

\ Discussion document: Local Government financial resilience in Wales

July 2017

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1. Introduction and context

- 1.1** Unprecedented spending cuts, challenging settlements, ballooning demand and political change at a national and local level have seen strategic priorities change rapidly in the public sector. The impact of the political and economic environment has hit local authorities and consequentially it's finance departments and hard.
- 1.2** For nearly a decade, public financial management has been built on an ever changing base of funding and service demands. The finance departments and directors of finance have a key role in supporting organisations in their responsibility to keep services, on which so many people depend, properly resourced in an environment that is hardly conducive to medium and long-term planning.
- 1.3** Wales has and continues to see local authorities strive to achieve increasingly challenging revenue support grant settlements. This is in an environment where annual settlements are seen as a block to robust medium and long term financial planning and a tendency to resolving immediate short term issues which could potentially be at the expense of longer term benefit.
- 1.4** The local government elections in May saw many council's political balance and composition change. In some cases more than 50% of councillors are new and in a number of cases authorities have a new cabinet in place (new in composition and with new councillors). Councillors face difficult decisions on core service provision which may account for many experienced ones having stepped down.
- 1.5** The financial climate and service demands will mean resource utilisation will face greater scrutiny and a need for much greater self-awareness of financial management and financial governance arrangements. This applies across the organisations departments and at a political and officer level.
- 1.6** All authorities in Wales are facing severe financial challenge. Some are in a better position to respond than others. We have authorities with no reserves, others managing to grow reserves, service pressures are well documented in social care and children's services, though schools delegated budgets are emerging as a high risk area. With each authority there are different approaches to considering issues around financial sustainability in the longer term and seeing the bigger picture when making decisions.
- 1.7** Today, and for the foreseeable future uncertainty marks almost every external factor that affects the finances of public sector organisations. Therefore, it is more important than ever that elected members, executives and directors have a robust awareness of their organisations financial management arrangements, procedures and capability and are on top of all that they do control. **This is the key to developing and ensuring continual financial resilience.**

- 1.8** CIPFA continues to work with the public sector on financial resilience through two main activities:
- The CIPFA Financial management model and;
 - Finance resilience reviews

2. Local authority understanding

2.1 Longer term financial scenario(s)

Settlements are and will become increasingly more challenging. The opportunity for making savings and introducing efficiencies with quick or easy actions has now effectively ended. To achieve savings difficult decisions around core services will need to be made by authorities. To achieve this it is essential that there is sound financial management and governance built on robust systems and processes – where reliance on information and advice is central. Financial management will need to be more responsive, accurate, realistic and mindful of the longer term. The ability to use reserves or technical accounting mechanisms such as MRP (minimum revenue provision) will rapidly disappear. Understanding the strengths and weaknesses within the organisations financial management system are crucial in supporting future direction.

2.2 Role of finance & finance transformation

For the chief finance officer (CFO, s151), the quality of financial challenge in departmental forecasts regarding pressures and likely savings is crucial. The wider finance team also need to adopt the responsibility of constructive challenge on the part of the CFO and a key warning sign that plans could fail is a lack of process and feedback to the CFO on the findings from such challenges.

A core skill for chief financial officers is the ability to talk to the political leadership and senior service colleagues about what is and is not possible. Members need openness, honesty and clarity. Hyperbole about difficulties and crises does not help them make decisions and what politicians actually need is hard-edged analysis, options and advice, supported by evidence.

Financial reports to Members should be models of clarity, and contain sufficient detail for robust discussion and challenge. Significant items should be separated out rather than lumped together, and context needs to be provided for estimates and projections.

It is evident that in some authorities that the role, value and activity of finance and that of the s151 officer is neither appropriate nor adequate to support the organisational financial challenge ahead.

Gaining a clear view of the organisations financial management arrangements provides an opportunity to evaluate opportunities, strengths, weaknesses and design through transformation a new operating model for finance, its role and relationships with departments, stakeholders and elected members.

2.3 Savings and efficiency plans and opportunities

These are a key element of achieving financial balance and are prepared as part of the budget setting process.

The process for agreeing these, challenging risk and potential success falls to officers and councillors alike. It is evident that whilst planning is improving the move to potential service change and difficult decisions will make the process more difficult.

Plans will need to be assessed on a regular and realistic basis with contingencies in place on a risk basis. Councillors challenge through pre and post decision scrutiny and continual monitoring by scrutiny and service committees in an effective manner is vital. Understanding how well this is operating and managed is a fundamental element of financial sustainability awareness.

2.4 Organisational awareness of current position

It is essential that the organisation has an overall view of its financial position now and forecast in to the future. Tied in to this is a good self-awareness of the strengths and weaknesses of the system of financial management and governance. This is not just the responsibility of the finance team but the whole organisation on a corporate basis.

Many organisations have segmented views of capability and the financial picture, based on services or subservice level. This can lead to poor financial management and 'parochial accounting' where teams are only concerned about their own area. Action to remove this can lead to collective efficiencies, improved financial management and ultimately better financial planning and control.

Awareness of the overall position is essential and allows action to improve and develop better practice. Undertaking a review with the FM Model and with a financial resilience approach will provide that platform for understanding and action.

2.5 The Well Being of Future Generations (WFG) Act 2016

A key element of this act is the sustainability of services in line with desired outcomes. The processes in place to meet the Acts requirements are audited and assessed. Understanding and financial sustainability with robust procedures will support the Act and its aims.

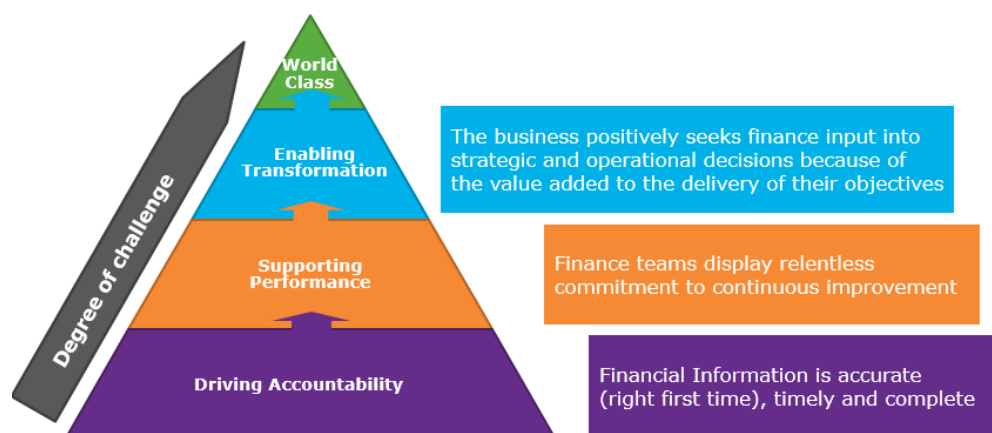
3. Direction of travel (what is needed?)

- 3.1** Given the current service demand environment, financial position of organisations and the future economic outlook effective financial management and governance is crucial.
- 3.2** The role of finance in decision making, financial reporting and establishing a sound financial platform is central to organisations having both an understanding of financial and service sustainability and also ensuring process and systems support effective governance.
- 3.3** Organisations need to have a clear understanding of the quality and capability of their financial management and governance arrangements in place. Being clear on strengths, weaknesses and ways to improve and strengthen operational arrangements.
- 3.4** Finance function transformation needs to develop in many organisations and establishing current arrangements at a corporate level will help determine directions and strategy. Finance needs to move away from transactional and reflective support, which can in many cases be automated to decision support, strategy and guidance. To do this there does need to confidence in authority wide financial management.
- 3.5** As a first step undertaking the **Financial Management Model** review establishes the current position, good and not so good and a direction for improvement.
- 3.6** Secondly where organisations consider financial sustainability is a potential issue, undertaking a **Financial Resilience Study** will give a clear view of the risks and actions that need to be taken.
- 3.7** These two techniques apply to authorities individually, gaining a view and plan to improve. When this evidence is combined over a number of organisations it will present a wider more economy based view. This can contribute to thinking on consistent issues and risks allowing for action collectively through training and development of officers, members and system improvement.
- 3.8** An economy wide view will also support thinking on how to ensure there is capacity and capability in key areas relating to financial management and whether there are options to develop alternate ways of working, intellectual shared services and learning or sharing better practice.
- 3.9** An additional benefit is the development of finance within organisations ensuring it adds value and positioned strategically within the authority.

4. Financial management model

- 4.1** CIPFA's Financial Management Model (FM Model) can help drive effective performance in financial management throughout an organisation. It uses an internationally recognised framework and diagnostic tool, enabling organisations to self-assess their financial management against world class financial management best practices in the public sector in order to optimise systems, processes, resources, compliance and reporting.
- 4.2** The FM Model will help organisation identify or substantiate weaknesses (as well as confirm strengths) and then help develop and implement a target-driven improvement plan allowing progress to be closely tracked and measured.
- 4.3** The FM Model measures the strengths and weaknesses across the whole of an organisation including areas such as processes, people, leadership and stakeholders.
- It will benchmark your organisation's financial management against best practice.
 - It raises effectiveness and confidence in stewardship, performance and ability to implement change.
 - It focuses on financial management capability across the whole organisation and helps pinpoint priorities for change.
 - The framework fully reflects today's public sector, with the very latest developments and opportunities such as business partnering, commercialism, procurement, governance and the role of the CFO and finance within an organisation.
- 4.4** The model;

Best Practice Financial Management



1. **Enabling transformation:** the finance team have input into strategic and operational plans taking into account proactive risk management, clear strategic directions and focus-based outcomes.
2. **Supporting performance:** finance teams are actively committed to continuous improvement focused on efficient and effective delivery and organisational performance.
3. **Delivering Accountability:** financial information is accurate, timely and focusses on controls, probity, compliance and accountability.

4.5 The FM model includes a powerful online assessment tool for flexible, convenient self-assessment over a series of statements focused on Leadership, Process, People and Stakeholders. Each of these are measured against the pillars of good financial management outlined above.

4.6 Measurement is based on a series of statements. A score is determined for each statement. Each statement has a number of supporting questions and then these are used to assist in the scoring process. The process is supported by an Online Diagnostic tool to undertake the assessment based on gathering evidence.

4.7 Evidence is collected from document reviews, interviews and through an online survey. Whilst the exercise can be undertaken on a self-assessment basis utilising independent set up, scoring review and validation can assist in the exercise being objective and if applied to a number of organisations consistency – allowing subsequent identification and interpretation of wider issues.

4.8 The model will produce a dashboard, similar to that below, which rates each of the areas and the report produced will indicate the reasons for the score and remedial action necessary.

Master Survey Score Matrix				
Financial Management Styles	Management Dimensions			
	Leadership	People	Processes	Stakeholders
Delivering Accountability	3	2.3	2.8	3.5
Supporting Performance	3	3	2.4	2.5
Enabling Transformation	2.5	2	1.5	2.5

- 4.9** An example of a report extract for two questions is shown below. The yellow highlighted areas indicate where the assessor or moderator can add comments to support the conclusion or actions necessary. Again using an independent assessor and moderator for review will add value to the process and support the independent review concept.

3.10 People – delivering accountability

Delivering Accountability	P1	The organisation identifies its financial competency needs and puts arrangements in place to meet them.	1.5
	P2	The organisation has access to sufficient financial skills to meet its business needs.	3.0

For the Delivering Accountability style these two statements cover the financial competencies required by the organisation and the skills that match these needs..

In formulating the narrative here, the assessor may wish to refer to the Master Scoring Report.

3.11 People – supporting performance

Supporting Performance	P3	The organisation manages its finance function to ensure efficiency and effectiveness.	2.5
	P4	Finance staff provide business partner support by interpreting and explaining performance as well as advising and supporting on key business decisions.	4.0
	P5	Managers understand they are responsible for delivering services cost effectively and are held accountable for doing so. Financial literacy is diffused throughout the organisation so that decision takers understand and manage the financial implications of their decisions.	2.5

The three performance related statements cover the assessment of the effectiveness of the finance function, finance support on key decisions, the enforcement of accountability and the degree of diffused financial management.

In formulating the narrative here, the assessor may wish to refer to the Master Scoring Report.

- 4.10** As indicated above the FM model can be a self-assessment tool. Given the nature of the exercise having independent support in designing the implementation, validation of results and overarching commentary would give the project additional weight and credibility.

5. Finance resilience reviews

- 5.1** The nature and scale of all the financial risk facing local government will not be uniform and local history and local circumstances will mean some authorities have a relatively more or less challenging local context to deal with. Despite the differences it is safe to generalise that the best local budget plans are those owned and articulated by the whole council and its senior leadership, not simply the CFO. Those plans will include cost drivers and income sources, risks and how the authority will deliver a balanced budget and savings.

5.2 Delivering a robust budget is an organisational responsibility and failure to do so points to wider failures within the Council. If a council finds it necessary to impose a voluntary spending freeze, or indeed if the situation is so serious that the CFO issues a Section 114 report, this must be seen as taking the correct steps needed to maintain the financial control expected by statute. Unlike other parts of the public sector, councils cannot borrow to fund revenue spending and it is not permissible to run a deficit where spending exceeds the budget and resources.

5.3 In recent years, Councils will have exhausted all 'the low hanging fruit' of actions and even those have longer term unintended consequences. In addition, service demands and expectations continue to grow but with income sources not aligning automatically which is especially so in times of austerity.

As a result, there could be financial failure in some Councils. CIPFA see this new product as vital in helping avoid, if at all possible, but we expect most councils will wish to gain an expert opinion on their current financial resilience. CIPFA will use its members, assets and partners to do just that through its new product – The Financial Resilience Advisory Report. A report based on experienced professional insight, typically from experienced CFOs but coupled with CIPFA's unique range of diagnostic tools.

5.4 Recent work has highlighted five warning signs of financial stress and for authorities to build resilience on all aspects of planning and operations to mitigate these. The five signs are:

- A rapid decline in reserves - using reserves to avoid cuts will only provide temporary relief.
- A failure to plan and deliver savings in service provision - so that councils are not living within their resources.
- Shortening of medium-term financial planning – a failure to plan ahead could indicate a lack of strategic thinking and an unwillingness to confront tough decisions.
- Firm objectives missing from savings plan – such as a saving plan with 'still to be found' gaps or consisting of targets rather than robust plans; this may also include a tendency for over optimism in timing and scale of savings.
- Tendency for unplanned overspends – carrying forward undelivered savings into the following year only creates the need for greater cuts in subsequent years.

5.5 CIPFA's report has 6 tests as part of its methodology which seek assurance that medium term financial planning is effective:

- Information – is it good quality, timely data, modelling and analysis
- Investment – that authorities are utilising tangible and intangible assets to create investment, growth and the development and delivery of strategy and policy objectives

- Revenue – that there is a maximisation tax yield and income
- Pressures – that the authority is mitigating pressures and future liabilities
- People & Governance – that there is capable, focused, and effective leadership that makes the decisions needed for strong stewardship, performance and transformation
- Plan – there is a compelling and credible savings or transformation plan that balances the budget and aligns with MTFS.

5.6 A number of pre review document studies are undertaken in support of the diagnostics but also to inform the fieldwork on site, there includes a review of the Council's key documents including:

- Medium term Financial Plan including capital and revenue
- Medium term savings and growth plan
- Treasury management strategy
- Planned medium term use of usable reserves, split between earmarked and non-earmarked, and change over the preceding three years
- The most recent budget report and description of budget process
- Recent monitoring reports and recent out-turn reports and accounts
- Asset Management Plan
- Key Governance documents; Annual Governance Statement, risk register, etc.

5.7 The process includes on site interviews with senior staff, elected members and stakeholders. These are conducted on site by the reviewers, usually over 3 days. It tests the question: does there appear to be a credible plan and planning process that gives confidence that this Council can deliver a sustainable budget over the medium term. It includes a focus on the quality and credibility of the savings plan and it tests issues raised by the background pre-report diagnostics and pre report review of key documents.

These discussion can incorporate expert capabilities if needed to explore integration plans or for example, use of the specific funding routes, initiatives and the alignment of s25 or s75 agreements to medium term financial plans to ascertain any potential risks.

5.8 A number of diagnostics exercises and tests are conducted in advance of the site visit, CIPFA will undertake a number of pre-visit diagnostics to inform the work on site and subsequent Resilience Report as follows:

- Costs & funding diagnostic – with the aim of identifying outlier benchmark data for both spend and statutory income sources.
- Local income generation diagnostic – to help ensure that you maximise your commercial income and trading opportunities.
- Balance sheet diagnostic - to understand the policy intentions of managing assets and liabilities and testing assumptions.

- 5.9** At the conclusion there will be a report with key learning points. The Report features is fast and responsive and an initial report will be produced within 10 days. It is based on experience and insight including the evidence around the six-test methodology. It is objective and frank, it is grounded in the difficult choices councils are having to undertake. The report will have recommendations to suggest key actions for the council, especially in relation to medium term opportunities and any short term areas of focus.

A key element of the report will be the learning and ongoing development of the organisation which will be in a number of ways.

CIPFA will take a continuous improvement approach to this process which will include anonymous feedback on process and added value to relevant and agreed bodies such as SWT and the WLGA. A matrix of key findings and most helpful pointers maintained for subsequent reviews and feedback to the sector which will be included in insight reports to support the wider sector. Future research commissioned with an academic partner to test the ongoing resilience/confidence of the sector to balance its budgets as awareness and knowledge develops.

6. Suggested approach & journey & benefits / value

6.1 Current findings

Over the last 18 months it has become evident that authorities financial resilience is suffering and presenting risks, demonstrated by reducing reserves, challenging savings plans, school deficits and short term decisions on resource allocations.

The issue is recognised as significant by chief financial officers, politicians, Welsh Government and the WLGA; the risk to organisational sustainability is increasing.

It is timely to have a clear view of the current condition of financial management and governance and take action to respond.

6.2 Tranche 1 of local authorities

The current financial position of authorities across Wales varies as does the awareness, process and systems supporting financial governance.

As a start it would be prudent to work with a proportion of the 22 local authorities to improve understanding and develop plans for a move to world class financial management.

Current discussions between CIPFA and the WLGA indicate an initial six local authorities should be selected. During recent conversations with chief finance officers all those met would be willing to receive support via CIPFA and the WLGA, also recognising that local input and support is necessary.

A pilot set of organisations will be selected based those most challenged and agreed between the organisation and WLGA. A second tranche would then be considered.

6.3 FM model and FRR

Following discussions the use of the FM model combined with key elements of the Financial Resilience Report is the most effective approach to follow. This would be delivered by CIPFA with support from the WLGA as appropriate.

This will provide the following benefits:

- A two year software licence for the FM model meaning after the initial review undertaken with CIPFA the authority can repeat itself if required to assess improvement and progress.
- CIPFA will support the design and implementation of the FM model for each authority ensuring it responds to local issues and challenges and crucially providing an independent input.
- CIPFA will support the running of the FM model acting as a support and also a moderator on responses, again adding independence.
- Should resources within the individual authorities be limited CIPFA can manage the whole process.
- Where there is an early indication that there are critical issues we will introduce elements of the Financial Resilience Report to allow immediate remedial action. The two projects in this respect would run together meaning no duplication of effort – particularly when interviewing and reviewing documents.
- At the conclusion of the model and / or resilience report a comprehensive report will be produced and findings fed back to the authority. This presents an unbiased independent position statement and supporting action plan.

6.4 Individual and collective view

Each of the authorities programmes are individual and tailored to each organisation and may well operate in differing areas which is entirely appropriate.

One benefit of extending the FM model across a number of organisations is the identification of key messages, issues and solutions. At the conclusion of the first tranche CIPFA provide a commentary on findings, risk and suggestions around direction of travel.

6.5 Shared learning / lessons / development

The collective intelligence from the first tranche on issues, risks and solutions can provide a basis for development and learning whether on technical, governance or indeed on finance transformation.

Support to the authorities would be available if required through training and development on areas requiring attention and the direction of finance. This could be on a collective (or individual authority) basis with the design of programme of learning events and specific workshops supported by the WLGA and Society of Welsh Treasurers.

7. Delivery

7.1 FM Model

A typical project plan for the FM model would be as follows:

Stage	Task/Process	Timescales
1	Initiation & Engagement	Sept
2	Documentation Review	Sept / Oct
3	Electronic Survey	Oct
4	Interviews	Sept / Oct
5	Review of Evidence	Nov
6	Vision for Financial Management	Nov
7	Reporting	Dec

The initial conversations would cover the project delivery and the resources available within individual organisations.

7.2 Financial resilience report

Typically the process will take up to 15 days excluding any follow up work requested by the client. The aim as stated above is to produce an initial report within 10 days.

Where this process is being introduced following the start of the FM model the timetable would be rescheduled but the aim will always be to report as quickly as possible.

8. Investment

A license to the model is for 24 months is £4950 exc VAT for organisation, which as indicated earlier allows re-running of the model if required.

CIPFA will support organisations with part or all of the process and our consultancy. Our standard day rate is £950 exc VAT & T&S. Given the desired approach of introducing this to a number of organisations once the scale and scope of resources is established it would be our intention to discount this rate and price as a package presenting economies.

Resources and capability within individual organisations would need establishing and support can be tailored to match requirements. Below is a typical scale of options (please note that this can vary depending on the size of individual organisations):

- Set up – 2-5 days
- Set up and help with some evidence gathering and reporting/validation – 15-20 days (to be confirmed at kick off meeting)
- Facilitation of whole process – 25-30 days

Additional costs would be incurred if the financial resilience report is also introduced but using the agreed day rate as covered above.

A final overarching report providing a summary of issues, risks and an approach to development would be included within the agreed project. Subsequent training and learning support would be an agreed additional cost.

9. Conclusions and next steps

The case for greater awareness, and strengthening financial management is clear. The next stage is to introduce a programme that will establish the current position and identify an approach and plan for the future to support financial sustainability.

This paper presents an approach that has been discussed over the last twelve months and is for consideration.