

Argyll and Bute Council
Internal Audit Report
December 2018
FINAL

Financial Planning

Audit Opinion: **Substantial**

	High	Medium	Low
Number of Findings	0	1	0

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1. Executive Summary

Introduction

1. As part of the 2018/19 internal audit plan, approved by the Audit & Scrutiny Committee in March 2018, we have undertaken an audit of Argyll and Bute Council's (the Council) system of internal control and governance in relation to financial planning.
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. The Council is predominantly funded by the block grant provided by the Scottish Government. The annual budget setting process is an iterative ongoing process however the key activities associated with it commence at the end of August and conclude at the council meeting in February where the budget is approved and the following year's council tax set.
5. The budget process is led by Strategic Finance with direct input from budget holders using their knowledge of the needs and pressures of their service. The annual budget is formed using the last agreed recurring budget as a base which is updated to incorporate identified changes. The salary budget is generated following a comprehensive review of the staff establishment.
6. A budget outlook, covering the medium term (3 years), is prepared to provide a high level estimated overview of the Council's future financial position. In addition the Council has a financial strategy which covers the period 2018-2019 to 2020-21 in detail and provides high level estimates for 2021-2028.

Scope

7. The scope of the audit is to review the Council's revenue budget setting process and arrangements for medium to long term financial planning as outlined in the terms of reference issued to the Head of Strategic Finance in November 2018.

Risks

8. The risks considered throughout the audit were:
 - **SRR03: Financial Sustainability** – Insufficient resource to meet current and future service requirement. Budget not aligned/does not support business outcomes.
 - **ORR01: Capacity/Act Aligned to Priorities** – Strategic finance capacity and activity not aligned to Council's key strategic priorities
 - **ORR02: Resource Availability** – Service provision and performance affected by difficulties recruiting/retaining suitably qualified staff, organisational change, and/or staff sickness.

Audit Opinion

9. 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.
10. Our overall audit opinion for this audit is that we can take a substantial level of assurance. This means that 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.

Key Findings

11. We have highlighted one medium priority recommendation where we believe there is scope to strengthen the control and governance environment. This is summarised below:
 - the current implementation of the revised Strategic Finance structure should be supported by a programme of knowledge sharing, skills transfer and, where appropriate the creation of procedure notes.
12. 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

13. 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	Link to Risk	Assessment	Summary Conclusion
1	The role of the Chief Financial Officer (CFO) and the structure of Strategic Finance is appropriate to deliver strong financial management.	ORR02	Substantial	The Council's CFO is an integral part of the Council's Strategic Management Team (SMT) and has a role on a number of appropriate Council committees and boards. Strategic Finance have experienced a number of resource pressures in the past two years however action is being taken to address this including the implementation of a new structure. In order to fully maximise the benefit that can be obtained from the new structure resilience should be built through establishing a programme of knowledge sharing, skills transfer and ensuring that procedural guidance is available to guide officers.
2	Revenue budget preparation guidance has been prepared and is followed	SRR03 ORR01	Substantial	Budget preparation guidance document has been created which sets out the key stages and timescales for the revenue budget preparation process. This is supported by

	Control Objective	Link to Risk	Assessment	Summary Conclusion
				regular engagement between finance and budget holders.
3	Budget outlook is prepared and regularly reviewed to ensure assumptions are based on up-to-date information.	SRR03	High	A paper, providing an update on the Council's three year budget outlook, is prepared and submitted to every Policy & Resources Committee (P&R). It considers a best case, worst case and mid-range scenario and appropriately revises key assumptions to reflect updated information.
4	Financial Strategy is aligned to corporate outcomes and is updated appropriately to reflect any changes to assumptions	SRR03	High	The Council's medium to long term financial strategy is based on a set of assumptions and provides a range of potential scenarios and their financial implications. Its content is consistent with Audit Scotland guidance and is reviewed annually as part of the budget setting process.

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

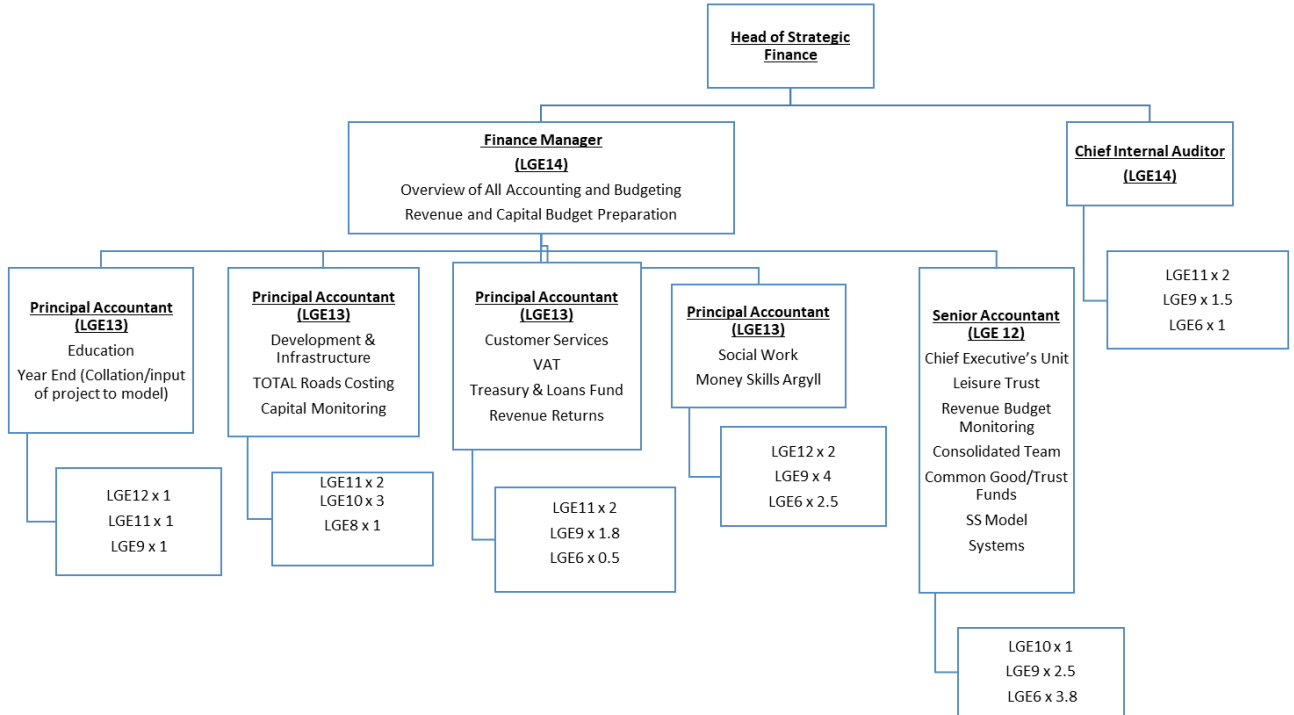
3. Detailed Findings

The role of the Chief Financial Officer and the structure of Strategic Finance is appropriate to deliver strong financial management

15. The Head of Strategic Finance is the Council's CFO as per the requirements of section 95 of the Local Government (Scotland) Act 1973. The CFO has responsibility for the administration of the financial affairs of the Council and the provision of financial advice to Council officers and elected members. The CFO role and its responsibilities are clearly set out in the Council's constitution.
16. The CFO is an integral part of the Council's SMT which meet on a weekly basis. She also attends, and present reports to, council committees including full Council, the Audit and Scrutiny Committee and the P&R, and is a member of the Council's Transformation Board and Human Resources Board. She has delegated her role on the Asset Management Board to the Finance Manager.
17. A review of minutes and attendance at some of these committees and boards confirmed that the CFO has sufficient status within the Council to carry out her role effectively.
18. In 2017 and 2018 Strategic Finance have experienced a number of resource issues. One finance manager left post in October 2017, a second retired in September 2018 and medium to long term absences due to illness have placed, and continue to place, the service under pressure. This has predominantly been managed through a combination of secondments, acting up and use of agency workers.
19. In June 2018 the CFO announced her intention to restructure Strategic Finance with a focus on providing greater team resilience. A new finance manager was appointed in August 2018 and the CFO consulted with the Strategic Finance Management Team (SFMT) on a draft structure at

meetings held in August and October. The structure was amended to reflect feedback and the revised structure, shown at exhibit 1, was communicated to all finance staff in November 2018.

Exhibit 1 – Revised Strategic Finance Structure



20. Exhibit 2 provides a summary of how the revised structure differs from the previous one in terms of full time equivalents (FTE) at each grade. This illustrates an overall increase of 0.83 FTE and, most significantly, increases at the LGE11 and LGE12 (qualified accountant) grades. The overall increase, and the increase in qualified staff, should provide additional capacity to deliver.

Exhibit 2 – Impact of Revised Strategic Finance Structure

Grade	Previous Structure (FTE)	Revised Structure (FTE)	Increase/Decrease (FTE)
Head of Service	1.00	1.00	0.00
LGE14	3.00	2.00	-1.00
LGE13	4.60	4.00	-0.60
LGE12	2.07	4.00	1.93
LGE11 (including trainees)	5.50	7.00	1.50
LGE10	4.00	4.00	0.00
LGE9	11.80	10.80	-1.00
LGE8	1.00	1.00	0.00
LGE6	7.80	7.80	0.00
Total	40.77	41.60	0.83

21. As per paragraph 19 one of the main reasons for the restructure was to provide greater resilience within the service to reduce the risk of long term absences having a detrimental

impact on service delivery. To support this objective the restructure needs to be supported by a programme of knowledge sharing and skills transfer and through ensuring appropriate procedure documents are in place to support service delivery.

Action Plan 1

22. It is a requirement that any officer above grade LGE11 is a qualified CCAB accountant and that grade LGE11 officers are either qualified, currently training towards an accountancy qualification or willing to undertake one. The current officers in posts comply with this requirement and there are a range of qualifications in the service including CIPFA, ICAS and CIMA. All finance officers are required to complete an annual performance review and development plan which includes a minimum of six targets to be achieved, two of which are linked to their job description, two to service or team plans and two to the Council's core competencies. Strategic Finance currently exceed the target of having 90% of staff with completed PRDs. Those still requiring completion are for staff who have recently returned from maternity leave.
23. Overall we are of the view that Strategic Finance, as a service, is appropriately qualified and experienced to carry out its duties. There are vacancies within the new structure which are to be filled through a combination of internal promotions and external recruitment. This has been consulted on and agreed with the trade unions. As the CFO is aware of the need to fill these posts, and is actively engaging in progressing this, we have not highlighted this as an action plan point.

Revenue budget preparation guidance has been prepared and is followed

24. A budget preparation guidance document has been created which sets out the key stages and timescales for the revenue budget preparation process. It defines key tasks and roles and responsibilities in relation to:
- calculating the base budget
 - preparing the salary budget
 - identifying savings
 - managing cost and demand pressures
 - budget profiling
 - financial risks.
25. There is regular engagement between Strategic Finance and budget holders throughout the year to discuss budget monitoring, projected outturn, earmarked reserves, and future year budget forecasts including cost and demand pressures and efficiency opportunities. These help inform the current year budgeting position, the preparation of the next year's revenue budget and the longer term budget outlook.
26. In their 2017/18 annual audit report the Council's external auditors, Audit Scotland, reported that the Council's financial management is effective with a budget process focussed on the Council's priorities. They further concluded that budget monitoring arrangements support effective scrutiny of the Council's finances and, in particular, that:
- the Council's budget monitoring arrangements were effective
 - there was satisfactory communication of accurate and timely information on financial performance to members

- budget reports provided a good overall picture of the budget position at service level including good explanations for variances and changes to the initial budget
- there were appropriate arrangements in place to identify funding gaps through the regularly updated Budgetary Outlook Reports.

27. We have placed reliance on the conclusions reached by Audit Scotland and concluded that no further work was required against this control objective.

Budget outlook is prepared and regularly reviewed to ensure assumptions are based on up-to-date information

28. A budget outlook paper is prepared and submitted to each P&R Committee meeting. It provides an update to the Council's three year budget outlook including information on any assumptions that have changed since the previous update.

29. The budget outlook is prepared using a best case, worst case and mid-range scenario. Whilst the text in the quarterly P&R Committee report focuses on the mid-range scenario, all three scenarios are provided to committee members in an appendix to the report.

30. A review of P&R Committee papers in 2017/18 confirmed that the CFO regularly reviews and revises key assumptions to reflect updated information such as the Scottish Government finance settlement, national pay awards, pension contribution rates, non-pay inflation, and a range of cost and demand pressures.

Financial Strategy is aligned to corporate outcomes and is updated appropriately to reflect any changes to assumptions

31. The Council's medium to long term financial strategy (2018/19 – 2027/28) is based on a set of assumptions and provides a range of potential scenarios and their financial implications. The strategy is reviewed annually as part of the Council's budget setting process to reflect changes to any underlying assumptions. The medium term estimates are reviewed more regularly via the budget outlook reports submitted to the P&R Committee.

32. In their June 2014 report '[Scotland's public finances – a follow up audit: progress in meeting the challenges](#)' Audit Scotland set out what they consider to be the key requirements of a financial strategy. Exhibit 3 details our analysis of the Council's strategy against these key requirements. We have concluded that the strategy, and supporting committee papers, contain all the key requirements.

Exhibit 3 – Assessment of Council's Financial Strategy against Audit Scotland's Key Requirements

Audit Scotland Key Requirement	Council's Financial Strategy
Costs A clear understanding of the business model and the cost of individual activities within it.	The current economic context of the Council is set out in the strategy and the costs of services and cost and demand pressures are discussed throughout the document. A need to develop cost information in the use of unit costs and trend analysis is highlighted and this has been progressed by Strategic Finance during 2018.
Savings Options Evidence-based options for achieving savings.	Section 6 'The Strategy to Address the Budget Gap' provides examples of activity which have been undertaken to deliver savings and further opportunities which are being explored to protect against future funding gaps. There is specific reference to the

Audit Scotland Key Requirement	Council's Financial Strategy
	Council's Transformation Board which has been established to oversee transformation opportunities.
Savings Details Details of one-off and recurring savings.	Section 6.1 highlights details of savings already made, both one-off and recurring.
Scenario Planning Scenario planning to outline best, worst and most likely scenarios of the financial position and the assumptions used.	The Council's approach to scenario planning is explained and used throughout the strategy to predict best, worst and mid-range case scenarios.
Assets/Liabilities & Reserves Details of assets, liabilities and reserves and how these will change over time.	Assets are considered including asset sustainability to ensure they continue to be fit for purpose, and service development to improve the efficiency and effectiveness of assets. Liabilities are considered as part of a consideration of the Council's debt management strategy. There is limited reference to the adequacy of reserves however the Council has a policy to hold a contingency balance equivalent to 2% of the Council's net expenditure budget to provide a working balance to cushion the impact of uneven cash flows and the impact of unexpected events. This is monitored on an ongoing basis with updates on projected year end reserve balances reported to the P&R Committee. In addition an annual report on reserves and balances is taken to full council as part of the budget pack. This advises members of the overall level of reserves held by the Council and an assessment of the potential impact of the Council's strategic, operational and financial risks on the adequacy of reserves.
Capital Investment Activity Details of assets, liabilities and reserves and how these will be paid for.	A capital investment programme is referenced as being needed to support the Council's key priorities. The Council's three year capital plan is referenced including consideration of capital funding streams, funding assumptions and longer term capital grant estimates.
Demand An analysis of levels of service demand and projected income.	Cost and demand pressures are referenced throughout the strategy including digitalisation, carbon management, income maximisation, asset and investment funds, shared services, fees and charges and service redesign.
Funding Shortfalls Any income or funding shortfalls and how to deal with these.	Medium term funding gaps have been identified for each of the scenarios provided and used to project out to ten years. Section six sets out the strategy to address the budget gap.
Strategy Links Clear links to the Corporate Strategy, CPP objectives and other relevant strategies such as workforce and asset management.	The Community Planning Partnership has agreed six outcomes in its Argyll and Bute Outcome Improvement Plan. The Council's Corporate Plan aligns the Council's business objectives with these six strategic outcomes. The strategy references these corporate documents and also references, and gives consideration to, both workforce planning and asset management in the relevant sections. This evidences that the strategy is considering relevant corporate strategy documents and although it might not clearly link to them, doing so is not considered to add any benefit to the document. Therefore no audit issue has been raised.

Audit Scotland Key Requirement	Council's Financial Strategy
<p>Risks & Timescales The risks and timescales involved in achieving financial sustainability.</p>	<p>Risks are considered throughout the strategy but with a main focus in section seven which specifically considers the main financial risks and assumptions that the Council needs to keep under review. Financial risks are also considered as part of the Council's annual budget process and financial risks are reported throughout the year as part of routine budget monitoring.</p>
<p>Underpinning Plans The strategy should be underpinned by detailed financial plans in the short (one year) and medium (two to five years) term.</p>	<p>There is an annual revenue budget agreed by Council which is subject to effective budget monitoring and a three year budget outlook which is updated for each meeting of the P&R Committee..</p>

Appendix 1 – Action Plan

	No.	Finding	Risk	Agreed Action	Responsibility / Due Date
Medium	1	<p>Building Resilience</p> <p>Strategic Finance is currently implementing a restructure focused on providing greater resilience and capacity to deliver. Consideration should be given to supporting the revised structure with a programme of knowledge sharing, skills transfer and procedure notes to reduce the impact on service delivery in the event of unforeseen absence.</p>	Quality of service delivery may suffer due to over reliance on key officers.	Strategic Finance, through the SFMT, will implement a project to build resilience by delivering a structured programme of knowledge sharing. This will be supported by the development of procedure notes to provide guidance on the delivery of key finance processes.	Head of Strategic Finance 31 March 2020

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 – 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.