

Agenda Item No: 8 **Report No:** 67/14
Report Title: Financial Resilience
Report To: Scrutiny Committee **Date:** 22 April 2014
Cabinet Member: Councillor Andy Smith
Ward(s) Affected: All
Report By: Director of Finance
Contact Officer(s)-
Name(s): John Magness
Post Title(s): Director of Finance
E-mail(s): john.magness@lewes.gov.uk
Tel No(s): 01273 484468

Purpose of Report:

To provide a commentary against the Grant Thornton good practice checklist as requested by the Scrutiny Committee at its meeting on 16 January 2014.

Officers Recommendation(s):

That the Scrutiny Committee:

- 1 Considers the commentary against the Financial Resilience good practice checklist.

Reasons for Recommendations

- 1 At its meeting on 16 January 2014 the Committee considered a report prepared by Grant Thornton called "2016 Tipping Point?" http://www.grant-thornton.co.uk/Global/Publication_pdf/LG-Financial-Resilience-2016-tipping-point.pdf

Information

- 2 Grant Thornton are the appointed external auditors to a number of councils, but not to Lewes District Council. The Council's external auditors are BDO LLP.
- 3 The financial resilience of councils is being severely tested against the backdrop of reducing government support as a consequence of the public sector deficit being addressed.
- 4 Grant Thornton published an analysis on the financial resilience of councils. The Government has made it clear that funding for the public sector will continue to reduce even when economic growth rises. This trend is expected to continue through to 2019/2020.
- 5 The publication included a good practice checklist and this is reproduced at Appendix A, together with the requested commentary.

6 Since the Committee last met, Grant Thornton produced an additional summary relating to councils in the south east. The report can be found at this link <http://www.grant-thornton.co.uk/Documents/local-authority-financial-resilience-in-the-south-east.pdf>

7 The one area in the checklist without a positive response is that relating to the Working Capital ratio. This ratio reports on a position at a precise point in time. It measures current assets less current liabilities and reports the result as a percentage of net revenue expenditure.

The Local Government Association compiled this ratio for all councils using data from their Balance Sheets at 31 March 2012. Lewes ranked 147 out of 201 English districts.

Type-based comparison (201 councils)

Highest	Median	Lowest	Authority rank
577.20	87.94	-466.63	147

This ratio seeks to measure the extent to which an authority could cover existing expenditure from working capital if necessary. Authorities with strongly positive indicators would have little difficulty liquidating sufficient assets to continue to operate in the event of a cash flow crisis; authorities with negative indicators may have to borrow to cover cash requirements, thus incurring additional costs.

Whilst it is essential to control and have targets for the constituent elements of working capital, having an overall indicator could be viewed as a rather simplistic approach that overlooks financial powers available to councils and strategies that may be adopted, such as the Annual Treasury Management and Investment Strategy which could have an objective to borrow internally thus minimising investment risk by using cash and investments to reduce external borrowings.

8 **Financial Appraisal** – the financial implications through to 2019/2020 were considered by Cabinet on 13 February 2014. Appendix E within this link is the latest Medium Term Financial Plan <http://cmispublic.lewes.gov.uk/Public/Binary.ashx?Document=6811>

9 **Sustainability Implications**

The Councils budget is considered to be sustainable when all savings have been delivered and the working balance is no longer drawn upon to support the recurring revenue budget. This is consistent with the objectives and principles of the medium Term Finance Strategy shown at Appendix B.

10 **Legal Implications**

There are no legal implications arising from this report.

11 Risk Management Implications

- 11.1** The Council maintains an overview of its policy programme, its Medium Term Financial Strategy and the external factors that affect them. Without this constant analysis and review there is a risk that the underlying recurring revenue budgets will grow at a faster rate than the resources available to fund them. This risk is mitigated through regular reports to Cabinet on the Council's overall revenue and capital position and Cabinet's correcting actions taken in accordance with the objectives and principles it set for management of the Council's finances.
- 11.2** An additional risk in the current climate is that reserves and balances will be drawn upon sooner than is necessary unless an assessment is made of resource implications where activity levels have fallen or risen to any significant degree. This risk is mitigated by identifying such areas, making an assessment covering the short and medium term and taking corrective action.

12 Equality Screening

The Equality Screening process for this Report took place on 8 April 2014. No potential negative impacts were identified.

13 Background Papers

Web links to the Grant Thornton publications are provided within the body of the report.

Appendix

Appendix A – Good practice checklist

Appendix B– Medium Term Finance Strategy (MTFS): Objectives and Principles.

Good Practice Checklist

Key indicators of financial performance	✓	✗	Comments
Regular monitoring of key indicators of financial performance	✓		A range of detailed weekly and monthly reports to budget holders and Corporate Management Team. Quarterly performance reports provided to Cabinet.
The authority operates within a locally determined appropriate level of reserves and balances	✓		Levels of reserves and need for reserves are reviewed at least twice each year
The General Fund balance is maintained at or above the locally agreed minimum level	✓		The minimum uncommitted level in the Medium Term Financial Strategy is £0.5m. As a minimum this is supplemented by the estimated amount needed to realign annual budgets through to 2019/2020 when a sustainable position is forecast.
Working capital is at, or above, a ratio set by the Section 151 officer		✗	Whilst we have not set an overall target for the working capital ratio we have targets for the constituent elements that make up the ratio e.g. debtors, creditors, stock, work in progress, cash and investments.
Manageable levels of long-term borrowing within prudential borrowing limits	✓		These are detailed in the Annual Treasury Management and Investment Strategy. Client reviews with the Council's Treasury Advisor "Arlingclose" are held throughout the year.
Targets have been set for future periods in respect of key indicators, such as reserve balances and prudential indicators	✓		During the annual budget cycle the detailed use of reserves are projected over a two year forward period. The majority of the reserves are earmarked for specific purposes. Prudential indicators are projected over a three year forward period; they are reported in the annual budget report for the Capital Programme and in the Annual Treasury Management and Investment Strategy.
The authority has a track record of spending to budget and proactively managing forecast overspends in-year	✓		Significant revenue and capital budget variances are reported to each Cabinet. Forecast variances are reviewed by Corporate Management Team. Meetings between the responsible budget officer / accountancy client officer identify areas that need action. We pursue a risk management approach to budget monitoring and carry out a monthly analysis of high risk income and expenditure budgets. We actively review high value / high risk (non payroll) income and expenditure budgets and we monitor the whole payroll in detail. Reports are provided to key budget officers.
A robust organisational approach and focus on absence management to improve productivity, reduce costs and enhance customer service	✓		We have a sound approach to absence management including trend analysis and return to work interviews. The latest release of our Human Resource/Payroll system (effective from April 2014) provides managers with an enhanced range of tools to monitor trends and manage absence.

Strategic Financial Planning	✓	✘	Comments
Focus on achievement of corporate priorities is evident through the financial planning process. The MTFS focuses resources on priorities	✓		The financial planning process is dynamic and is evidenced in specific Cabinet reports throughout the year, as well as in the Annual Council Plan and performance monitoring reports. The focus on priorities is supplemented through an earmarked “Strategic Priorities” reserve and a budget for Service Priorities.
Service and financial planning processes are integrated	✓		They are integrated within a clearly defined financial governance framework set out in the Council’s Constitution. This enables the Council to respond to opportunities within a sound control framework.
The MTFS includes outcome measures, scenario planning, benchmarking, resource planning and details on partnership working	✓		The MTFS models the high level outcome in relation to future taxation levels, based upon stated assumptions. This is supported by scenario planning, particularly in relation to future government grant streams and the level of retained business rates income. Separate benchmarking reviews and studies are undertaken to ensure that resources are used effectively.
Annual financial plans follow the longer-term financial strategy of the authority	✓		In the current financial climate it is essential to integrate the annual planning cycle with medium term projections including the availability of earmarked and general balances. The Council’s annual savings targets for each year through to 2019/2020 are modelled on drawing upon general balances until the budget returns to a sustainable position by that point in time. The MTFS principles and objectives clearly set out the ground rules for delivering a sustainable budget.
There is regular review of the MTFS and the assumptions made within it. The authority responds to changing circumstances and manages its financial risks	✓		Regularly reviewed throughout the year with significant variances and actions required, reported to Cabinet. External factors impacting upon the MTFS are also reported as they arise.
The authority has performed sensitivity analysis on its financial model using a range of economic assumptions including the impact of SR10 and SR13	✓		Completed. Until SR16 is underway our two key planning assumptions, following scenario planning, are that Revenue Support Grant will be zero by 2019/2020 and that after 2014/2015 our share of retained business rates will remain constant in real terms (i.e. it will rise by inflation only and there will not be any net increase in rateable values from business growth).
The MTFS is linked to and is consistent with other key strategies, including workforce	✓		Yes – this is a key component and driver of the strategy along with future changes anticipated in pay levels, employers national insurance contributions and employers pension arrangements.
KPIs can be derived for future periods from the information included within the MTFS	✓		Yes – there are implicit KPI’s within the MTFS such as collection rates for council tax and business rates. We have a separate (but integrated) process for monitoring performance against targets.

Zero based budgeting on priority based budgeting is used to improve strategic prioritisation during the financial planning cycle	✓		The financial planning cycle is dynamic, iterative and ongoing. New projects/services and opportunities are worked up from a zero base methodology and integrated with a project management methodology that requires a supporting business case and a PID.
Effective treasury management arrangements are in place	✓		We prepare and review our Strategy with assistance from Arlingclose. Detailed procedures and clear lines of responsibility are documented. Treasury Management operations receive priority each day. Training opportunities are offered to all Councillors.

Financial Governance	✓	✘	Comments
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There is a clear understanding of the financial environment the council is operating within	✓		In addition to the formal annual financial planning process involving the Scrutiny Committee, Cabinet and Council, numerous briefings are offered and provided to Councillors. The financial position is regularly reviewed by the Corporate Management Team. The Chief Executive's all staff meetings and the internal communications channels have clearly set out the challenge facing the Council.
Regular and transparent reporting to members. Reports include detail of action planning and variance analysis	✓		Financial Updates are provided to each Cabinet meeting.
Actions have been taken to address key risk areas	✓		Yes, even for those outside the direct control of the council e.g. the impact of outstanding appeals on the Council's share of retained business rates income.
The chief finance officer is a key member of the leadership team	✓		Yes.
Officers and managers across the authority understand the financial implications of current and alternative policies, programmes and activities	✓		Yes. This is an area where support has been provided and expertise has developed, particularly through the adoption of programme and project management controls.
The leadership ensures appropriate financial skills are in place across all levels of the organisation – for example, a good understanding of unit costs and cost drivers	✓		A programme of Service Heads unit cost and benchmarking reviews has been subject to challenge by the Council's Scrutiny Committee over the last three years. All service Heads are supported by client officers from the Council's Financial Services Team. Unit cost reviews and desired outcomes continue through specific projects, such as that for Agile Working.
The leadership fosters an open environment of open challenge to financial assumptions and performance	✓		Yes.

There is an effective scheme of delegation, ensuring clarity of financial responsibilities and accountabilities	✓		Set out in the Constitution – and regularly reviewed and updated.
There is engagement with stakeholders, including budget consultations	✓		The Council is committed to citizen participation and community involvement through its “Principles of Local Participation” adopted in November 2012. Budget consultations are conducted through focus groups and the Lewes District Business board.
There are comprehensive policies and procedures in place for members, officers and budget holders which clearly outline responsibilities	✓		Set out in the Constitution.
Internal and external audit recommendations are not overdue for implementation	✓		Regularly reviewed by the Audit and Standards Committee.
Committees and cabinet regularly review performance and it is subject to appropriate levels of scrutiny	✓		Yes. The roles are set out in the Constitution.
There are effective recovery plans in place (if required)	✓		Our project management procedures require the identification of risks and for the project sponsor to report on the resource and delivery position on a regular basis. This would include a recovery plan if needed.

Financial Control	✓	✘	Comments
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Budgets are robust and prepared in a timely fashion and the authority has a good track record of operating within its budget	✓		All deadlines are adhered to and we have a consistent track record of operating within budget.
Budgets are monitored at an officer, member and cabinet level and officers are held accountable for budgetary performance	✓		Yes.
Financial forecasting is well-developed and forecasts are subject to regular review, including trend analysis, benchmarking of unit costs, risk and sensitivity analysis	✓		Methodology has been referred to above.
Budget profiles are accurate and regularly monitored	✓		Real time monitoring by service managers is supplemented with meetings and a monthly review of “risk” budgets.
There is particular focus on monitoring income related budgets	✓		Yes. Page 7 of 9

Savings programme reporting includes effective management information on countervailing savings and the use of RAG ratings	✓	The early years of the savings programme were managed through a RAG process and covered a large number of individual budgets. The current savings programme has a small number of larger corporate budget savings that are regularly monitored for delivery. A savings plan through to 2020 will be produced as the next phase of realigning the budget.
The capacity and capability of the finance department and service departments are fit for purpose for effective financial planning and financial management	✓	Constantly kept under review, particularly in a rapidly changing environment where changes elsewhere in the Council impact on the information flows into the finance team and also having regard to the age profile of the workforce.
Key financial systems have received satisfactory reports from internal and external audit	✓	Satisfactory reports have been received and summaries of all reports are publicly available. Where deficiencies in controls have been identified management has agreed to strengthen them.
Financial systems are adequate for future needs, for example commitment accounting functionality is available	✓	Systems are adequate and they include a commitment accounting module.
There is an effective internal audit which has the proper profile within the organisation and agreed internal audit recommendations are routinely implemented in a timely manner	✓	The internal audit team has been stable for many years, contains experienced staff and well developed procedures and approaches which have been approved by the Audit and Standards Committee.
There is an assurance framework in place which is used effectively by the authority and is how business risks are managed and controlled	✓	A well established framework is in place.
The annual governance statement gives a true reflection of the organisation	✓	The statement is reviewed annually and considered by the Audit and Standards Committee. The external auditors have confirmed they are satisfied that the Annual Governance Statement is not inconsistent or misleading with their review and that it complies with best practice.

Extract From the Medium Term Finance Strategy

The Objectives of the Council's MTFs are as follows:

	Objective
1	To provide a robust framework to assist the decision making process.
2	To enable the Council to be proactive rather than reactive.
3	To act as a barometer and give early indication of need to review priorities.
4	To show how resources support the Council Plan over a four year period.
5	To support sustainable services through reserves, equalisation and renewal funds.
6	To hold a working balance at an adequate level to respond to unexpected events and opportunities.
7	To be flexible and responsive to changing needs and legislation.
8	To support the Council's service and core strategies.
9	To provide forward indications of Council Tax levels.

A number of Principles have been established to underpin the financial objectives:

	Key Principles
1	Resources will be prioritised to meet statutory (core service) obligations.
2	We will work with partners and the local community to determine priorities.
3	We will constantly review and reconcile priorities in line with the available resources.
4	Capital receipts will only be used to fund capital programmes, when banked.
5	General Fund capital receipts will be used to improve and replace existing assets.
6	Capital receipts from Council house sales will be reinvested in a housing capital programme or to improve and replace existing assets.
7	The budget for investment income will take account of specific market advice. If investment rates rise or are expected to rise, we will not use the additional income to fund items within the recurring base budget.
8	We will aim to achieve a zero balance on the Collection Fund when estimating the Council Tax collection rate each year.
9	Council Tax amounts will be transparent and sustainable. This means that the budget requirement will not be lowered through the use of one-off balances or reserves without a published intention to realign priorities with the Medium Term Financial Strategy.
10	Changes to the Council's priority programme must be reported to Cabinet and supported by a risk assessment and financial appraisal showing part year and full year costs, including the revenue consequences of any capital investment and lifetime costs.
11	Every request for capital investment must be supported by a Business Case which shows how the cost of that investment will be repaid over time.