

Final Internal Audit Report

Reserves – General and Earmarked 2021-22

September 2022

Distribution: Corporate Director of Resources and S151 Officer
Interim Director Finance and Deputy S151 Officer

Assurance Level	Issues Identified	
Substantial Assurance	Priority 1	0
	Priority 2	1
	Priority 3	0

Confidentiality and Disclosure Clause

This report ("Report") was prepared by Mazars LLP at the request of London Borough of Croydon and terms for the preparation and scope of the Report have been agreed with them. The matters raised in this Report are only those which came to our attention during our internal audit work. Whilst every care has been taken to ensure that the information provided in this Report is as accurate as possible, Internal Audit have only been able to base findings on the information and documentation provided and consequently no complete guarantee can be given that this Report is necessarily a comprehensive statement of all the weaknesses that exist, or of all the improvements that may be required.

The Report was prepared solely for the use and benefit of London Borough of Croydon and to the fullest extent permitted by law Mazars LLP accepts no responsibility and disclaims all liability to any third party who purports to use or rely for any reason whatsoever on the Report, its contents, conclusions, any extract, re-interpretation, amendment and/or modification. Accordingly, any reliance placed on the Report, its contents, conclusions, any extract, re-interpretation, amendment and/or modification by any third party is entirely at their own risk.

Please refer to the Statement of Responsibility in Appendix 3 of this report for further information about responsibilities, limitations and confidentiality.

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1. Introduction

- 1.1 On 23 October 2020, London Borough of Croydon (the 'Council's) external auditor, Grant Thornton, issued a Report in the Public Interest (RIPI) due to the Council's financial position and related governance arrangements. This report noted that the Council had had an unsustainably low level of reserves for some time with spending pressures within both children's and adult social care as well as additional financial challenges due to the pandemic.
- 1.2 It further stated that the Council has had the lowest level of all London Boroughs of General Fund and Earmarked General Fund Reserves as a percentage of net service revenue expenditure and the reported level of reserves had continued to decrease in 2017/28, 2018/19 and 2019/20. Included within the report was one recommendation directly related to reserves:
- 'R2 - The Council (including Cabinet and Scrutiny and Overview Committee) should challenge the adequacy of the reserves assessment which should include a risk assessment before approving the budget.'*
- 1.3 In March 2021, the Council received a government offer for a capitalisation direction of £120m – £70m in 2020-21 and £50m (in principle) in 2021-22. Following the support, the Council's general reserves were at £27.5m in March 2021 compared with a negative £3.9m in March 2020. Similarly, earmarked reserves were £43.0m in March 2021 compared with £9.1m in March 2020.
- 1.4 The Quarter 2 update of progress made against recommendations within the RIPI were presented to the General Purpose and Audit Committee (GPAC) on 16th September 2021. T
- 1.5 Examination of the 'Budget Report 2021/22' presented to Cabinet on 8 March 2021 confirmed plans that '£20m is being earmarked as part of the 20/21 planned capitalisation directive for contribution to the General Balance. With a further increase of £10m 21/22.' (i.e. to increase reserves by £50m). The updated MTFs presented to Cabinet 12 July 2021 confirmed that, 'Part of the approved capitalisation direction request in 2020/21 contained provision to bolster general reserves by a further £15.0m in order to provide sufficient resilience to meet future risks and challenges. The 2021/22 base budget has £10m of contributions to reserves and the MTFs provides for a further £5m of reserves contribution in 2022/23 and a further £5m in 2023/24. This will result in a total of additional £45m in reserves by the end of 2023/24 which should leave a General Fund Reserve balance of £72.5m.'
- 1.6 Our review and testing were performed remotely. However, all relevant documents required to complete this review were not made available to us. This included the Council's reserves policy and evidence related to training of Members. Therefore, Internal Audit has not been able to fully deliver the scope for the audit.
- 1.7 This audit was being undertaken as part of the agreed Internal Audit Plan for 2021/22. The objectives, approach and scope are contained in the Audit Terms of Reference at Appendix 1.

2. Key Issues

Priority 2 Issues

Evidence of a Reserves Policy was not made available to Internal Audit. **(Issue 1)**

3. Actions and Key Findings/Rationale

Control Area 2: Governance Arrangements

Priority	Action Proposed by Management	Detailed Finding/Rationale - Issue 1				
2	The Council’s financial position is currently being reviewed through the Opening the Books initiative. This is expected to report by January 2023. The findings of the Opening the Books project will be built into the Council’s budget setting for 2023/24 and its Medium Term Financial Strategy, both of which will be approved by Cabinet and then Full Council by 11 March 2023.	<p>Expected Control</p> <p>On 23 October 2020 the Council’s external auditor, Grant Thornton, issued a Report in the Public Interest (RIPI) due to the Council’s financial position and related governance arrangements. R2 from the report requires the Council (including Cabinet and Scrutiny and Overview Committee) to challenge the adequacy of the reserves assessment which should include a risk assessment before approving the budget.</p> <p>Finding</p> <p>Internal Audit was informed by the Interim Director Finance (Deputy S151 Officer) that a Reserves Policy was being drafted at the time of fieldwork. We were advised this policy would document the process for performing risk assessments and would be submitted to the Audit and Governance Committee (AGC) as well as the Cabinet in March 2022. However, evidence of a Reserves Policy could not be seen in the stated papers.</p> <p>Risk</p> <p>In the absence of a reserves policy (which has been agreed by the Council’s Senior Management and the Cabinet) which defines the process for performing risk assessments, it can be difficult to follow a consistent approach to performing such assessments. This can potentially lead to lack of adequate reserves assessments (including risk assessments) resulting in a weak financial position.</p>				
	<table border="1"> <thead> <tr> <th>Responsible Officer</th> <th>Deadline</th> </tr> </thead> <tbody> <tr> <td>Corporate Director Resources</td> <td>March 2023</td> </tr> </tbody> </table>	Responsible Officer	Deadline	Corporate Director Resources	March 2023	
Responsible Officer	Deadline					
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AUDIT TERMS OF REFERENCE

Reserves - General and Earmarked

1 INTRODUCTION

- 1.1 On 23 October 2020, London Borough of Croydon (the 'Council's) external auditor, Grant Thornton, issued a Report in the Public Interest (RIPI) due to the Council's financial position and related governance arrangements. This report noted that the Council had had an unsustainably low level of reserves for some time with spending pressures within both children's and adult social care as well as additional financial challenges due to the pandemic.
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- 1.4 The Quarter 2 update of progress made against recommendations within the RIPI were presented to the General Purpose and Audit Committee (GPAC) on 16th September 2021. The Medium-Term Financial Strategy (MTFS) and 2021/22 Budget agreed on 8 March 2021 contain a strategy for growing the reserves base up to £60 million by 2023/24.
- 1.5 This audit was undertaken as part of the agreed Internal Audit Plan for 2021/22.

2 OBJECTIVES AND METHOD

- 2.1 The overall audit objective was to provide an objective independent opinion on the adequacy and effectiveness of controls / processes.
- 2.2 The audit will for each controls / process being considered:
- Walkthrough the processes to consider the key controls;
 - Conduct sample testing of the identified key controls; and
 - Report on these accordingly.

4. SCOPE

4.1 This audit included the following areas (and issues raised):





Control Areas/Risks	Issues Raised		
	Priority 1 (High)	Priority 2 (Medium)	Priority 3 (Low)
1.Reserves assessment (including a risk assessment) before approving the 2022/23 budget.	0	0	0
2.Governance arrangements to oversee performance against the MTFS and 21/22 budget, including strategies for growing the reserves base.	0	1	0
3.Reports to Members on the financial position, including reserves.	0	0	0
4.Approval mechanisms for moving funds into and out of reserves.	0	0	0
5.Provision of training to relevant Members.	0	0	0
Total	0	1	0

Appendix 2

Definitions for Audit Opinions and Identified Issues

In order to assist management in using our reports:

We categorise our **audit assurance opinion** according to our overall assessment of the risk management system, effectiveness of the controls in place and the level of compliance with these controls and the action being taken to remedy significant findings or weaknesses.

	Full Assurance	There is a sound system of control designed to achieve the system objectives and the controls are constantly applied.
	Substantial Assurance	While there is basically a sound system of control to achieve the system objectives, there are weaknesses in the design or level of non-compliance of the controls which may put this achievement at risk.
	Limited Assurance	There are significant weaknesses in key areas of system controls and non-compliance that puts achieving the system objectives at risk.
	No Assurance	Controls are non-existent or extremely weak, leaving the system open to the high risk of error, abuse and reputational damage.

Priorities assigned to Identified Issues are based on the following criteria:

Priority 1 (High)	Fundamental control weaknesses that require immediate attention by management to action and mitigate significant exposure to risk.
Priority 2 (Medium)	Control weakness that still represent an exposure to risk and need to be addressed within a reasonable period.
Priority 3 (Low)	Although control weaknesses are considered to be relatively minor and low risk, still provides an opportunity for improvement. May also apply to areas considered to be of best practice that can improve for example the value for money of the review area.

Statement of Responsibility

We take responsibility to the London Borough of Croydon for this report which is prepared on the basis of the limitations set out below.

The responsibility for designing and maintaining a sound system of internal control and the prevention and detection of fraud and other irregularities rests with management, with internal audit providing a service to management to enable them to achieve this objective. Specifically, we assess the adequacy and effectiveness of the system of internal control arrangements implemented by management and perform sample testing on those controls in the period under review with a view to providing an opinion on the extent to which risks in this area are managed.

We plan our work in order to ensure that we have a reasonable expectation of detecting significant control weaknesses. However, our procedures alone should not be relied upon to identify all strengths and weaknesses in internal controls, nor relied upon to identify any circumstances of fraud or irregularity. Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud.

The matters raised in this report are only those which came to our attention during the course of our work and are not necessarily a comprehensive statement of all the weaknesses that exist or all improvements that might be made. Recommendations for improvements should be assessed by you for their full impact before they are implemented. The performance of our work is not and should not be taken as a substitute for management's responsibilities for the application of sound management practices.

This report is confidential and must not be disclosed to any third party or reproduced in whole or in part without our prior written consent. To the fullest extent permitted by law Mazars LLP accepts no responsibility and disclaims all liability to any third party who purports to use or rely for any reason whatsoever on the Report, its contents, conclusions, any extract, reinterpretation amendment and/or modification by any third party is entirely at their own risk.

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