

Financial Controls Assessment; Summary Presentation

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Nottingham City Council

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EY Purpose and approach

Purpose

EY was appointed to review the Council's approach to the financial management of ring-fenced funds or other financial arrangements whose use is prescribed under legislation and/or ring-fenced through direction and guidance for the following financial years: 2019/20, 2020/21 and 2021/22. The main areas of focus covered by this review are set out below:

1. Capital
2. Transforming Cities Funds
3. Dedicated Schools Grant
4. Licensing income
5. Traffic enforcement
6. Better Care Fund

Approach to the Controls Assessment

EY's approach was founded upon five key steps, as follows

1

All items identified within a Gap Analysis and Agreed Upon Procedure (AUP) process as control failures, errors or anomaly's were drawn into a Risks and Controls matrix and classified.

2

A determination was made whether controls existed or not, and the primary reason for control weakness or failure identified.

3

The broader control environment was investigated; whether this weakness could have been prevented or detected through differing policy, evidence, approval or other actions.

4

Each financial arrangement in scope was assessed against a Control Maturity Framework to provide a view on the strength or weakness of NCC's Control Environment.

5

Interviews of key staff were undertaken and documentation assessed. An aggregate perspective was formed on NCC's Controls Environment, and recommendations were developed into a Control Remediation Plan.

EY Key observations (1)

Controls Assessment - Key Observations

The work undertaken identified a number of significant concerns within NCC's control environment. Observations indicate a weak controls environment, ineffective systems and associated management information and a culture which is not focused on the value of compliance. Key observations include:

Ineffective audit trail

An ineffective audit trail to support transactions, with extensive records either incomplete, onerous to draw from systems or in many cases, missing. Of the issues identified, 50% of them could be attributable to lack of, or inappropriate, evidence.

A high incidence of issues

A high incidence of issues across the AUP sample with a wide range of causes from transactions classification, application of accounting policy, and transaction timing through to more substantive control weaknesses in transaction recording, approvals, and error. Across all samples, 60% were identified to have issues, with 50% of these issues attributable to an identified transaction error or control short-falling.

Limited preventative and detective controls

Ineffective means to reconcile and identify process error, resulting in limited preventative and detective controls. This is further compounded by limited means to extract relevant management information from systems to help inform management of control breaches.

A poor culture of compliance

A culture where policy adherence along with process and control knowledge is weak. This was evidenced both in relation to adherence with NCC's own policies, particularly procurement, and in relation to grant policies and permissibility.

A risk of management override

A high risk of controls being circumnavigated through management override. It is recognised that there may be range of reasons for why controls are overridden by management that may include both active decisions by management to override driven by a broad range of reasons including expediency, efficiency or self-interest, along with unintentional override which then is not flagged by a system. However, such risks are at the core of an ineffective control environment and hinders the ability of NCC to effective proper financial stewardship.

EY Key observations (2)

Summary of Areas In Scope

Across the six financial arrangements in scope, the high level output of the assessment is summarised below:

In-scope area	Parking, Traffic Regulation and Bus Lane Enforcement	Better Care Fund (BCF)	Capital Expenditure	Transforming Cities Fund (TCF)	Dedicated Schools Grant (DSG)	Licensing Income	
Description	NCC generates income from civil enforcement operations including Parking, Traffic and Bus Lane Enforcement	The BCF requires NHS and local government to create a local pooled budget to incentivise closer working, placing wellbeing at the focus of health and care services, shifting resources into social care and community services.	NCC expenditure incurred either to purchase or build a non-current asset, or to improve or upgrade an existing non-current asset. Capital and revenue expenditure should be identified separately in the financing statements.	NCC and Derby City Council jointly received a four year £161m capital grant from the TCF to strengthen connections between major employment sites, upgrade public transport, and improve options for people on foot or bike.	The DSG is a ring-fenced to fund school budgets and services that directly support the education of pupils. It is divided into four blocks: Schools Block, Central School Services Block, High Needs Block and Early Years Block.	NCC are responsible for administering a range of licences and approvals relating to both national legislation and discretionary functions that are agreed locally.	
FY19/20 Spend	£8.4m	£42.0m	£171.7m	£8.0m	£109.5m	£5.4m	
FY20/21 Spend	£6.3m	£43.6m	£150.0m	£20.3m	£114.9m	£5.4m	
FY21/22 Spend	£4.8m	£44.9m	£100.8m	£62.6m	£120.7m	£5.2m	
AUP Sample Issue Rates	18 of 24; 75% Issue Rate	21 of 27; 78% Issue Rate	10 of 24; 42% Issue Rate	21 of 24; 88% Issue Rate	10 of 24; 42% Issue Rate	8 of 24; 33% Issue Rate	
Lack of Evidence	15	18	16	24	12	7	
Identified Error	17	22	6	25	3	19	
Total Issues Identified	32	40	22	49	15	26	
Risk Rating	Audit Trail	47%	45%	73%	49%	80%	27%
	Control Environment	1.8 / 5	2.3 / 5	3.0 / 5	1.7 / 5	2.8 / 5	2.0 / 5
	Management Override	High	Medium	Low	Medium	Medium	Medium
Primary Control Weakness	Preventative: Lack of Evidence Detective: Review Procedures	Preventative: Lack of Evidence Detective: Review Procedures	Preventative: Policy & Guidance, Approval Detective: Reconciliation	Preventative: Lack of Evidence Detective: Reconciliation	Preventative: Lack of Evidence Detective: Review Procedures	Preventative: Lack of Evidence Detective: Review Procedures	
Overarching Risk Materiality	High	High	High	High	High	High	

EY Key observations (3)

Issue rate

Figure 1 displays issue rates identified across the areas in scope.

- The total issue rate for the samples gathered across all areas in scope amounted to 60% which is high and indicative of a weak control environment.
- Some areas incurred very high issue rates, with 88% of the Transforming Cities Fund samples returning an issue.
- Of the issues identified, 50% were due to incomplete samples or inappropriate evidence, and 50% were due to a controls failure.

Control environment score

Figure 2 displays the range of control performance scores identified across the areas in scope.

- This illustrates how issues vary across different areas in scope and where priority focus will need to be applied going forward.
- The analysis also identifies that although the value of expenditure in scope and sampled varied significantly between the areas in scope, even for those with lower values of spend are deemed to represent a high materiality of risk, due to the consequences of error or poor process compliance within these services.

Fig 1: Control Failure and Incomplete Sample Rate

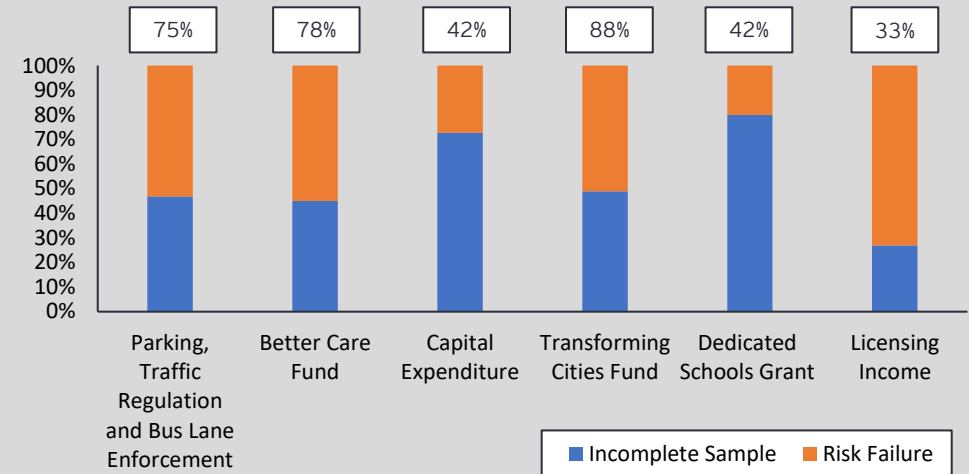
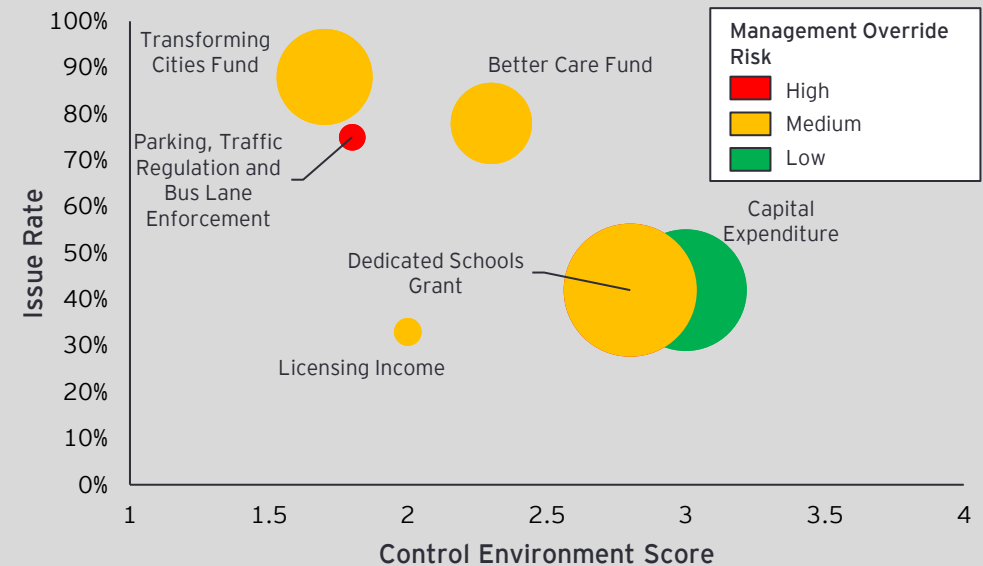


Fig 2: Issue Rate over Control Environment Score



EY Conclusions from key observations

Conclusions drawn from the Key Observations

The findings of the Controls Assessment underpin a conclusion that NCC is operating with a considerably weakened control environment which is not fit for purpose in allowing a Local Authority to enact effective financial stewardship.

In particular, the following conclusions are drawn from the observations and output of the assessment:

Interim Controls	The current state of controls in operation require urgent intervention to avoid the risk of inappropriate financial activity. This should initially focus on establishing interim controls along with an organisation wide health check to determine how prevalent issues identified as part of this process exist elsewhere within NCC.
Link between poor compliance culture and ineffective systems	Whilst the observations identify clear risk and evidence of management override, this doesn't suggest that the responsibility for the weakened controls environment sits solely with management. Rather, ineffective systems and processes, that in many cases are inefficient and lack sufficient agility and automation, contribute to a culture where compliance is not valued nor seen as a priority
Implementation of IT systems	NCC needs to ensure that lessons are learnt, especially with regards to future IT systems that will need to be adopted and implemented to support the Council's operation. In particular, this references the need to ensure that the control environment is core to NCC's systems, along with ensuring that the appropriate skills and capabilities are utilised during there design and implementation.
A focus on skills and capabilities to improve the culture of compliance	Key to NCC transforming its control environment is the need for a shift in culture within the organisation. Steps need to be taken to improve skills and capabilities that support effective financial management and thereby establish a culture where compliance is valued and controls are recognised for the outcomes they seek to achieve.
Longer Term Transformation	Whilst urgent action is required to establish grip on NCC's financial activities, it also needs to be recognised that the scale of change required to establish an effective control environment is a transformative process and will take a number of years to fully implement.

EY Remediation Plan

Controls Remediation Plan

To intervene with the objective of strengthening the Council's control environment and associated financial stewardship a Controls Remediation Plan composed of four steps is recommended to be implemented with urgency.

1 **Establishing Grip:** Designing and integrating new and in some cases interim controls into policy and process that safeguard NCC and its subsidiaries.

2 **Improving Capability:** Defining accountability for control, and identifying and closing training needs across NCC divisions with an overarching focus on transforming the culture of compliance.

3 **Developing Enhanced Control Processes and Supporting Monitoring Tools:** Developing detective and preventative controls and exception reports at entity level, supporting improved management information to maintain a view on control performance.

4 **Optimising the Enabling Systems:** Determining the controls that can be automated within technology platforms and embedding within NCC's future system design and implementation activities.

Engagement with CLT, NCC External Auditors, and Finance Improvement leadership will provide a platform for collective ownership of the recommendations made in this report and the associated opportunity to enhance the lines of defence in the control environment in FY23/24 and beyond.



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