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Dear Antoinette

Cambridge City Council (the Council) - Financial Re-forecast Review

In December 2012, the Council discovered errors in its financial 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.

This letter sets out our findings from the Phase 1 review of the Council's financial re-forecast that you requested in December 2012.

Scope of Phase 1

We agreed the scope of the Phase 1 review on 18 December 2012. The scope contained three procedures, those procedures being:

1. Quantify the difference between the Council's re-forecast position and the original forecast;
2. Consider the source and nature of the inputs to the re-forecast model and identify the reasons for differences from the original forecast and the sensitivity of any of these inputs; and
3. Assess whether the formula within the re-forecast model compute correctly.

Terminology

Original FY 12/13 Budget - the original budget requirement within the published Medium Term Strategy (MTS) (as notified to us by the Council's Finance Team).

Re-forecast Model - the 'GF Budget Model (Review Version) v 6-0' provided to us by the Council on 18 December 2012.

Background

Our review initially focussed on understanding the Council's financial forecasting process and the annual timeline within which that process operates. For reference purposes, and in order to provide context to our findings, Appendix 1 to this letter sets out our understanding of this process.

It is relevant to note that the process set out in Appendix 1 indicates a significant degree of complexity in the Council's financial forecasting process.



The detailed reasons for the differences between the Council's original budget and re-forecast are properly matters for consideration and conclusion under the scope of phase 2 of the review. Nevertheless, whilst our work in respect of Phase 2 has not been completed at the date of this letter, we consider that it is helpful to set out from our work to date our preliminary understanding of the reasons for the differences.

Departures from documented financial forecasting process

We have identified two departures from the documented financial forecasting process for the 2012/13 financial year. These departures are relevant to our findings to the three procedures of our Phase 1 scope.

Firstly, we have not identified any evidence that the Original FY12/13 Budget, amended for year-end and other known adjustments, was correctly reconciled to the starting point of the FY 13/14 MTS process as part of what would normally be considered an annual reconciliation process ("the June Reconciliation"). The June Reconciliation is designed to ensure that year-end adjustments required as part of the year-end audit are reflected in the starting point of the MTS process.

Our preliminary understanding is that:

- whilst the June 2012 reconciliation may have been performed, there is no audit trail to evidence this;
- there is no evidence that a formal review of this reconciliation was performed by a supervising officer; and
- this reconciliation, had it been performed appropriately and on a timely basis, may have indicated the existence of a difference in the financial forecasting.

Together, these findings indicate a weakness in the Council's budget setting control process.

Secondly, outside of the annual process as described and as a consequence of the development of the Re-forecast Model in October 2012, a detailed remodelling exercise was performed utilising the FY 12/13 budget working papers (BWPs) downloaded from the ledger which had been updated to reflect year-end and other known adjustments. This identified a variance which could not be explained by year-end adjustments. The Council has suggested that the difference in the net spend requirement and projected level of reserves may be due to an error in how the BWPs were fed into the original budget, which was not identified because of a failure in the June Reconciliation.

The BWPs are a line by line analysis across all cost centres on Oracle, the Council's financial ledger system. The BWPs total approximately 10,000 lines of budgetary analysis. An initial exploration of the difference in the projected level of reserves (the BWP Reconciliation) was undertaken by the Council Finance Team to assess the extent of the difference between the Original FY12/13 Budget and the aggregated BWP position.

Although we have been provided with a copy of the BWP Reconciliation comparing the Original FY12/13 Budget and the aggregated BWP position, we have not undertaken an analysis of this exercise on the basis that it was not undertaken at a detailed BWP level and it represents only an initial exploration of the issue by the Council Finance Team. Instead, we have focused our work on the Council's revised budget modelling tool (the Re-forecast Model), which has been built up from a detailed analysis of information within the Council's financial ledger system.

The Re-forecast Model

The Council provided us with a version of its General Fund modeling tool on 18 December 2012 titled 'GF Budget Model (Review Version) – v 6-0' ('the Re-forecast Model'). The Re-forecast Model is an excel spreadsheet containing 32 worksheets. The 'GF Projection Data tab' shows a summary of the Council's budgetary requirement across the five year MTS period and also a longer term period of 25 years. All the worksheets within the Re-forecast Model are linked either to the 'GF Projection data' tab or to other supporting worksheets within the Re-forecast Model.

We have been informed by the Council Finance Team that the Re-forecast Model differs from the modeling tool previously used by the Council as it combines the MTS and BSR modeling tools into one. In addition, we have been informed that the Re-forecast Model, on the 'GF Projection Data' tab, provides a more detailed overview of budgetary inputs, separating out lines of income and expenditure in greater detail than the previous tool.

We have further been informed by the Council Finance Team that the net spend requirement and projected level of reserves within the Re-forecast Model take account of the difference identified by the Council between its Original FY12/13 Budget and the BWPs.

Review Findings

Due to the differences in the way data is input and analysed within the Re-forecast Model, and due to the continuing, iterative nature of the budgeting process, it is not possible to perform a direct comparison with outputs from previous modeling tools, including in particular the Original FY12/13 Budget, to identify where and how the Council-identified difference in its budgetary requirement has arisen.

We understand that the Council Finance Team has historically stored multiple iterations of its budget models, which are subject to numerous revisions and updates but not easily traced to a specific point in time. This is indicative of poor version control, a weakness in the audit trail and a risk to financial controls and may have contributed to the Council's difficulties in identifying its budget setting issues.

Given no direct comparison is possible which would enable the Council-identified difference to be tracked and since the Re-forecast Model uses as its starting point the BWPs for FY 12/13 as extracted from the ledger in October 2012, our approach in Phase 1 has therefore sought to gain comfort that the BWPs for FY12/13 provide a sensible starting point upon which the Council can base its future projections and also to consider whether the Re-forecast Model is well structured, operating properly and supported by an adequate audit trail.

Q1 - Quantify the difference between the Council's re-forecast position and the original forecast.

The Council Finance Team has rebased the Council's FY 12/13 budget using the detailed BWPs drawn from the ledger. In light of the evolving nature of budgets, which include ongoing updates to reflect virements, new budget items or changes to previous items, and to establish a position for use as the starting point for its Re-forecast Model, the Council Finance Team took a snap shot of the BWPs at a point in time. That starting point, a committee spend total of £21.73m, is then adjusted within the Re-forecast Model for known changes to arrive at a net spend requirement of £22.34m and a projected level of reserves of £4.59m.

The position in the Re-Forecast Model for FY12/13, which has been built from the detailed BWPs and adjusted for all known information at that point in time, was compared to the Original FY12/13 Budget.

The Original FY12/13 Budget had a net spend requirement of £19.44m and a closing level of reserves of £6.85m.

A variance of £2.26m in the closing level of reserves was therefore identified between the Original FY12/13 Budget and the Re-forecast Model. The Council has not been able to explain this variance and has proposed the amount of £2.26m as an error in its budget setting process.

Our work in Phase 1 has focused on the Re-forecast Model provided to us by the Council on 18 December 2012. As we have conducted our work, we have been informed that the Council Finance Team has continued to update and revise its re-forecast budget for known movements arising as a natural consequence of Council operations and budgetary requirements. We have not considered these movements, which have taken place outside of the version of the Re-forecast Model provided to us.

The BWPs are drawn from the ledger, as adjusted for year-end and other known changes arising from the audit process. The Council has historically received a clean audit opinion and has taken assurance from the audit process as to the veracity of its ledger figures. Whilst we have not performed an audit of the figures input to the ledger, we have confirmed that the BWP figure included within the Re-forecast Model agrees to the Council's financial ledger.

In considering the BWP process, we held interviews with four budget holders and discussed the overall budgeting process with them. Our discussions with budget holders focused on their use of BWPs, their interaction with the finance team and the level of review carried out by the Council Finance Team of budget holder's budgetary requirements.

As part of our discussions, budget holders informed us that they felt the budget process to be robust and challenging and felt that the budgets submitted to, and agreed with, finance, were reasonable and well supported.

In addition, we reviewed spreadsheets maintained by the Council Finance Team which tracked the distribution and return of BWPs to budget holders for the year FY13/14. These budget papers included the budgets for FY12/13 and provided budget holders with another chance to review and consider their base budget requirements.

We note from our review of the finance BWP monitoring spreadsheet that 90 of 96 BWPs were returned to the Council Finance Team by budget holders. We further note from discussions with finance team members that the nil returns have been explained to the satisfaction of the Council Finance Team.

Therefore, on the basis that the BWPs can be agreed to the audited ledger position, that the collation of BWPs and the entry of those into the Re-Forecast Model operates as described to us, and that our work has not identified any fundamental flaws, we would consider this to be a sensible basis for establishing the Council's re-forecast budget requirement.

Q2 - Consider the source and nature of the inputs to the re-forecast model and identify the reasons for differences from the original forecast and the sensitivity of any of these inputs.

In considering the source and nature of the inputs to the Re-forecast Model, our work has focused on tracing figures the Council Finance Team has input in the 'GF Projection Data' tab to supporting working papers for the FY12/13 budgetary year (being the base year from which the Council will now project its future budgetary requirements). We have also considered the calculations and formulae used on the 'GF Projection data' tab, the results of which are discussed at Q3 below.

We have not identified any significant variances between the amounts input into the FY12/13 year of the GF Projection data tab of the Re-forecast Model provided to us on 18 December and the supporting working papers prepared by the Council.

We note that, as of 16 January 2013, the Council has published its revised Budget Setting Report which shows a net spend requirement of £22.54m and a projected level of reserves of £4.41m due to more information being available to the Council as the budget setting process advanced (in accordance with the process described at Q1 above). We have been informed that these figures were drawn from version 15, part 2 of the reforecast model. Our work has not considered that model, nor the changes that have resulted in the figures reported within the Council's latest budget setting report.

Q3 - Assess whether the formula within the re-forecast model compute correctly

In assessing whether the formulae within the Re-forecast Model compute correctly, our work has focused on the GF Projection Data tab for the five year MTS period covering FY 2012/13 to FY 2016/17.

For the five year MTS period FY 2012/13 to FY 2016/17, where possible, we have traced figures from the GF Projection Data tab to the linked supporting work sheets within the model and checked that all totals have been calculated correctly.

For FY 2012/13 to FY 2016/17 we have not identified any computational errors on the 'GF Projection Data' tab in the totals or subtotals.

We note that the Re-Forecast Model contains a significant amount of "hidden" data on the GF Projection data tab (we understand the purpose of this was to maintain historical data in the model for audit trail purposes whilst making the model more user friendly) and also that the model contains a number of #REF results. We further note that a significant amount of data within the model is hardcoded, and some formulae have been amended to deliver an intended result. Whilst the Council is aware of these amendments to formulae, for example in the net savings requirements for future years, such amending of formulae should not be considered as good practice.

The model used by the Council's Finance Team appears to be poorly constructed in a number of areas and a number of lines within the GF Projection data tab, such as blank rows which contain no data, appear redundant and could be removed.

Recommendations

From our work as described above, we make the following recommendations:

- ▶ The Council should ensure that an annual reconciliation is performed between the detailed BWPs, as amended for year-end audit adjustments, and its budget model at the start of its budgeting and MTS processes. This reconciliation should be subject to review and sign off by a senior officer. Evidence of this process being completed should be retained for Council and audit purposes.
- ▶ Improved version control methodologies should be implemented to enable a robust and adequate budgetary audit trail to be maintained.

- ▶ Controls and methodology in respect of the forecasting and modelling processes, including the coding and model logic within the Re-forecast model, should be reviewed to minimise the risk of future errors occurring and to satisfy the Council that the Re-forecast model is appropriately structured to suit the Council's need.

Conclusion

The budget working papers, adjusted for year-end and other known changes, may be considered by the Council to represent a sensible foundation upon which it can model its future budgetary requirements. Whilst there is considerable scope for improving the Re-forecast Model, our review has not identified any issues to suggest that it is not operating as the Council intends.

Yours sincerely



Sara Fowler
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cc. Councillor Tim Bick, Leader of the Council

Appendix 1 – The Council's budget setting and medium term forecasting process

Budget Setting Process

The overall budgeting and strategy setting process culminates in the production of two key Council documents – The Medium Term Strategy (MTS) and the Budget Setting Report (BSR).

Financial projections and co-ordination of changes to be submitted for approval is undertaken through the use of a spreadsheet-based General Fund (GF) budget model.

During 2012/13 the council developed a version of its budget model that amongst other things provided, through a switch in the spreadsheet, a functionality to work on an MTS or BSR basis, allowing the same model to be used throughout the annual process.

The GF budget model is used to help the Council forecast its outturn position, over the 5 year MTS period and a longer term 25 year period. The model allows the Council to build in a number of assumptions to the budget, such as inflation, planned savings and changes in levels of reserves.

The Council uses the model to undertake sensitivity analysis on its budgets (and the MTS) to aid it in setting a balanced budget.

The Council also uses an in-house developed Budget Database to hold, and report on, individual detailed budget proposals which are raised as part of the budget process.

Stage 1 – Medium Term Strategy (MTS)

The MTS sets out the Council's vision for the City and the priority actions which the Council has approved as part of its Annual Statement process. The output of the MTS is to recommend a financial strategy for the medium term (5 years) and the detailed proposals for the development of revenue and capital budgets (in this case for 2013/14).

June

Preparations for the production of the MTS commence with the roll-forward of the five-year MTS period within the budget model.

The 'Original Budget' (Original Budget) for the (then) current financial year will need to be updated for any of the following arising as part of the final accounts process for the previous year:

- Revenue underspends in the previous year, resulting in higher reserves level carried forward
- Revenue carry-forwards approved from the previous year, resulting in an increase in net spending met through the use of the higher level of reserves brought-forward
- Capital underspends in the previous year which were to be funded from DRF, resulting in higher reserves level brought forward
- Capital re-phasing approved from the previous year to account for slippage in capital programme, where funded from DRF this would result in higher DRF contributions in the current year met from higher reserves level carried forward

This is undertaken as part of the exercise intended to reconcile the Budget Model to the ledger, allowing the start of the process to undertake financial modelling.

The preparation of the MTS will then consider the following potential issues:

- Adjustments to reflect known events impacting budgets and services in the current or future years
- Capital re-phasing to account for any anticipated slippage in capital programme
- Adjustments to reflect current under/over spends on approved budgets
- Budget virements
- Recognition of new grants or funding opportunities
- Recognition of 'unavoidable' spend due to, for example, new contracts let, increased costs e.g. fuel
- Effects of inflation

The model provides the basis for consultation on options with regard to financial planning assumptions and outcomes. The adjustments listed above are included within Appendix B of the MTS document (based on Sept 2012 MTS) and incorporated within the model. Detailed budget working papers at a cost centre level are not produced at this stage of the budget process.

September

Once the proposals have been finalised, the MTS is published. The Executive will recommend the MTS to full Council.

October

Full Council considers and approves the MTS. Once the MTS has been approved by the Council, the required changes (reflecting detailed approvals in the MTS) are processed for the updating of the ledger as a specific batch. These are reconciled back to the MTS approvals on a manual basis.

Stage 2 – Budget-Setting Report (BSR)

October

The MTS has set the financial planning framework, and assumptions within which the detailed budget-setting process can now take place.

'Current' (2012/13) budgets (i.e. those updated for changes agreed as part of the MTS process) are downloaded from the ledger onto detailed electronic budget working papers.

The budget working papers (BWPs) are sent to budget holders and service managers for them to update to reflect any known budget changes, reflecting approved virements actual employee budget requirements, etc. Budget holders also receive electronic pro formas which allow them to submit bids and savings for consideration as part of the budget process. These will include:

- Revised Budget items
- Savings
- Service Review Savings
- Unavoidable Revenue Bids
- Priority Policy Fund Bids
- Capital Bids
- External or Existing Fund Bids

These are returned electronically to Finance and are then automatically loaded into the Budget Database via an interface. The database is used to co-ordinate and manage all of the items raised and to produce detailed reports for submission to committee.

Information is extracted from the database to populate worksheets within the Budget Model for each of the item types. These are used to model the implications of inclusion or exclusion of the items.

Technical accountants are involved in generating the budget working papers (which are a download of business objects report from the ledger). These reports are then sent to budget managers who, in conjunction with the service accountants, complete and return the working papers to the technical accountants. A Senior Accountant will check the budget working papers to the MTS to ensure that no unagreed changes have been processed by the budget holders.

When the papers are received back, the totals are checked to service expectations. The expectations of service accountants for each service area are based on the financial system, any budget proposals and monthly budget monitoring reports which show position at any point in time. If discrepancies are identified, the accountants will challenge the managers and appropriate adjustments will be made. Once all issues are resolved, the budget working papers are uploaded to Oracle (GL) and then a manual reconciliation is done from the updated general ledger back to the working papers (to ensure that all working papers have been received and that they have been uploaded correctly). This process also ensures that all of the budget working papers have been received back from services.

January

Reports presented to Executive Councillors in January are based on the budget working papers and other budget information, which could include items drawn from the model (being primarily in-year adjustments that impact future years). During January, the detailed budget working papers are uploaded to the Ledger and the reconciliation between ledger and working papers is carried out. Each accountant will do their own reconciliation for uploaded workpapers. A Senior Accountant oversees this process to enable reconciliation from the ledger to the model.

The BSR is produced following completion of the modelling and is initially presented to Strategy and Resources Scrutiny Committee to consider. At a separate meeting in January, the Executive will recommend the BSR to Full Council for approval.

The BSR is a published document setting out in detail key aspects of the Council budget, including taxation policy and requirements, savings requirements and service requirements.

The model generates the General Fund projection tables which appear in the BSR. The high-level strategic projection is submitted to Councillors for them to make policy decisions. This includes the current items as costed, new bids and savings proposals, changes to council tax and grants. Those are detailed in the BSR document and the financial implications derived from within the model.

In early February, a Special Strategy and Resources Scrutiny Committee considers any budget amendments submitted by opposition groups, together with any further Executive budget amendment proposals (e.g., as a result of Government grant announcements), before passing the BSR on to Full Council. Full Council, toward the end of February, will approve the Budget and set the Council Tax for the forthcoming year.

March

A Budget Book is published giving the approved budgets for each Portfolio at cost centre level, together with details of the key changes (in terms of bids and savings) for the forthcoming year.

April

The agreed budget is uploaded to the ledger in April. This is frozen within the ledger as the 'original budget' for the year. Any further approved adjustments to this budget will be shown as 'current budget' levels e.g. approved carry-forwards as part of the final accounts process.