

CIVIC AFFAIRS

17 April 2013
6.30pm - 9.20 pm

Present: Councillors Boyce (Chair), Rosenstiel (Vice-Chair), Marchant-Daisley, Herbert, Benstead and Pitt

Other Councillors in attendance:

Leader of the Council (Councillor Bick)
Executive Councillor for Customer Services and Resources (Councillor Smith)

Officers Present:

Chief Executive: Antoinette Jackson
Director of Resources: David Horspool
Head of Legal Services: Simon Pugh
Committee Manager: Glenn Burgess

Representatives from Ernst and Young:

Sara Fowler
Leo Brown
Mark Hodgson

FOR THE INFORMATION OF THE COUNCIL

13/18/CIV Apologies for absence

There were no apologies for absence.

13/19/CIV Declarations of Interest

There were no interests declared.

13/20/CIV Public Questions

There were no public questions.

13/21/CIV Action Plan to address issues emerging from budget error and Ernst and Young Review

The committee received a confidential report from the Chief Executive outlining the actions proposed to address issues raised by the budget error and the subsequent investigation by Ernst and Young. Appended to the confidential report were two publically available reports from Ernst and Young, and a confidential Action Plan (which was subsequently made publically available prior to the meeting).

The committee resolved not to exclude the press and public from the first section of the meeting. The Chair reminded members to be mindful of discussing any elements of the exempt report during this session.

Councillor Herbert asked for clarification on the process to date and questioned the structure of the committee report. The Chief Executive responded that errors had been identified in the Council's budget forecast and Ernst and Young, the Council's external auditors, had been asked to undertake an independent external review. It was noted that a clear plan, highlighting specific actions against the six recommendations by Ernst and Young, was deemed the most appropriate structure for the report.

Councillor Herbert requested that a 'plain English' version of the report be made available to the public. The Chief Executive confirmed that Appendix 1 of the report (Action Plan) had been made publicly available and it was agreed that a covering summary report would be attached.

(subsequent to this meeting a 'Plain English Summary' was produced and can be found at Appendix A to these minutes)

Councillor Marchant-Daisley questioned the rationale for the committee report being exempt. The Chief Executive responded that, due to the close correlation between the process issues and the staffing issues identified, it was deemed inappropriate to make the report publically available.

Councillor Benstead asked what level of lay member scrutiny had taken place on the financial forecasts. The Chief Executive responded that the Medium Term Strategy (MTS) is presented to a meeting of The Executive in September before being recommended for approval by full Council in October. The Leader of the Council confirmed that members of The Executive had an oversight of the budget process leading up to the presentation of the MTS. He stated that

members of The Executive had asked the appropriate questions during this process and had been given satisfactory answers by officers.

The committee received a report from Ernst and Young outlining their review into the errors in the Council's financial modelling in respect of the 2012/13 financial year budget.

Councillor Pitt asked for clarification on the root cause of the issue and how the re-phasing of the capital slippage had led to an on-going issue within the budget. Ernst and Young responded that, whilst the original source of the error remained unexplained, the modelling and subsequent interlinking adjustments had been a contributing factor.

Councillor Pitt questioned why concerns regarding the Council's financial processes had not been identified through the regular audit process. Ernst and Young confirmed that, as the error originated within the modelling process and was therefore outside of the formal financial process, the audit process had not identified it. In response to a further question from Councillor Pitt, Ernst and Young confirmed that all version control and audit trail processes were suspect to the risk of internal control failure. It was also noted that the modelling process used by the City Council was very complex and cumbersome, and Ernst and Young did not think that it was necessarily fit for purpose.

In response to a question from Councillor Rosenstiel regarding the "#REF" results, Ernst and Young confirmed that these were not necessarily driven by the model itself but by the way the modelling was undertaken.

Councillor Herbert asked if the re-phasing of the capital financing in the MTS model was the likely source of the original error. Ernst and Young reiterated that it was not possible to be definitive about the source of the error. This was one error identified but there could have been others.

Councillor Herbert requested a response from the Director of Resources concerning the modelling. The Director of Resources confirmed that all versions had been numbered and dated and he had personally undertaken checks of the different versions in order to identify changes. It was noted that, due to the total figure of slippage being updated incorrectly, an adjustment error had led to on-going issues.

In response to a further question from Councillor Herbert, the Director of Resources confirmed that, in his view, re-phasing of the capital financing in the MTS model was that the source of the original error.

In response to a question from Councillor Benstead, Ernst and Young confirmed that it would not be economically viable to continue to look for the original source of the error. It was deemed more important to identify how the error had progressed undetected through the model and amending the process appropriately.

Councillor Herbert asked if Ernst and Young felt that individual officers or the overall process had been at fault. Ernst and Young confirmed that, whilst the problem could have started with human error, it was the inability of the process to highlight and prevent the error that had caused the major issue. Councillor Herbert agreed with this assessment.

Councillor Marchant-Daisley agreed that, whilst any task could be prone to human error, it was the inability of the process to pick the error up which was concerning. It was suggested that the error was only picked up by accident and it was therefore essential that the process be amended.

The Director of Resources confirmed that the error had been highlighted during the next stage of reconciliation, but unfortunately the timing of this meant that it was after the publication of the MTS.

Councillor Rosenstiel felt that an error in the ledger would have been picked up. Whilst Councillor Benstead agreed with this, he did highlight that the forecasting error had had an effect on the way the Council had planned its future spending.

Councillor Benstead reiterated his view that lay member scrutiny of the MTS was needed in order to highlight any issues at an earlier stage in the process. Councillor Rosenstiel responded that reconciliation earlier in the process would be more beneficial than further scrutiny.

The Executive Councillor for Customer Services and Resources questioned the need for such an extensive mid-year finance document. It was suggested that the inclusion of previous year figures in the MTS would make it easier to identify where deviations had occurred.

Councillor Herbert questioned why such a large increase in reserves (£2.3m) over a relatively short period (July-December) had not been picked up and questioned. The Director of Resources responded that as the increase came in an area where the Council were used to seeing large variances in figures the error had not been immediately visible. It was also noted that, as the MTS was very much a 'forward looking' document and focused more on future spend rather than current year spend, the error had not been quickly identified.

Whilst Councillor Herbert acknowledged this, he felt that such a large change in the figures should have been questioned.

Councillor Pitt confirmed that through the MTS process Executive Councillors had highlighted changes in the figures and were given satisfactory explanations by officers. He agreed that greater scrutiny of this process would be beneficial.

In response to a question from Councillor Pitt, Ernst and Young confirmed that, whilst it was the responsibility of this committee to approve the proposed action plan, they felt the proposed plan addressed the issues.

Ernst and Young left the meeting at 8.03pm.

Councillor Herbert suggested that the role of internal audit be reviewed and discussed in more detail by this committee. The Chief Executive responded that, whilst there were compulsory elements of the internal audit process, the committee did have an opportunity to input into the audit team's work programme. It was noted that the committee had already reviewed and inputted into the 2013/14 Audit Plan.

The Director of Resources confirmed that an annual report looking at the effectiveness of Internal Audit would be brought to a future meeting of the committee and could form the basis of further discussion.

In relation to recommendation 5 from the Ernst and Young report, the Executive Councillor for Customer Services and Resources questioned whether an escalation policy was currently in place within the Finance Department. The Chief Executive responded that, apart from broad corporate HR policies, there was not a specific corporate policy for this. Ernst and Young had recommended that a specific policy be implemented for the Finance Department.

Councillor Rosenstiel noted that the City Council had always been very effective at longer term financial planning and raised concern that the proposed review of the financial model (Action 1 of the Action Plan) may affect this. The Chief Executive responded that the review would check that the spreadsheet model was fit for purpose and would not change the overall approach of the City Council to its financial planning.

Councillor Marchant-Daisley asked how progress on the Action Plan would be reported back and if it would be open for member scrutiny. The Chief Executive confirmed that an update report would be brought back to this committee but she would expect some elements, such as the procurement of any new software Model, to be progressed at an officer level.

Councillor Pitt suggested that the Leader of the Council should also be consulted on any changes to the structure of the Resources Department (Action 6 of the Action Plan). The Chief Executive confirmed that this would be the normal process.

In relation to the streamlining and simplification of the Council's financial decision making processes (Action 8 of the Action Plan) Councillor Herbert emphasised the need for more scrutiny of the MTS. It was suggested that the financial remit of the Strategy and Resources Scrutiny Committee be strengthened and that it be given a greater role in scrutinising the budget. The Chief Executive responded that, whilst constitutionally the budget required a recommendation from The Executive, the process could be looked at to ensure more scrutiny of the MTS.

Councillor Herbert welcomed this approach, but requested that the process be looked at in time for the 2013/14 budget. Whilst the Leader also welcomed the proposal for more scrutiny of the MTS, he felt it unlikely that this approach would have identified the errors in officer processes for the 2012/13 budget. Councillor Pitt noted that all 42 Councillors received copies of the MTS and the Budget Setting Report (BSR) and that the error had not been identified.

The Leader noted that Opposition Councillors were given the opportunity to input into discussion on the MTS at The Executive meeting in September 2012. Councillor Herbert stated that, whilst opposition Councillors had been invited to the meeting to ask questions on the MTS, this could not be seen as full scrutiny. Councillor Rosenstiel agreed that The Executive was not an effective forum to fully scrutinise the MTS.

Councillor Benstead emphasised the need for wider scrutiny of the budget and requested that Action 8 of the Action Plan be strengthened to reflect this.

On the proposal of Councillor Boyce the committee agreed the following amendment to Action 8 of the Action Plan (additions underlined):

8. 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.

A minor clerical error was also identified in Action 5 of the Action Plan (amendment underline):

5. Appropriate actions are being taken ~~with~~ in accordance with the Council's HR policies

Exclusion of Press and Public

At 8.55pm the committee resolved to exclude members of the public for the remainder of the meeting on the grounds that, if they were present, there would be disclosure to them of information defined as exempt from publication by virtue of paragraphs 1 and 2 of Part 1 of Schedule 12A of the Local Government Act 1972.

The committee discussed the proposed restructure of the Resources Department and the related Human Resources implications.

The committee resumed the meeting in public at 9.17pm.

Resolved (Unanimously) to

- i. Support the actions proposed by the Chief Executive in Appendix 1 (as amended) to address issues raised by the budget error and subsequent investigation.

On the proposal of Councillor Herbert the committee agreed the following additional recommendation:

Resolved (Unanimously) that:

- ii An update on the implementation of the Action Plan would be brought back to the committee as part of the broader report on the decision making process.

The meeting ended at 9.20 pm

CHAIR

Appendix A: 'Plain English Summary'

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.	<p>In accordance with recommendations 3 and 5, systems within the finance team will be reviewed</p> <ol style="list-style-type: none"> 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 <p>All staff in the team will be provided with copies of these policies and processes and any necessary training will be provided.</p> <p>Managers tasked with ensuring these are effectively embedded in the culture and practice of the service</p>	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
--	----	--	-----	-----------