

ABERDEEN CITY COUNCIL

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| COMMITTEE | Audit, Risk and Scrutiny Committee |
| DATE | 22 June 2017 |
| TITLE OF REPORT | Internal Audit Report AC1719 – General Fund Revenue Budget Setting |
| REPORT NUMBER | IA/AC1719 |
| DIRECTOR | N/A |
| AUTHOR | David Hughes |

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the planned Internal Audit report on General Fund Revenue Budget Setting.

2. RECOMMENDATION

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

- 3.1 Internal Audit has completed the attached report which relates to an audit of General Fund Revenue Budget Setting.

4. FINANCIAL IMPLICATIONS

- 4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

- 5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

- 6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. IMPACT SECTION

7.1 **Economy** – The proposals in this report have no direct impact on the local economy.

7.2 **People** – There will be no differential impact, as a result of the proposals in this report, on people with protected characteristics. An equality impact assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. The proposals in this report will have no impact on improving the staff experience.

7.3 **Place** – The proposals in this report have no direct impact on the environment or how people friendly the place is.

7.4 **Technology** – The proposals in this report do not further advance technology for the improvement of public services and / or the City as a whole.

8. APPENDICES

8.1 Internal Audit report AC1719 – General Fund Revenue Budget Setting.

9. REPORT AUTHOR DETAILS

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ABERDEEN
CITY COUNCIL

Internal Audit Report

General Fund Revenue Budget Setting

Issued to:

Steven Whyte, Head of Finance
Fraser Bell, Head of Legal and Democratic Services
Carol Smith, Accounting Manager
Helen Valentine, Finance Manager (Projects)
External Audit

Date of Issue: May 2017

Report No. AC1719

EXECUTIVE SUMMARY

The Council is required Section 93(3) of the Local Government Finance Act 1992 to set a balanced budget in February each year. There is an established collaborative process in place, and a dedicated Finance Team, to ensure that this is the case.

In February 2016, as in previous years, the Council agreed a balanced budget for 2016/17, having identified and considered a range of options for closing a potential budget gap arising due to challenging cost and funding pressures. Budgeted revenue expenditure for delivery of services for 2016 was £455 million.

The objective of this audit was to review the procedures used in setting the Council's revenue budget for 2016/17. In general, the process applied was well structured and supported, however more detailed procedures, timetables, and improved audit trails of supporting documentation, have been recommended and agreed. Strategy and budgeting could also be more clearly linked, and Finance has stated that this has been improved for the 2017/18 budget.

Although there is sufficient substantial detail provided in the budget setting paper regarding options and assumptions to allow Full Council to set a balanced budget, there is no information on the split of budgets between Council Services. Finance has stated that this information is provided separately both before the budget is set, and afterwards through budget monitoring. However, these may reflect a different position due to timing and application of options. There is an implicit assumption that the split of Service budgets is agreed and correct.

1. INTRODUCTION

- 1.1 The Council is required under Section 93(3) of the Local Government Finance Act 1992 to set a balanced budget in February each year. There is a collaborative process in place, and a dedicated Finance Team, to ensure that this is the case.
- 1.2 In February 2016, as in previous years, the Council agreed a balanced budget for 2016/17, having identified and considered a range of options for closing a potential budget gap arising due to challenging cost and funding pressures. Budgeted revenue expenditure for delivery of services for 2016 was £455 million.
- 1.3 The objective of this audit was to review the procedures used in setting the Council's revenue budget for 2016/17. This report was due to be presented to the Audit, Risk and Scrutiny Committee in November 2016, but was delayed pending completion of an audit of Budget Monitoring. The draft report was issued in December 2016 following a meeting with Finance staff to discuss the contents.
- 1.4 As a result of the above, this audit did not cover procedures employed in setting the most recent budget, for 2017/18. However, statements from Finance in relation to the 2017/18 process have been included where appropriate.
- 1.5 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, Carol Smith, Accounting Manager, and Helen Valentine, Finance Manager (Projects).

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Procedures

- 2.1.1 The CIPFA publication “the role of the chief financial officer in Local Government” states that one of the core responsibilities of the chief financial officer is to lead on the development of the annual budget process.
- 2.1.2 Finance starts with an existing 5-year budget model, and updates this based on known changes, including a review of staffing and contracts budgets, potential legislative changes, demographic forecasts and changes in cost drivers around material service areas. In this way, the base budget is updated for significant changes. The 5-year model is updated throughout the year and is reviewed as a result of budget monitoring findings.
- 2.1.3 Thereafter, for the 2016/17 process, budget holders were tasked, in conjunction with the Financial Planning and Projects Team and Finance Business Partners, with identifying options for balancing the budget through savings, to offset pressures (unavoidable cost increases) and growth (cost increases as a result of changes to the level of service provided), and for making service efficiencies and improvements. Services were supported through Finance engagement with Service Management Teams (SMT’s) to develop their options and explore areas of budget for review. Services then collated their proposals and presented them to Extended Corporate Management Team (ECMT) and CMT as part of an iterative process for consideration in preparation of an officer budget. Thereafter this was presented to Full Council, which makes the final decisions. Subsequent to completion of the audit, Finance noted that changes were made during the 2017/18 budget setting process, however this has not been reviewed as part of this audit.
- 2.1.4 There is a separate Financial Planning and Projects Team whose main focus is on budget setting. Services are supported by the Team through the process, and it is progressed via regular reporting to CMT, and Service SMT’s, however there are no detailed written procedures outlining what they must do in order to feed into the budget setting process.
- 2.1.5 The process was set out in a series of documents in May 2013 for the 2014-18 budget setting process. This included an overview, key stages, and standard documents (e.g. for presenting business cases for growth, savings options etc). CMT was provided with a new overview for 2017/18, outlining an iterative process which includes Function reviews (Heads of Service and management teams), Directorate round tables, and Cross-directorate round tables.
- 2.1.6 Each year a ‘Project Plan – Budget’ document was presented to CMT, which set out the main stages and months in which these would take place. Although this plan was not formally approved, minuted or monitored against, there were regular updates prepared for CMT, and a budget was prepared for presentation to Full Council by the due date in February each year.
- 2.1.7 Generally, the process is well planned and supported, however it may be useful to set out the process in more detail so that e.g. budget holders understand their role and responsibilities, and what happens with the information and bids they submit, in order to better engage them with the process, and to clarify deadlines. Setting out the procedures to be followed by the Finance Projects Team and other Finance colleagues would also be useful, particularly in the event of experienced team members leaving.

Recommendation

Finance should create more targeted guidance on the budget process for budget holders and team members.

Service Response / Action

Agreed. The process currently in place is already considered to be well structured and supported, there are clear decision points throughout, and there is a need for some flexibility as the process is fluid and subject to external influences, however more targeted guidance and clarity on deadlines might strengthen the process and prove useful to budget holders. A working group consisting of the Head of Policy, Performance and Resources (E&CS), Head of Legal and Democratic Services, Head of Land and Property Assets, Head of Public Infrastructure and Environment, and the Acting Head of Planning and Sustainable Development has been set up to help facilitate the 2018/19 budget process.

Implementation Date

June 2017

Responsible Officer

Officers detailed in Service Response.

Grading

Important within audited area

2.2 Budget Approach

- 2.2.1 The budget setting process, as set out above, is largely incremental – existing budgets are reviewed and adjustments are made based on historical spend, known changes, and assumptions about the future. ECMT determines an initial priority between the declared options and anticipated growth, and how to address any shortfall in the budget after these items have been considered and accepted / rejected. Individual Services and budget holders identify the savings options to offer, and growth / pressures to request. As the majority of budget lines reviewed by Internal Audit were rolled forward at the same level as the previous year, unless there are planned and agreed changes this could build in an implicit assumption that existing budgets are correct.
- 2.2.2 Finance has stated that over half of all budgets are reviewed in detail each year, particularly staffing and areas in which transformational change is planned, or options identified. Although smaller budgets may be rolled forward, these are reviewed in detail on a rotating basis in year. Budget monitoring and forecasts should identify any recurring issues to be addressed either in-year by virement or as part of future budget setting exercises.
- 2.2.3 For 2016/17 the Full Council budget setting papers show that challenge of existing budget assumptions took place (e.g. increasing vacancy factors and identifying other recurring underspends). Further challenge has been demonstrated in the 2017/18 papers prepared for CMT, as additional risks to achieving a balanced budget have been identified for the next financial year.
- 2.2.4 Although Finance piloted an ‘outcome based’ budgeting process in 2015/16 for 2016/17 this has not yet progressed into a revised budget process. Finance noted that information was gathered on performance, challenge questions, cost and activities. Activity maps were then refined into the main outcomes and a planning table created. This was found to be helpful as it collated the activities linked to outcomes, performance, priority and cost on one page and it gave insight to the service involved. It is likely that rollout of this approach as a service planning tool to further pilot areas will be considered, rather than a whole Council approach to budgeting.
- 2.2.5 Directorate Business Plans for Corporate Governance, Communities Housing & Infrastructure, and Education and Children’s Services were presented to Council as a

bulletin item on budget setting day. However, it is not clear that the draft 2016/17 budget figures within these plans correlate with the figures presented in the budget setting paper, since only adjustments are discussed in the latter and there is no analysis into Services (other than savings and growth options). It is also unclear whether options pending Council agreement had been included within the Business Plan figures. Finance state the Directorate Business plans were developed by management teams concurrently with the budget and the service analysis working papers presented to Directorates. They were developed with a recognition of the options under consideration for their Directorates.

2.2.6 The above process was compared to the Audit Scotland Best Value Financial Management Toolkit and areas where potential improvements could be made were examined. Although the Council has incorporated elements of 'better practice' (as defined by the toolkit) Internal Audit considers that there are areas where this could be better demonstrated, or moved to 'advanced practice'. This includes how well the budget reflects the organisation's strategic priorities and objectives, and the need for clear links between service plans and financial strategy.

2.2.7 While the budget process remains incremental, although it does include opportunity for cross-service interaction to develop and agree proposals, supported by Finance, there is a risk that individual directorates or functions might retain their non-core budgets at the expense of other Services' core functions and statutory duties. Finance stated that a review of functions was undertaken in 2013, but the results were inconclusive: each service has its merits and the balance is determined through Council strategy, business planning, and agreement of the annual budget and options. Due to the financial pressures and budget process implemented in the last 6 years there has been challenge of non-statutory budgets. The challenge concluded that non-statutory budgets that considerably benefit the council's objectives and customer feedback have been protected, whilst those of lesser value have been reduced. In addition, there have been a considerable number of options resulting in major change in the way service operations are undertaken to drive improvement and efficiency.

Recommendation

The Council should ensure there is a clear link between strategy and budgets.

Service Response / Action

Agreed. Strategy and budgets are already linked, but there may be room to improve this linkage and more explicitly document it, particularly in relation to areas of significant transformation, application of savings options, or budget pressures. This has been achieved as demonstrated in budget papers being presented to Council on 22 February 2017

Implementation Date

Implemented

Responsible Officer

Corporate Management
Team

Grading

Significant within audited
area

2.3 Supporting Information

2.3.1 All service options have been recorded on a template, and have been reviewed, considered by management, and where selected for action or Council approval: summarised into the budget setting paper. However, not all of these templates had been fully completed with all of the required detail, including the risks and assumptions associated with taking the option forward. Although management has discussed and agreed the options, there is no evidence of this discussion, beyond the outcome in the budget setting paper. Without a record of the assumptions it may be difficult to progress the agreed actions, and to ensure that there is no overlap between options, or unexpected impact on other services.

- 2.3.2 Service options are supported by varying levels of detail. Where there is supporting detail or workings, these do not always clearly demonstrate how figures have been arrived at through clear calculations and narrative. It is acknowledged that estimates have to be made based on knowledge and professional judgement, and it would be misleading to suggest that precise calculations can be made to determine future income and expenditure requirements. However, estimates should be made on the basis of the best available data, and it is important to retain an audit trail for material changes.
- 2.3.3 Although budget holders and ECMT have agreed the options, if there are insufficient supporting calculations, or records of consideration of the risks and assumptions underlying planned savings, there is a risk they may not be achieved in the way originally intended – particularly in the event of changes in Finance teams or budget holders. Alternative actions may have to be taken during the year to resolve budget variances, which may exceed or differ from those agreed by Full Council.
- 2.3.4 This is however being mitigated against, after the budget has been set, through budget monitoring, and a new Benefit Tracker spreadsheet being used by Finance which tracks savings delivery, for reporting to CMT, throughout the year. In the event of any difficulty in achieving savings, alternatives can be considered through this process.

Recommendation

The Council should ensure all service options have been detailed, risks and assumptions explained and are supported by reasonable calculations, before they are taken forward for approval.

Service Response / Action

Agreed. The audit trail could be improved in some cases, and will be developed to reflect the materiality and priority of the options. Significant options have been subject to more scrutiny and review.

Head of Finance will make recommendations for CMT to apply in respect of the quality of service option audit trail.

Implementation Date

February 2018

Responsible Officer

ECMT

Grading

Significant within audited area

- 2.3.5 Budget data is updated promptly in the financial system to provide data for both Finance and Service colleagues to assist them in managing their budgets. The Budget Tracker spreadsheet that is used to document changes does not however clearly match the agreed adjustments included in the budget setting paper presented to Full Council, nor does it accurately reflect all of the adjustments made to the budget in the financial system.
- 2.3.6 Service Cost Model spreadsheets present the data in a different way, however it is not straightforward to compare the data in this spreadsheet with the agreed adjustments, or with the Budget Tracker. This is largely due to the way in which the adjustments have been combined, and shared between Services. These allocations are not consistently recorded across Services, and it was not possible for Internal Audit to verify that they were complete and accurate. Finance has stated that the way in which they are recorded is understood by those operating the process. As with the Budget Tracker, the data recorded on these spreadsheets does not always match the adjustments made to the financial system.
- 2.3.7 There are also differences due to some changes being applied in stages prior to final Council agreement to the budget paper, or the figures being presented net of prior years'

time-limited savings. Where this has occurred the spreadsheet does not clearly indicate it, and the budget paper does not clearly show the impact of prior years' decisions.

- 2.3.8 The audit trail is insufficient to determine whether all, and only, the adjustments presented to and agreed by the Council have been applied. If the adjustments are not sufficiently backed up, particularly given Councillors do not see the full budget, the process may not be sufficiently transparent. It is difficult to trace through from the changes agreed in the budget paper by Full Council, to the changes in the ledger: which are then used to monitor financial performance. There is a risk that some items may fall between these gaps and not be budgeted for.

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| <u>Recommendation</u> | | |
| Finance should ensure there is a clear audit trail to show that all budget adjustments agreed through the budget process have been applied, and disclosed, appropriately. | | |
| <u>Service Response / Action</u> | | |
| Agreed. Finance considers that an overall reconciliation is already carried out and there is minimal risk in respect of detail, as all elements of the budget are reflected in the ledger, and in the event of any errors this would be picked up and corrected through the budget monitoring process. A review of the audit trail will however be carried out to strengthen it where appropriate. | | |
| <u>Implementation Date</u> | <u>Responsible Officer</u> | <u>Grading</u> |
| July 2017 | Accounting Manager | Significant within audited area |

2.4 Publication

- 2.4.1 Finance acknowledged that there is no communications plan regarding the budget process. However, there are key stages during which key groups are consulted and provided with detailed updates as set out in the overall budget plan.
- 2.4.2 Finance has stated that Administration Leaders meet with CMT regularly to receive updates on the budget position. Directors then meet with Committee Convenors and other relevant Members at a later stage, during which their options are challenged / discussed. Although Finance has noted that there are records of regular meetings taking place, and of changes being applied as appropriate, there are no minutes of these discussions. At an early stage (November / December) Councillors are provided with budget packs setting out additional detail and the provisional options.
- 2.4.3 The 2016/17 budget was the first since the end of the previous 5 year rolling budget process and was presented as a single year budget – due to limited information on national grant settlements for future years. In contrast to the previous year, it was not presented to the Finance, Policy & Resources Committee in December prior to its presentation in February 2016 to Full Council. Finance noted that there were some delays in finalising the budget proposals due to delays in obtaining grant settlement data from Scottish Government.
- 2.4.4 High level risks and assumptions have been highlighted quite clearly as part of the budget setting paper, and this has given all Councillors the opportunity to feed into the process. The paper discussed the 'risk fund' whereby sums are held in reserves against the risk of savings targets not being met / other risks crystallising during the financial year. In addition, each proposed budget adjustment has been given a financial impact, and assessment of impact (high, medium or low) on customers, and on staff. The Council has then been given the opportunity to select between competing options (though only where officers had determined that the decisions require Committee / Council approval) to

balance the budget. Each option was briefly but adequately explained. Options selected, which have an equalities impact, had separate Equality and Human Rights Impact Assessments appended to the budget setting paper – further exploring the risks from this viewpoint. This presented an opportunity for improved understanding and buy-in to the content – which is likely to have been important given the impact on services from reduced financial resources.

- 2.4.5 The budget was not presented at a detailed level for 2016/17 – there is no overall cost per Service presented in the Council report. Only movements since the last budget have been included. Although the Council was asked, and agreed, to set a budget, Councillors had not seen it in detail other than agreeing the main changes, and selecting from a number of options to achieve the final balanced position. Without a Service by Service split, it is difficult to see how the Council's spending has been prioritised.

Recommendation

Finance should ensure Councillors have sufficient information regarding service budgets before they are agreed.

Service Response / Action

Not Agreed. Finance considers that there is already sufficient information provided through the budget process, and thereafter through the budget handovers and monitoring process. The priority areas for the Council are reflected in the service options, which are detailed within the budget setting report on a council-wide basis. It would be difficult to request Full Council to agree Service budgets before the service options have been agreed and applied to them.

Budget options are prioritised by Members in consideration of the costs and benefits of the individual options as identified through the service option sheets. For many options, there is considerable further consultation of Finance and Service Managers.

Following the approval of the budget, budget packs are created corporately and for individual directorates and services. These are handed over to the service and shared with service accountancy staff through a series of formal budget handover meetings. During the first few months of the financial year the new budgets are reviewed by all budget holders with their finance contact in the context of the prior year's out-turn position, financial issues arising are identified as the new forecast position is prepared. At this point the cost pressure and savings monitoring process commences.

A clearer timetable for the provision of budget information to Councillors would be of value, and Finance will develop this for 2018/19.

Internal Audit Comment

Service position noted. There remains a risk that Full Council may have insufficient information to prioritise budgets across the Council at the point the budget is set.

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 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. |