Budget Error and Ernst & Young Review – Summary of the Issues Considered by Civic Affairs Committee on 17 April 2013 and agreed actions

Background

Errors were identified in the Council's budget forecasts in December 2012, which understated the Council's spending requirements.

These errors had been embedded in the Council's Medium Term Strategy approved by the Council in October 2012. Once the errors were discovered, Council finance officers immediately set to work to re-base the budget forecasts on revised figures.

The Council asked Ernst & Young, the Council's external auditors, to take an independent external review of its financial forecasts in light of those errors.

Ernst & Young Review

Ernst & Young's work had two stages.

At Phase 1 of their review, Ernst & Young reviewed the work undertaken by the Council's finance team to re-base the Council's budget forecasts. Their findings indicated that the re-basing methodology the Council had used to re-base its budget forecasts was sound. The Council therefore continued to prepare a budget for 2013/14 based on the revised forecast, which adjusted the figures agreed in the Medium Term Strategy (MTS) published in September 2012 by £2.3m.

In Phase 2 of their work, Ernst & Young focused on how the error happened, its impact and what changes the Council might need to make to its financial systems to make sure such errors did not happen again. Ernst & Young were asked to identify where in the Council's financial model the £2.3m error occurred.

The Council Finance Team had identified certain adjustments between different versions of the MTS model which were not accurate. The adjustments they identified related to an error in entering data to the MTS model in respect of Capital Slippage. In version three of the MTS model, there is an entry of £1.381m against the Capital Plan Revenue Contributions line, representing the agreed level of annual revenue contribution. Version four of the MTS model showed an entry of £4.981m, an increase of £3.6m. The £3.6m is the total capital slippage but only the revenue-financed element of this should have been used in the model. The true figure for Capital Plan Revenue Contributions should have been £2.639m (not £4.981m), and was therefore overstated by £2.342m.

Ernst & Young reviewed the work of the Council Finance Team in identifying this error and carried out their own comparison of the MTS models to assess the validity of this approach in explaining what had gone wrong.

Ernst & Young's Conclusions

In summary, Ernst & Young concluded:

- Budget working papers, the Council's general ledger (its main accounting system) and the budget setting report reconciled, therefore the issue was isolated to 2012/13 and did not affect previous years.

- The re-based MTS was a sound starting point for the 2013/14 budget. Therefore the Council can be confident the problem occurred because of the way the forecasting model was used last summer leading up to production of the September 2012 MTS.

- Ernst & Young are confident that the forecast model and its use are at the heart of the problem and there are not wider systemic issues in the Council's financial systems.

- They believe that incorrect data entry is the most likely explanation of how the error occurred.

- These were not picked up because of ineffective controls and supervision.

- The Finance Team's explanation about how capital slippage data was entered appears a credible explanation of the mistake and the most likely as it is the right quantum.

- But lack of audit trails means that Ernst & Young cannot be absolutely definitive that there are not other errors within the model.

- The Council could theoretically spend more time trying to trace this back but may never have absolute certainty because of gaps in audit trails and it would not be a sensible use of Council resources to attempt this.

Ernst & Young's recommendations

1. Formal reconciliation and review points should be established throughout the MTS and BSR processes to ensure that the General Ledger, Forecasting Models and Budget Database are aligned. These reconciliations should be formally documented by the person preparing them and reviewed and signed off by a senior officer.

2. The Council should consider the timings of its current process and ensure that reconciliations between the General Ledger and the Forecasting Models are done at predefined, regular intervals and that these intervals are timed to coincide with the publication of budgetary information.

3. Effective knowledge sharing protocols should be established to aid continuity in the absence of key staff members.

4. A full and clear audit trail should be maintained for all changes made to all systems and the Forecasting Models during the MTS and BSR processes.

5. The finance team should implement its own escalation policy to ensure that any identified issues are raised in a timely manner and senior team members are involved at an early stage in the identification and resolution process.

6. The controls and methodology in respect of the forecasting and modelling processes should be reviewed to minimise the risk of future errors occurring. In particular, the Council should address the suitability of the Forecasting Model format given its complexity and the importance of forecasting to the Council's financial performance.

Council's response

The Chief Executive considered the issues raised by the budget error and the findings from the external review. She reported to the Civic Affairs Committee on her proposals to take action in 4 main areas

(a) Improvement to the control environment for the Council's financial modelling
(b) Addressing staffing related issues
(c) Structure
(d) Improvements to future processes

The action plan was endorsed by the Committee.

Issue		**Action**	Who	When
Improvement to the control environment for the Council's financial modelling	1.	Internal Audit will work with the Finance team to make improvements to the control and supervision in the service and to address Recommendations 1,2 and 4.	Head of Internal Audit Head of Accounting Services	By May 2013
	2.	The financial model will be reviewed to ensure it is fit for purpose in accordance with recommendation 6 and decisions made on whether to make changes and improvements to the existing model or to procure a new one.	Head of Accounting Services DOR	By July 2013

	3.	Any recommendations from external audit as part of their annual audit work will also be incorporated into improved process.	External Audit	As appropriate
Addressing staffing related issues	4.	In accordance with recommendations 3 and 5, systems within the finance team will be reviewed 1. to ensure that there are clear processes in place to capture information and knowledge in case of staff absence 2. to ensure there are clear escalation polices and process for problems with the service All staff in the team will be provided with copies of these policies and processes and any necessary training will be provided. Managers tasked with ensuring these are effectively embedded in the culture and practice of the service	Head of Accounting Services (supported by Head of HR)	By May 2013
	5.	Appropriate actions are being taken in accordance with council's HR polices.	CEX	Ongoing
Structure	6.	CEX to consult on changes to the structure of the Resources department to the separate the role of Section 151 officer from the role of Director of Resources.	CEX	End of April 2013
	7.	Implementation of agreed changes	CEX	June 2013 onwards

Improvements to decision making processes	8.	The Chief Executive will make recommendations to Civic Affairs to streamline and simplify the council's financial decision making processes. The aim will be to balance the need to free up capacity and make efficient use of the organisational resources available, with the need to give all members clear and transparent oversight and scrutiny of the council's finances.	CEX	July 2013

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