



**Chief Internal Auditor
Jill Stacey**

Auditor: Chris Hurt, Ext 3285

Final Internal Audit Report

to

- Chief Executive
- All Directors
- All Heads of Service

on

Revenue Financial Budget Monitoring

24 January 2019

1 Introduction

1.1 The purpose of this audit was to review the overarching arrangements for setting and monitoring the Revenue Financial Budget within Midlothian Council.

2 Audit Scope

2.1 The scope of this audit was to examine and evaluate the following areas:

- Financial sustainability in setting the revenue budget, including the utilisation of reserves;
- Financial budget monitoring reporting for elected members including assessment of scrutiny and challenge of those reports by elected members; and
- Budget monitoring processes and information at service level and senior management level.

3 Management Summary

3.1 Budgets have not been set on a financially sustainable basis over the last three financial years ending 2018/19. General Fund Reserves have fallen sharply and £3.984M remains uncommitted as at 31 March 2018 which is just below the minimum prudent level. Over the last three financial years the primary contributors to the reduction in reserves are £11.091M approved by members, and net overspends by officers of £3.435M (the latter assuming no variance at year ending 2018/19).

3.2 Unless drastic action is taken the predicted financial position beyond 2019 can only be expected to deteriorate and Midlothian Council could potentially completely deplete its General Fund Reserves before 31 March 2020. Since the appointment of a new Chief Executive there is a greater clarity on budget holders' accountability and responsibility to manage within set budgets and not overspend as part of good financial discipline. For example, the implemented Quarter 1 recovery plans has resulted in most of the £3.005 million projected overspend in the Quarter 1 position reported to Council on 21 August 2018 being recovered and Quarter 2 reported a £0.298M projected overspend. The Budgets for 2019/20 onwards must be realistic and self-sustaining and given the very significant budget gaps already identified further rounds of cost cutting are unlikely to provide a complete solution. A radical rethink of what services the Council provides and how those services are provided is urgently required and changes quickly implemented.

3.3 There is limited evidence of robust challenge from Members prior to approval of the budget. Budgets set were clearly unrealistic in the context of reducing public sector funding and population growth within Midlothian area. Whilst there are adequate arrangements in place for the approval of revisions to the budgets during the year, a fuller explanation of the reasons and implications for all stakeholders would be helpful to aid their understanding.

3.4 Budget monitoring and reporting processes do not universally meet the needs of all classes of user. There were concerns expressed over both the timing of and detail contained in the reports.

3.5 A number of users expressed doubts about the completeness and accuracy of budget monitoring information provided to them, primarily caused by limitations on the information available on which to prepare projections which makes decision making with confidence difficult based on the financial information available.

- 3.6 The following examples of good practice were found:
- The commitment by the Council to setting out an indicative 4 year allocation to the Midlothian Integration Joint Board.
 - The Financial Services Manager and those Senior Accountants we met with during the course of our audit clearly understood the service areas that they support and were able to relate business activities with consequent financial outcomes. Their ability to support budget holders is limited by the financial systems in place and the information available to them.
- 3.7 Internal Audit considers that the level of assurance we are able to give is Limited Assurance.
- 3.8 The Internal Audit function conforms to the professional standards as set out in the Public Sector Internal Audit Standards (2017), including the production of this report to communicate the results of the review.
- 3.9 We would like to thank those officers who assisted us during our review
- 3.10 This report should be read alongside the Internal Audit report on the Delivering Excellence Programme, as these two areas are inextricably linked. In light of these findings Internal Audit will include assurance work on Business Planning, Budget Setting and associated Monitoring within its Annual Plan for 2019/20.

4 Findings

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
4.1 Budgets are set that are unsustainable in the short to medium term.	Budgets are set within available resources and uncommitted General Fund reserves are maintained at a prudent level and are approved by Members.	<p>General Fund Reserves have fallen sharply and £3.984M remains uncommitted as at 31 March 2018 which is just below the minimum prudent level. In the last three financial years 2016/17, 2017/18 and 2018/19 to Q2 reduction in reserves so far stem from a combination of factors, primarily:</p> <ul style="list-style-type: none"> • Members approved the utilisation of £11.091m of reserves (including £6.448M to balance budgets, £1.446M to fund additional expenditure, £1.184M to support transformation, and £3.139M to fund VSER costs). Members have been unwilling to take potentially unpopular decisions which are necessary to balance the books in times of extreme financial difficulty. • Budgets set, which relied heavily on service and transformation savings, were clearly neither realistic nor robust. Transformation savings are not ambitious enough and have not been fully delivered. Outturns were consequently worse than expected. Net overspends resulted in the utilisation of £3.435M of reserves. • Budget setting and savings delivery arrangements are poor and require significant improvement. 	Weak	5.1 5.2 5.3

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
<p>4.2 Budget monitoring processes do not adequately support budget holders and elected members in discharging their budgetary responsibilities.</p>	<p>The requirements of budget holders at all levels are understood and fulfilled.</p>	<p><u>Limitations in Budget monitoring systems.</u></p> <p>There are a range of management information systems which provide data that is utilised by the Finance Team and others to evaluate the financial performance of services. Whilst a number of these contain data on commitments there are doubts about the reliability of this data. Accordingly as part of the budget monitoring process a careful evaluation of commitments takes place in detail at each quarter end and commitments are recognised in the projected outturn to the end of the year. The limitations with the available data results in additional work which is both inefficient and time consuming and is a contributory factor in the timescales for reporting to budget holders and other stakeholders.</p> <p>The actual to date figures do not always reflect the expenditure committed. We understand that this is exacerbated in some areas due to delays and problems in processing information within feeder systems; these have been long standing issues and need to be addressed.</p> <p>The original approved budget for each financial year is not shown in the quarterly budget monitoring reports. Only the revised budget is shown. Whilst there are adequate arrangements in place for the approval of revisions to the budgets during the year, these variations might not be apparent to those using quarterly Budget Monitoring reports. A fuller explanation of the reasons and implications for all stakeholders would be helpful to aid their understanding.</p> <p>The Financial Services Manager and those Senior Accountants we met with during the course of our audit clearly understood the service areas that they support and were able to relate business activities with consequent financial outcomes. Their ability to support budget holders is limited by the financial systems in place and the information available to them. The Senior Accountant post covering Education, Communities and Economy is vacant which brings some limitations to the support provided to the Directorate. Full adoption of a Finance Business Partner model can be invaluable not only in relating business activities to financial consequences but also in the decision making process, in particular in these times of reducing government funding and the rapid pace of change arising from legislative and policy obligations.</p>	<p>Weak</p>	<p>5.4 5.5 5.7</p>

Risk	Expected Control	Results	Effectiveness of Actual Control	Rec. Ref No
<p>4.2 Budget monitoring processes do not adequately support budget holders and elected members in discharging their budgetary responsibilities. (cont'd)</p>	<p>The requirements of budget holders at all levels are understood and fulfilled. (cont'd)</p>	<p>Within the context of the aforementioned we obtained and evaluated monitoring and reporting at primary levels within the Council. In the case of Senior Officers and Heads of Service we also sought their views on Budget Monitoring in relation to their roles and responsibilities.</p> <p><u>Members</u></p> <p>Members receive a quarterly financial monitoring report. The information in the report for the first quarter of each financial year is not received for the first time until August of each year, as a consequence of quarterly reporting and the timing of Council Meetings.</p> <p>The report includes commentary on the financial position, and the Delivering Excellence Programme together with a projection of the General Fund Reserve.</p> <p>Included as appendices is a General Fund overview which shows revised budget, projected outturn and variance for each service area. Also included is a variance analysis which provides an explanation for significant variances. We noted that actual figures at each quarter are not reported.</p> <p>Minutes recording deliberations when approving budgets and receiving budget monitoring reports indicate a lack of meaningful challenge from Members. An exception to this is resistance from Members to accept transformation and savings proposals which underpinned the 2018/19 base budget.</p>	<p>Weak</p>	<p>5.2 5.4 5.6</p>

5 Recommendations

Rec. No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.1	<p>The budgets set for 2019/20 onwards must be realistic and self-sustaining. Undue reliance should not be placed on further rounds of cost cutting unless imposed by CMT. The budget must also reflect the outcomes of a radical rethink of what services the Council provides and how those services are provided.</p> <p>Budget holders need to be accountable and responsible for the budgets they manage including delivering within agreed budget.</p>	High	Steps are underway to develop a Medium Term Financial Strategy to ensure a robust response to the financial outlook and Council priorities.	Chief Executive, Directors and Heads of Service June 2019
5.2	<p>The budget for 2019/20 and beyond should be presented to CMT, in such detail as they require, <u>prior</u> to Members for approval. CMT should consider the budget proposals and provide robust challenge to the assumptions contained therein. This is particularly important where balancing the budget relies upon significant transformational savings.</p> <p>Members should similarly challenge the budget proposal presented to them for approval.</p>	High	As above	As above
5.3	<p>Whilst normally not considered to be good practice, but in recognition of the Council's fragile financial position, if absolutely necessary CMT should consider imposing cost reductions across all Directorates. These imposed savings should be articulated in cogent savings plans for which the plan owner should be held fully accountable for delivery. This approach might not result in full achievement of the imposed cost reduction but will encourage innovation and cost reduction out of necessity especially in areas with a history of overspending.</p>	High	As above	As above

Rec. No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.4	<p>All quarterly Budget Monitoring Reports, irrespective of the intended user, should contain at least the following information:</p> <ul style="list-style-type: none"> • Approved Budget • Revised Budget (Full Year and Year to Date with appropriate phasing and full explanations for any changes from the previous reporting period) • Actual Year to Date • Latest estimate for Full Year (projected outturn) • Variance (Full Year and Year to Date with variance analysis and commentary) 	Medium	A review of the information contained in quarterly Budget Monitoring Reports will be undertaken with consideration to them containing at least the recommended information.	<p>Head of Finance & Integrated Support Services and Financial Services Manager</p> <p>June 2019</p>
5.5	<p>Processes, whether system automated or otherwise, should better recognise commitments when arriving at actual and projected outturn reported figures.</p> <p>The long standing issues with feeder systems must be addressed.</p>	Medium	Agreed. An improvement plan will be developed by the indicated timescale and in light of resource limitations any improvements will be prioritised by volume / value transactions.	<p>All feeder systems administrators and Finance and ISS</p> <p>June 2019</p>
5.6	<p>The Finance Team should ascertain the informational needs of all classes of reporting user subject to minimums set out in 5.4 above.</p> <p>Reports should be tailored to the needs of users in terms of :</p> <ul style="list-style-type: none"> • timeliness in reporting; • frequency of reporting; • format and content detail; and • extent and timing of engagement between Finance Officers and users of Budget Monitoring Reports to discuss the contents of the reports and to answer any queries. 	Medium	Agreed	<p>Head of Finance & Integrated Support Services and Financial Services Manager</p> <p>April 2019</p>

Rec. No	Recommendation	Rating	Management Response	Responsibility and Timescale
5.7	<p>The vacant post of Senior Accountant supporting Education, Communities and Economy Directorate should be filled.</p> <p>The Council should consider full adoption of a Finance Business Partner model in order to facilitate better decision making.</p>	Medium	<p>The Chief Executive has instructed that the Head of Finance & Integrated Service Support meet with the Director Education, Communities and Economy to progress the appointment of a Senior Accountant as a matter of urgency.</p> <p>Initial discussions will be followed up asap.</p>	<p>Head of Finance & Integrated Service Support March 2019</p> <p>Chief Executive, Directors and Heads of Service Evaluation by March 2019</p>

Overall Audit Opinion level and definition

Comprehensive Assurance	Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas might be required.
Substantial Assurance	Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse.
Limited Assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse.
No Assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or misuse is unacceptable. Significant improvements are required.

Recommendation Ratings

Recommendations in Internal Audit Reports are suggested changes to existing procedures or processes, to improve the controls or to introduce controls where none exist. The rating of each recommendation reflects our risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact. The ratings are:

High	Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high to require immediate action within one month of formally raising the issue. The risk should be added by Management to the relevant Risk Register for control and monitoring purposes and included in the relevant Head of Service Annual Assurance Statement.
Medium	Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue.
Low	Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to the attention of Senior Management.
Other	Minor administrative weaknesses posing little risk of error, fraud, financial loss or reputational damage.

The Action Plans in Internal Audit Reports address only Recommendations rated High, Medium or Low. Outwith the Internal Audit Report, we inform Service Management about Other Minor matters to improve internal control and governance.

The recommendations will be input to Pentana performance system to assist with Management tracking of implementation. If responsible owners are unable to achieve the standard timescales for actions please notify the Chief Internal Auditor with the reason for the delay in implementation and the revised timescales to assist with the implementation and follow-up of these recommendations to improve internal control and governance.

Jill Stacey
Chief Internal Auditor