

Appendix 2

The City of Edinburgh Council

Statement on the system of internal financial control

1. This statement is provided in respect of the internal financial controls operated by The City of Edinburgh Council. As the Council's designated section 95 officer as defined under the provisions of the Local Government (Scotland) Act 1973, I acknowledge my responsibility for ensuring that an appropriate system of internal financial control is in place and its on-going effectiveness regularly reviewed.
2. The system of control can provide reasonable, but not absolute, assurance that material control weaknesses or irregularities do not exist, and that there is no unacceptable risk of material error, loss, fraud or breach of legislation. Consequently, the Council continually seeks to improve the effectiveness of its systems of internal financial control so that irregularities are either prevented or detected within an acceptable period of time. Tracking of agreed internal audit actions forms a standing item on Corporate Leadership and Senior Management Team agendas, with progress in implementation also regularly reported to the Governance, Risk and Best Value Committee.
3. In view of successive years' staffing reductions and various resulting changes in responsibilities, the self-attestation exercise undertaken early in 2018 was helpful in assessing the extent to which previous improvements had been embedded within service areas, highlighting a need for further action in some areas to implement and sustain the required controls. This exercise has subsequently been complemented, within the Corporate Services Directorate (where the majority of finance-related controls lie), by quarterly Service Performance and Assurance meetings at which progress in implementation of agreed actions is also considered.

Independent assessments of the effectiveness of the system of internal financial control

4. The effectiveness of the Council's internal financial control framework as a whole is subject to annual review by its external auditors, with the principal findings of the most recent annual assessment reported to the Governance, Risk and Best Value Committee in November 2021 (as part of the Council's Annual Audit). This assessment did not result in the identification of any significant weaknesses in these systems.
5. As with other systems across the Council, some aspects of the financial control framework have had to be adapted to a home-working environment following the COVID-19 pandemic but with the emphasis consistently being on obtaining assurance in a different way rather than compromising or relaxing existing controls. Specific contingency plans had been developed in areas where service continuity is most crucial, including Financial Systems, Procurement, Treasury Management, Council Tax collection, Benefits Processing, Payroll and Supplier Payments. These plans have worked effectively following enforced offsite working and performance against a range of key targets in these areas has largely been maintained.

6. A number of specific finance- and procurement-related risks and corresponding mitigating actions linked to the COVID-19 emergency were identified for inclusion in the Council Incident Management Team (CIMT) Risk Management Plan and have continued to be actively monitored during 2021/22. While the financial and economic risk category was assigned “critical” status in the period to December 2020, following confirmation that pressures had been appropriately reflected and managed and offsetting sources of funding identified, this was revised to “high” and then subsequently to “medium” later in 2021, albeit with continuing implications for the Council’s medium- to longer-term sustainability. Further commentary on this aspect is included later in this statement.
7. The Finance Division has also taken forward, or embedded, a number of specific audit actions during the year, including:
 - (i) working with Digital Services, creating a Shadow ICT Register and producing associated guidance on expected content of contracts for shadow IT/cloud-based systems;
 - (ii) identifying critical suppliers and supply chain-associated risks in connection with the UK’s exit from the European Union;
 - (iii) improving contract management arrangements for high-risk contracts;
 - (iv) reconciling the NSL Apply system and CEC ledger to confirm on-going accuracy of parking fee income received;
 - (v) documenting end-to-end procedures for the Edinburgh and South East Scotland City Region Deal funding process;
 - (vi) reviewing the Council’s budget-setting process, including conducting an annual “lessons learned” exercise, producing process guidance for budget managers and better aligning project management and savings template documentation;
 - (vii) enhancing financial systems training, with evidence of attendance/completion required prior to granting of systems access; and
 - (viii) improving oversight and consistency of a range of financial models, including a half-yearly risk-based peer review.
8. A review of the Council’s capital budget-setting and management processes undertaken in early 2022 concluded that current arrangements were effective. A report on the procedures and processes for administration of the Transfer of the Management of Development Funds (TMDF) Grants also found these to be effective.
9. Progress in implementing the resulting actions is regularly considered by the Finance Management Team. As of the time of writing, there are no Finance-led actions where relevant work is not underway, with improved arrangements to track progress also now in place. In the coming days,

however, I anticipate receiving a report setting out required improvements to compliance with payment card industry data security standards and, working with colleagues in Customer and Digital Services, implementation of these actions will be a priority going forward.

10. As part of the Accounts Commission's national studies, an assessment was also reported in May 2020 of the Council's arrangements for the **prevention and detection of fraud in procurement**. The report highlighted only one moderate-level risk (the need to ensure checking of invoice sums with contract rates prior to payment authorisation), a reminder for which was sent to all relevant managers. A number of other areas of good practice were also identified, consistent with the Council's high Procurement and Commercial Improvement Programme (PCIP) rating.

Role of Internal Audit

11. The Internal Audit section operates in accordance with the Chartered Institute of Public Finance and Accountancy's United Kingdom Public Sector Internal Audit Standards (PSIAS). The Section undertakes an annual programme based on an agreed audit strategy. The plan is based on formal assessments of risk and audit needs which are reviewed regularly to reflect evolving risks and changes within the Council. During 2021/22, the section reported to the Head of Legal and Assurance. It also has, however, unfettered access to the Chief Executive, Executive Directors, Service Directors (including the Service Director: Finance and Procurement) and elected members of the Council when required.
12. The Chief Internal Auditor will present her annual audit opinion on the adequacy and effectiveness of the system of internal control (including financial controls) to the Governance, Risk and Best Value Committee in August 2022. Whilst noting positive trends in the overall assessments for recently-issued audit reports and significant progress in addressing overdue findings, given the equivalent assessments in recent years, the opinion is expected to highlight a continuing need for enhancements to the control environment and associated governance and risk management frameworks. The required control improvements implicit in this opinion will be examined and any corresponding necessary actions as they relate to financial systems implemented as a matter of urgency.

Elements of system of internal financial control

13. The existing system of internal financial control is based on a framework of regular management information, financial rules and regulations, administrative procedures (including segregation of duties), management supervision and a scheme of delegation and accountability. This system of control has been modified, where appropriate, to take account of the impacts of the pandemic, although as noted above this has been with a view to obtaining equivalent assurance in a modified way. The system is maintained and developed by Council management and includes:
 - **comprehensive budgeting systems;**
 - **preparation and regular review of periodic reports that measure actual financial performance against budgeted net expenditure.** Given the unprecedented nature and scale of the financial challenges facing the Council in 2020/21, the frequency of reporting to the Corporate Leadership Team and elected members (through the Leadership and Advisory

Panel, Policy and Sustainability Committee and Finance and Resources Committee) was greatly increased, with a focus not only on the immediate in-year position but estimated implications for the budget framework in future years. This reporting frequency was relaxed somewhat in 2021/22, albeit still at an enhanced level relative to pre-COVID periods. A revenue budget-setting and management internal audit undertaken in 2020 identified a number of areas of good practice but with some opportunities for improvement highlighted through the adoption of standardised documentation and procedures and regularising formal “lessons learned” exercises after each year’s process, with a corresponding action plan agreed and relevant actions now largely completed;

- **agreement of targets against which financial and operational performance can be assessed.** Key amongst these financial targets is the achievement of a balanced Council-wide revenue outturn. While 2021/22 has again been subject to significant expenditure and income-related impacts of the pandemic, thanks to savings in service and corporate budgets, a provisional in-year underspend of £3.8m was achieved, alongside not requiring to draw down planned sums from reserves to offset in-year COVID-related impacts. Despite the impacts of the pandemic, it was also encouraging to note that the provisional proportion of approved savings delivered, at 89%, continued the improving trend from 2020/21;
- **clearly-defined capital and other expenditure guidelines** communicated to services and set out in the Finance Rules which were refreshed in June 2019. The Financial Regulations were also reviewed and minor amendments to their content approved in August 2020;
- a **five-year revenue budget framework and ten-year capital strategy** approved by Council in February 2022. The Council’s Best Value Assurance Review encouraged the Council, once the recurring impacts of the pandemic become clearer, to continue to look at opportunities to adopt medium- to longer-term financial planning. It is my intention to bring a report setting out the basis of a balanced five-year revenue plan, with a particular emphasis on the earlier years, to members later in the year prior to initiating a period of public consultation;
- **formal project management disciplines** as supported and promoted through the Strategy and Communications section, including senior Finance representation on all major project boards and assurance review panels; and
- **formal governance arrangements operated within both subsidiary and associated companies**, complemented by a strengthened Council observer role. Service Level Agreements are also in place for finance-related services provided to a range of external bodies. In recognising the scale of the pandemic’s operational and financial impacts on their activities, I also met with representatives of the Council’s main Arm’s-Length External Organisations (ALEOs) on a monthly basis during 2020/21, as well as regularly reporting these impacts to the Finance and Resources Committee, including two dedicated sessions to explore the issues concerned in greater depth. These meetings continue, albeit on a revised frequency.

14. My review of the effectiveness of the internal financial control system is informed by:

- **assurance certificates** on internal control received from all Executive Directors of the Council, service areas and relevant service heads;

- **regular senior management-level consideration of progress in implementing internal audit recommendations**, including self-attestation of previous actions where relevant;
- **governance arrangements in place for subsidiary and associated companies** and an on-going assessment of the effectiveness of these arrangements;
- the **work of managers** within the Council;
- the work of **Internal Audit**; and
- **external audit reports**, in particular the independent annual report on the Council's financial statements and internal control framework.

15. The Council's financial management arrangements conform with the governance requirements of the CIPFA Statement on the Role of the Chief Financial Officer (2014) as set out in the Application Note to Delivering Good Governance in Local Government Framework, an opinion confirmed as part of recent external audit scrutiny. Having reviewed the framework, it is therefore my opinion that **although a degree of assurance can be placed upon the adequacy and effectiveness of the Group's systems of internal financial control, further improvements, including some embedding of actions taken in response to previous recommendations, are still required.**

16. I have overseen the improvements put in place in response to Finance-specific recommendations made by internal and external audit work during the year, with a number of actions additionally currently, or soon to be, in progress. This said, the extent of change and reduction in overall resources in recent years has reinforced the importance of robust, documented and well-understood procedures for key system controls and, in light of the follow-up audits undertaken by both internal and external audit, a priority continues to be to consolidate these improvements, identify any further required actions and gain necessary assurance by regularly assessing their effectiveness. These arrangements have been thoroughly tested during the COVID pandemic and, across the piece, have performed well although there is always room for improvement.

CIPFA Financial Management Code

17. 2021/22 marks the first full year of implementation of the requirements of the CIPFA Financial Management (FM) Code. The Code is designed to support good practice and assist councils in demonstrating their financial sustainability and resilience by setting out expected standards of financial management.

18. My initial assessment, carried out with reference to the 2021/22 budget process and involving interviews with a range of key stakeholders including service directors, elected members and colleagues within partner services, highlighted a number of recent improvements contributing positively to the Council's financial resilience and stability, including:

- (i) realigning and reprioritising the Council's reserves to enable the creation of a £16m COVID-specific contingency whilst also increasing the level of the unallocated general reserve to £25m;

- (ii) incorporating within the budget framework explicit provision for underlying service pressures and anticipated shortfalls in savings delivery, all based on detailed discussion with members of the Corporate Leadership Team;
- (iii) reflecting within the budget framework, insofar as is practicable at this stage given the on-going nature of the pandemic, increased provision for its continuing impacts, particularly for losses of income; and
- (iv) dedicated investment in prevention-related resource which, if used effectively, should make a contribution towards future years' savings requirements, as well as improving outcomes for service users.

19. Improvements then introduced for the 2022/23 process included the following:

- (i) finalisation of financial management guidance and communication to the Wider Leadership Team;
- (ii) development of a fully-funded 2022/32 capital investment programme (albeit with full funding strategies for large-scale initiatives such as the City Plan, City Centre Transformation Plan and City Mobility Plan still to be developed);
- (iii) earlier publication of the schedule of proposed fees and charges for 2022/23; and
- (iv) further recognition of underlying service pressures and estimated recurring COVID-related impacts within the budget framework, alongside review of other key assumptions.

20. These steps build on a number of aspects already in place that are conducive to enhancing the Council's longer-term financial sustainability including (i) regular reviews, reported to both CLT and elected members, of revenue and capital budget planning assumptions, (ii) close working between the CLT and the Coalition Budget Core Group and (iii) development of updated, detailed and consistently-applied guidance for Finance staff used to assess savings implementation plans and mitigation of service budget pressures. I also intend to undertake a customer and staff survey, based on the good practice guidelines included in the FM Code, during 2022.

21. While the above position reflects a number of positive aspects, I have continued to impress upon all elected members the need for additional savings proposals to be brought forward if the Council's financial sustainability is to be maintained.

22. The urgent need to initiate a structured medium to longer-term savings programme was also highlighted in both the Council's Best Value Assurance Report and the external auditor's report for 2020/21. In recognising this urgency, Directorates have been asked to develop potential options, captured by means of a standard template detailing service and performance impacts, risks and dependencies, with reference to the priorities set out in the Council's business plan. These proposals will be subject to a process of co-design between the incoming administration and officers and form the basis of public consultation in Autumn 2022. Given the extent of the

challenge noted above, members will likely need to make increasingly difficult choices about the Council's priorities, including considering service reductions, across all service areas to maintain expenditure in line with available income.

23. In addition to the Council's own activities, I have considered the immediate and potential on-going impacts of the pandemic on major projects within the city, including the St James Centre Growth Accelerator Model (GAM), Tram Extension and Edinburgh International and Conference Centre (EICC) Hotel project. There has, and continues to be, a need to revisit relevant business cases in light of these significant changes in the external environment and I will therefore keep all under active review in the coming months.
24. Consideration of the FM Code has also highlighted a number of areas where I assess further actions are potentially required going forward, including a need, in some cases, for more systematic options appraisal to be undertaken. In addition, improvements could be made to the effectiveness of current service arrangements in demonstrating value for money, including their contribution to broader Council objectives. Relevant actions will continue to be taken forward with CLT colleagues.

Hugh Dunn

Service Director: Finance and Procurement

31 May 2022