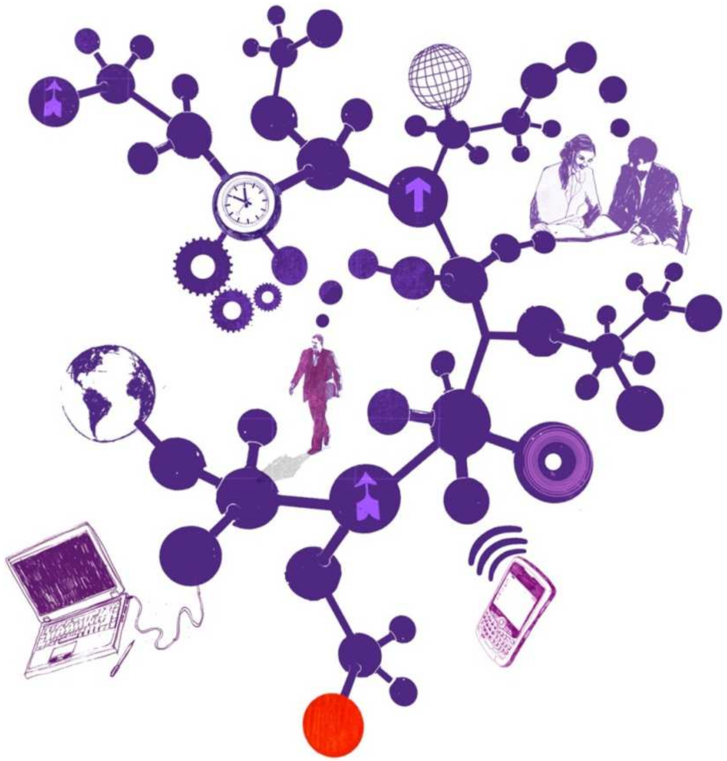
# Review of the Council's Arrangements for Securing Financial Resilience
# Cheshire East Council

**Year ended 31 March 2013**

27 September 2013




**Judith Tench**
**Engagement lead**
**T** 0161 214 6369
**E** judith.m.tench@uk.gt.com

**Stephen Nixon**
**Manager**
**T** 0161 234 6362
**E** stephen.r.nixon@uk.gt.com

**Ivan Parkhill**
**Executive**
**T** 0161 214 6377
**E** ivan.parkhill@uk.gt.com

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

# Contents


| | |
|---|---|
| 1 Executive Summary | Page 3 |
| 2 Key Indicators | Page 9 |
| 3 Strategic Financial Planning | Page 13 |
| 4 Financial Governance | Page 17 |
| 5 Financial Control | Page 22 |
| Appendix - Key indicators of financial performance | Page 27 |

1 Executive Summary
2 Key Indicators
3 Strategic Financial Planning
4 Financial Governance
5 Financial Control
Appendix - Key indicators of financial performance

# Executive Summary

## Our approach

**Value for Money Conclusion**

Our work supporting our Value for Money (VfM) conclusion, as part of the statutory external audit, includes a review to determine if the Council has proper arrangements in place for securing financial resilience.

In so doing we have considered whether the Council has robust financial systems and processes in place to manage its financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future. We have carried out our work in discussion and agreement with officers and completed it in such a way as to minimise disruption to them.

The definition of foreseeable future for the purposes of this financial resilience review is 12 months from the date of this report.

We have reviewed the financial resilience of the Council by looking at key indicators of financial performance and its approach to:

- strategic financial planning;
- financial governance; and
- financial control.

Overall we have assessed the Council as **Amber**

While the Council has faced significant financial pressures, and continues to do so, its current arrangements for securing financial resilience are satisfactory. The Council's arrangements have continued to evolve since 2009 and a number of important improvements were made during 2012-13. Further improvements are being made in 2013-14.

Historically, the Council has had a poor track record of delivering its budget without major variances. Having made a number of improvements to budget monitoring and review processes in year the Council recorded a small underspend of £300,000 in March 2013.

The Council will continue to face challenging financial pressures and members will need to take tough decisions during the budget setting process to ensure that a realistic budget is set. This should also reduce the need to find additional savings in year.

During the latter part of 2012 and into 2013 the Council improved its financial planning and control arrangements in a number of key areas. For example agreeing the 2013 - 2016 Medium term Financial Plan, (MTFP), a revised budget setting process for 2014 and introducing the Financial Resilience Update for Cabinet in July 2013.

We have also identified areas where further improvements can be made including ensuring:

- a robust budget setting process that secures a realistic budget for services to deliver;
- that its governance and risk management processes both within the council and also with future service providers are robust;
- understanding and compliance with processes and procedures; and
- that its decision making processes are - and are seen to be - clear and transparent and subject to appropriate scrutiny, challenge and review.

We have used a red/amber/green (RAG) rating with the following definitions.

| | |
|---|---|
| Green | **Arrangements meet or exceed adequate standards**. Adequate arrangements identified and key characteristics of good practice appear to be in place. |
| Amber | **Potential risks and/or weaknesses**. Adequate arrangements and characteristics are in place in some respects, but not all. Evidence that the Council is taking forward areas where arrangements need to be strengthened. |
| Red | **High risk**: The Council's arrangements are generally inadequate or may have a high risk of not succeeding |

# Executive Summary

## National and Local Context

### National Context

The Chancellor of the Exchequer announced the current Spending Review (SR10) to Parliament on 20 October 2010. SR10 represented the largest reductions in public spending since the 1920's. Revenue funding to local government was to reduce by 19% by 2014-15 (excluding schools, fire and police). After allowing for inflation, this equates to a 28% reduction in real terms with local government facing some of the largest cuts in the public sector. In addition, local government funding reductions were frontloaded, with 8% cash reductions in 2011-12. This followed a period of sustained growth in local government spending, which increased by 45% during the period 1997 to 2007.

The Chancellor of the Exchequer, in his 2011 Autumn Statement, announced further reductions of 0.9% in real terms for 2015-16 and 2016-17. In his 2012 Autumn Statement, the Chancellor reinforced austerity measures announcing a further £6.6bn for 2013-2015. Whilst health and schools will continue to be protected local government will continue to face significant funding reductions. The Department for Communities and Local Government will contribute £470m of these additional savings, £445m of which will come from local authority funding during 2014-15, with local authorities being exempt from additional savings in 2013-14. In his March 2013 Budget, the Chancellor announced further departmental savings of 1%. The NHS and schools remain protected, but police and local government will need to find an additional 0.5% n both 2013-14 and 2014-15.

In June 2013 the Chancellor announced that local government will face a further 10% funding reduction in 2015-16..

These funding reductions come at a time when demographic and recession based factors are increasing demand for some services, and there is a decreasing demand for some services, such as car parking, where customers pay a fee or charge. Financial austerity is expected to continue until at least 2017.

### Local Context

The Council's 2012-13 net budget of £239m was set in the context of significant funding reductions and the need to generate some £21.7m in savings in-year. As expected, the Council experienced greatest cost pressures within adults, (£7m), and children's, (£8.9m), services. At the year-end the Council reported a small underspend of £300,000 - having made its planned contribution of £7.6m to its general reserves. The Council's general reserves of £19m are now more in line with the level of financial risk set out in its medium term financial plan.

The challenging financial climate has continued to shape the Council's borrowing strategy - to use cash balances to fund capital expenditure rather than raise new loans. This approach has been used successfully for a number of years given the low interest rates available for cash investments.

The Council spent £51.4m, (61%), of its approved capital budget of £83.8m for 2012-13. This underspend followed a comprehensive review of the programme during the year to focus upon initiatives with the highest priority and closest links to the Council's strategic objectives.

Following governance failings reported by internal audit, the Council's previous auditor and the designated independent person's (DIP) review of Lyme Green there have been a number of changes in senior staff. The timing of these changes meant that three of the Council's most senior officers were interim appointments for large parts of 2012-13. Under the leadership of the interim Chief Executive the management team made good progress to address the reported issues.

The new Chief Executive will complete the organisation re-structure during 2013-14. This is an important step towards addressing the cultural weaknesses noted in the Council's annual governance statement for 2012-13. It is also a key part of its vision to become a commissioning body.

# Executive Summary

## Overview of Arrangements

| Risk area | Summary observations | High level risk assessment |
|---|---|---|
| **Key Indicators of Performance** | • The Council reports a healthy balance sheet, with net assets of £238.6m, (£377.9m at 31 March 2012), a reduction of £139.3m. This is largely as a result of an increase in the pension liability of £71.1m and a reduction in non current assets of £71m.<br>• The working capital ratio has remained low compared to similar councils however should improve in 2013-14 once the Local Enterprise Partnership grant creditor is utilised.<br>• Cash and cash equivalent balances have fallen by £1.9m to £32.7m at the year end but remain high.<br>• The Council's 2012-13 revenue outturn was an underspend of £300,000 with in-year capital spending of £51.4m. The capital budget was underspent by £23.3m compared to the revised capital programme approved in December 2012.<br>• The Council's sickness absence rates have increased marginally to 9.55 days, compared to a target of 8.5 days. The Council needs to continue monitoring sickness absence rates at a detailed level to identify outliers, and take appropriate action. | Green |
| **Strategic Financial Planning** | • A Medium Term Financial Plan (MTFP) is in place covering the period 2013 to 2016. The Plan is regularly reviewed. It identifies budget shortfalls, for which the Council is yet to identify savings of £8.3m in 2014-15 and £14.1m in 2015-16. The Council will need to ensure the MTFP remains responsive given the scale of savings it has still to deliver alongside progressing its ambitious plans to become a commissioning body.<br>• The key planning assumptions cover the main areas which impact on the Council's operations.<br>• The Council experienced significant management turnover during 2012-13. It is now completing a comprehensive re-structure expected to improve efficiency and cut costs.<br>• The Council's business and financial planning process encourages teams to consider radical alternative ways of providing services including collaborative arrangements. Throughout this process of change the Council must ensure that proper risk management and due diligence assessments are carried out and supported by effective governance and decision making processes. | Green |

# Executive Summary

## Overview of Arrangements

| Risk area | Summary observations | High level risk assessment |
|---|---|---|
| **Financial Governance** | • The Council's approach to financial governance continues to develop. Both members and officers have a strong focus on the its financial position with clear engagement in the financial management process.<br>• Under the leadership of the interim Chief Executive the management team made good progress to address the issues reported by internal audit, the Council's previous auditor and the designated independent person's (DIP) review of Lyme Green.<br>• Budget monitoring and reporting processes continue to improve so that variances can be identified at an earlier stage and appropriate action is taken. But more needs to be done to ensure that tough decisions are taken when setting the budget rather than relying on services to deliver savings in year.<br>• The Council's new Financial Resilience Update Report in 2013-14 provides better information to members in terms of key financial health indicators for example working capital ratio and improved benchmark data. This reporting suite will be further developed during 2013-14.<br>• The Audit and Governance Committee provides adequate challenge, however committee needs to focus on its terms of reference and ensure that its agendas and discussions reflect its responsibilities.<br>• The Council's project management decision making processes have improved with the gateway approval process although there remains a need to ensure the approach is clear, transparent and subject to appropriate scrutiny, challenge and review – and be seen to be so.<br>• The Council has a significant number of corporate policies and procedures not all of which are fully understood and embedded across the Council. Compliance with these polices and procedures needs to be properly monitored and reviewed to ensure that they are followed and also that they remain appropriate during the Council's transition to its new operating model.<br>• The Council has a strong outward focus and considers some external performance data. But it needs to demonstrate a more robust use of national benchmarking information. | Amber |
| **Financial Control** | • The Council's approach to financial and performance reporting continues to develop. Good progress is also being made to improve the Council's performance management framework including a suite of indicators for the Corporate Leadership Board.<br>• In-year financial forecasting is improving. In the final quarter the Council addressed budget pressures and managed its outturn position to report a small surplus of £300,000. The final position was also helped by some additional income.<br>• The outturn for 2013-14 quarter one shows that services already face budget pressures of £7.5m, with action agreed to mitigate £4.3m. Realistic forecasting is essential if the Council is to keep control over key cost categories. In 2013-14, the rebasing of budgets (done in December 2012) is starting to show an improvement in budget setting and forecasting.<br>• Internal Audit concluded that for 2012-13, the Council's framework of governance and internal control was satisfactory . This provides reasonable assurance regarding the economic, efficient and effective achievement of its objectives. | Amber |

# Executive Summary

| Area of review | Key points for consideration | Responsibility | Timescale | Management response |
|---|---|---|---|---|
| **Financial Governance** | • Continue to develop the budget setting process so that the agreed budget is realistic and not dependent upon securing in year savings. | Finance/Democratic Services | Throughout 2013-14 | Financial Resilience update is due for publication in October 2013. |
| | • Revisit the Terms of Reference of the Audit and Governance Committee to ensure the member oversight is operating effectively. | | | |
| | • The Council should ensure the gateway approval process is embedded and used consistently to support the implementation of the Council's objectives. | | | TEG/EMB processes and discipline are now embedded in to the budget setting and monitoring processes. |
| | • Ensure that proper stewardship and governance arrangements are in place in new provider bodies as the Council moves towards a commissioning model. | TBA | On going as bodies develop | Governance arrangements will be monitored. MTFP will remain responsive and engage CLB and members at regular points throughout the year. |
| | • Ensure that compliance with the Council's policies and procedures is properly monitored and reviewed to ensure they are followed and also remain appropriate during the Council's transition to its new operating model. | | | |
| **Financial control** | • The Council needs to ensure that realistic spending plans are built into the budget to ensure that in year budget variances are less common and there is less reliance on late remedial measures to achieve financial balances | Finance | December 2013 | Identification of potential budget variations will continue to focus on highlighting issues to CLB/Informal Cabinet via a monthly report. This in turn should lead to improved year end forecasting. However, prudent forecasting will have to remain a feature of the reporting cycle especially where there is dependency placed on data or income from external sources. |

1 Executive Summary

2 Key Indicators

3 Strategic Financial Planning

4 Financial Governance

5 Financial Control

Appendix - Key indicators of financial performance

# Key Indicators

## Introduction

This section of the report includes analysis of key indicators of financial performance, benchmarked where this data is available. These indicators include:

- Working capital ratio
- Long term borrowing to tax revenue
- Long term borrowing to long term assets
- Sickness absence levels
- Out-turn against budget
- Useable Reserves: Gross Revenue Expenditure
- Schools Reserves - Balances to DSG allocations

We have used the Audit Commission's nearest neighbours benchmarking group comprising the following 15 authorities:

- Herefordshire Council
- Bedford Borough Council
- Trafford Metropolitan Borough Council
- Central Bedfordshire Council
- Warrington Borough Council
- East Riding of Yorkshire Council
- Shropshire Council
- Bath and North East Somerset Council
- Stockport Metropolitan Borough Council
- South Gloucestershire Council
- City of York Council
- Cheshire West and Chester Council
- Wiltshire Council
- North Somerset Council
- Cheshire East Council

# Key Indicators

## Overview of performance

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Liquidity** | • The Council's working capital ratio was low (0.88) at 31 March 2012 and remains low compared to similar authorities at 31 March 2013. This is primarily due to the Council holding the Growing Places grant creditor of£13m which funds the Cheshire and Warrington Local Enterprise Partnership (LEP). The LEP expects to use this money during 2013-14.<br>• The Council has retained its position among the top third of Unitary Councils in terms of council tax collection. Over 99% of Council Tax and Business Rates for 2011-2012 have been collected. | Green |
| **Borrowing** | • The Council's long term borrowing ratio (as a percentage of tax revenue) was the lowest of the comparator group in 2011-12 at 0.61, (at 0.63 in 2010-11) . Year end borrowing as at 31 March 2013 remains unchanged compared to March 2012.<br>• Following an in-year review of the balance sheet, undertaken by Treasury Advisors - Arlingclose, the Council decided to use existing capital reserves to finance capital expenditure which had in previous years been met from borrowing. In 2012-13 £15.6m was applied from capital reserves to repay borrowing for assets purchased after 2008.<br>• Borrowing is being repaid at a rate of £5.5m per year underpinned by the Treasury Management Strategy to finance capital expenditure from cash balances rather than raise long term loans. | Green |
| **Workforce** | • The Council employed 8,225 full time equivalents (FTEs) at 31March 2013 – compared to 8,326 FTEs as at 31 March 2012. Some of the reduction is due to schools becoming academies. The overall reduction in staffing reduced the Council's pay bill by £21.7m - from £299.3m in 2011-12, to £277.6m in 2012-13.<br>• During 2012-13 the contracts of 110 staff were terminated at a cost of £2.631m (£4.820m in 2011-12). Of this total £2.25m was paid to 103 staff who were made redundant as part of the rationalisation of various services. A further £407,000 was paid to seven senior officers in the form of compensation for loss of office and enhanced pension benefits.<br>• Sickness absence in 2012-13 totalled 9.55 days per employee against a target of 8.50 days. This was reported to Cabinet on 24 June 2013 as part of the Corporate Scorecard. The Council needs to closely monitor sickness absence at a sufficiently detailed level to identify outliers, and take appropriate action. An action plan now exists to improve sickness levels – this includes the introduction of an employee assistance programme during 2013-14. The Council is now reporting sickness performance monthly to CLB and the informal Cabinet and is already seeing a reduction in absence levels. | Green |

# Key Indicators

## Overview of performance

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Performance Against Budgets: revenue & capital** | • The Council's 2012-13 outturn position was a £300,000 underspend against its revenue budget of £239m .<br>• To achieve the revenue budget, the Council addressed budget pressures of £24.2m in Q4 of 2012-13 with remedial actions of £22.4m. This was supplemented by additional income particularly within Adults Service (health contribution for complex care £0.5m, winter pressures £0.5m, re-ablement funding £0.5m) and within corporate services (benefits subsidy £0.5m) .<br>• In-year capital spending was £51.4m, representing a £23.3m underspend compared to the revised capital programme which was approved by the Council on 13 December 2012. | Amber |
| **Reserve Balances** | • The Council increased its General Fund Reserves by £7.6m to £19m at March 2013 year end. This is in line with planned contributions. This takes the Council close to the £22.9m opening reserve position at 1 April 2009.<br>• The increase in General Reserves provides the Council with greater flexibility to manage its finances as it moves towards becoming a commissioning council. This is an improvement on the position of the last two years where reserves have only been adequate to cover risks. | Green |
| **Schools Balances** | • Schools balances have fallen by £2.3m to £12.6m at the year end. The key reasons for the reduction in balances relate to:<br>    • funding cost pressures facing schools; and<br>    • the transfer of balances following moves to academy status.<br>• The Council plans to undergo an external revaluation of all schools. This process commenced with 16 schools in 2012-13 with 110 remaining for 2013-14.<br>• Two schools converted to Academy status during 2012-13. | Green |

1 Executive Summary
2 Key Indicators
3 Strategic Financial Planning
4 Financial Governance
5 Financial Control

Appendix - Key indicators of financial performance

# Strategic Financial Planning

**Key characteristics of good strategic financial planning**

In conducting our review of strategic financial planning we have assessed the Council's performance against the following indicators:

- Focus on achievement of corporate priorities is evident through the financial planning process. The MTFP focuses resources on priorities.
- The MTFP includes outcome measures, scenario planning, benchmarking, resource planning and details on partnership working. Targets have been set for future periods in respect of reserve balances, prudential indicators etc.
- Annual financial plans follow the longer term financial strategy.
- There is regular review of the MTFP and the assumptions made within it. The Council responds to changing circumstances and manages its financial risks.
- The Council has performed stress testing on its model using a range of economic assumptions including CSR.
- The MTFP is linked to and is consistent with other key strategies, including workforce.
- KPIs can be derived for future periods from the information included within the MTFP.

# Strategic Financial Planning

## Medium Term Financial Strategy

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Focus of the MTFP** | • The Council appointed a new Leader in May 2012 and an interim Chief Executive joined in August 2012. Working together the new Leader and interim Chief Executive quickly recognised the need to provide clearer strategic direction and leadership - this is reflected in the 2012-13 MTFP and the new sustainable community strategy<br>• The longer term 2013 to 2016 MTFP was approved by the Council in February 2013. This plan sets out the core purpose of the Council, reflects the changing role of local government, responds positively to the challenge of major funding reductions, and is in line with policy changes at both national and local levels. It also reflects the major change programmes for service delivery in Cheshire East.<br>• The MTFP includes high level scenario analysis, the financial impact of pressures including business rate receipts, localisation of council tax benefit and the increase in academies. It now adequately considers significant funding changes, pressures and other scenarios which impact on the Council. | Green |
| **Adequacy of planning assumptions** | • The key planning assumptions include income, inflation, the Council's asset base and how these help deliver strategic priorities and service needs. Expected levels of council tax inflation and central government funding are adequately addressed. Council tax is frozen for 2013-14 and 2014-15.<br>• The key financial risks are identified in the plan for 2013-14 and properly addressed. These are set out as:<br>- outturn spending against the budget;<br>- increasing demand for services;<br>- flexibility in general reserve levels;<br>- reducing government grants;<br>- movement towards local funding for local services; and<br>- inflationary pressures.<br>• However at the end of quarter one 2013-14 outturn is already showing budget pressure of £7.5m. Corrective action is already in place to address £4.3m of this pressure. The most recent forecast for 2013-14 is an overspend of £3.7m. The Council will have to continue to closely monitor performance and redress the shortfall during the remainder of 2013-14. | Green |

# Strategic Financial Planning

## Medium Term Financial Strategy

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Scope of the MTFP and links to annual planning** | • The MTFP is the over-arching strategy of the Council which fits into other strategies and business plans. The business challenge process has continued to develop during 2012-13. It encourages radical thinking and challenges service delivery and alternative ways of working including collaborative working. This process must continue to develop and become fully embedded in 2013-14.<br>• The MTFP and budget for 2013-14 adequately reflect the Council's proposals after consideration of all relevant information. However the MTFP identifies budget shortfalls of £8.3m in 2014-15 and £14.1m in 2015-16. Again, this will require members to take difficult decisions to agree a balanced budget at the same time as moving towards the new operating model.<br>• Significant progress was made during 2012-13 to enable informed transparent decision making which are subject to appropriate scrutiny and risk management using the Gateway model. The model was introduced in August 2012 to provide overall assurance and controlled start up of major projects. This was in part a response to address criticisms around business planning and governance arrangements reported in 2012. The Gateway process is made up of the new Executive Management Board (EMB) and Technical Enabler Group (TEG). Monthly meetings of these groups are held to review, challenge and endorse all new major projects and programmes. EMB also oversees the monthly monitoring of major projects and programmes to ensure the objectives of capital projects are consistent with the Council's MTFP and its strategic objectives.<br>• The Council experienced significant management turnover during 2012-13. It is now completing a comprehensive re-struture expected to improve efficiency and cut costs. The revised structure is an important element of the Council's vision to become a commissioning authority in the medium term.<br>• It has already started to create arms length bodies to deliver some services. These include a development company , waste, leisure and bereavement services. In December 2012 the Council also set up a wholly owned company - Tatton Park Enterprises - to manage the park's catering services. Outsourcing of services follows the government's agenda but the Council must ensure that governance arrangements are in place to ensure the new bodies operate successfully. | Amber |
| **Review processes** | • An established review process is in place to update the MTFP each year. It is also kept under review in the light of changing circumstances. This is particularly relevant given the current financial pressures in funding from central government. The MTFP is monitored and reported to Members throughout the year.<br>• A revised budget setting process for 2014-15 onwards was approved by Council in July 2013. This recognises that the budget setting process for 2014-17 requires closer links to the Sustainable Community Strategy and Council Plan Priorities. | Green |
| **Responsiveness of the Plan** | • The MTFP is refreshed annually including financial risks and a detailed budget setting approach is agreed. The key financial risks to achieving the plan are clearly explained to Members. | Green |

1 Executive Summary
2 Key Indicators
3 Strategic Financial Planning
4 Financial Governance
5 Financial Control

Appendix - Key indicators of financial performance

# Financial Governance

**Key characteristics of effective financial governance**

In conducting our review of financial governance we have assessed the Council's performance against the following indicators:

**Understanding**

- There is a clear understanding of the financial environment the Council is operating within:
  - Regular reporting to Members. Reports include detail of action planning and variance analysis etc.
  - Actions have been taken to address key risk areas.
  - Officers and managers understand the financial implications of current and alternative policies, programmes and activities.

**Engagement**

- There is engagement with stakeholders including budget consultations.

**Monitoring and review**

- There are comprehensive policies and procedures in place for Members, Officers and budget holders which clearly outline responsibilities.
- Number of internal and external recommendations overdue for implementation.
- Committees and Cabinet regularly review performance and it is subject to appropriate levels of scrutiny.
- There are effective recovery plans in place (if required).

# Financial Governance

## Understanding and engagement

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Understanding the Financial Environment** | • The Executive Management Team monitor the financial position on a monthly basis. Executive members also maintain a strong focus on the financial position through the challenge process.<br>• Historically, the Council has a poor track record of delivering its budget without major variances. A number of improvements were made during 2012-13 to improve budget setting and in year monitoring and reporting. The revenue budget was achieved for 2012-13 with a small surplus.<br>• Members receive regular briefings and attend training days at which issues such as financial scenario planning, growth agenda issues and capital programming are considered. | Green |
| **Executive and Member Engagement** | • The level of senior management and member level engagement in the financial management process remains appropriate. Quarterly budget update reports are presented and debated at Council.<br>• The introduction of the Financial Resilience Update (FRU) for Cabinet in July 2013 is a significant step. The overall aim of the FRU is to support member decision making and help create a sustainable financial environment for the Council. The approach is intended to promote decisions that can make a valuable difference to residents in the medium and long term and place less focus on detailed day-to-day operational management. The intention is for the report to act as a guide at the start of the planning process and then be reviewed periodically to include updated plans and reports. New charts and data can be added as members become more engaged with the process.<br>• The Audit and Governance Committee provides adequate challenge. However, the committee needs to focus on its terms of reference and ensure that its agendas and discussions reflect its responsibilities. A new Chair of the Audit and Governance Committee takes over in September 2013 – this provides a good opportunity to refresh the committees terms of reference and review its performance. | Green |

# Financial Governance

## Understanding and engagement

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Overview for controls over key cost categories** | • Budget reporting arrangements are in place for both revenue and capital in the form of quarterly performance reports during 2012-13.<br>• Variances to budget were identified in a timely way and clearly reported to the Executive. However, in year variances are typically too high which causes uncertainty and prevents effective control.<br>• The outturn for 2013-14 quarter one shows that services already face budget pressures totalling £7.5m, with identified remedial actions of £4.3m to mitigate these issues. Realistic forecasting is essential if the Council is to keep control over key cost categories.<br>• The Council's 2011-12 VFM conclusion was qualified because its processes to develop business proposals and manage significant projects needed to be improved. A lot of progress has been made since late 2012 including the introduction of the gateway process.<br>• Good progress is also being made to improve the Council's performance management framework including a proposed suite of indicators. The latest proposals were shared with the Corporate Leadership Board in September 2013. | Amber |
| **Budget reporting: revenue and capital** | • While in-year financial forecasting is improving it remained unreliable for much of the year. At 31 December 2012 the Council reported an expected revenue budget overspend of £6.8m with services reporting emerging pressures of £21.5m. At that stage remedial action to mitigate these pressures totalled £14.7m.<br>• In the final quarter of the year the Council addressed its budget pressures and managed its outturn position to report a small surplus of £300,000 against its revenue budget of £239m. The final position was also helped by some additional income particularly within the adults service (health contribution for complex care £0.5m, winter pressures £0.5m, re-ablement funding £0.5m) and within corporate services (benefits subsidy £0.5m). In quarter three, the Council recognised that this additional income was likely but remained prudent by not recognising it until it was secured. The Council needs to forecast more accurately and plan for revenue streams rather than rely on late solutions.<br>• In-year capital spending was £51.4m, representing a £23.3m underspend compared to the revised capital programme approved by the Council on 13 December 2012. The Council needs to more accurately identify and agree capital schemes and agree a realistic capital budget. Good progress is now being made through the use of the gateway approval process.<br>• Whilst the Council has a strong outward focus and considers some external performance data, it needs to demonstrate a more robust use of national benchmarking information. This is developing in 2013/14 with the Financial Resilience Update which provides better information to members in terms of key financial indicators and benchmark data. This reporting suite will be further embedded and developed during 2013-14. | Amber |

# Financial Governance

## Understanding and engagement

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Adequacy of other committee reporting** | • Overall the Council has satisfactory reporting arrangements in place. The new Financial Resilience updates will provide better information to members including key financial health indicators and improved benchmark data.<br>• There have been instances in previous years relating to the adequacy and transparency of Council decision making, especially in relation to the Lyme Green waste transfer station. Whilst the Council's decision making processes have improved, there remains a need to ensure the approach is clear, transparent and subject to appropriate scrutiny, challenge and review - and be seen to be so. | Amber |
| **Monitoring and review** | • Following governance failings reported by internal audit, the Council's previous auditor and the designated independent person's (DIP) review of Lyme Green there have been a number of changes in senior staff. The timing of these changes meant that three of the Council's most senior officers were interim appointments for large parts of 2012-13. Under the leadership of the interim Chief Executive the management team have made good progress to address the reported issues.<br>• The Council has a significant number of corporate policies and procedures not all of which are fully understood and embedded across the Council. These have now been mapped by the Corporate Governance Group. It remains important that compliance with these polices and procedures is properly monitored and reviewed to ensure that they are followed and also that they remain appropriate during the Council's transition to its new operating model.<br>• The Council's governance framework continues to develop to enhance cabinet members' roles in decision making and support new scrutiny arrangements and policy development groups. The annual governance statement for 2012-13 recognises the weaknesses in the Council's organisational culture which have sometimes caused confusion, poor decision making, and inefficiency. The new structure is an important part of addressing these issues. | Amber |

1 Executive Summary
2 Key Indicators
3 Strategic Financial Planning
4 Financial Governance
**5 Financial Control**

Appendix - Key indicators of financial performance

# Financial Control

## Key characteristics of effective financial control

In conducting our review of financial control we have assessed the Council's performance against the following indicators:

**Budget setting and budget monitoring**

- Budgets are robust and prepared in a timely fashion.
- Budgets are monitored at an officer, member and Cabinet level and officers are held accountable for budgetary performance.
- Financial forecasting is well-developed and forecasts are subject to regular review.

**Savings Plans**

- Processes for identifying, delivering and monitoring savings plan schemes are robust, well thought through and effective.

**Financial Systems**

- Key financial systems have received satisfactory reports from internal and external audit.
- Financial systems are adequate for future needs.

**Finance Department**

- The capacity and capability of the Finance Department is fit for purpose.

**Internal Control**

- There is an effective internal audit which has the proper profile within the organisation. Agreed Internal Audit recommendations are routinely implemented in a timely manner.
- There is a an assurance framework in place which is used effectively by the Council and business risks are managed and controlled.

# Financial Control

## Internal arrangements

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Budget setting and monitoring - revenue and capital** | • The Council has well established budget setting processes that encourage ownership from budget holders. Training is also provided to officers and members.<br>• In year forecasting is improving. The Council has consistently reported significant variances against budget including Q1 of 2013-14. The net underspend for 2012-13 was £300,000 compared to the forecast overspend of £6.8m at the end of quarter 3. The net overspend for 2011-12 was £8.2m. Proper understanding of budgets and costs will become increasingly important if/when budgets are devolved to new providers.<br>• The Budget setting process for 2013-17 should improve following the introduction of revised arrangements agreed by Council in July 2013. This reflects the changes brought in by the interim senior management team and on-going review of the Council's structures as it moves towards its new operating model, whilst recognising a potential funding shortfall of £35m over the three year period. The Council recognised that the budget setting process needed more closely aligning to the resource allocation requirements to deliver the Sustainable Community Strategy and Council Plan Priorities. The revised arrangements include the new project management framework, wider member involvement and increased transparency and availability of information. In addition, the preparation deadline for large project business cases is now extended from September to October to allow more time to test proposals. | Amber |
| **Performance against Savings Plans** | • In addition to delivering a small surplus in 2012-13 the Council made its planned contribution of £7.6m to reserves.<br>• The Council originally budgeted to generate savings of £21.7m during 2012-13 to achieve a balanced budget. This was achieved but required savings of £22.4m through a mixture of corrective measures in quarter four and additional income streams.<br>• The Council is increasingly making use of financial health indicators to monitor its performance and developing key financial ratios.<br>• The Council's year on year savings plans are incorporated into the budget. There is no reported performance against the savings plans, only against overall budget. This makes it harder to identify where savings are being made. | Amber |
| **Key Financial Accounting Systems** | • The Council has an effective in-house Internal Audit function which undertakes a comprehensive programme of work including reviewing the Council's key financial systems. For 2012-13 Internal Audit concluded that the Council has in place a satisfactory framework of governance and internal control which provides reasonable assurance regarding the economic, efficient and effective achievement of its objectives.<br>• No significant issues were identified by Internal Audit on the operation of critical financial systems during the year. | Green |

# Financial Control

## Internal and external assurances

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Finance Department Resourcing** | • In 2012-13 The Corporate Finance Team comprised 14.8 FTE, and was fully staffed throughout the year. Five members of the team are professionally qualified and a further three are part qualified/studying. Nine members of the team have completed the Accountancy Technician qualification or equivalent.<br>• The staff resourcing in the Council's Finance Department is stable and the turnover is low. External audit interaction with the Finance Department indicates they are both competent and experienced. The Finance Department has specialised skills in areas including, capital and financial planning. | Green |
| **Internal audit arrangements** | • The Council has an in-house Internal Audit service of 11 staff (9.2 FTE) which is well respected within the Council.<br>• Of the 11 Internal Audit staff five are fully qualified. Two staff also have the CIPFA Diploma in Public Audit.<br>• A comprehensive risk based Internal Audit Plan is developed each year after consultation, including with external audit.<br>• External audit work has confirmed that Internal Audit meets the CIPFA Code of Practice requirements.<br>• The Head of Internal Audit post has remained unfilled since July 2011. The Council's Management Review Phase 2 has resulted in one 'Internal Audit Manager' post (which formally has the roles and responsibilities of a Head of IA), although the process and consultation period is still on-going.<br>• The Internal Audit service continues to provide an independent and satisfactory service to the Council. | Green |
| **External audit arrangements** | • Grant Thornton UK LLP became the Council's external auditors from November 2012.<br>• There were significant concerns raised in the 2011/12 Annual Governance Report and Annual Audit Letter , primarily around the VFM conclusion - an "except for" opinion around securing economy, efficiency and effectiveness. This was due to inadequate processes at the Council to develop business proposals and manage significant projects.<br>• There were no significant issues included in the external audit interim report issued in March 2013. Management have responded to the issues raised in the Audit Commission's 2011-12 audit report and annual audit letter, although it is recognised that some of the improvements will take time to embed. | Green |

# Financial Control

## Internal and external assurances

| Area of focus | Summary observations | Assessment |
|---|---|---|
| **Assurance framework/risk management** | • The Council has risk management arrangements in place and reports to Members.<br>• The 2014-17 MTFP shows a good understanding of the financial implications of risks facing the Council at the planning stage.<br>• The financial implication of risks are also considered as part of the process for risk assessing the adequacy of general reserves.<br>• However the financial outturn for 2013/14 quarter one already shows that Services face budget pressures totalling £7.5m, with identified remedial actions of only £4.3m to mitigate these issues.<br>• Realistic forecasting is essential if the Council is to keep control over key cost categories. The pattern in 2012-13 was to report adverse budget variances throughout the year with late remedial measures introduced in Q4 to address the risks and achieve financial balance. | Amber |

1 Executive Summary
2 Key Indicators
3 Strategic Financial Planning
4 Financial Governance
5 Financial Control

Appendix - Key indicators of financial performance

# Key Indicators of Financial Performance

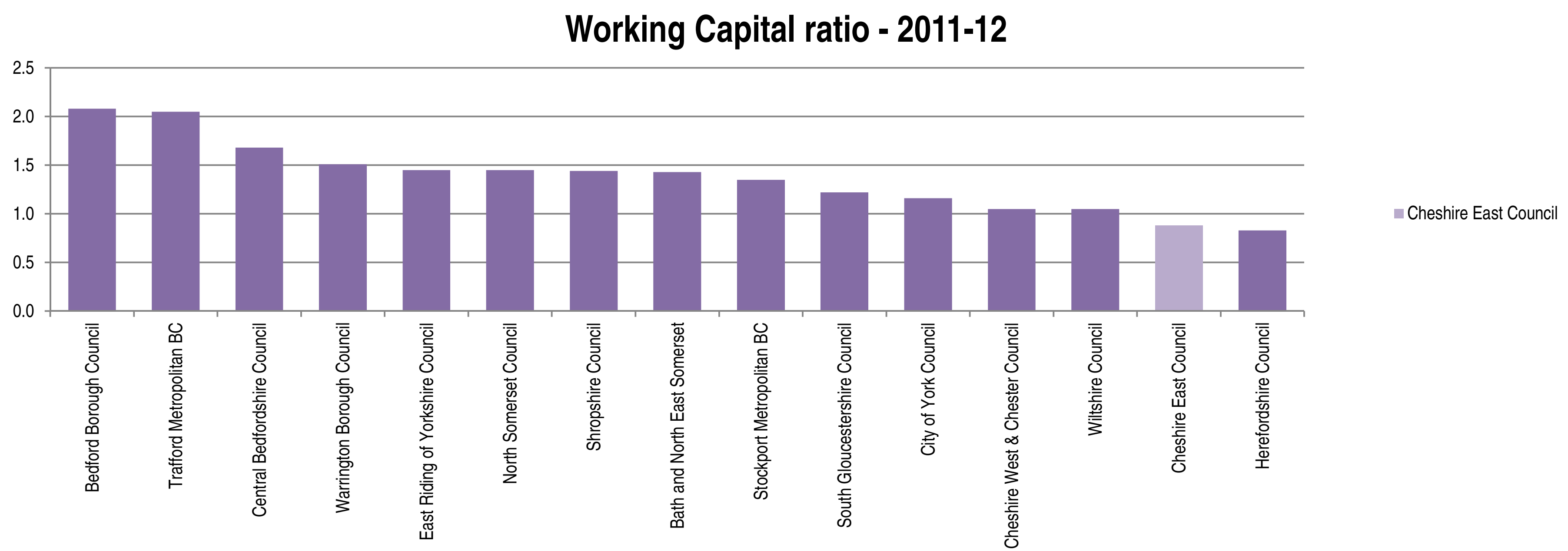
## Working Capital Ratio – 2011/2012

### Definition

The working capital ratio indicates if an authority has enough current assets, or resources, to cover its immediate liabilities - i.e. those liabilities to be met over the next twelve month period. A ratio of less than one - i.e. current liabilities exceed current assets - indicates potential liquidity problems. It should be noted that a high working capital ratio isn't always a good thing; it could indicate that an authority is not effectively investing its excess cash.

### Findings

The Council's 2011-12 working capital ratio is 0.88. The Council had the second lowest working capital ratio in the benchmarking group for 2011-12.



# Key Indicators of Financial Performance

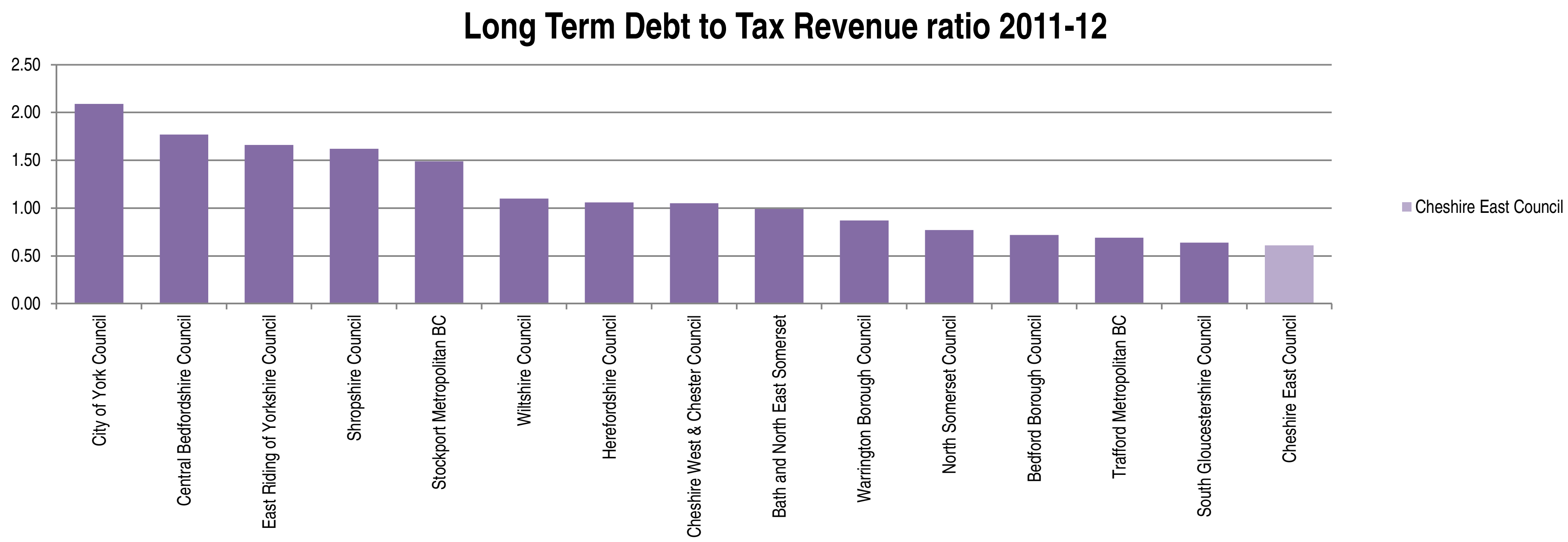
## Long Term Borrowing to Tax Ratio – 2011/2012

### Definition

Shows long tem borrowing as a share of tax revenue. A ratio of more than one means that long term borrowing exceeds council tax revenue.

### Findings

The Council's 2011-12 long term borrowing ratio as a proportion of tax revenue is 0.61 placing the Council as the lowest of its benchmarked group.



# Key Indicators of Financial Performance

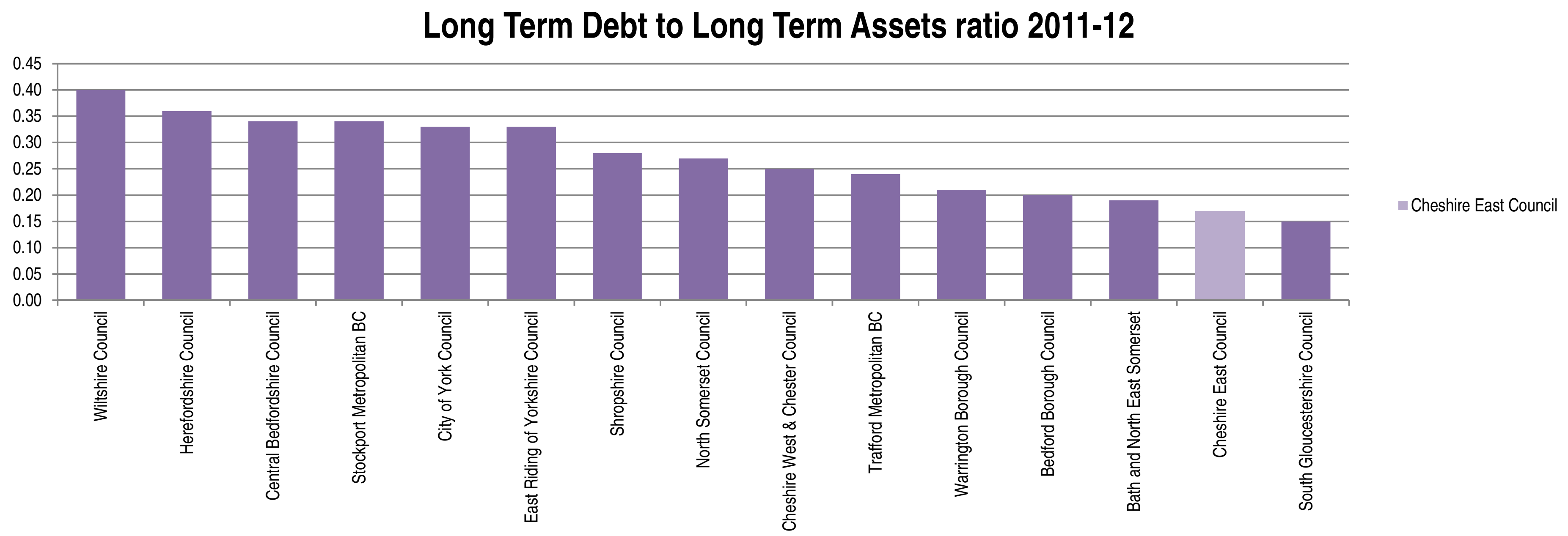
## Long Term Borrowing to Long Term Assets – 2011/2012

### Definition

This ratio shows long tem borrowing as a share of long term assets. A ratio of more than one means that long term borrowing exceeds the value of long term assets.

### Findings

The Council's 2011-12 long term borrowing to long term assets ratio is 0.17. The Council's ratio is the second lowest of the benchmarked group.



# Key Indicators of Financial Performance

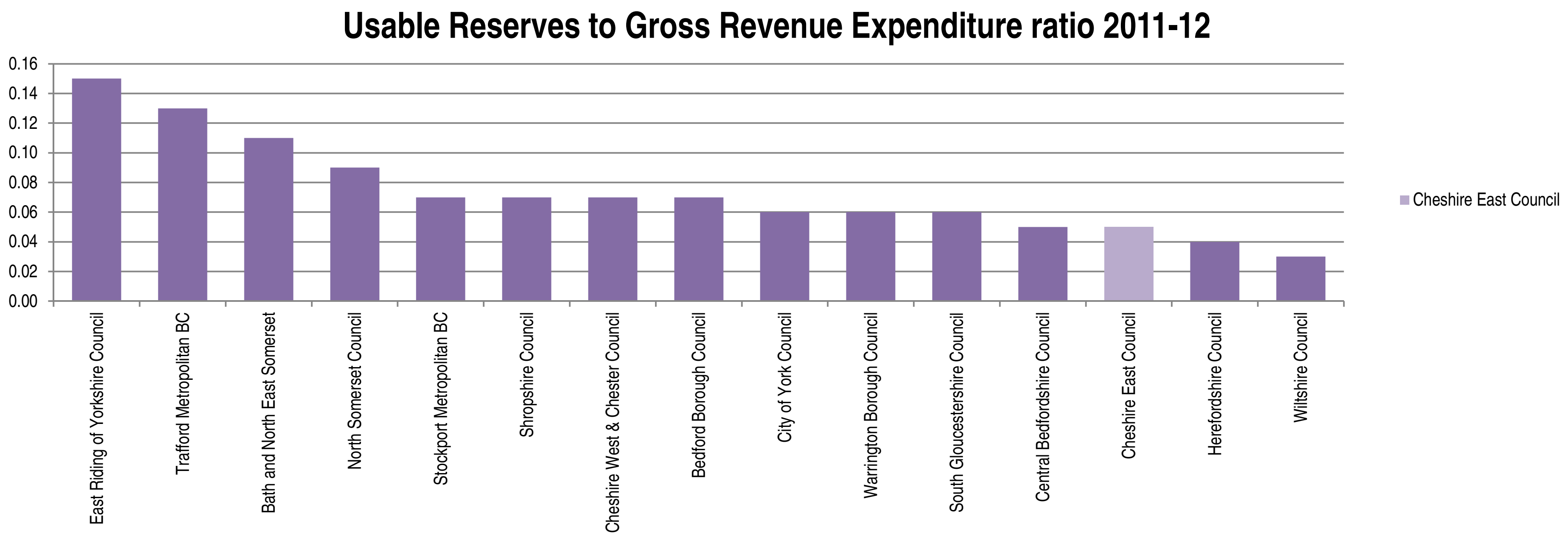
## Usable Reserves to Gross Revenue Expenditure – 2011/2012

### Definition

This ratio shows the Council's reserves which are available for use as a proportion of gross revenue expenditure. A higher ratio indicates the Council has a greater ability to fund expenditure from available reserves.

### Findings

The Council's 2011-12 usable reserves to gross revenue expenditure total 0.05, at the third lowest of the benchmarked group.



# Key Indicators of Financial Performance

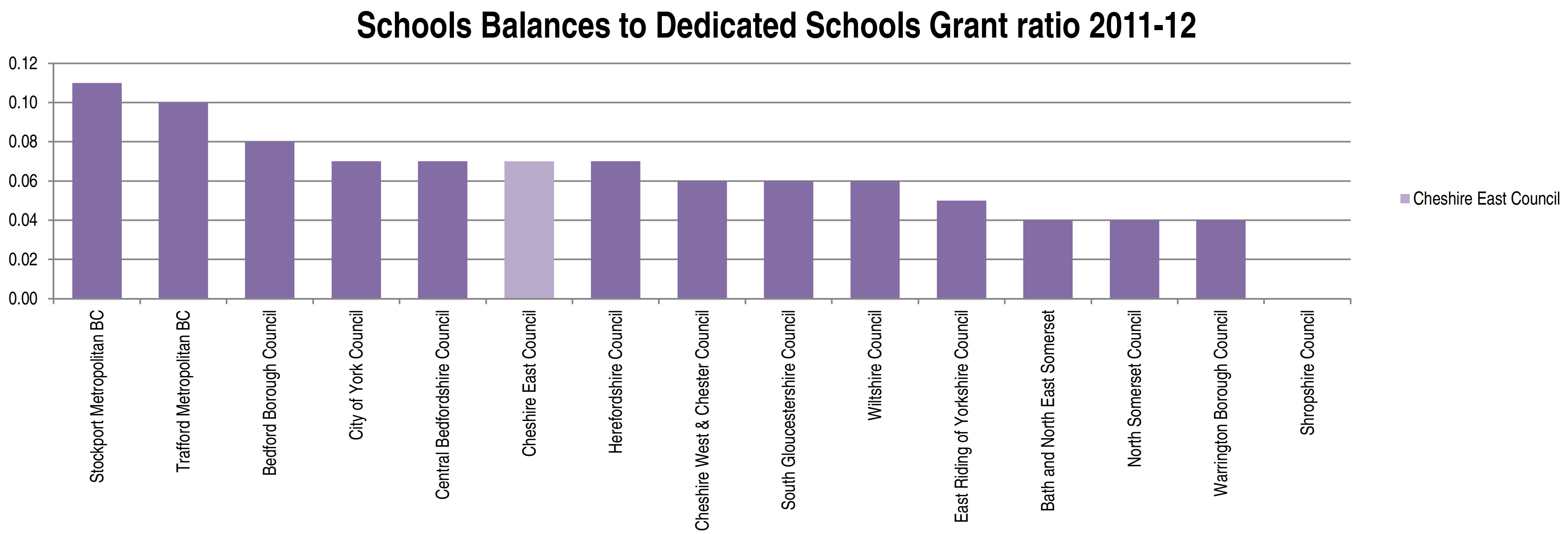
## Schools Balances to Dedicated Schools Grant – 2011/2012

### Definition

This shows the share of schools balances in relation to the total DSG allocation received for the year. For example a ratio of 0.02 means that 2 per cent of the total DSG allocation remained unspent at the end of the year.

### Findings

The level of the Council's 2011-12 schools balances to DSG is 0.07, broadly at the midpoint of the benchmarked group.



Grant Thornton



**grant-thornton.co.uk**