

Horsecross Arts

Review of Financial Management

AUDIT GLASGOW

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Management System Certification

Horsecross Arts Review of Financial Management

1. Introduction

1.1 This report provides a summary of the findings from an audit review of financial management and control in Horsecross Arts Ltd. The review considered the governance arrangements which are in place and took into account recent concerns identified by the Board and the Sole Member, Perth and Kinross Council.

1.2 The purpose of this audit was to gain assurance that there are ongoing financial governance arrangements in place and that financial information is accurate and timeous. The scope of the audit included:

- Arrangements for reviewing and updating medium term financial plans and setting the annual budget;
- The financial governance framework, including the associated policies and procedures;
- Arrangements for preparing financial monitoring reports from the ledger, including reconciliations and budget adjustments;
- Reporting on financial performance to senior management and the Board;
- Consideration of associated key processes that may impact financial performance, including employee costs, accounts payable and ticketing income.

2. Audit opinion

2.1 Based on the work undertaken, the audit has identified serious control weaknesses relating to financial management, budgetary control and associated key processes including employee costs and accounts payable. Urgent action is required in order to ensure these key elements of the internal control environment are designed and operating effectively. Currently the organisation is running at significant risk of failing to manage its finances effectively, which may impact on its ability to deliver on its strategic priorities.

3. Main Findings

Budget setting and monitoring

3.1 There is no defined framework for agreeing financial forecasts, setting the budget and monitoring financial performance. Roles and responsibilities are not formally defined or well understood. Whilst there are budget holders in place, there is no clear understanding of what that role requires and cost centres are not clearly aligned to budget holders' areas of responsibility. As a result, there is no "ownership" of the budget across the organisation.

3.2 Financial forecasting appears to have been undertaken in an informal way. We could not identify robust forecasts taken to the Board that then informed strategic financial decision making. Instead, for example, where budget gaps emerged, they appear to have been dealt with through unrealistically inflating income targets. The overall audit trail for building the 2019/20 budget was not apparent. Ultimately this had the effect that the budget approved by the Board for 2019/20 was not competent, leading to ongoing financial crisis

management during the year. The Board was advised in March 2019 that budget holders and the Senior Management Team approved the budget, but the available evidence contradicts that assertion.

3.3 Whilst the budget setting process was flawed, the Board did approve an annual budget for 2019/20. However, the subsequent monitoring process was not subject to a formal control framework. For example:

- Budget holders have not formally reviewed and signed off the annual budget.
- There is no process for reviewing phasing of budgets, or formally authorising and controlling changes to the original approved budget.
- Up to September 2019, there is no evidence of regular formal budget monitoring reports being produced and scrutinised by budget holders. Ad hoc budget monitoring reports were produced for the Board, but there was no ownership at budget holder level or SMT.
- There are no defined variance thresholds above which management explanation and action is required.
- Monitoring information is not fully reconciled to the financial ledger and we were unable to substantively reconcile some differences.

3.4 Since September 2019, the Board has only received financial forecasting reports. This was necessary due to the budget setting issues noted above. However, in developing a new robust financial management control framework, the focus should be on setting a competent budget, monitoring actual income and expenditure against an appropriately phased budget, and then from the appropriate point in the year including forecast projections to year end.

3.5 Cash flow monitoring should be closely aligned to budget monitoring arrangements. Detailed cash flow projections are now being produced, however at the time of our review, two weeks were outstanding. We also understand that management are considering ways to better monitor financial commitments as part of these enhanced cash flow monitoring arrangements.

3.6 We reviewed year end accruals and prepayments as failure to properly manage these year end adjustments can have a significant impact on financial performance in the new financial period. The audit trail in these areas was also lacking and we noted that accruals were not being proactively reversed and monitored. Similarly management should develop a defined process for monitoring and reconciling control accounts within the ledger, including VAT and deferred income.

3.7 Appropriately controlled ledger access is an important element of the overall financial management control framework. We found that access to the Xero ledger system was unnecessarily wide, with a large number of employees being given considerable read and write access rights. This included some employees that had left employment who had not had their access rights removed. The risk of inappropriate access in these circumstances is magnified since Xero is a cloud based ledger system, enabling offsite access for those with active user accounts. We therefore expanded our testing to include a sample of journals. Whilst we did not find anything untoward, the risk of inappropriate access remains and management should therefore undertake an urgent user access review on the basis of minimum-need for each role.

Employee costs

- 3.8 Horsecross Arts use SAGE payroll. This does not automatically interface with the Xero financial ledger. Instead a manual journal has to be raised. Access to SAGE is restricted to two officers, but there are no built in controls to limit read / write access rights and there are no authorisation controls in place. Specifically, there is no authorisation required of the payrun, or for updating the payroll for timesheets and other changes. In order to mitigate the risk of fraud and error, all payroll amendments should be subject to formal segregation of duties and authorisation controls.
- 3.9 In order to ensure that all employees on the payroll are still contracted to the organisation, and that pay details are correct, we are recommending that management conduct an annual payroll verification exercise. However, in order to do that efficiently it would also be beneficial for management to create and maintain a formal staffing establishment, which line managers are required to maintain for starters, leavers, and changes, on an ongoing basis.
- 3.10 There are inadequate controls over casual and temporary staff, including creative freelance and private contractors. Any decision to enter into agreements in these areas should be properly authorised and underpinned by an approved budget. The audit trail was also critically lacking in this area.
- 3.11 Special tax rules (IR35) apply where a worker provides his/her services through their own intermediary, for example a Personal Service Company. Prior to April 2017 the intermediary was liable for income tax and national insurance contributions (NICs) for that person. However, amended legislation affecting public authorities, was implemented in April 2017. As a result, when a public authority engages with

a worker provided via an intermediary (either directly or via a third party such as an agency) the public authority is required to assess employment status and potentially account for income tax and NICs when making payment to these types of workers. Management should review whether there are any such arrangements falling within IR35 at Horsecross Arts.

- 3.12 There is no formal policy or monitoring of employees that are entitled to earn Time Off In Lieu (TOIL). This has led to significant accrued balances of TOIL by some employees. Since this is not being actively monitored, significant TOIL balances could undermine the accuracy of budget monitoring and financial projections. Management should review these arrangements and also conditions of service to ensure these meet the needs of the business. Where TOIL is accrued, it should be subject to a formal policy that is then regularly monitored by management.
- 3.13 A policy on travel and subsistence is in place. However, we identified one case where expenses were paid out but there was no audit trail showing authorisation and retention of receipts. A sound control framework would ensure that all trips are authorised in advance, and out of pocket claims for subsistence business expenditure are formally authorised on the presentation of proper receipts.
- 3.14 There is no formal remuneration policy or committee in place. The absence of formal arrangements, including a formal pay scheme and arrangements for senior officer emoluments can lead to inconsistencies and divergence in pay structures. This is also an example of an anomaly that would be mitigated through the implementation of the additional payroll controls noted at 3.8-3.9.

- 3.15 The final area of employee expenditure that we considered was complementary tickets. We found that employees are routinely offered free tickets to events held or supported by Horsecross Arts. However, there is no policy underpinning what types of events this should include, in what situations and the number of tickets and frequency. We are therefore recommending that management establish a formal policy to ensure that complementary tickets for staff are offered on a consistent basis and in such a way that does not cut across the wider objectives of the organisation.

Accounts payable

- 3.16 Alongside employee costs, accounts payable represents the other significant element of expenditure for Horsecross Arts. A normal purchase invoice processing control environment would see a “3-way check”, with clear segregation of duties. The overall premise is that one person should not be able to raise a purchase order, confirm goods/services received, and authorise the purchase invoice. As part of our audit, we tested a sample of 20 invoices and found that these key segregation of duties and authorisation controls are not in place. Ultimately one employee could set up a supplier, create a purchase order, and authorise the invoice and payment. There is also no restriction on cost centre coding, meaning that it is possible to charge goods / services to cost centres in areas of another officer’s budget responsibility.

- 3.17 We were advised that there was a control for all payments over £1,000 to be authorised by the Chief Executive. However, testing confirmed that this control is not being followed in all cases. The absence of a formalised control framework in this area underpinned by written procedures has led to divergence in practice across the organisation.

Next steps

- 3.18 An action plan is provided at section four outlining our observations, risks and recommendations. We have made 12 recommendations for improvement. All actions should be progressed as a matter of priority. Taken together, the absence of effective budget monitoring controls, inadequate payroll management and accounts payable arrangements, and poorly controlled system access, leads to a toxic mix of control failures that leaves the organisation significantly exposed to fraud and error.

Priority	Definition	Total
High	Key controls absent, not being operated as designed or could be improved. Urgent attention required.	5
Medium	Less critically important controls absent, not being operated as designed or could be improved.	7
Low	Lower level controls absent, not being operated as designed or could be improved.	0
Service Improvement	Opportunities for business improvement and/or efficiencies have been identified.	0

3.20 The audit has been undertaken in accordance with the Public Sector Internal Audit Standards. We would like to thank officers involved in this audit for their cooperation and assistance.

3.21 It is recommended that the progress on implementing the agreed actions in the action plan is reported periodically to the Board.

3.19 Recognising that the focus of this audit was on financial management, through our fieldwork we have also become aware of other key areas that should be subject to separate in depth assurance reviews, including:

- Cash security and imprest management;
- Governance arrangements (scheme of delegation, authorised signatories etc.);
- Gifts and hospitality, and declarations of interest;
- IT general controls and cyber security;
- HR management; and
- Board effectiveness and organisational culture.

4. Action Plan

Horsecross Arts: Financial Management

No.	Observation and Risk	Recommendation	Priority
1	<p>Budget setting and monitoring</p> <p>There is no overall framework for budget forecasting, budget setting and budget monitoring. This has led to a period of financial crisis and a short term focus on projections of year-end actuals. It can therefore be concluded that there is no operationally effective budgetary control system in place currently.</p>	<p>A full financial management framework must be developed, encompassing the following broad areas:</p> <ul style="list-style-type: none"> • Medium term financial forecasting and trend analysis. • Annual budget setting, including strategic considerations arising from the financial forecast, and specific strategic initiatives being separately identified to meet any anticipated budget gaps. • Formal identification of budget holders, aligned to business areas and reflected in the ledger structure. • Budget holder involvement in building the annual budget and medium term forecasts. • Sign off by budget holders and the SMT of the budget prior to Board approval. • Review of annual budgets for accurate phasing in order to reflect business expectations and peaks and troughs of trading. • Regular budget monitoring reports, produced and reconciled to the ledger, discussed with and approved by budget holders, and presented to the SMT and Board. • These should include appropriately detailed variance analysis, with standard thresholds (% variance triggers). • At the appropriate point in the year, budget monitoring should include projections of actuals and variances to the year end, and proposed management action for ensuring a balanced outturn. • A formal scheme of delegation should also be established alongside a list of authorised signatories with associated financial limits and parameters. 	High

No.	Observation and Risk	Recommendation	Priority
		<p>The Board should also consider whether a professionally qualified finance manager, as a permanent member of the SMT, should be appointed. The benefit would be that one single officer has overall responsibility for ensuring budget holders operate in accordance with the budgetary control framework.</p>	
2	<p>Cash flow monitoring</p> <p>Cash flow monitoring is ongoing, but at the time of our audit 2 weeks were outstanding.</p> <p>Given the critical financial position of Horsecross Arts, weekly cashflow monitoring is important to ensure ongoing solvency.</p>	<p>Management should ensure the weekly cashflow monitoring and projections are undertaken timeously to ensure liquidity is maintained. This is especially important given the inadequate budgetary control environment currently in place.</p>	Medium
3	<p>Year end accruals and control accounts</p> <p>The audit trail around certain year end accruals and prepayments was not clear and some are not being timeously reversed.</p> <p>Proper financial reporting requires year end accruals to be supported by an appropriate audit trail. In addition, a failure to properly manage, monitor and reverse accruals can impact on the financial position in the following period.</p> <p>We also found that there was no formal review of control accounts, VAT or deferred income. This can lead to unexplained balances building up in the ledger, impacting the reported financial position.</p>	<p>All accruals and prepayments should be reviewed by a secondary professional finance officer and supported by an appropriate audit trail. Once posted to the ledger, a designated officer should review these periodically and ensure accruals are reversed at the appropriate time. Any unexpected prior year variances should also be built into the budget monitoring reports.</p> <p>Similarly, management should develop a defined process for monitoring and reconciling control accounts within the ledger, including VAT and deferred income.</p>	Medium

No.	Observation and Risk	Recommendation	Priority
4	<p>Ledger access</p> <p>We reviewed users with access to the Xero ledger system and have noted that too many officers have unnecessary access. We also identified leavers who had not been removed.</p> <p>This may lead to unauthorised or inappropriate access, and erroneous or fraudulent postings to the system. This risk is increased as the system is cloud based and can be accessed remotely.</p>	<p>Management should undertake a full user access review of the Xero ledger system. The overriding principle should be one of minimum need for each role.</p> <p>A formal leavers process should also be adopted to ensure that all staff that leave employment immediately have access rights removed.</p>	High
5	<p>Payroll controls</p> <p>The Horsecross Arts payroll is not subject to a formal system of control that enforces authorisation controls prior to running the payroll or posting amendments. The system also does not enforce segregation of duties.</p> <p>It is therefore possible for one officer to post a change to the payroll, run the payroll and post the journal to the ledger without second officer approval. This increases the risk of fraud and error.</p>	<p>A system of secondary authorisation should be implemented to ensure at least two separate officers are involved in amendments to the payroll and the payrun itself. Given the SAGE payroll system does not automatically interface with the ledger, the journal should be subject to independent review and the two systems reconciled on a monthly basis.</p>	High
6	<p>Payroll verification</p> <p>There is no formal establishment maintained of contracted employees. Given the wider control issues identified, there is a risk that employees that have left or changed working time or pay scales may not be accurately reflected in the payroll.</p>	<p>A full establishment list of all employees should be created and maintained. Thereafter all budget holders should complete an annual verification process, comparing information on the payroll with local establishment information to identify any anomalies.</p>	High

No.	Observation and Risk	Recommendation	Priority
7	<p>Casual staff & IR35</p> <p>There are inadequate controls over casual and temporary staff, including creative freelance and private contractors. The audit trail was also critically lacking in this area.</p> <p>Due to the nature of the business, it is important that budget holders are fully accountable for the recruitment of casual and temporary staff.</p> <p>We also noted that there has been no review of current contracted staff against IR35 requirements, and there is no process to undertake this on an ongoing basis.</p>	<p>Any decision to enter into agreements with casual and temporary staff should be properly authorised and underpinned by approved budget.</p> <p>In addition, a review of all casual and temporary staff against IR35 requirements should be undertaken, and recruiting managers should be provided with guidance to ensure compliance on an ongoing basis.</p>	Medium
8	<p>Time off in lieu</p> <p>There is no formal policy or monitoring of employees that are entitled to earn TOIL. This has led to significant accrued balances of TOIL by some employees.</p> <p>Since this is not being actively monitored, significant TOIL balances could undermine the accuracy of budget monitoring and financial projections.</p>	<p>Management should review the arrangements for TOIL to ensure these meet the needs of the business. Where TOIL is accrued, it should be subject to a formal policy that is then regularly monitored by management. Consideration should be given to ensuring employees are on the most appropriate working pattern to ensure it is reflective of the needs of the business.</p>	Medium

No.	Observation and Risk	Recommendation	Priority
9	<p>Travel and subsistence</p> <p>We identified one case where expenses were paid out but there was no audit trail showing authorisation and retention of receipts.</p> <p>The absence of an agreed authorisation process and audit trail may lead to inappropriate expenses being reimbursed and tax and VAT issues arising.</p>	<p>A formal process should be established and rolled out to employees to ensure that all trips are authorised in advance, and out of pocket claims for subsistence business expenditure are formally authorised on the presentation of proper receipts.</p>	Medium
10	<p>Employee remuneration</p> <p>There is no formal remuneration policy or committee in place. The absence of formal arrangements, including a formal pay scheme and arrangements for senior officer emoluments can lead to inconsistencies and divergence in pay structures.</p>	<p>Management should consider formalising the pay and grading structure across the organisation to ensure consistency.</p> <p>The Board should also consider reviewing the governance around senior employee emoluments, specifically the creation of a remuneration committee.</p>	Medium

No.	Observation and Risk	Recommendation	Priority
11	<p>Complementary tickets</p> <p>There is no policy underpinning what types of events should be offered to employees on a complementary basis and in what situations.</p> <p>We identified some instances where up to 6 tickets were offered to individual employees.</p> <p>There is a potential reputational risk to the organisation if this area is not properly controlled.</p>	<p>We are therefore recommending that management establish a formal policy to ensure that complementary tickets for staff are offered on a consistent basis and in such a way that does not cut across the wider objectives of the organisation.</p>	Medium
12	<p>Accounts payable</p> <p>As part of our audit, we tested a sample of 20 invoices and found that key segregation of duties and authorisation controls are not in place. Ultimately one employee could set up a supplier, create a purchase order, and authorise the invoice and payment. There is also no restriction on cost centre coding, meaning that it is possible to charge goods / services to cost centres in areas of another officer's budget responsibility.</p>	<p>Management must urgently implement a 3-way check control framework across accounts payable to ensure that no single officer can transact the whole ordering and accounts payable process. System controls should also be explored to ensure that authorising signatories cannot authorise transactions to cost centres out with their own business area.</p>	High