

EAST RENFREWSHIRE COUNCIL13 December 2017Report by Chief ExecutiveFINANCIAL CONTROLS**PURPOSE OF REPORT**

1. To provide information to elected members on the present responsibilities of officers and elected members for the financial management of the Council and for the reporting of financial and audit matters to the Council.

RECOMMENDATIONS

2. Elected members are asked to note:
- (a) Background information on the roles of the Section 95 Officer, the Chief Auditor, External Auditor and the Audit and Scrutiny Committee with regard to financial controls; and
 - (b) The established reporting procedures associated with Financial Controls in the Council.

BACKGROUND AND CONTEXT**Role of the Section 95 Officer**

3. Section 95 of the Local Government (Scotland) Act 1973 requires local authorities to make arrangements for the proper administration of their financial affairs and appoint a Chief Financial Officer to have responsibility for those arrangements.

4. The Chief Financial Officer (also known as the Section 95 Officer) is fundamental to ensuring sound financial management and has an important role in establishing and maintaining internal financial controls and in providing professional advice to councillors on all aspects of the Council's finances. Access to decision-makers and influence at a senior management level is critical.

5. CIPFA, the professional body for public sector accountants sets out 5 principles for the role of the Chief Financial Officer:

- is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest;
- must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy; and

- must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively. To deliver these responsibilities the CFO:
 - must lead and direct a finance function that is resourced to be fit for purpose; and
 - must be professionally qualified and suitably experienced.

6. In East Renfrewshire Council, the role of Chief Financial Officer is undertaken by Margaret McCrossan, Head of Accountancy. Mrs McCrossan reports to the Chief Executive but also has direct access to the Council through her Section 95 role.

Role of the Internal Auditor

7. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisations operations. It helps an organisation accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management control and governance procedures.

8. The Internal Audit service operates in compliance with the Public Sector Internal Audit Standards (PSIAS).

9. In East Renfrewshire Council the Chief Auditor is Michelle Blair. Mrs Blair reports to the Chief Executive from a line management perspective with any reports prepared by her in relation to her activities being submitted to the Audit and Scrutiny Committee for consideration.

Role of the Audit and Scrutiny Committee

10. The role of the audit and scrutiny committee is set out in the council's Scheme of Administration as below:-

- to promote internal controls, financial and otherwise, in order to provide reasonable assurance of effective and efficient operations and compliance with laws and regulations;
- to review the control environment and make an annual statement to the Council on its evaluation of internal controls;
- to develop an anti-fraud culture within the Council to ensure the highest standards of probity and public accountability;
- to promote good financial practice within the Council;
- to agree the internal audit strategy and plan;
- to receive internal audit progress reports;
- to oversee and review action taken on internal audit recommendations and assist in responding to any criticisms made;
- to review the internal audit annual report;
- to be consulted on the external audit strategy and plan;
- to review all external audit material, in particular the annual report and management letters relative to the audit opinion of the Council's financial statements;

- to oversee and review action on external audit recommendations;
- to review financial procedures including the effective operation of financial regulations; (m) to review the Council's financial performance as contained in the Annual Accounts;
- to examine the activities and accounts of the Council in order to ensure that (a) the expenditure approved by the Council has been incurred for the purposes intended, (b) services are being provided efficiently and effectively and (c) value for money is being obtained;
- to consider those decisions of the Cabinet “called in” in terms of agreed procedure;
- to make recommendations to the Cabinet on the introduction and development of appropriate risk management arrangements across the Council;
- to review the performance of the Council in terms of:
 - service delivery;
 - the processes by which policy decisions have been taken;
 - the substance of a particular policy and how it fits in with the overall objectives of the Council; and
 - the effectiveness of a policy in terms of implementation
- to undertake whatever research and consultation is required in support of the analysis being undertaken on any particular issue.

Role of External Audit

11. External Auditor responsibilities are derived from statute, the Audit Scotland Code of Practice, International Standards on Auditing (UK and Ireland), professional requirements and best practice, and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- notify the Auditor General or Controller of Audit when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies;
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies':
 - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
 - suitability and effectiveness of corporate governance arrangements;
 - financial position and arrangements for securing financial sustainability;

- effectiveness of arrangements to achieve best value;
- suitability of arrangements for preparing and publishing statutory performance information.

REPORT

12. The updated financial regulations of the Council, were approved by full Council in June 2017. The financial regulations and associated procedures form a significant part of the corporate governance of the Council. Adhering to the regulations ensures that all financial transactions of the Council are conducted in a manner of openness, integrity and transparency.

Budgetary control

13. Section 3.5 of the financial regulations state that the Chief Financial Officer must report regularly and timeously on all budgetary control matters to Cabinet detailing actual expenditure and income and projected year end variances.

14. The Chief Financial Officer therefore reports 5 times a year to Cabinet with a revenue monitoring report and the capital monitoring report plus similar reports for the housing accounts. The general fund and housing capital monitoring reports then go forward to Council for further scrutiny/approval.

15. The Financial Monitoring Reports refer to matters related to budgetary sufficiency and control and therefore if the Council suffered a material, confirmed, financial loss this would be reported. The definition of a loss in this context would generally be an unrecoverable and usually unanticipated and non-recurring removal of, or decrease in, an asset or resource. Examples could be the demise of a bank (Icelandic bank was an issue many years ago) or a theft or successful fraud. Whilst the loss may be expected to be unrecoverable, the council would continue to attempt to recover the loss through whatever means possible. For example in the case of the Icelandic Bank all monies were eventually recovered.

16. The Chief Financial Officer has advised that losses of above £30k would be regarded as material to the annual accounts and are likely to justify a stand-alone report to Cabinet. Smaller losses of over £10k (in the current year) would be reported through the scheduled Budget Monitoring Report. This reporting ensures that any time critical adjustments to budgets can be made timeously. However it should be noted that whilst in some circumstances a loss can be quickly identified, in other cases an audit may require to be completed before a loss can be confirmed. For clarity, many types of loss are covered by the Council's insurance policies and whilst likely to ultimately be recoverable, these would be reported to Cabinet.

Financial Controls

17. Section 1 of the financial regulations outlines the role of Internal Audit, which is to provide assurance to the Council on the adequacy of its control environment. Internal Audit carries out independent examinations of financial and related systems of the Council to ensure that the interests of the Council are protected

18. All organisations require a system of internal financial controls which are regularly tested and improved. Systems of internal controls must provide a balance between the scale

of the risk and the cost of the control. Therefore no system of internal control can ever give an absolute guarantee. Similarly Internal Audit can only ever give a reasonable assurance

about the performance of controls and responsibility for ensuring that sound financial controls are in place rest with operational management.

19. The annual audit plan is approved by the Audit and Scrutiny Committee and outlines the audits which will be undertaken during the year as well as providing for an element of contingency time.

20. Audit reports are intensive pieces of work which take time to complete and then further time to be quality checked by the Chief Auditor. The report is then distributed for management comment and completion of the action plan.

21. Using contingency time within the annual plan, the Chief Auditor can be asked to undertake particularly sensitive audits such as suspected fraud or embezzlement which often result in a report being issued to management. It may also then result in a report being passed to the police or an investigation being undertaken by Human Resources. Such audits and subsequent investigations must be undertaken in a confidential manner.

22. The Chief Auditor reports progress against the audit plan to the Audit and Scrutiny Committee every quarter. She highlights audits with high risk recommendations where controls should be strengthened. Within the last year, she has introduced a process to grade recommendations as high, medium or low. These categories are based on the Chief Auditor's professional judgement.

23. When reporting to the Audit and Scrutiny Committee at a meeting which is open to the public, the Chief Auditor must to be sensitive to the requirements of any ongoing police or HR investigations or legal action being carried out as a result of her investigations.

24. The Chief Auditor also completes an annual statement of internal controls and highlights to the Audit and Scrutiny Committee any areas where she believes there has been a significant control failure. The definition of a significant control failure is a matter for the professional experience and judgement of the Chief Auditor.

25. Directors have a duty to report any financial irregularities they are aware of to the Chief Auditor who will carry out an audit on their behalf. It is important that all staff feel that they can report an irregularity, audit issue or error to the Chief Auditor without fear and if required in confidence.

26. Directors may decide that it would be useful for Councillors to receive a detailed report on a specific issue in addition to the audit report, especially if there are wider issues to consider. However the report would not include information on Human Resource issues or police matters. Legal matters may be discussed but usually with a recommendation that the paper is taken as an exempt item.

27. Directors also complete and sign a detailed annual statement on internal controls which are part of the end of year preparation of the accounts. These statements are summarised in the Governance Statement which is part of the Annual Accounts and signed by the Leader of the Council and the Chief Executive.

28. During the year External Audit review the work of Internal Audit and comment on its effectiveness as well as carrying out their own audit testing. External Audit have always placed reliance on the work of Internal Audit.

Financial Systems

29. The Financial Systems which the Council uses have been in place for a number of years. They consist of a number of linked systems requiring a significant number of manual processes to transfer data with the resulting risk of manual error. Through MAP, work is ongoing to automate as many processes as possible.

30. However, technology has developed significantly within the last few years and there are now Financial and HR Systems on the market which may be affordable to councils of the scale of East Renfrewshire Council and will reduce manual processing and the risk of error or non-compliance.

31. A paper will be presented to Elected Members in Spring to request outline approval to take forward the procurement of a new system.

RECOMMENDATIONS

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(b) The established reporting procedures associated with Financial Controls in the Council.

REPORT AUTHOR

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