



London Borough of Merton

Report and recommendations arising from the scrutiny task group review of financial monitoring

Overview and Scrutiny Commission

February 2012

Task group membership

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Acknowledgements

The task group would particularly like to thank Caroline Holland, the Director of Corporate Services, for taking the time to provide the information sought and answer all our questions.

All contributors are listed in Appendix 1 and Appendix 2 of this report.

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Foreword by the Chair of the Task Group

I accepted the job of chairing this task group for two reasons: first, that it gave others on the group, more qualified than me, the freedom to put their views forward, present evidence and indulge in blue-sky thinking; second, that I genuinely believe that clearer financial reporting results in better decision-making and scrutiny, and hoped to drive us in that direction.

Did we achieve? In part. We all agreed the same ultimate vision – clarity and timeliness. We all acknowledged that the department has already made great strides towards these and understood the practical barriers to further improvement and the strategies for overcoming them, adding suggestions of our own. We were, though, constantly aware of the constraints on resources in the current climate, and the final report is tailored accordingly. Everyone around the table would have liked us to achieve more, and I am in no doubt that the issues will be revisited in years to come. In the meantime, reporting will become clearer and more training offered.

The task group was quick, focussed and intense. I would like to thank Councillor Allison, the Cabinet Member, and all my fellow panel members for making it happen. I would like to give particular thanks to Councillor Diane Neil Mills for her clarity of vision, and to Caroline Holland, who we cross-examined very thoroughly and who took it in her stride. Finally thanks to Julia Regan, who not only clerked the group but translated it into this excellent report.

Happy reading!

Councillor Nick Draper
Chair, financial monitoring task group

Executive Summary

The task group was set up in order to carry out a light touch task group review to investigate and advise on the format and content of the Council's financial monitoring reports. In doing so, the task group has also examined the management culture and reporting systems for financial control in order to identify and make recommendations to overcome any barriers to making improvements.

The report is evidence based, drawing on the detailed examination of financial monitoring reports produced by Merton and a number of other councils, plus extensive discussion with the Director of Corporate Services and the Cabinet Member for Finance.

The task group has endorsed the Director of Corporate Service's immediate priority to improve the accuracy of financial forecasting and the need to address this on a number of fronts, including system improvements, staff training and a higher level of compliance with budgetary reporting requirements. The task group has made a number of recommendations intended to support this work.

The task group has identified two improvements to financial reports that can be made this year:

- regular production of cash flow statements – the first of which should be presented to the December meeting of Cabinet
- income and expenditure report for the 2011/12 accounts, three months after year end (format as outlined in appendix 4 of the task group's report)

The task group has identified the components of a longer term vision for the Council's financial reports, to be progressed once the accuracy issues have been addressed. Financial reports should be up-to-date, accurate, clear, and with a standard monthly format containing comprehensive information about cash flow, assets and liabilities and the capital programme.

The task group's recommendations are listed in full overleaf.

List of task group's recommendations

	Responsible decision making body
Recommendation 1 (paragraph 12)	
We recommend that Cabinet institute a monitoring system to identify those budget holders who do not complete the monthly budget return.	Cabinet
Recommendation 2 (paragraph 13)	
We recommend that training is provided to ensure that all budget holders have the skills and the motivation to complete a monthly budget return on time and accurately.	Cabinet
Recommendation 3 (paragraph 17)	
We recommend that financial monitoring reports be published as soon as possible after the month end and that these be published on the intranet (perhaps alongside the performance monitoring dashboard) and reported to the next available Cabinet and Overview and Scrutiny Panel or Commission meetings.	Cabinet
Recommendation 4 (paragraph 26)	
We recommend that Cabinet endorse the Director of Corporate Services' immediate priority of improving the accuracy of the Council's financial forecasting whilst working towards a medium term priority of improving the content of the monthly, quarterly and year-end financial reports (both revenue and capital)..	Cabinet
Recommendation 5 (paragraph 33)	
We recommend that the Director of Corporate Services, in consultation with the Head of Democracy Services, produces an action plan to ensure that officers produce reports (including budget reports) that are short, clear and jargon-free, containing recommendations setting out how scrutiny can make a contribution.	Cabinet
Recommendation 6 (paragraph 34)	
We recommend that the Member training and development programme should contain opportunities for financial training, to include information on the content and importance of the capital budget and cash flow statements.	Cabinet

Recommendation 7 (paragraph 42)	
We recommend that the Director of Corporate Services investigate the extent to which a “Wandsworth style” cash flow statement could be produced so that a format can be adopted that will strike the optimum balance between content and ease of production.	Cabinet
Recommendation 8 (paragraph 46)	
We recommend that, in the medium term, Cabinet aim to produce a quarterly balance sheet, income and expenditure statement and cash flow statement in the same format as the year end report.	Cabinet
Recommendation 9 (paragraph 48)	
We recommend that the Director of Corporate Services produce an income and expenditure report for the 2011/12 accounts three months after the year end and report this to the General Purposes Committee. The format should follow that set out in appendix 4.	Cabinet

Report of the Financial Monitoring Scrutiny Task Group

Introduction

Purpose

1. The Council's Overview and Scrutiny Commission, at its meeting on 28 June 2011, agreed to establish a task group to carry out a light touch task group review of the Council's financial monitoring reports.
2. It was agreed that the purpose of the task group should be to investigate and advise on the format and content of the financial monitoring reports for revenue and capital accounts with a view to making recommendations to enable timely and accurate reporting to be put in place. It was also agreed that, in doing so, it would also examine the management culture and reporting systems for financial control in order to identify and overcome any barriers to making these changes.
3. The task group's terms of reference were:
 - to investigate and advise on the purpose, format, content and timing of the financial monitoring reports for revenue and capital accounts
 - to examine the management culture and reporting systems for financial control
 - to identify any barriers to making changes to the financial monitoring reports
 - to make recommendations for change

What the task group did

4. The task group has had three meetings at which financial monitoring reports and other budget information was examined in detail, including:
 - financial monitoring reports produced by Merton, Kingston, Sutton and Wandsworth Councils
 - budget reports from Wandsworth Council
 - diagram illustrating the financial systems used by Merton Council
 - report from PriceWaterhouseCoopers reviewing Merton's financial reporting and other budget issues (attached in appendix 5)
5. The task group received information on how the current financial monitoring reports (monthly and year end) are compiled. It then looked at the format and content of reports produced by other councils in order to draw up recommendations for change.
6. The task group has questioned the Cabinet Member for Finance and the Director of Corporate Services extensively and has discussed its views and emerging proposals with them in order to identify shared objectives that could be addressed through the task group's recommendations.

7. Appendix 1 lists the written evidence received by the task group and Appendix 2 lists the witnesses at each meeting.
8. This report sets out the task group's findings, conclusions and recommendations. The task group's recommendations run throughout the report and are set out in full in the Executive Summary at the front of this document.

Financial monitoring: current processes

9. We were informed that the Council's revenue monitoring reports are produced by an interaction between the main financial ledger (FMIS) and a management reporting tool (Proactis) that sends to each budget holder a monthly report setting out for each cost code (and totals):
 - budget for the year
 - spend to date (current year and previous year)
 - budget to date
10. The budget holders then provide a forecast of full year spend and a written explanation for any large over or under spend. This information is aggregated by department to produce information on net service expenditure in the financial monitoring reports.
11. We heard that a small number of budget holders do not complete a monthly budget return and that if no return is received then the assumption made on the monitoring report is that spend will equal budget at year end. We understand that non-compliance with the completion of monthly budget returns is partly due to lack of commitment to sound financial monitoring and partly due to lack of knowledge and/or skills.
12. **We therefore recommend that Cabinet institute a monitoring system to identify those budget holders who do not complete the monthly budget return. (recommendation 1)**
13. **We further recommend that training is provided to ensure that all budget holders have the skills and the motivation to complete a monthly budget return on time and accurately. (recommendation 2)**
14. The monitoring of the capital budget is carried out from the general ledger (FMIS). We heard that there is no reporting tool at present. We were pleased to hear that officers are working with the provider of Proactis in order to develop one that will be able to monitor not just the current year but throughout the life of each capital project. We were told that this should be operational by December 2011.

timeliness

15. The Corporate Capacity Panel raised concerns during 2010/11 that the financial monitoring reports being received at scrutiny meetings were often several months out of date. We were pleased to hear that the Director of Corporate Services has addressed these concerns and that the reports will continue to be presented to both Cabinet and Overview and Scrutiny but that, instead of going automatically first to Cabinet, the latest report available will be reported to the Overview and Scrutiny even if Cabinet has not already received that report.

16. We welcome this development but would like to see further work being undertaken to ensure that financial monitoring reports are made available to councillors at the earliest possible date.
17. **We therefore recommend that financial monitoring reports be published as soon as possible after the month end and that these be published on the intranet (perhaps alongside the performance monitoring dashboard) and reported to the next available Cabinet and Overview and Scrutiny Panel or Commission meetings. (recommendation 3)**

frequency

18. We discussed whether it was more important to have comprehensive, accurate and meaningful reporting on a less frequent basis rather than inaccurate or incomplete information on a more frequent basis. In particular, we debated whether, as a temporary measure, it would be desirable to move to quarterly financial reporting until the accuracy of forecasting has improved and revised format and content has been agreed.
19. We agreed that, although most councillors would find quarterly reports sufficient, there were compelling reasons for retaining monthly reporting. The Cabinet Member for Finance and the Council's Corporate Management Team use the monthly reports to understand the pattern of spend, consider impact on services and on financial and other decisions going forward. The information improves their understanding of the business and is linked to discussion of other decisions, including the identification of savings options.

accuracy

20. The Director of Corporate Services told us that the main challenge in relation to the revenue account is to improve the accuracy of forecasts made by budget managers so that the predicted out-turn is more reliable. Some of the forecasts made early on in the financial year, including those for some of our high spend areas, have proved to be substantially different to the zero variance reported at the end of the year.
21. We were pleased to hear that, in response to these concerns, senior finance officers now challenge managers on their budget forecast in a systematic way, focussing on those "serial offenders" who have provided inaccurate returns or failed to submit a return. Finance are working with these services to monitor spend closely this year and provide support to help them make accurate forecasts.

22. Accurate forecasting of the year end position is important so that, if necessary, adjustments can be made during the year so that spend remains within budget.
23. PricewaterhouseCoopers (report attached in appendix 5) found that although the revenue account final outturn was close to the planned breakeven position in 2009/10, the capital programme had slipped significantly and was well behind budget. They asserted that there were less robust procedures in place to monitor capital expenditure than there were for revenue.
24. The slippage (spending less than planned) in the capital programme impacts on the Council's revenue budget because there is less need to borrow and a reduction in interest payable. In 2009/10 the consequent savings for the revenue account only become apparent in January 2010, until which point it had been wrongly assumed that the Council was likely to overspend.
25. It is therefore imperative to establish robust forecasting mechanisms through a variety of initiatives including culture change, system improvements and training for staff.
26. **We recommend that Cabinet endorse the Director of Corporate Services' immediate priority of improving the accuracy of the Council's financial forecasting whilst working towards a medium term priority of improving the content of the monthly, quarterly and year-end financial reports (both revenue and capital). (recommendation 4)**
27. PricewaterhouseCoopers also commented on the accuracy of forecasts within the Medium Term Financial Strategy and recommended that the Council adopt the most likely case scenarios rather than the current more pessimistic (prudent) outcomes that were modelled in the 2010/11 MTFS. They suggested this would have reduced budget gap for 2010/11 by £0.534m.
28. We were pleased to hear that a forecasting model had been developed for use by officers, at scrutiny meetings and elsewhere that set out the Council's medium term financial strategy and made explicit links between capital and revenue as well as modelling other factors that would help to improve understanding of the budget. We believe that this tool has the potential not only to improve understanding but also to increase the transparency and accuracy of our financial decision making.

format and content

29. We examined the current monthly and year-end financial monitoring reports for Merton and a number of other London councils. We also noted the comments made by PricewaterhouseCoopers in their review of the Council's financial monitoring processes.
30. The Cabinet Member for Finance asked us to be mindful of the cost implications of making changes to financial reporting and highlighted the importance of balancing this against the purpose and use of the information. He told us that the current system has been developed in part as a discipline for officers so that financial pressures are monitored and reported in a timely fashion. This has been tweaked over the years and he welcomed the task group's role in reviewing the current position.
31. We believe that a number of improvements could be made that would result in continuity of information, improved accessibility and improved usefulness of the reports.
32. We discussed the need to make financial reports more accessible to the majority of councillors. Making the information easier to understand and adopting a standard format will help but there is a need for training too.
33. **We recommend that the Director of Corporate Services, in consultation with the Head of Democracy Services, produces an action plan to ensure that officers produce reports (including budget reports) that are short, clear and jargon-free, containing recommendations setting out how scrutiny can make a contribution. (recommendation 5)**
34. **We further recommend that the Member training and development programme should contain opportunities for financial training, to include information on the content and importance of the capital budget and cash flow statements. (recommendation 6)**
35. We would like the content of the year end financial reports to be produced on a quarterly basis during the year. This would include a quarterly balance sheet, income and expenditure statement and a cash flow statement. We believe that this information is necessary in order to fully understand the council's financial position.
36. The Director of Corporate Services agreed that this would be helpful as a longer term aim but that there are more immediate priorities to address, in particular the quality of forecasts and some system issues. She also had some concerns that in producing "year end" type quarterly reports we would run the risk that changes might be made to the CIPFA code of practice during the year which would result in different requirements for the end of year statement thus producing additional work.

37. We accept the need to take a medium term view to achieve our objectives.
38. PricewaterhouseCoopers observed that there had been a tendency not to undertake detailed monitoring in –year, preferring to wait until the year end when the data can be processed with certainty. Their view is that while the monthly reporting statements can never be as complete as the year end exercise, the benefits of having a commitments and accruals-based monitoring during the year outweigh any risks of the data being incomplete. (explain what commitments and accruals are)
39. We were pleased to hear that a cash flow statement will be provided to the Cabinet meeting on 12 December.
40. We were impressed by the format that Wandsworth Council used for cash flow statements in its 2009/10 statement of accounts (shown in appendix 3). We discussed this with the Director of Corporate Resources. Her initial view was that adopting this format would require additional staff resources but she undertook to investigate whether how much of this could be produced by developments made to the treasury management system (Logotec).
41. We accept the need to balance the resources required to achieve this against the advantages that such a format would bring. We also accept the need to settle on a single format for our cash flow statement.
- 42. We recommend that the Director of Corporate Services investigate the extent to which a “Wandsworth style” cash flow statement could be produced so that a format can be adopted that will strike the optimum balance between content and ease of production. (recommendation 7)**
43. We noted that the existing monthly reports are a hybrid of accruals (transactions to which the Council is committed) and cash (transactions that are received and paid). Our view is that this undermines accuracy and prevents accurate forecasting and decision making for future budget years. Regular information on accruals would provide more accurate information to back up or challenge predictions made.
44. We understand that there are a number of difficulties to be overcome before it would be feasible to provide quarterly or monthly reports on accruals. One of the difficulties is that the income part of CareFirst system for adult social care packages doesn't link to Proactis at the moment, though work is in process to address this.
45. A quarterly balance sheet on the capital account would indicate the level of cash in the bank and how much the Council could spend without further borrowing.

- 46. We recommend that, in the medium term, Cabinet aim to produce a quarterly balance sheet, income and expenditure statement and cash flow statement in the same format as the year end report. (recommendation 8)**
47. Councillor Diane Neil Mills has drafted a format for an income and expenditure monitoring sheet (shown in appendix 4) that includes a more detailed breakdown within the subjective headings.
- 48. We recommend that the Director of Corporate Services produce an income and expenditure report for the 2011/12 accounts three months after the year end and report this to the General Purposes Committee. The format should follow that set out in appendix 4. (recommendation 9)**

Concluding remarks

49. We have carefully examined the current format and content of the Council's financial monitoring reports, considered those produced by other councils and taken into account the findings of the review carried out by PricewaterhouseCoopers. Our conclusions and recommendations have been reached following extensive questioning of the Director of Corporate Services and discussion with the Cabinet Member for Finance.
50. We believe that we have made some progress towards reaching a shared medium term vision for improving the financial monitoring reports. We accept that there is little to be gained by changing the format of the monthly reports until forecasting accuracy has been improved. We have therefore endorsed the Director's immediate priority of improving the accuracy of the Council's financial forecasting whilst working towards a medium term priority of improving the content of the monthly, quarterly and year-end financial reports (both revenue and capital).
51. Our ultimate aim is to have information that is as up-to-date, comprehensive and transparent as possible without being too resource intensive to produce. We would like to see:
 - continuity of content and a standard format from month to month so that councillors can become familiar with the content and can identify and ask questions about trends
 - robust forecasting mechanisms so that accurate forecasts are reported to councillors, avoiding an unexpected under or over spend at the end of the financial year
 - regular information about the cash flow position
 - information about the Council's assets and liabilities (balance sheet)
 - inclusion of corporate and technical items during the year
 - inclusion of information on the capital programme
52. It is important to be clear about the purpose and use of any changes made to the content of the financial monitoring reports, particularly in the context of scarce financial resources. We also need to ensure we don't lose the parts of the financial monitoring system that are useful at present.
53. Finally, we hope that the Overview and Scrutiny Commission will continue to keep a close eye on progress made to improve the accuracy, format and content of the Council's financial monitoring reports.

What happens next?

54. This task group was established by the Council's Overview and Scrutiny Commission and so this report will be presented to its meeting on 7 February 2012 for the Commission's approval.
55. The Commission will then send the report to the Council's Cabinet on 20 February 2012 for initial discussion.
56. The Cabinet will be asked to provide a formal response to the Commission within two months, as required by the Council's Constitution.
57. The Cabinet will be asked to respond to each of the task group's recommendations, setting out whether the recommendation is accepted and how and when it will be implemented. If the Cabinet is unable to support and implement some of the recommendations, then it is expected that clearly stated reasons will be provided for each.
58. The lead Cabinet Member (or officer to whom this work is delegated) should ensure that other organisations to whom recommendations have been directed are contacted and that their response to those recommendations is included in the report.
59. A further report will be sought by the Commission six months after the Cabinet response has been received, giving an update on progress with implementation of the recommendations.

Appendices

Appendix 1: written evidence

Budget scrutiny snapshot survey of London authorities, carried out by Hounslow Scrutiny team, July 2010

Budget scrutiny: a report of a learning event for scrutiny members held by the London Scrutiny Network, 21 February 2011

Merton Borough Council – review of funding levels. Draft report by PricewaterhouseCoopers, 2011

A3 sheet mapping financial systems

Financial monitoring reports from other London authorities:

Kingston – medium term service & financial plan, month 10 report for 2010/11

Kingston – medium term service & financial plan, outturn position for 2010/11

Kingston – final accounts 2010/11

Sutton – performance and finance report, April-June 2011

Sutton – performance and financial outturn report, April 2010-March 2011

Sutton – business and financial planning 2011/12-2014/15

Wandsworth – General Revenue Budget 2010-2014

Wandsworth – quarterly progress report, June 2011

Wandsworth – Council's financial results for the year 2010/11

Wandsworth Council, statement of accounts, 2009-10

Wandsworth Council, statement of accounts, 2010-11

Wandsworth Council, council budgets 2011-12

Appendix 2: list of oral evidence

Speakers:

- Caroline Holland, Director of Corporate Services, 22 September and 19 October 2011
- Councillor Mark Allison, Cabinet Member for Finance, 22 September 2011