accounting Manager	<u>Grading</u> Significant within audited area
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2.4 Forecasting

- 2.4.1 An important part of the budget monitoring process is determining the forecast year end outturn for each budget. This can only ever be a best estimate, based on professional judgement and knowledge of the service, and consultation with budget holders, however it is key to ensuring that the Council's budget is met. Management may need to take action in response to forecast budget variances, in order to resolve them before the end of the financial year.
- 2.4.2 The accuracy of the forecast should increase with each successive period of budget monitoring as new information on income and expenditure patterns is received. At a Council and Directorate level the final year-end outturns for 2015/16 were all within a small percentage variance of each Directorate's budget (-5% to +3%), and differences between forecasts and final outturn were also very small in percentage terms (-4% to +2%). This level of accuracy was generally maintained between periods.
- 2.4.3 For a sample of budgets at a Head of Service level there was more variation in the level and accuracy of forecasts (-15% to +27%), and the outturn from budget (-11% to +39%). The level of accuracy was maintained in some areas, and deteriorated marginally in others, between periods. At a detailed cost centre level variations were more marked, but not all forecasts are entered, or regularly updated, at this level of detail. This may be as a result of focusing on higher risk and more material budget variances.
- 2.4.4 Although there is a record of the net value of forecast changes in the ledger system, there is generally only a limited audit trail supporting their calculation. Forecasts are being updated by Finance teams based on their own judgement or figures provided by budget holders – directly or via Collaborative Planning. As with accruals there are limited records of how forecasts have been calculated or arrived at. Whilst there are records of budget holder meetings, these do not all clearly demonstrate or match the changes to individual forecasts.
- 2.4.5 Whilst it is appropriate that professional judgement is applied, which may not always be based on a specific detailed calculation, there is a risk that incorrect or unsupported revisions may be made and not identified, resulting in adjusted forecast figures which are not as accurate as they could be. If these figures are used to determine ongoing spending priorities, decisions may be made on the basis of inaccurate information. This is partly mitigated by the segregation of duties and review stages through which each set of monitoring figures passes, however these checks are at a summary level, and may miss smaller variations – which could have a cumulative effect or affect individual lower level budget holders' actions.
- 2.4.6 Forecasts at a detailed level are often not changed to demonstrate an anticipated variance from the budget until later in the financial year, particularly where spend has been less than expected in the year to date. As a result, in combination with the accrual of expected spend as discussed at 2.3.8 above, it can look as though budgets will be fully spent, even though they have not been thus far. This is prudent – as there may still be expenditure later in the year, and Services will want to avoid an over-spend. However, as there is a delay between the end of the period and publication of management and Committee reports the following month/s, this may not leave much time to take action to resolve under-spends by virement or spending.

- 2.4.7 If forecasts are not updated regularly there is a risk that expenditure variations will not be corrected promptly. Where spend is less than profiled there may be a temptation to leave the forecast at the budgeted level, as the service may still spend the full budget, and the perceived risk is lower than those areas at risk of over-spending. However, under-spending and over-forecasting risks tying up resources unnecessarily.

Recommendation

Finance should ensure it can demonstrate that forecasts have been appropriately calculated, and are updated regularly – including where spend is less than profiled.

Service Response / Action

Not Agreed. Forecasts are agreed in consultation with budget holders at budget holder meetings. It is not evident that these findings materially compromise the forecast process. This would be picked up by training identified in 2.1.4

Implementation Date

N/A

Responsible Officer

N/A

Grading

Significant within audited area

2.5 Variance Identification and Commentary

- 2.5.1 Forecast variances from budget indicate a need for management action. However, not all variances will be material in size or nature. Finance has set a variance threshold of £50,000, at which point a variance note must be produced and included within relevant reports to management and Committees.

- 2.5.2 The threshold applies regardless of the size of the budget line affected: i.e. this is £50,000 whether the budget is £50,000 or £50,000,000. Although straightforward to apply, a variance of £50,000 may be insignificant in percentage terms for larger budgets, and would not cover smaller variances which whilst less material in the context of a Service or Council budget, may represent a significant impact on specific aspects of service delivery.

- 2.5.3 Applying a mixed threshold, or more than one threshold, including both a percentage and an absolute value may provide more useful information. E.g. variances exceeding 5% of the relevant budget and £10,000, and those exceeding £50,000.

Recommendation

Finance should regularly review the variance threshold and tolerances.

Service Response / Action

Agreed. The current agreed method was decided after consultation in order to provide a simple to understand method. It is recognised that the needs of the organisation may change in more challenging economic times. The revised procedures in 2.1.3 will consider the approach to materiality and ensure financial risk is appropriately reported and managed through the use of thresholds.

Implementation Date

April 2017

Responsible Officer

Accounting Manager

Grading

Important within audited area

- 2.5.4 Application of the materiality level varies according to how the budget monitoring figures are combined – for example in the Committee and Highlight reports there are often divisions or combinations of costs across a directorate. For example staff costs across Finance, Procurement and Legal might collectively vary by over £50,000 but individually by less than £50,000. If presented by Service, there would be no variance note required, but if presented by category there would. Presentation varies between the Directorates.

Standardising this would promote consistency in variance reporting, but might be considered unnecessary if the Committees / management are satisfied with existing reports.

<u>Recommendation</u>		
Finance should review the consistency of presentation of budget monitoring reports across services to ensure variances are consistently identified and reported.		
<u>Service Response / Action</u>		
Agreed. This will be incorporated in procedures in 2.1.3.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
April 2017	Head of Finance	Important within audited area

- 2.5.5 As with accruals and forecasts there is limited supporting evidence to demonstrate that variances have been assessed and discussed with management. Variances are typically identified and highlighted but there is limited information on their nature and action being taken to resolve them.

<u>Recommendation</u>		
Finance should ensure there are clear records of discussion of variances with management, including their extent, nature and actions being taken to resolve them.		
<u>Service Response / Action</u>		
Agreed. Variances are discussed and highlighted at budget holder meetings, SMTs, CMT and Committee. It is recognised that there could be clearer documentation of the nature and discussions undertaken and this will be incorporated in the revised procedures highlighted in 2.1.3.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
April 2017	Accounting Manager	Important within audited area

- 2.5.6 The Financial Regulations set out a scheme of virement – which sets out the rules for moving budgets between different headings and services after they have been set by Full Council for the year. Approval must be sought from Service Committees for specific types and values of virement, and they must be advised of others approved by management.

- 2.5.7 Whilst it is evident that approval for some virements is being sought from Service Committees, not all virements are being clearly documented in order to explain their necessity and impact before they are processed and changes are made to budgets. It is not apparent that virements selected from the financial system for review by Internal Audit were included within a Committee report (though they may have formed part of a larger whole) as the relevant budgets and / or values have not been clearly disclosed in the Committee reports. In other cases there does not appear to have been any reference in Committee reports to virements within the areas audited, yet budgets have been vired. Although the ledger system holds an audit trail of virements processed against the budget, as with other journal entries there is limited narrative detail to explain them.

- 2.5.8 As with budget monitoring reporting, Office of the Chief Executive and Corporate Budget virements are not reported to a Committee. This could provide significantly more opportunity to make budget changes within these areas without seeking Committee approval.

Recommendation

Finance should ensure adherence to the scheme of virement is clearly documented and adhered to.

Service Response / Action

All virements are processed by the budgeting team, and have to be signed off by a Finance Business Partner. The budget tracker records all cases of virement. OCE and Corporate budget virements would be reported through FP&R Committee. The importance of recording virements to an appropriate level of detail will be incorporated in the revised procedures highlighted in 2.1.3. This is not seen as a significant risk to budgetary control.

Implementation Date

April 2017

Responsible Officer

Accounting Manager

Grading

Significant within audited area

AUDITORS: D Hughes
C Harvey

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	<p>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.</p> <p>Financial Regulations have been consistently breached.</p>
Significant within audited area	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system's adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
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.