

Argyll and Bute Council
Internal Audit Report
January 2018
FINAL

Earmarked Reserves

Audit Opinion: Substantial

	High	Medium	Low
Number of Findings	0	0	3

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1. Executive Summary

Introduction

1. As part of the 2017/18 internal audit plan, approved by the Audit & Scrutiny Committee in March 2017, we have undertaken an audit of Argyll and Bute Council's (the Council) earmarked reserves.
2. The audit was conducted in accordance with the Public Sector Internal Audit Standards (PSIAS) with our conclusions based on discussions with council officers and the information available at the time the fieldwork was performed.
3. The contents of this report have been agreed with the appropriate council officers to confirm factual accuracy and appreciation is due for the cooperation and assistance received from all officers over the course of the audit.

Background

4. In July 2014, the Chartered Institute of Public Finance & Accountancy (CIPFA) published LAAP bulletin 99. This provides guidance to local authority chief financial officers on the establishment and maintenance of local authority reserves and balances.
5. It is the responsibility of the Council's Section 95 Officer (Head of Strategic Finance) to advise on the level of reserves the Council should hold and to ensure there are clear protocols for their establishment and use. The Council holds a general fund reserve, which comprises of the following elements:
 - a contingency for any unforeseen events or emergencies, which is reviewed annually as part of the budget setting process
 - the Strategic Housing Fund
 - balances held to support the following year's budget
 - earmarked funds.
6. The Council's end of year flexibility policy (the policy) details seven situations where earmarking of the general fund reserve is permitted, being:
 - unspent grants
 - unspent third party contributions
 - unspent budget within the Devolved Management of Resources Scheme of Delegation for schools
 - previous Council or Policy and Resources Committee decisions
 - existing legal commitments

- Scottish Government initiatives
 - energy efficiency fund.
7. Outwith these seven situations, unspent budget is not automatically carried forward and will be transferred back to the general fund unless a business case for earmarking unspent funds is submitted and approved. Business cases must be linked to the objectives, priorities and targets set out in the Council's corporate plan, area plans and service plans and are initially submitted to the Strategic Management Team before being presented to full Council.
8. The general fund balance as at 31 March 2017 was £53.489 million with £41.519 million of this held as earmarked balances.

Scope

9. The objective of the audit was to "review compliance with the policy in place and the control environment around the approval, reporting and monitoring of earmarked reserves" as outlined in the terms of reference agreed with the Head of Strategic Finance on 26 October 2017.

Audit Opinion

10. We provide an overall audit opinion for all the audits we conduct. This is based on our judgement on the level of assurance which we can take over the established internal controls, governance and management of risk as evidenced by our audit work. Full details of the five possible categories of audit opinion is provided in Appendix 2 to this report.
11. Our overall audit opinion for this audit is that we can take a **substantial** level of assurance. This means that whilst internal control, governance and the management of risk is sound there are minor areas of concern which need to be addressed in order for the residual risk to be at an acceptable level.

Key Findings

12. We have highlighted three low priority recommendations where we believe there is scope to strengthen the control and governance environment. These are summarised below:
- The policy does not cover all requirements of LAAP bulletin 99. The policy is reviewed on an annual basis as part of the budget process; however this is not evidenced.
 - Although there is a sound process in place for the approval, monitoring and reporting of earmarked reserves, this is not formally documented.
 - The monitoring of earmarked reserves is incorporated into the normal budget monitoring process and progress is discussed with budget holders at engagement meetings. However, these discussions are not consistently recorded.
13. Full details of the audit findings, recommendations and management responses can be found in Section 3 of this report and in the action plan at Appendix 1.

2. Objectives and Summary Assessment

14. Exhibit 1 sets out the control objectives identified during the planning phase of the audit and our assessment against each objective.

Exhibit 1 – Summary Assessment of Control Objectives

	Control Objective	Assessment	Summary Conclusion
1	There are appropriate and accessible policies/procedures to support the management of earmarked reserves which are aligned to LAAP bulletin 99.	Substantial	There is an end of year flexibility policy in place however this policy does not reference all requirements as set out in LAAP bulletin 99. The policy is subject to an annual review as part of the budget process; however there is no evidence of this.
2	Current practice is compliant with the Council's approved earmarked policy and procedures.	Substantial	There is a sound process in place for the approval, monitoring and reporting of earmarked reserves; however this is not formally documented.
3	Documentation is complete, accurate and not excessive and is compliant with the data retention policy.	Substantial	Drawdown requests are submitted by the relevant finance contacts and there is a clear audit trail of these requests. However, finance contacts are not consistently recording discussions with budget holders in relation to progress and drawdown of earmarked reserves.

15. Further details of our conclusions against each control objective can be found in Section 3 of this report.

3. Detailed Findings

There are appropriate and accessible policies/procedures to support the management of earmarked reserves which are aligned to LAAP bulletin 99

16. LAAP bulletin 99 recommends that "for each earmarked reserve held by a local authority there should be a clear protocol setting out:

- the reason for/purpose of the reserve
- how and when the reserve can be used
- procedures for the reserve's management and control
- a process and timescale for review of the reserve to ensure continuing relevance and adequacy."

17. The reason for/purpose of the earmarked reserve and an indicative spend profile are detailed in the business cases for new earmarked reserves and are also recorded in the year-end earmarked reserve report to Council.
18. Although there is a sound process in place in relation to the management and control of earmarked reserves, this process is not referenced in the policy.
19. Earmarked reserves are reviewed on an ongoing basis throughout the year with a report submitted to full Council at the year-end which provides a justification for the ongoing earmarking. This process is not referenced in the policy.
20. The current policy was reviewed and approved by Council on 29 June 2017. The policy is reviewed on annual basis as part of the budget process; however this review is not evidenced. Current practice is that the policy is only included in the year end earmarked reserves report if it has been subject to change.

Action Plan 1

Current practice is compliant with the Council's approved earmarked policy and procedures

21. There were 13 new earmarked reserves approved in 2016/17 and a business case was submitted for each. All 13 business cases contained the information as required by the policy.
22. From a sample of 11 earmarked reserves, expenditure to date was reviewed and was consistent with the agreed purpose of the reserve.
23. Following council approval, there is a process in place for the monitoring and review of earmarked reserves;
 - funds are held in a central cost centre
 - drawdown requests are prepared by the finance contact on behalf of budget holder and submitted to consolidated team for processing
 - the consolidated team move budget from the central cost centre into the relevant service cost centre to cover expenditure
 - progress with earmarked funds, including over/under spends, is regularly monitored and reported to departmental management teams and the Head of Strategic Finance by principal accountants
 - progress is also reported to the Policy & Resources Committee (P&R) as part of the earmarked reserves report which is a standing agenda item.
24. This process is not formally documented.

Action Plan 2

Documentation is complete, accurate and not excessive and is compliant with the data retention policy

25. Access to the general ledger is restricted to designated personnel. Access is requested via the Oracle Systems Administrator via a request form that requires third tier manager authorisation.
26. Financial papers reported to Council and the P&R committee are public documents in line with standard practice.
27. The earmarked reserve monitoring spreadsheet and a register of budget changes are maintained within strategic finance's shared drive.
28. The monitoring of earmarked reserves is incorporated into the normal budget monitoring process and progress is discussed with budget holders at engagement meetings. However, these discussions are not consistently recorded. In some cases there was no audit trail of the original request from the budget holder.

Action Plan 3

Appendix 1 – Action Plan

	No.	Finding	Risk	Agreed Action	Responsibility / Due Date
Low	1	<p>Update End of Year Flexibility Policy</p> <p>The end of year flexibility policy does not reference all requirements as set out in LAAP bulletin 99. The policy is subject to an annual review as part of the budget process however this review is not evidenced. The policy is not included in the year-end report to council if it has not been subject to any changes.</p>	<p>Failure to ensure policies and procedures are aligned to bulletin may lead to non-compliance with legal and/or professional requirement and standards.</p>	<p>The policy will be amended to reflect LAAP bulletin 99 and the policy will be included as an appendix to the end of year earmarked reserves report to Council going forward.</p>	<p>Head of Strategic Finance</p> <p>30 June 2018</p>
Low	2	<p>Procedure Note for Managing Earmarked Reserves</p> <p>Although there is a sound process in place for the approval, monitoring and reporting of earmarked reserves, the process has not been formally documented.</p>	<p>Failure to document formal policies, procedures and processes may lead to inefficient and ineffective operations resulting in inconsistencies and non-compliance with agreed practice.</p>	<p>A procedure note will be prepared to formally document this process.</p>	<p>Head of Strategic Finance</p> <p>31 August 2018</p>
Low	3	<p>Completeness & Consistency of Record Keeping</p> <p>The monitoring of earmarked reserves is incorporated into the normal budget monitoring process and progress is discussed with budget holders at engagement meetings. However, these discussions are not consistently recorded. In some cases there was no audit trail of the original request from the budget holder.</p>	<p>Failure to maintain complete and consistent records may lead to an inability to support decision making.</p>	<p>A consistent approach to record keeping will be adopted to ensure a clear audit trail is available to support decision making.</p>	<p>Head of Strategic Finance</p> <p>31 August 2018</p>

In order to assist management in using our reports a system of grading audit findings has been adopted to allow the significance of findings to be ascertained. The definitions of each classification are as follows:

Grading	Definition
High	A major observation on high level controls and other important internal controls or a significant matter relating to the critical success of the objectives of the system. The weakness may therefore give rise to loss or error.
Medium	Observations on less significant internal controls and/or improvements to the efficiency and effectiveness of controls which will assist in meeting the objectives of the system. The weakness is not necessarily substantial however the risk of error would be significantly reduced if corrective action was taken.
Low	Minor recommendations to improve the efficiency and effectiveness of controls or an isolated issue subsequently corrected. The weakness does not appear to significantly affect the ability of the system to meet its objectives.

Appendix 2 – Levels of Audit Opinion

Level of Assurance	Definition
High	Internal control, governance and the management of risk are at a high standard. Only marginal elements of residual risk have been identified with these either being accepted or dealt with. A sound system of control designed to achieve the system objectives is in place and being applied consistently.
Substantial	Internal control, governance and the management of risk is sound. However, there are minor areas of weakness which put some system objectives at risk and specific elements of residual risk that are slightly above an acceptable level and need to be addressed within a reasonable timescale.
Reasonable	Internal control, governance and the management of risk are broadly reliable. However, whilst not displaying a general trend, there are a number of areas of concern which have been identified where elements of residual risk or weakness may put some of the system objectives at risk.
Limited	Internal control, governance and the management of risk are displaying a general trend of unacceptable residual risk above an acceptable level and placing system objectives are at risk. Weakness must be addressed with a reasonable timescale with management allocating appropriate resources to the issues raised.
No Assurance	Internal control, governance and the management of risk is poor. Significant residual risk and/or significant non-compliance with basic controls exists leaving the system open to error, loss or abuse. Residual risk must be addressed immediately with management allocating appropriate resources to the issues.