

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 Team (CLT) agendas, with progress in implementation also regularly reported to the Governance, Risk and Best Value Committee. Progress in implementation of recommendations resulting from the external audit process is likewise reported to elected members.
3. In view of successive years' staffing reductions and various resulting changes in responsibilities, previous self-attestation exercises undertaken have been helpful in assessing the extent to which improvements have 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 and discussion at the Corporate Services Management Team 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 October 2022 (as part of the Council's Annual Audit). This assessment did not result in the identification of any significant weaknesses in these systems, albeit scope for improvement in the Council's payroll processes and controls was highlighted.
5. As with other systems across the Council, some aspects of the financial control framework have had to be adapted to a continuing home-working environment but with the emphasis consistently being on obtaining assurance in a different way rather than compromising or relaxing existing controls. Specific contingency plans had previously 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 and continuing offsite working and performance against a range of key targets in these areas has largely been maintained.

6. There remain, nonetheless, inherent risks within the Council's activities. Unsuccessful attempts to defraud the Council through a fictitious change of supplier details were made in December 2022, leading to updates in current procedures and refresher training being provided.

Risks included within Council risk register

7. A number of specific finance- and procurement-related risks linked to the COVID-19 emergency (and corresponding mitigating actions) were identified for inclusion in the Council Incident Management Team (CIMT) Risk Management Plan and actively monitored during 2021/22. While these COVID-specific risks have lessened somewhat, the Financial and Budget Management risk within the Council's Risk Report remains rated as high and outside the Council's current moderate risk appetite. This is mainly due to the impact of exceptional inflationary pressures alongside reduced resources and limited options identified for immediate savings. The Council also has a share of the substantial budget gap within the Edinburgh Integration Joint Board (EIJB). In light of these risks, the Council is developing a Medium-term Financial Plan (MTFP), albeit the related savings required to bridge these gaps remain at a formative stage. Development of robust and sustainable savings sufficient to bridge the immediate 2024/25 gap and make significant inroads into future years' requirements will therefore be a key priority in the coming months, particularly as I will be retiring at the end of September 2023.

Implementation of Internal Audit recommendations

8. The Finance Division has also taken forward, or embedded, a number of specific audit actions during the year, including the creation and maintenance of a shadow ICT register, improved contract management arrangements for high-risk contracts, enhanced financial systems training and improved oversight and consistency across a range of financial models, including a half-yearly, risk-based peer review. Finance colleagues are also working closely with relevant colleagues elsewhere within Corporate Services in implementing the recommendations of recent audits in the areas of payment card industry data security and purchase cards.
9. 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 Funding (TMDF) Grants also found these to be effective.
10. More recently, an internal audit examining procedures for Housing Revenue Account budget-setting and monitoring noted a number of positive aspects. In January 2023, the Council's preparations for implementation of the IFRS16 leasing standard were also favourably assessed.
11. The key findings and recommendations arising from a review of the Council's most recent budget-setting process will be reported to the Finance and Resources Committee of 20 June 2023 and Finance staff will work with relevant colleagues in taking any improvement actions forward. A Financial Management customer survey based on the CIPFA FM Code has also recently been completed and will be used to agree and implement improvement actions.

12. Progress in implementing internal audit 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 arrangements to track progress also in place.
13. As part of the Accounts Commission's national studies, an assessment of the Council's arrangements for the prevention and detection of fraud in procurement was also reported in May 2020. 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

14. 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 2022/23, 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.
15. The Head of Internal Audit will present an 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 September 2023. In line with the equivalent 2021/22 opinion, in-year progress reports on audit action implementation and internal audits newly undertaken, this is anticipated to consolidate recent improvements, albeit with further actions still required. 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

16. 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 continuing homeworking, 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 2022/23, albeit still at an enhanced level relative to pre-COVID periods;

- **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. Thanks to savings in corporate budgets, a provisional in-year underspend of £13.7m was achieved, alongside not requiring to draw down planned levels of reserves to offset in-year COVID-related impacts. While acknowledging that the majority were in corporate budgets, approved savings delivery in 2022/23 was some 98%, the highest level achieved since these have been actively tracked;
- **clearly defined capital and other expenditure guidelines** communicated to services and set out in the Finance Rules which were refreshed in May 2023. The Financial Regulations were also reviewed and minor amendments to their content made in May 2023;
- a **five-year revenue budget framework and ten-year capital strategy** approved by Council in February 2023. The Council's Best Value Assurance Review encouraged the Council, once the recurring impacts of the pandemic became clearer, to continue to look at opportunities to adopt medium- to longer-term financial planning. To this end, an update on the development of the Council's Medium-Term Financial Plan will be reported to the Finance and Resources Committee on 20 June;
- **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.

17. 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.

18. 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, as in previous years, **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.**
19. 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 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 both during the COVID pandemic and amidst continuing home-working and, across the piece, have performed well although there is always room for improvement.

CIPFA Financial Management Code

20. 2022/23 marks the second 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.

A focus has been maintained to embed improvements introduced through the 2021/22 and 2022/23 budget processes including:

- maintaining an increased level of unallocated general reserve;
- incorporating explicit revenue budget provision for underlying service pressures including temporary accommodation for homeless households;
- continuing to reflect the ongoing impacts of the pandemic, particularly for losses of income; and
- earlier publication of the schedule of proposed fees and charges for 2023/24.

21. Improvements introduced for the 2023/24 budget process include the following:

- progress in the identification of service revenue budget savings, with £13.4m of new service savings options approved in setting a balanced revenue budget for 2023/24;
- improved financial performance in service revenue budgets with the provisional outturn for 2022/23 showing services delivered within the approved revenue budgets across the Place, Children, Education and Justice Services and Corporate Services Directorates;

- the establishment of a formal change programme is underway to support the development of the Council's Medium-Term Financial Plan. The Year 1 focus will include the Social Care Operating Model, Inclusion Services and the HR/Pay Core System. The MTFP remains at a formative stage and the Council's Leadership Team, supported by service managers, will need to develop realistic and robust savings options to address projected medium-term funding gaps.

22. Further initiatives are completed or underway to support my assessment and further strengthen financial management arrangements including:

- positive outcomes from Internal Audit reviews of financial management arrangements for both the Council's Capital Investment Programme and Housing Revenue Account;
- a Financial Management customer survey has recently been completed based on the CIPFA FM Code and will be used to agree and implement improvement actions. Areas for development are likely to include greater use of benchmarking and other techniques to assess the value for money of services and to identify opportunities for improvement; and development of training necessary to support budget management including training in the use of core financial management systems.
- updated Financial Management guidance is being finalised and will incorporate additional guidance on the Capital Investment Programme and Housing Revenue Account.
- business cases to recruit additional professional accounting staff have been approved to recognise additional workload, risk and complexity relating to the Council's Capital Investment Programme and areas of the revenue budget including Housing, Refugee Support and Homelessness. Adequate resourcing of the Finance function will be a prerequisite for continued compliance with the requirements of the FM Code going forward.

23. 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 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.

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

25. 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 2021/22 and while I am somewhat disappointed at the time it has taken to initiate this programme, relevant work is now underway. Given the extent of the financial challenge, members will 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.

26. 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.
27. 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

2 June 2023