

Item: 5.3

Monitoring and Audit Committee: 23 September 2021.

Internal Audit Report: Financial Planning and Corporate Budget Setting.

Report by Chief Internal Auditor.

1. Purpose of Report

To present the internal audit report on procedures and controls relating to financial planning and corporate budget setting.

2. Recommendations

The Committee is invited to note:

2.1.

That Internal Audit has undertaken an audit of the procedures in place within the Council for financial planning and corporate budget setting.

2.2.

The findings contained in the internal audit report, attached as Appendix 1 to this report, relating to the procedures in place within the Council for financial planning and corporate budget setting.

It is recommended:

2.3.

That the Committee review the audit findings to obtain assurance that action has been taken or agreed where necessary.

3. Background

3.1.

Financial planning is an important part of the strategic process in ensuring that funds are used effectively to achieve the aims of the Council. The budget setting process plays a vital role to ensuring that public money is used efficiently by the Council in running its services.

3.2.

With government funding reducing in real terms and increasing demand for Council services, budget savings are a necessary means of bridging the gap between funding received and spending commitments.

3.3.

The objective of this audit was to review that the Council has both medium and long-term financial plans which are reviewed periodically, the corporate budget is set timeously and in accordance with the Council's framework for budget setting arrangements and that budget savings and their estimated consequences are subject to effective scrutiny and challenge by the Senior Management Team and Elected Members.

4. Audit Findings

4.1.

The audit provides substantial assurance that the processes and procedures relating to financial planning and corporate budget setting are well controlled and managed.

4.2.

The internal audit report, attached as Appendix 1 to this report, includes one medium priority recommendation within the action plan. There are no high-level recommendations made as a result of this audit.

4.3.

The Committee is invited to review the audit findings to obtain assurance that action has been taken or agreed where necessary.

5. Corporate Governance

This report relates to the Council complying with governance and scrutiny and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

6. Financial Implications

There are no financial implications associated directly with the recommendations in this report.

7. Legal Aspects

Complying with recommendations made by the internal auditors helps the Council meet its statutory obligations to secure best value.

8. Contact Officers

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Peter Thomas, Internal Auditor, extension 2135, email peter.thomas@orkney.gov.uk.

9. Appendix

Appendix 1: Internal Audit Report: Financial Planning and Corporate Budget Setting.



Internal Audit

Audit report

Financial Planning and Budget Setting Process

Draft issue date: 16 August 2021

Final issue date: 15 September 2021

Distribution list:	Strategic Finance Manager Interim Head of Finance Interim Executive Director of Finance, Regulatory, Marine Services and Transportation Services
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Audit Opinion

Based on our findings in this review we have given the following audit opinion.

Substantial

The framework of governance, risk management and control were found to be comprehensive and effective.

A key to our audit opinions and level of recommendations is shown at the end of this report.

Executive Summary

Our audit review has provided substantial assurance that the procedures in place for financial planning and the corporate budget setting process within the Council are sound, with several areas of good practice evident. For example:

- Effective scrutiny carried out by Officers and Members throughout the whole budget setting process.
- Detailed and generally comprehensive reporting of information to the annual corporate budget setting presented to the Policy and Resources Committee of the Council.
- A balanced budget being set timeously by the Council against a backdrop of uncertainty over the level of funding available to the Council, both in the short and long term, together with the challenges of the pandemic, both immediately and for long term recovery.
- The budget setting process adapting well to the challenges of remote working during the pandemic with good use of Microsoft Teams and evaluation scoring sheets completed by Members to facilitate effective engagement of individual and collective opinions.
- Equality Impact Assessments (EqIAs) were prepared to a high standard for the corporate budget and, where applicable, for budget savings during the 2021/22 budget setting process.

The Council has developed a medium-term resource strategy to establish the framework for budget setting over the period 2017 to 2022 and a Long-Term Financial Plan for 2018/19 to 2029/30 which provides an indication of possible funding gaps that the Council could face over that period.

Future funding settlements from the Scottish Government remain uncertain while demand for Council services continues to increase.

The number and priority of the recommendations are set out in the table below. The priority headings assist management in assessing the significance of the issues raised.

Responsible officers will be required to update progress on the agreed actions via Pentana Risk.

Total	High	Medium	Low
1	0	1	0

The assistance provided by officers contacted during this audit is gratefully acknowledged.

Introduction

Financial planning is an important part of the strategic process in ensuring that funds are used effectively to achieve the aims of the Council.

The budget setting process plays a vital role to ensuring that public money is used efficiently by the Council in running its services.

Between 2013/14 and 2018/19, Orkney's revenue funding from government saw a reduction, in real terms, of 6.7%. During the same period the population of Orkney grew by just over 3%.

It has been estimated that by 2024, 30% of the population of Orkney will be of pensionable age, (compared to a Scottish average of 23%). Orkney has one of the fastest ageing populations in Scotland, with the number of residents aged 75 and over predicted to rise by 115.8% by 2037, according to the National Records of Scotland.

An ageing population increases demand for Council services. Rurality makes it more difficult to deliver services cost-effectively. All councils face the challenge of delivering an increasing range of national policies.

It is anticipated that pre-pandemic trends of funding amounts are likely to continue into the future. The impact on funding from the pandemic and to its post economic recovery, and also the UK's withdrawal from the EU is yet to be known.

Funding settlements from the Scottish Government to councils continue to be provided on an annual basis. This makes it challenging for all councils to plan and budget effectively for the medium term. This is even more challenging for Orkney when considering the proportion of its funding which comes from the Scottish Government settlement.

With constraints on funding from government reducing in real terms and increased demand for services, efficiency savings are a necessary means of bridging the gap between funding received and spending commitments.

The budget setting process continues to play a pivotal role in ensuring that all Officers and Elected Members are made aware of the on-going issues as they arise.

This review was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing.

Audit Scope

The scope of this audit included a review of the following:

- That the Council has both medium and long-term financial plans.
- That both the medium and long-term plans are reviewed periodically to take account of changing circumstances.
- That the 2021/22 corporate budget was set timeously and in accordance with the Council's framework for budget setting arrangements for the period covering 2017-2022.
- That budgets, and in particular budget savings and their estimated consequences are reported and are subjected to effective scrutiny and challenge by the Senior Management Team (SMT) and by Elected Members.

- That for proposed budget savings, consideration is given to whether communication and engagement should be carried out with the public.
- That Equality Impact Assessments (EqIAs) are carried out where necessary.

Background

Data published by the Scottish Parliament Information Centre (SPICe), within its document entitled “Local Government Finance: Budget 2021-22 and provisional allocations to local authorities”, showed the provisional Revenue allocation for Orkney to be £3,712 per head. This being £532 less than Shetland’s settlement and £91 less than Eilean Siar (Western Isles) per head. Adjusting for differences in how ferry funding is carried out, the Council estimates that it receives around £673 per head lower than the Western Isles. Stated in another way, if Orkney was funded in the same way as the Western Isles, it would receive around £14.9 million more each year to deliver Council Services.

An earlier SPICe publication, entitled “Local Government Finance: Facts and Figures 2013-14 to 2020-21”, shows that ring-fenced funds as a proportion of the total revenue settlement, for all local authorities within Scotland continue to be on an increasing trend. Orkney has the second highest proportion of its total revenue settlement in Scotland being ring-fenced, at 9.1%. The Scottish average stands at 6.1%. Shetland and the Western Isles had the two lowest rates at 4.4% and 4.1%. In 2013-14, ring-fencing of revenue funding throughout Scotland for local authorities was negligible.

The SPICe facts and figures document also showed that for 2020-21 Orkney has the second lowest proportion of its total funding being received from non-domestic rate income (NDRI) and gross council tax revenue, standing at 7.9% and 11.7% respectively or 19.6% combined. The respective averages for Scotland as a whole are 13.8%, 21.5%, and 35.3% respectively.

The Western Isles has the lowest combined total of 15.8%, with the lowest NDRI revenue in Scotland at 5%. Shetland’s combined total was 27.5% with NDRI making up 17.1% of its total funding.

The Council has consistently needed to make year on year efficiency savings, totalling £14,590,000 over the decade between 1 April 2011 to 31 March 2021. Further efficiency savings for the 2021/22 financial year totalled £573,700.

It is realistic to assume that the above trends in constraints from funding, and increased demand for services will continue. However, the extent and timing of which are largely uncertain.

Audit Findings

1.0 Corporate Budget Setting Process

- 1.1 The Council approved its annual budget at the General Meeting of the Council on 2 March 2021. By law, under the Local Government Finance Act 1992, there is a requirement upon councils to set their budget for the following financial year by 11 March.
- 1.2 A report considering the revenue budget, Council Tax level and the level of contribution from the general fund and other reserves for the financial year 2021/22, (the report) was presented to the Policy and Resources Committee at its special meeting held on 23 February 2021. The report also included the subject of capital funding.

- 1.3 Other reports to the same meeting of the Policy and Resources Committee were entitled: Reserves and Provisions Strategy (reserves report), Strategic Reserve Fund – Budget Review and Long-Term Forecast and Strategic Reserve Fund – Contribution to General Fund Services – Proposed Notional Allocations (SRF report).
- 1.4 The reports listed at 1.3 considered the strategy for managing the Council's Reserves, reviewed the level of disbursements from the Strategic Reserve Fund used to support General Fund Services and other Council priorities for financial year 2021/22 onwards. The SRF report considered proposed notional allocations of contributions from the Strategic Reserve Fund to specific activities.
- 1.5 The budget setting process was carried out timeously with the budget recommended for approval by the Policy and Resources Committee at its meeting of 23 February 2021. The local government finance circular 1/2021 which set out the provisional total local government revenue and capital funding for 2021/22 was issued on 1 February 2021.
- 1.6 The budget was set in challenging circumstances against a backdrop of significant uncertainty with the provisional Scottish Budget allocations being only the first stage in what was anticipated to be an ongoing process in relation to 2021/22 budget allocations. At the time of budget setting there was uncertainty over various potential additional funding decisions, potential political negotiations in passing the Scottish Budget, any top-ups from the UK Budget due on 3 March 2021, and any further Scottish or UK emergency funding.
- 1.7 The financial year 2020/21 had itself seen huge financial uncertainty and risk on account of the COVID-19 pandemic, with considerable financial risks for Council services remaining for 2021/22.
- 1.8 Reports presented to the Policy and Resources Committee on 23 February 2021 are considered by Internal Audit as being detailed, informative and generally comprehensive. One example of this was the noting of three pressure areas, with a total cost of £2,294,200, that required consideration in the budget setting deliberations. The pressure areas being: the School and Public Bus Service, the Re-opening of the North Ronaldsay School and waste disposal arrangements. The report detailed the options to deal with each of these significant spending pressures.
- 1.9 The report noted that adding the spending pressures required a draw from the Strategic Reserve Fund of up to £7,469,900, to balance the 2021/22 budget.
- 1.10 A suitable level of scrutiny by Members at the meeting of the Policy and Resources Committee was observed by Internal Audit based on the recording of the meeting.
- 1.11 During the budget setting process, the budget, and in particular budget savings are scrutinised by the Senior Management Team and by Members during a series of three budget seminars.
- 1.12 During the meeting on 23 February 2021, the Policy and Resources Committee resolved, inter alia, to recommend to the Council:
 - 1.12.1. That a contribution of £2.1 million, to be funded from the non-earmarked General Fund balance, be made to the Repairs and Renewals Fund, to be utilised specifically for roads and paths repairs and renewals works.

- 1.12.2. That the Executive Director of Development and Infrastructure should submit a report, to the next meeting of the Development and Infrastructure Committee, outlining a detailed programme for utilisation of the £2.1 million allocation towards roads and paths repairs and renewals works.
- 1.12.3. That, once the provisional budget outturn for 2020/21 was known, as well as any provisional draw on reserves, the Head of Finance should submit a report, to the Policy and Resources Committee, reviewing the non-earmarked General Fund balance and any proposals to amend the level of the reserve.
- 1.13 The background to this motion followed a reduction in surface dressing during the financial year 2020/21 as a result of COVID-19 restrictions, impacts from weather, in particular wintery conditions in Orkney during January and February which caused further damage to road surfaces within the county.
- 1.14 The Policy and Resources Committee were advised by the Head of Finance that based on information available at that time, it was estimated that undesignated Reserves could be reduced to 3% of the budget total that would allow a sum of £2.1 million to be designated within reserves.
- 1.15 The motion to allocate this amount was made ahead of a detailed programme for utilisation of the £2.1 million allocation towards roads and pathway repairs and renewals works. The rationale given for this course of action being that if Members chose to await the detailed programme for the utilisation of the allocation, this could delay making use of the reserve for several months, most probably into the summer.
- 1.16 The allocation was generally supported by Members and the motion was unopposed; however, some comments were made by Members during the meeting that they had no prior knowledge of a motion being considered or if the potential for this allocation within reserves could become available. Some Members also made comments of the benefits of being proactive and responsiveness to a clear need.
- 1.17 A report establishing a plan for addressing supplemental roads and path repairs and renewal works, following the allocation within reserves was presented to the meeting of the Development and Infrastructure Committee on 30 March 2021.
- 1.18 Whilst acknowledging that the sum of £2.1 million is significant and, amounts of this sum and less, would usually be subject to detailed scrutiny earlier within the annual budget setting process, it is open to any Member to propose, any amendment which is relevant and competent. There is no requirement (at meetings of the Policy and Resources Committee) for pre-notification of motions or amendments.

2.0 Financial Planning

- 2.1 In general recognition of the need for further spending reductions to be considered in a strategic manner over the medium-to-long term, the Council developed a medium-term resource strategy to establish the framework for budget setting over the period 2017 to 2022.
- 2.2 The Council has also prepared a Long-Term Financial Plan for 2018/19 to 2029/30 which gives indications of the funding gaps that the Council could face over that period.
- 2.3 The Council's Long-Term Financial Plan identifies a range of cumulative funding gaps over a ten-year period from the best-case scenario of £23,600,000 to a likely case of

£65,700,000 and a worst case of £145,600,000. These projections serve to illustrate both the high level of uncertainty and significant challenges the Council faces over the next ten years in matching the level of expenditure to available resources.

- 2.4 For context, the potential funding gaps identified in the Council's Long-Term Financial Plan stated at 2.3 compares to identified efficiency savings for the 2021/22 and 2020/21 financial years of £573,700 and £1,041,800 respectively. The two financial years of efficiency savings in total is less than the £2,294,200 of the three individual service pressures detailed at 1.8.
- 2.5 The separate report on the review of the Strategic Reserve Fund presented at the meeting of the Policy and Resources Committee detailed that for the three financial years 2021/22, 2022/23 and 2023/24, £22,082,000 will be allocated from the fund to support General Fund Services over the same period. Supporting General Fund expenditure to this extent is estimated to reduce useable reserves, as a percentage of the annual revenue budget, from approximately 6.1% to 3.1% over the next three years.
- 2.6 Whilst the report shows good practice in estimating reserves that may be affordable over the next three financial years, the report also details that over-reliance on the Strategic Reserve Fund as a means of balancing the General Fund budget as part of a long-term financial strategy is not best practice, particularly given the levels of volatility that continue to impact on investment returns.
- 2.7 In recognising the benefits to General Fund expenditure from contributions from the Strategic Reserve Fund, the Council faces an ongoing need to balance the risks of reducing essential services against the sustainability of balancing the General Fund budget with contributions from the Strategic Reserve Fund.
- 2.8 In short, the long-term financial strategy identified a cumulative funding gap of between £23.6 million and £145.6 million based on a range of optimistic to pessimistic assumptions. Although settlements for the early years of the Long-Term Financial Plan have been around the optimistic range of the scale, settlements in future are hugely uncertain and prone to a substantial level of volatility. It should be recognised that opportunities for efficiency savings identified during annual budget setting are becoming more and more limited whilst service cost pressures from delivery vital services continue to grow.
- 2.9 It is recommended that the Council considers options for long term savings and produces detailed savings plans in addressing the range of forecasted cumulative funding gap identified in its longer-term financial strategy.

Recommendation 1

Action Plan

Recommendation	Priority	Management Comments	Responsible Officer	Agreed Completion Date
1. The Council should consider options for long term savings and produce detailed savings plans in addressing potential funding gaps identified from its long-term financial plan.	Medium	Savings options will be considered in the 2022/23 budget setting process and in the review of the medium and long-term financial plans. In addition to savings options to address the potential funding gaps the Council will also consider income generating strategies.	The Senior and Corporate Management Teams	February 2022

Key to Opinion and Priorities

Audit Opinion

Opinion	Definition
Substantial	The framework of governance, risk management and control were found to be comprehensive and effective.
Adequate	Some improvements are required to enhance the effectiveness of the framework of governance, risk management and control.
Limited	There are significant weaknesses in the framework of governance, risk management and control such that it could be or become inadequate and ineffective.
Unsatisfactory	There are fundamental weaknesses in the framework of governance, risk management and control such that it is inadequate and ineffective or is likely to fail.

Recommendations

Priority	Definition	Action Required
High	Significant weakness in governance, risk management and control that if unresolved exposes the organisation to an unacceptable level of residual risk.	Remedial action must be taken urgently and within an agreed timescale.
Medium	Weakness in governance, risk management and control that if unresolved exposes the organisation to a high level of residual risk.	Remedial action should be taken at the earliest opportunity and within an agreed timescale.
Low	Scope for improvement in governance, risk management and control.	Remedial action should be prioritised and undertaken within an agreed timescale.