

## **Item: 8.1**

**Monitoring and Audit Committee: 9 June 2022.**

**Internal Audit Report: Budget Monitoring Process.**

**Report by Chief Internal Auditor.**

### **1. Purpose of Report**

To consider the internal audit on processes and controls relating to budget monitoring.

### **2. Recommendations**

The Committee is invited to note:

#### **2.1.**

That Internal Audit has undertaken an audit of processes and controls relating to budget monitoring.

#### **2.2.**

The findings contained in the internal audit report, attached as Appendix 1 to this report, relating to processes and controls relating to budget monitoring.

**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.**

The Financial Regulations of the Council require that the Head of Finance is responsible for preparing budget monitoring procedures to set out the Council's budget monitoring arrangements and the distribution of these to the Chief Executive and Corporate Directors.

#### **3.2.**

Following consultation between Corporate Directors and the Head of Finance, monthly budget monitoring reports are issued to the members of each Service Committee. Service Committees also receive quarterly reports, and the Policy and Resources Committee receives summary reports.

### **3.3.**

The objective of this audit was to confirm:

- That there are policies and procedures in place to ensure that budget management is exercised within cash limits and through delegated budget holders.
- That there are regular reports to managers and Committees.
- That any significant divergence from budgets is investigated and reported.

## **4. Audit Findings**

### **4.1.**

The audit provides adequate assurance that the processes and procedures relating to budget monitoring are well controlled and managed.

### **4.2.**

The internal audit report, attached as Appendix 1 to this report, includes six low priority recommendations within the action plan. There are no medium or 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](mailto:peter.thomas@orkney.gov.uk).

## **9. Appendix**

Appendix 1: Internal Audit Report: Budget Monitoring Process.



## Internal Audit

### Audit Report

### Budget Monitoring Process

**Draft issue date: 23 March 2022**

**Final issue date: 13 April 2022**

<b>Distribution list:</b>	<b>Manager (Strategic Finance)</b>  <b>Interim Head of Finance</b>  <b>Corporate Director for Enterprise and Sustainable Regeneration</b>
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## Audit Opinion

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

**Adequate**

**Some improvements are required to enhance the effectiveness of the framework of governance, risk management and control.**

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

## Executive Summary

Our audit has confirmed that budgetary management and processes operating within the Council are working well with several areas of good practice evident. For example:

- Generally efficient use of the budgetary management module within the Council's accounting software system.
- A comprehensive structure of designated budget holders throughout the Council.
- A clear structure of prioritisation of review for under or overspends (variances) for each revenue cost and income centre within the Council.
- Regular reporting of revenue and capital expenditure monitoring reports with effective scrutiny carried out by respective Committees and Sub-Committees of the Council.

The report includes 6 recommendations which have arisen from the audit. 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.

Our recommendations are focused on potential options to enhance the review of priority actions which are identified from the criteria set within the budget monitoring software system and also in identifying the corrective action to address the priority actions identified. It is recognised that this enhancement activity would require significant resources and planning to take place.

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

Total	High	Medium	Low
6	0	0	6

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

## Introduction

Effective budget monitoring plays a vital role in ensuring that public money is used efficiently by the Council in running its services in accordance with its objectives and approved annual budget.

Budget monitoring is carried out within the Council by utilising its financial accounting software system, Integra.

The Financial Regulations of the Council require that the Head of Finance is responsible for preparing budget monitoring procedures, to set out the Council's budget monitoring arrangements and the distribution of these to the Chief Executive and Corporate Directors.

The Council's budget monitoring process has the following aims and objectives:

- To ensure that actual expenditure and income is in line with the approved financial plan.
- To ensure Members are kept up to date with regards to actual expenditure and income against budget.
- To ensure Corporate Directors can take an overview of priority under and overspend positions and to effect virements to manage that the service budget is achieved.
- To ensure that budget holders have the appropriate information to assess and control their budget performance during the financial year.
- To ensure that all expenditure and income received in a cost centre is a valid expense or receipt in pursuit of the Council's business.
- To ensure the expenditure and income is coded to the correct cost centre.

The Council's Financial Regulations require that the Chief Executive and Corporate Directors, in consultation with the Head of Finance, are responsible for the submission of regular budget monitoring reports to the Members of each Service Committee, and summary reports to the Policy and Resources Committee. The de facto practice has been that the Head of Finance has presented budget monitoring reports to Committees.

This review was conducted in conformance with the Public Sector Internal Audit Standards.

## Audit Scope

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

- That budget management is exercised within annual cash limits unless the Council agrees otherwise.
- That budget management is exercised through a scheme of delegated budget holders across each service.
- That the Chief Executive and Corporate Directors are provided at regular intervals (normally monthly) with information of income and expenditure in sufficient detail to enable budget holders to fulfil their budgetary responsibilities.
- That significant divergence from approved budgets is investigated and reported by budget holders as appropriate.
- That regular budget monitoring reports are presented to Members of each Service Committee, and summary reports to the Policy and Resources Committee.

- That budget virements (the process of transferring a budgetary allocation from one financial account to another) are only carried out within the constraints of the Council's Financial Regulations.

## Budget Monitoring Process - Overview

The Council carries out budget monitoring using its finance software system, namely Integra.

The Council's Budget Monitoring Approach, Systems and Processes Procedure document (the process document) details four key elements to the Council's budget monitoring approach, these being:

- The Budget Monitoring Report (BMR) process.
- The Revenue Expenditure Monitoring Report process (REMR).
- The REMR review.
- The Distribution of Committee Reports.

### The Budget Monitoring Report (BMR) process.

This element of the process covers monitoring that is in place over the range of cost centres that have been put in place throughout the Council.

The Integra system identifies priority action criteria for variances between the actual spend and income that has occurred compared to the amounts budgeted for, based on the following criteria.

- Expenditure or income exceeds the amount budgeted for by more than £10,000 and also by more than 10% of the budgeted amount.
- Expenditure or income exceeds the amount budgeted for by more than £50,000, but less than by 10% of the budgeted amount.

Budget holders are required to report upon each priority action which should include the cause of the variance and the details of the corrective action that they will take. Reported information is available to the Head of Service to make responses as part of the REMR process.

### The Revenue Expenditure Monitoring Report Process (REMR).

This element of the process is similar to the BMR process, the difference being that monitoring takes place over service functions, comprised of a group of cost (or income) centres.

Heads of Service are required to report upon each priority action which should also include details of the cause of the divergence to the amounts budgeted and the corrective action that they will take. Priority action flags are set to the same criteria for service functions to those in place for cost or income centres. Reported information is available to the Corporate Director as part of the REMR process.

### The REMR Review

The process document states that where a committee report is being submitted a review of the report, including the Heads of Service responses, is carried out between accountancy and the relevant Corporate Director.

The process document also requires Corporate Directors, inter alia, to review the relevant budget monitoring Committee reports and record the outcome of the review by way of further reports to the Corporate Leadership Team, and or the Committee, as appropriate.

Should an overspend situation occur, which cannot be addressed by means of a virement within the service, the Corporate Director, in consultation with the Head of Finance, is required to report the position to the relevant Council Committee.

### The Distribution of Committee Reports

Revenue expenditure monitoring reports, and capital expenditure monitoring reports are subjected to scrutiny by Members of the relevant Committee.

## **Audit Findings**

### **1.0 The Budget Monitoring Report (BMR) process stage**

- 1.1 Budget monitoring is carried out, for the monthly periods 2 to 11 of the financial year, on just under 1,000 cost (or income) centres throughout the Council. The process is inclusive to over 150 budget holders throughout the Council.
- 1.2 Priority flags criteria are considered suitable in focusing on significant levels of variances between actual expenditure or income and that budgeted for. Monthly reports accurately flag priority actions for cost centres in accordance with their respective criteria.
- 1.3 December 2021 was the most recent period where responses to priority flags, made by budget holders could be analysed. For the December period, 281 cost centres were marked with a priority flag. 133 responses (47%) were made within the required five-day period. Responses were not made in 55 (20%) of relevant instances. Non-response rates ranged between 7% and 51% for each Directorate.
- 1.4 Budget holders receive at least two system generated reminders that a response is due for flagged cost centre variances.
- 1.5 It is recommended that addressing late and non-response rates to the BMR process is considered by the Corporate Leadership Team of the Council. Action may include non-responses to flagged priority cost centre variances being escalated to the respective budget holder's line manager, where this occurs, each month.

### **Recommendation 1**

### **2.0 Revenue Expenditure Monitoring Report (REMR) stage**

- 2.1 Budgetary monitoring is carried out on just under 200 functions throughout the Council.
- 2.2 Similar to the BMR process, priority flags criteria are considered suitable in focusing on significant levels of variances between actual expenditure or income and that budgeted for. Monthly reports accurately flag functions in accordance with their respective criteria.
- 2.3 For December 2021 there were 103 functions flagged for priority action. Responses were made by Heads of Service for all 103 functions. 71 (69%) were made within the required time period and 32 (31%) returns were made late.



- 2.4 It is recommended that addressing late responses to the REMR process is also considered by the Corporate Leadership Team of the Council.

**Recommendation 2**

- 2.5 Integra is not utilised for monitoring capital expenditure compared to budget. It is recommended that it be considered whether Integra could be utilised effectively as a tool for monitoring capital expenditure.

**Recommendation 3**

**3.0 The Revenue Expenditure Monitoring Report Review stage.**

- 3.1 The budget monitoring process should be seen as an integrated process where functions within the Council are the accumulation of individual cost centres. Effective review therefore requires that responses are provided and substantiated by both budget holders and Heads of Service.
- 3.2 Process and good practice require that where a Committee report is being submitted, a review of the report, including the Heads of Service responses, is carried out, prior to the meeting of the Committee between the relevant Corporate Director and accountancy.
- 3.3 In order to ensure effectively considered reviews to Heads of Service responses takes place between Corporate Directors and Accountancy, it is recommended that a schedule of meetings is agreed, in advance to ensure that these reviews take place.

**Recommendation 4**

- 3.4 A primary purpose of budget monitoring is to ensure that income and expenditure match the approved budget at the end of the year.
- 3.5 To enhance budget monitoring processes in ensuring this purpose is met, reporting on considered year end outturn positions could be included within Committee revenue expenditure reporting. It is recognised that this recommendation in particular would require significant resourcing to establish and then embed this process.

**Recommendation 5**

- 3.6 To assist budget holders and also Heads of Service in future estimating, using the functionality within the budgeting software system should be considered to track commitments (in essence designated future expenditure) should be considered.

**Recommendation 6**

- 3.7 To ensure that budget monitoring is effective, it is important that corrective action should also be identified and reported upon for each identified priority action.
- 3.8 Whereas explanations are usually, but not always provided, it is rare for corrective actions to be reported to flagged priority actions.
- 3.9 The following table details the assessed action category for each cost centre and function priority action for the 10 months to January 2022, and the nine months of the financial year to December 2021 for function priority actions reported to respective committees.

			Priority Action Category						
Type	Period	Total No. of Priority Actions	Monitor the Situation	No Action Required	Manage Income / Expenditure	Management Input Required	Raise a Virement	Raise a Journal	No Response
<b>Count</b>									
Cost Centre (BMR)	10	276	171	61	8	3	19	11	3
Function (REMR)	10	94	67	15	1	1	5	1	4
Function - (Committee Report)	9	92	68	11	1	1	9	2	0
<b>Percentage</b>									
Cost Centre (BMR)	10	100%	62%	22%	3%	1%	7%	4%	1%
Function (REMR)	10	100%	71%	16%	1%	1%	5%	1%	4%
Function - (Committee Report)	9	100%	74%	12%	1%	1%	10%	2%	0%

Table 1

3.10 Table 1 shows that 74% and 12% of identified priority actions for the financial year to 31 December 2021 are categorised to be either: monitor the situation, or no action required respectively. In comparison priority actions for the same period categorised as, requiring income and expenditure to be managed, or management input required is 1% and 1% respectively.

3.11 The priority action category in Committee reports follows responses made to cost centre and function variances.

3.12 Although the statistical data in table 1 is indicative, variances to 31 December 2021 are reporting 9 months or 75% of the financial year's activity. The data therefore demonstrates a tendency for responses being focused to ongoing monitoring of priority actions with a low number of responses for management of income and expenditure taking place or management input into determining corrective action.

3.13 The table is therefore viewed to support our recommendations made around estimating and reporting of year end out-turn positions and the need to determine the corrective action for priority actions once they are identified.

#### 4.0 Committee Reports

4.1 Quarterly revenue expenditure monitoring reports, and capital expenditure monitoring reports have been presented to the relevant Council Committee throughout the year. Each report has been subjected to scrutiny by Members of the relevant Committee.

## Action Plan

Recommendation	Priority	Management Comments	Responsible Officer	Agreed Completion Date
1 Addressing late and non-response rates to the BMR process should be considered by the Corporate Leadership Team of the Council.	Low	Agreed.	Head of Finance	July 2022
2 Addressing late responses to the REMR process should be considered by the Corporate Leadership Team of the Council.	Low	This has been done, but not consistently, and can be recommenced.	Head of Finance	July 2022
3) Consideration should be given to whether integra could be utilised effectively as a tool for monitoring capital expenditure.	Low	Previously agreed within Finance but not implemented due to resource limitations.	Service Manager – Corporate Finance	March 2023 (for Q1 2023/24 reporting)
4) Schedules of meetings should be agreed, in advance, between Corporate Directors and Accountancy for review of revenue monitoring committee reports.	Low	Agreed, where necessary, and when timescales and workload permit.	Service Manager – Accountancy	July 2022
5) Revenue monitoring reports to respective Committees should include considered year end outturn positions to each	Low	Agreed in principle, review needs to be undertaken to establish how current system can be adapted	Service Manager – Accountancy & Financial Systems Manager	March 2023

identified priority action				
6) Consideration should be given to utilising functionality to identifying commitments within the Council's budget monitoring system.	Low	Agreed in principle, review needs to be undertaken to establish how current system can be adapted	Service Manager – Accountancy & Financial Systems Manager	March 2023

## Key to Opinion and Priorities

### Audit Opinion

Opinion	Definition
<b>Substantial</b>	The framework of governance, risk management and control were found to be comprehensive and effective.
<b>Adequate</b>	Some improvements are required to enhance the effectiveness of the framework of governance, risk management and control.
<b>Limited</b>	There are significant weaknesses in the framework of governance, risk management and control such that it could be or become inadequate and ineffective.
<b>Unsatisfactory</b>	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
<b>High</b>	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.
<b>Medium</b>	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.
<b>Low</b>	Scope for improvement in governance, risk management and control.	Remedial action should be prioritised and undertaken within an agreed timescale.