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19 February 2013

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Dear Antoinette

Cambridge City Council (the Council) – Financial Re-forecast Review Phase 2

In December 2012, Cambridge City Council discovered errors in its modelling in respect of the 2012/13 financial year budget, and specifically differences between its original budget and a re-forecast undertaken in December 2012.

Ernst & Young was engaged by the Council to investigate the error and the issues which may have given rise to it. Further to our letter dated 23 January 2013, which set out our findings from Phase 1 of our review, this letter sets out the results from Phase 2 of our work.

Scope of Phase 2

We confirmed with the Chief Executive the scope of the Phase 2 review on 25 January 2013. The scope set out five areas for consideration:

1. What was the cause of differences in forecasts?
2. Do any of the issues identified impact on prior financial periods?
3. Who was involved in the preparation and review of forecasts and what were the relevant governance procedures?
4. Why were any underlying issues in budgeting and reporting not identified earlier?
5. Are the differences indicative of wider systemic issues in financial systems?

Approach to Phase 2

Our work for Phase 2 involved the following activities:

- ▶ Interviews of relevant Council finance staff members
- ▶ Consideration of work undertaken by the Council finance team to identify where the error in its budget setting process occurred through the analysis of a number of iterations of its forecasting model.

For the purposes of this letter, the following terminology is used:



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MTS Model – an MS Excel-based modelling tool, developed and used by the Council for forecasting purposes as part of its Medium Term Strategy process

BSR Model – an MS Excel-based modelling tool, developed and used by the Council for forecasting purposes as part of its Budget Setting Reporting process

Forecasting Models – collective term used to refer to both the MTS and BSR Models

Budget Database – an MS Access database used by the Council which holds information on approved budget bids and savings

General Ledger – the Council's financial ledger used to record all financial transactions

We note that the Council uses one excel-based modelling tool, which by changing its functionality, is used for both the MTS and BSR processes. For the purpose of clarity in our report, we refer to separate MTS and BSR Models to reflect the different purposes for which the modelling tool is being used.

Background to the error and how it was identified

The Council published its financial year (FY) 12/13 Budget Setting Report (BSR) in February 2012. This set out the Council's budget for FY12/13, indicating a Net Spending Requirement of £17.637m and a contribution from reserves of £0.6m. As the BSR is published before finalisation of the accounts for FY 11/12 and before the opening reserve balance for FY12/13 has been established, the £0.6m contribution from reserves represented a projected contribution to achieve the Council's target level of reserves of £5m.

The Council begins its Medium Term Strategy (MTS) Process in June each year. The MTS process is a forward-looking rolling cycle of financial forecasting covering a medium-term five year plan and a longer term 25 year plan. The Council carries out its MTS forecasting via the use of an 'in-house' designed MS Excel-based modelling tool, known as the 'MTS Model'.

The starting point for the MTS each year is the BSR published in February (the original budget) so the original budget for FY12/13 becomes the 'base year' in the MTS Model for projecting forward 25 years. At the start of the MTS process, a Finance Team member will roll forward the MTS Model by updating the 'base year' in the MTS Model to reflect the final version of the BSR Model, thereby removing the first year of the previous period and adding a new 25th year to the end. This is a manual update which in essence confirms that the starting point of the MTS matches the end point of the BSR Model and so also agrees to the General Ledger. This matching exercise represents a key exercise in the annual forecasting process.

The Council then takes this updated version of the MTS model as the starting point for its forecasting under the MTS process. The original budget for FY12/13 is adjusted within the MTS Model for known changes which have occurred between publication of the BSR in February and the end of the MTS process in September. The most significant changes will be from the completion of the draft final accounts for the previous financial year and during this period, adjustments are made to the MTS Model to reflect the closing FY11/12 Reserves position and carried forward underspend from FY 11/12.

These changes include new and revised budget bids and savings, budget virements and any other known adjustments and are processed manually in the MTS Model by a Finance Team member. The changes should also be reflected in the Council's General Ledger.

The MTS is published in September each year and itself then forms the basis of the future year's budget setting process. The base position in the MTS Model as at September 2012 showed an FY12/13 net spending requirement of £19.44m and a closing level of reserves of £6.85m¹.

The accuracy of the MTS and validity of the process is predicated on the assumption that all identified required changes are correctly captured in the MTS Model during the MTS process and are accurately reflected in the Council's General Ledger. Whilst changes will have been made directly to the General Ledger as a result of year-end adjustments, other changes identified as required during the course of the MTS process are not automatically reflected in either the General Ledger or in the MTS Model.

To ensure the General Ledger is appropriately updated and accurate, all the changes captured in the MTS Model should be matched by changes made in the General Ledger (for the purposes of this letter, we refer to this exercise as 'the MTS Reconciliation')². The MTS Reconciliation between MTS Model and the General Ledger generally takes place in late September/early October each year, after the publication of the MTS, and serves as the starting point for the forthcoming budget setting process. In October 2012, a Finance Team member was on leave due to illness so the MTS Reconciliation took place later in FY 12/13 than in prior years.

As part of the process to reconcile the two, a Finance Team member downloaded a detailed line-by-line analysis of all cost centres from the Council's General Ledger. This analysis was exported to MS Excel to form detailed Budget Working Papers (BWPs) and at the point of download, the BWPs should agree to the MTS Model and published Medium Term Strategy in September. An attempt to reconcile the MTS Model to the General Ledger in October 2012 to start the BSR process identified a difference in that the downloaded BWPs showed a net spend requirement of £21.87m compared to the published MTS net spending requirement of £19.44m.

Attempts were made to resolve the difference but when it was not possible to reconcile the BWPs to the MTS Model the issue was escalated within the Finance Team on 25 November, and then reported to the Director of Resources and Council s151 Officer on 26 November. As the Council Finance Team was unable to resolve the variance, ultimately the decision was taken to rebase the FY12/13 budget, using the Council's General Ledger position as the starting point.

The rebasing exercise was completed in December 2012 and resulted in the MTS Model showing a rebased FY12/13 net spend requirement of £22.34m and a projected closing level of reserves of £4.59m. The difference in closing level of reserves of £2.26m between the MTS Model (£6.85m) and the rebasing exercise (£4.59m) could not be explained by the Council's Finance Team and was reported as an error in its budget setting process.

1. What was the cause of differences in forecasts?

In the reporting of our Phase 1 work we noted the following with respect to the cause of the differences in forecasts:

¹ We note that the closing level of reserves of £6.85m reflects an adjustment of £197,250 due to an overspend being identified by the Council Finance Team as part of the revised budget process.

² In our Phase 1 letter, we referred to this exercise as the 'June Reconciliation'. Further inquiries during Phase 2 of our work indicate that this process is carried out in late September/early October.

'due to structural differences between the Re-Forecast Model and earlier models, along with the extent of updating of information within the models, the number of iterations, and poor version control, a comparison between the Re-forecast Model and earlier models has not been possible'.

The lack of audit trail between different versions of the Council's Forecasting Models, and the associated lack of transparency as to the nature of the changes reflected in those versions, have given rise to difficulties in establishing the cause of differences in forecasts. Notwithstanding these difficulties, in an attempt to identify the cause of the differences, the Council Finance Team has undertaken a limited exercise to identify the changes that had been processed through nine versions of its MTS Model.

We have reviewed the work of the Council Finance Team, and carried out our own comparison of the MTS Models to assess the validity of this approach. We note the following:

- Across the nine versions of the MTS Model, there are a number of changes that have been processed as a result of changes approved during the MTS process which affect the net spend requirement
- These changes include updates to reflect budget bids and savings that have been approved as part of the MTS process
- Version eight of the MTS Model can be traced to the published MTS document at a Net Spend Requirement, Funding and Use of Reserves level

The Council Finance Team has identified certain adjustments between versions three and four of the MTS Model which were not in accordance with the movements anticipated in the MTS process.

These adjustments relate to an error in entering data to the MTS Model in respect of Capital Slippage and Direct Revenue Financing. 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. However, the increase of £3.6m represented total capital slippage against plan, when the correct entry should only have included the element of capital slippage to be funded by revenue. We understand based on work undertaken by the Council Finance Team that the true figure for Capital Plan Revenue Contributions should have been £2.639m³ (not £4.981m), and was therefore overstated by £2.342m.

We understand that £1.325m of the £4.981m Capital Financing was re-phased in a subsequent iteration of the MTS Model (version 8) to FY13/14 as part of the MTS process⁴. We have confirmed this amount to the published MTS document but note that this adjustment was itself based on the erroneous assumption that the Council was due to spend £4.981m on Capital Financing. The Council Finance Team has assumed that this adjustment has had the effect of reversing £1.325m of the overstatement in the Capital Plan Revenue Contributions line.

The entries made in version 4 of the MTS Model in respect of the erroneous Capital Financing entry, whilst increasing the total net spend requirement within version four of the MTS Model to £19.987m, also had the effect of depressing the Committee Spend Total by a corresponding £2.342m due to the net spend total being adjusted as a balancing figure to meet a predetermined use of reserves. We

³ Comprising the annual contribution of £1.381m, an agreed increased contribution of £0.555m and New Homes Bonus funding of £0.703m

⁴ We have been informed that subsequent to the error being identified, the Council has rebased its capital plan so the re-phasing of £1.325m, which was based on a false starting point of £4.981m, has been reconsidered and so does not constitute an error being carried forward into future financial years.

understand that the re-phasing adjustment of £1.325m processed in version 8, which may have reduced the error in the Capital Financing line, was not adjusted within the Committee Spend total. This had the effect of keeping the Committee Spend total artificially depressed, which would have resulted in an overstated level of closing reserves.

The adjustments identified above therefore represent the Council Finance Team's best explanation of what caused the error. Given the high number of adjustments that are made between versions of the MTS Model and due to significant deficiencies in the audit trail with respect to these adjustments, it has not been possible to trace and establish all adjustments that have been processed within the MTS Model in order to establish the source of the entire difference identified of £2.26m. In the absence of a full reconciliation it is not possible to determine the size and nature of other erroneous adjustments that may have been processed in the MTS Model.

When the Council Finance Team identified the error and were unable to resolve it, the team rebased its FY12/13 budget from a detailed consideration of budgetary requirements and information drawn from the General Ledger. From Phase 1 of our work, we are satisfied that the approach adopted in the rebasing exercise was reasonable. From our phase 2 work, we are further satisfied that the starting point for the MTS process in FY12/13 was appropriate (see 2 below).

Given the appropriateness of the MTS starting point and the reasonableness of the approach adopted in the rebasing exercise, we consider that erroneous entries in the various iterations of the MTS Model are the most likely cause of the difference. However, the limited work which has been undertaken by the Council Finance Team does not fully explain the difference identified and has not identified all the erroneous entries which may have contributed to that difference. It is for the Council to decide whether there is any merit in further investigation of the cause of the £2.26m error. In the absence of an audit trail for the numerous adjusting entries made (see further comments at 4 below), we consider that to do so would require significant Finance Team time and resource and have little certainty of a complete answer being reached.

2. Do any of the issues identified impact on prior financial periods?

The findings described above indicate that the issues identified relate to the MTS forecasting process. The MTS process which commenced in June 2012 took as its base year the budget for FY12/13 which was approved by Council and published as the Council's Budget Book and also its Budget Setting Report in February 2012.

The Council's Budget Setting Report is a high-level summarised version of the Council's budget based on changes to current year budgets which have been approved during the MTS Process. All the approved changes in the MTS process are reflected on the Council's General Ledger and are independently captured in the Council's BSR Model. The Budget Book represents a detailed published version of the Council's budget for the forthcoming year and is drawn from the Council's General Ledger. As the changes made to the General Ledger should also be captured in the BSR Model, the BSR Model should also agree to the General Ledger. The BSR Model then acts as the starting point for the MTS process which commences in June each year.

To assess whether the identified error in the budgeting process might impact on prior financial periods, the Council Finance Team undertook a review to determine whether the Council's General Ledger as at February 2012 agreed to the Budget Book and BSR published in February 2012 and also the first iteration of the Council's MTS Model. To the extent that no differences were observed between these sources, this would indicate that the starting point for the MTS process in June 2012 was appropriate and that any difference in the forecasting process would be attributable to an error in the MTS

forecasting process after that date rather than representing an issue carried forward from prior financial periods.

Our review has confirmed that the Council's General Ledger, Budget Book, Budget Setting Report and first iteration of its MTS Model are consistent across the Net Spend Requirement, sources and levels of funding and use of reserves, supporting the assertion that the error is contained within the MTS forecasting process undertaken in the FY12/13 period.

3. Who was involved in preparation and review of forecasts and what were the relevant governance procedures?

Based on information obtained during interview and wider discussions with Council Finance Team members, we set out below our understanding of responsibilities for preparation and review and also of the related governance procedures involved in the BSR and MTS forecasts during FY 12/13.

The MTS and BSR processes at the Council, as described in the background to the error section above, are reliant on a number of systems and data sources:

- ▶ The General Ledger
- ▶ The Budget Database
- ▶ The Forecasting Models
- ▶ Numerous working papers, such as excel spreadsheets, bids and savings papers and monthly budget monitoring reports which feed into and support the process.

It is important to note that these inputs operate independently and do not directly interface with each other. For example, a change in either of the Forecasting Models is not automatically reflected as a change in the General Ledger and vice versa. All the inputs are reliant on members of the Council Finance Team processing the correct entries in all systems and models to ensure that they all remain aligned with one another and that all changes are appropriately reflected across all systems and models.

We consider that the resulting level of manual intervention required within the BSR and MTS processes, and the reliance on all changes being reflected across the various systems in a timely, complete and accurate manner, increase the potential for errors to occur across the various inputs. However, if robust and timely checks were built into the MTS and BSR processes, this segregation between the systems could provide an additional control within the forecasting processes, requiring detailed review of the adjustments being made to each system to ensure that the systems are appropriately aligned.

The BSR Process

The BSR process commences each year from late September/early October in order to set the budget for the following financial year. In late September/early October, each year a Finance Team member will download the detailed budget working papers (BWPs) from the Council's General Ledger system.

The starting point for the BWPs is the original current year budget (for FY12/13, the February 2012 BSR) updated for changes in the published MTS (September 2012). The BWPs represent a line by line, cost centre analysis, of all budget items. Once downloaded from the ledger, the BWPs are manually updated by members of the Council Finance Team to reflect further changes since the publication of the MTS and form the starting point for the budgeting process (for FY 13/14).

Changes made manually to the BWPs include new and approved budgetary items, changes to savings plans and any restructuring of budgets. This information will typically be captured in the Budget Database. Once these changes have been made to the BWPs, a Finance Team member sends the BWPs out to budget managers for their review and any additional updates. Following review by the budget managers, BWPs are then sent back to members of the Finance Team to review the changes.

The Council's Budget Database stores information on approved bids and savings to budgets. The net impact of these changes to budgets is used by the Finance Team as a control total against which changes that are made manually to the BWPs can be checked. When the BWPs are returned to the Council Finance Team by budget managers, the changes made to them should reflect the changes that have been stored in the Budget Database. Once all the required changes have been made to the BWPs, these changes are then uploaded manually to the General Ledger. For the purposes of this letter, we refer to this process as the 'General Ledger Reconciliation'.

As an additional check on the completeness of the BWP process, the Finance Team maintains a tracking spreadsheet of all BWPs sent out and returned. Via the use of a macro in the spreadsheet, the Finance Team member is able to run a search to ensure that all BWPs (96 in FY12/13) have been returned and follow up on any that have not.

When the changes to the BWPs are manually uploaded by the Finance Team to the General Ledger, there is no independent verification to ensure that this upload accurately reflects in the General Ledger the changes made to the BWPs. For FY 12/13, the original net control total adjustment for current year changes to the BWPs was £197,250⁵. We were told by the individual involved in this work that he was not aware of any checks by any other staff member or more senior officer of the General Ledger Reconciliation.

We were told in interview that the Council relies on its budget managers raising any concerns and identifying any errors in the changes to their budgets and also relies on the Council Finance Team picking up any anomalies as and when they arise. Accordingly we find that there is a lack of defined review or reconciliation points in the BSR process to assure the Council that all the related systems are appropriately aligned and the information within them is accurate.

The MTS Process

As outlined above, the MTS process runs from June to September each year. In FY 12/13, the starting point in June was the published BSR from February 2012, adjusted for known changes post publication.

A Finance Team member will manually roll forward the BSR Model into the MTS Model. If the adjustments have all been processed appropriately in the BSR and General Ledger and the roll forward carried out correctly then at that point in time, the BSR, General Ledger and MTS should all be aligned. We note that this manual roll forward is not formally documented and does not require the individual Finance Team member to sign it off as completed, nor does any senior officer review the work and check for potential errors.

During the MTS process, as changes are agreed to budgets, with budget bids being approved and additional savings requirements arising, these are captured in the MTS Model. We note that these changes are reflected in the MTS Model by means of hardcoded entries to the MTS Model, with little or no narrative or support captured within the model itself to explain what the change is, why it has happened and when it was processed. No central log of changes was maintained by the Council in

⁵ We have been informed that the control total was agreed to the returned BWPs but due to the lack of audit trail, the Council has not been able to provide evidence to demonstrate this.

FY12/13 or previous years. Finance Team members would rely on effective communication between them to avoid potential duplication and to ensure that all required changes are accurately reflected.

The changes processed in the MTS model are not captured at set dates and there are no specified points for periodic reconciliation between the General Ledger and the MTS Model to ensure that all changes in the MTS Model are being reflected in the General Ledger. The cut off point for all changes in the MTS Model to be reflected in the General Ledger is the end of September, at the close of the MTS process. The uploading of the changes in the MTS Model on to the General Ledger is carried out as part of the MTS Reconciliation.

The only reconciliation between the General Ledger and the MTS Model is the MTS Reconciliation carried out in late September/early October of each year. As noted in the background section, the purpose of this reconciliation between the MTS Model and the General Ledger is to check that all changes captured in the MTS Model have been accurately reflected in the General Ledger.

The Council Finance Team allows changes to be made to the MTS up to the point of publication to provide as much flexibility in the process as is possible. The MTS Reconciliation therefore takes place post publication of the MTS and serves multiple purposes. It ensures that all required and approved changes are captured within both the MTS Model and the General Ledger, thereby confirming the alignment of both, and their consistency with the published MTS document. In addition, as the MTS position forms the basis of the forthcoming BSR process, the reconciliation also ensures that the starting point for the BSR process is appropriate.

Given the importance of the MTS Reconciliation, the reconciliation and its supporting audit trail should be fully documented by the person completing it and then be reviewed and signed off by a more senior team member. The timing of this reconciliation (i.e., currently only after the MTS has been finalised and published) is sub-optimal and should be reviewed by the Council due to the serious implications to both the MTS and the BSR process of errors being identified only at a later stage.

Governance Procedures

In addition to the points noted above with respect to the BSR and MTS processes we set out below under the following headings a number of issues we have identified through discussions and interviews with relevant members of the Council Finance Team.

- ▶ General oversight of MTS and BSR
- ▶ Maintenance of the Forecasting Models
- ▶ Lack of interface between systems
- ▶ Concentration of knowledge within two staff members
- ▶ Lack of formal documentation of processes

General oversight of MTS and BSR

For the MTS and BSR processes under review, there was a general lack of oversight of the work of the individual team member in regard to the financial modelling by more senior members of the Council's finance team. The role of senior officers was primarily focused toward coordinating the production and publication of the MTS and BSR documents. No senior officers were involved in the detailed technical elements of the forecasting process and no senior officer reviewed the detailed technical work, nor

required evidence of accurate completion. Beyond the senior members of the Finance Team, the Director of Resources primary involvement was at a strategic level, in discussions with the Senior Leadership Team, Chief Executive and elected Members around Council priorities and strategy looking forward.

We were told in interview that the lack of review of other Finance Team members' work reflected in part cultural issues within the Finance Team. The Council Finance Team consists of a number of long-serving individuals, who have worked closely together for a number of years. We were informed of a culture whereby long-serving staff members were assumed to be reliable and aware of their responsibilities and the expectations on them for delivery. In addition, certain interviewees indicated that limitations in resource within the Finance Team made it more difficult to ensure formal review of the work of other team members.

The level of trust within the Council Finance Team has led to excessive reliance on individuals not making mistakes. A control environment with greater levels of checks and review would significantly increase the likelihood that the Council Finance Team would identify and resolve errors on a timely basis.

Maintenance of the Forecasting Models

The Forecasting Models are held on the Council's Finance server. Access to the server is restricted to Finance Team members and then there are further restricted sub-levels of access to folders within the server depending on the job requirements of each staff member. Nevertheless, at present, up to 30 people have access to the part of the server in which the Forecasting Models are contained.

The Forecasting Models are maintained as 'live' working versions on the server, such that any member of the Council Finance Team with access to the Forecasting Models can make alterations to them. The Forecasting Models are not password protected. When alterations are being made to the opened live version, the file becomes 'read only' preventing simultaneous updates by multiple users. Whilst we understand that generally only two Finance Team members use the Forecasting Models, we consider that the extent of access to the Forecasting Models gives rise to the potential for others to make unauthorised changes to the models. However, we have not seen any evidence of this having occurred.

As the server version of the model is 'live', it represents the master version of the Forecasting Model. A log of the changes to the Forecasting Model has not historically been maintained by the Council. Given the number of hardcoded alterations to the Forecasting Model, this represents a significant weakness in the audit trail. We have been informed that, subsequent to the error being identified, a log of changes has been introduced on the 'Key' tab of the Model, which requires users to note any changes they have made, and the date of and reason for those changes. However, this update to the Key tab is reliant on the end user completing the log in a sufficiently detailed manner for it to provide a robust audit trail. On that basis, it is susceptible to the same issues which affect updates to the Model. As per our Phase 1 letter, we recommend that the controls and methodology in respect of the forecasting and modelling processes should be urgently reviewed to minimise the risk of future errors occurring.

Lack of interface between systems

The Council's General Ledger, Forecasting Models and Budget Database all operate independently of each other with no electronic interface between them. Ensuring consistency between them relies on each being manually updated in a timely and accurate manner. There are no formal reconciliation points identified by the Council, save for the reconciliation between the MTS Model and General Ledger in late September/early October, which, as noted above, is not formally documented or reviewed and is also not timely in the context of representing an effective control prior to publication of the MTS.

In addition, the number of inputs into the process has increased considerably over the years and concerns were raised in interview that the Forecasting Models may no longer be the most effective or appropriate means of capturing those inputs. Given the absence of automated interfacing between the systems, any weaknesses in the operation of the Forecasting Models will increase the risk of errors entering the process.

Concentration of knowledge within two staff members

We note that the detailed knowledge of the MTS and BSR modelling processes rests with one individual Finance Team member. Whilst the Director of Resources also possesses a good working knowledge of the process, and was instrumental in creating and developing the Forecasting Models, his role as Director of Resources results in his being several steps removed from the detailed work. This separation from the detailed work, whilst appropriate, effectively has resulted in a single individual being the only person with the knowledge to use the Forecasting Models and capture the required inputs to the process.

Prior to the error occurring and being identified, no senior officer was closely involved in the technical aspects of either forecasting process. No senior officer had a detailed knowledge of the Forecasting Models being used, nor how the inputs into those models were captured and monitored.

The limited knowledge and understanding of the Forecasting Models within the Finance Team in all likelihood contributed to the failure to escalate the problem sooner (see further comments at section 4 below). Effective knowledge sharing amongst the Finance Team would have enabled greater continuity of the MTS and BSR process.

Lack of formal documentation of processes

There is a level of complexity within both the MTS and BSR processes which we consider is likely to have been compounded by the escalating numbers of inputs over recent years and the high levels of changes to budgetary items, resulting in Forecasting Models which may no longer be best equipped for the Council's purposes.

In interview we were told of a process which had evolved from a focus on one budgetary year where inputs affected only that year, to a process which now looked across five and twenty five year periods, with changes having part and full year impacts and/or being carried forward across several years.

The MTS and BSR processes are fundamental to the effective running of the Council and enable the Council to make appropriate decisions about how best to use the resources available to it. To ensure the smooth running of the MTS and BSR process therefore, the increasing level of complexity referred to above requires a detailed knowledge of the process and the ability to capture information in a complete, accurate and timely manner.

Despite this level of complexity, we have identified weaknesses in the Council's audit trail and no formal review points have been established to ensure that all systems are periodically and regularly reconciled. In addition, neither the MTS nor BSR processes are documented by the Council to provide for continuity in process in the absence of key staff members.

4. Why were any underlying issues in budgeting and reporting not identified earlier?

During the course of our investigation, we have identified a number of reasons why underlying issues in budgeting and reporting were not identified earlier.

Issues contributing to a delay in identifying the error

We note above that a key test of the accuracy of the MTS is the reconciliation between the MTS Model and the General Ledger, yet this reconciliation is not completed until after the MTS is published. Had the reconciliation been conducted as a final test of accuracy pre-publication, the Council may have been able to identify the issue and start working to resolve it at least one month earlier.

We also note above the lack of regular reconciliation and cross checking within the BSR and MTS processes. The absence of review by senior staff members of work undertaken will have contributed to the error not being identified earlier in the process. It was stated in interview that the Council Finance Team is reliant on budget managers and individual accountants picking up errors on an ad hoc basis, rather than through any formal review process.

We were also told in interview that issues in how the MTS and BSR information is published and reported may have made it difficult for certain, 'high-level', basic checks to have been carried out. The information in the published MTS and BSR is summarised at a high level, with for example, totals for Net Spending Requirements being published which, if broadly consistent across financial years, may disguise significant 'in year' fluctuations in budget lines at a detailed level. We understand that plans are in place to introduce changes to future publications of the BSR and MTS to try to address this issue.

We were also told in interview that the mindset of the individuals involved, in particular with the MTS process, is forward-looking to the next financial year and longer term. When coupled with the way information is presented in the published documents, this has the effect of moving their focus away from the current financial year.

In addition, we were informed in interview that the Council has been undergoing significant changes over the last few years. Events such as departmental and service line restructuring, pay reviews and changes in accounting policies have meant that the annual net spend requirement (NSR) has fluctuated over recent years. We were informed in interview that the extent of these fluctuations has made it more difficult to conduct effective comparisons of movements in net spending requirements.

Another potential reason why the issue was not identified earlier is the fact that the responsibility for the MTS and BSR process, including the responsibility for reconciling the Forecasting Model to the ledger and budget database is overly dependent on a single Finance Team member. Given the level of complexities identified in the process, and the increasing number of inputs to the process, the Council should consider whether the extent of dependency on one individual is appropriate.

The work undertaken in regard to the MTS and BSR processes appears to be subject to only limited review by more senior officers, and the Council relies on its monthly budget monitoring process to identify any problems with its budgets, hence the Council Finance Team's ability to identify errors in a timely fashion is limited.

Regular reconciliations between systems and forecasting models, timely review of the work of others and effective knowledge sharing are important elements in an effective control environment. These elements require improvement in the Council Finance Team in order to reduce the risk of similar error going undetected in the future.

Issues contributing to a delay in reporting and escalating the error

It has been stated in interview that the error was first identified in late October 2012 and that the reconciliation between the MTS Model and the General Ledger was carried out slightly later than in previous years. The issue was escalated in November only once attempts to resolve the issue had failed. A major contributing factor to the inability to resolve this in a timely manner and therefore delaying

escalation is the lack of clarity in the Council Finance Team's audit trail in its MTS forecasting process. The Council maintains multiple iterations of its Forecasting Models, each with significant numbers of hardcoded changes without supporting narrative of what the change is, or when or by whom the change was made.

In addition, during FY12/13, the Finance Team was in the process of revising the Forecasting Models and changing the layout of how information was analysed within it. Our work in comparing nine iterations of the MTS Model identified difficulties in comparing newer versions with older versions due to the changes in analysis across the different versions.

The significant weaknesses in the audit trail have contributed not only to delays in escalating the issue, but also to the fact that the Council Finance Team has not been able to identify definitively the entries which will explain the entirety of the £2.26m difference identified.

5. Are the differences indicative of wider systemic issues in financial systems?

For the reasons outlined above, the information provided to and reviewed by us indicates that the error in the budgeting process is contained within the MTS forecasting process of the FY12/13 financial period and is not indicative of wider systemic issues in the financial systems.

However, on the basis of the governance structure operating as described to us, there are significant weaknesses in that structure which the Council should seek to address to aid it in preventing future errors, or helping to identify them sooner.

Recommendations

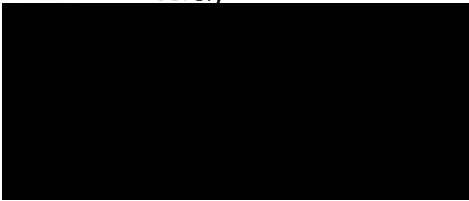
- ▶ Formal reconciliation and review points should be established throughout the MTS and BSR processes to ensure that the General Ledger, Forecasting Models and Budget Database are aligned. These reconciliations should be formally documented by the person preparing them and reviewed and signed off by a senior officer.
- ▶ 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.
- ▶ Effective knowledge sharing protocols should be established to aid continuity in the absence of key staff members.
- ▶ 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.
- ▶ 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.
- ▶ 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.

Conclusion

Whilst it has not been possible to explain the total forecasting difference of £2.26m, the appropriateness of the MTS starting point and the reasonableness of the approach adopted in the rebasing exercise indicate that the cause of the forecasting difference is likely to be errors made by a Finance Team member when entering information into one of the versions of the MTS Model. We do not therefore consider that the forecasting difference is likely to be indicative of wider systemic issues or to have affected prior periods.

We have noted a number of significant weaknesses in the Council's current MTS and BSR processes which will have contributed to the error not being identified, reported and resolved sooner. The Council should look to address those weaknesses as an urgent priority to prevent a recurrence of similar issues in future periods.

Yours sincerely



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