

Committee: Financial Monitoring Task Group

Date: 13th November 2018

Wards:

Subject: Financial Risk Management

Lead officer: Caroline Holland

Lead member: Cllr Mark Allison

Contact officer: Roger Kershaw

Recommendations:

That Members note the current position in respect of financial risk management and the best practice developments being progressed.

1 PURPOSE OF REPORT AND EXECUTIVE SUMMARY

- 1.1. To provide Members with an understanding of Merton's approach to Financial Risk Management.
- 1.2. This report builds on the risk management work undertaken within the Authority which is attached as Appendix 1 and focusses on developments in strategic financial risk management. The report also focusses on the latest information from Central Government and the Chartered Institute of Public Finance and Accountancy (CIPFA) in relation to resilience and strategy.

2 DETAILS

- 2.1. Attached as Appendix 1 is the annual update on risk management within Merton which is being presented to the Standards and General Purposes Committee on 8th November 2018.
- 2.2. Local government has faced unprecedented financial challenges in recent years that are likely to remain well into the next decade. The harsh financial economy faced by local authorities was driven home by the situation faced by Northamptonshire County Council this year. In February 2018 [and then in July 2018](#), the statutory financial officer for Northamptonshire County Council issued section 114 notices indicating that the Authority was at risk of spending more in the financial year than the resources it had available, which would have been unlawful. Central government and the public sector accounting body CIPFA are currently considering how best to minimise the chance of further Section 114 notices being released and providing early warnings of authorities being unable to balance their budgets.
- 2.3. Section 2.4 considers information from Central Government and Sections 2.5 and 2.6 consider developments from CIPFA:
- 2.4. Central Government

2.4.1 A report by the House of Commons Committee of Public Accounts on the Financial Stability of Local Authorities (Fiftieth Report of Session 2017-19) quoted.

“Since 2010-11 successive governments have reduced funding to English local authorities as part of their efforts to reduce the fiscal deficit. By 2017-18 government funding to authorities had fallen by 49.1% in real terms. Over the same period, local authorities have faced growing demand for key services such as adult and children’s social care, and housing services alongside new cost pressures such as the National Living Wage. While local authorities have coped well in absorbing the costs, there is now growing evidence of pressure in the system. Local Authorities are increasingly reliant on unsustainable measures such as reducing debt costs or drawing down their reserves. Local authorities with social care responsibilities overspent their service budgets by over £1 billion in 2016-17, and there is evidence of service reductions across a number of areas such as waste collection, libraries and bus services.....

Signs of financial pressure are now present amongst local authorities, particularly those with social care responsibilities. Nearly two thirds of these local authorities drew on their funding reserves in 2016-17 to support their spending and over 80% overspent their social care budgets. Some of these authorities are rapidly depleting their reserves: more than one in ten local authorities with social care responsibilities will have completely exhausted their reserves within three years if they continue to use them at the rate they did in 2016-17.....

Merton - As at 31st March 2018 Merton overspent by £2.4 million and £1.2 million against its Children, Schools and Families and Community and Housing budgets respectively. This overspend occurred even though as part of the Business Plan 2017-21 Merton added £1.0 million (CSF) and £9.3 million (C&H) growth to 2017/18 budgets

2.4.2 The Financial Stability of Local Authorities also states *“If the Department is not able to secure sufficient funding for local authorities from the [2019] Spending Review [which will determine funding levels from 2020-21], alternative means of ensuring that local authorities remain financially sustainable will be needed.*

The Department uses a range of data and information to assess sustainability in the local authority sector on an ongoing basis but does not share its methodology with the sector or publish the outputs of its work.....the Department is not able to say at what specific point it would have a concern either about individual local authorities or the sector as a whole. This lack of information on the Department’s understanding of financial risk amongst local authorities complicates both assessing risk in the local authority sector and holding the department to account. It also raises concern that the department lacks a clear methodology for assessing risk on a consistent basis. Similarly, the Department does not make public any of the work underlying its bid as part of the government’s 2015 Spending Review, which determined how much money the Department will have over the following 4 years, and how much government funding local authorities will receive. This evidence is vital to make the case to Treasury for more funding particularly at a time when there are so many competing calls for increased funding across Whitehall.”

Merton - Local authorities are required to be as transparent as possible, unfortunately central government funding calculations tend to be opaque in nature making it difficult to track funding sources through to the Revenue Support Grant. The analysis required for any lobbying is hindered by the lack of information underpinning funding

2.4.3 *The Financial Stability of Local Authorities also states “Local authorities are spending a greater proportion of their funding on social care services. The share of local authorities’ service spend devoted to adult and children’s social care grew from 45.3% in 2010-11 to 54.4% in 2016-17. This results from a combination of a 3% in real terms reduction in social care spend a 32.6% reduction in spend outside social care..... Council tax rates are increasing and much of the additional income is being used to fill the gap in funding for social care.....”*

Merton – The growth provided to CSF and C&H detailed at 2.4.2 demonstrates this percentage is also increasing for Merton.

2.4.4 *The Financial Stability of Local Authorities also states “A series of significant changes to the funding of local government and the scale of funding will come into force in 2020-21. These are the 2019 Spending Review, the Fair Funding Review and the introduction of 75% local retention of business rates (up from 50% retention..... Local authorities will not know the cumulative outcome of these changes until late 2019, by which time they will be well into the process of setting their budgets for 2020-21. The government is considering making changes to the funding arrangements for adult social care too, although both the timing and the impact of these is uncertain.... The lack of clarity over the design of the new funding framework and the potential scale of changes to their funding means that authorities are not able to manage their financial planning within the normal three to five year medium term financial strategies and will have to take a short term approach..... This is a risk both to the value for money of local authority spending and also their financial sustainability.....”*

Merton – The table below shows Merton’s projected shortfall in funding as at October 2018 Cabinet. These figures assume that there a loss of Adult Social Care grant funding and are excluding any savings targets from the 2019-23 Business Planning Process:

| | 2019/20 £000 | 2020/21 £000 | 2021/22 £000 | 2022/23 £000 |
|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Budget Gap | 653 | 14,692 | 2,593 | 1,828 |
| Budget Gap (Cumulative) | 653 | 15,345 | 17,938 | 19,766 |

Merton’s ability to effectively predict over the planning period above is severely hindered by lack of knowledge on the outcome of the 2019 Spending Review.

Merton is currently at a critical phase in addressing the funding challenges it faces in order to plan for a balanced budget for 2019/20 and beyond. Departments are in the process of developing savings plans to address the budget gap anticipated in the business plan highlighted above.

This task is further complicated to the extent that a range of key financial pieces in the jigsaw are still currently unknown. Some of these include:

- Continuance of Adult Social Care Grant beyond 2019/20
- Future of the London Pool – 75% or 100%
- Fair Funding Review (for 2020/21)
- Local Government Settlement Announcement (due 6 December 2018)
- Council Tax
- Brexit

2.4.5 *The Financial Stability of Local Authorities also states “Both audit and scrutiny form an important part of the framework to support financial sustainability in local authorities. However, there are weaknesses in aspects of the current arrangements..... There was a risk that the role of the external auditor was becoming reduced to that of purely financial audit and meeting regulatory requirements, rather than scrutinising the financial standing of the authority. The willingness and capacity of authorities’ audit committees to respond to external auditors’ findings is also a concern and was a factor in the issues faced by Northamptonshire County Council. Scrutiny committees also support local arrangements to secure financial sustainability, but stakeholder bodies questioned whether their level of resourcing was adequate and whether they receive sufficient independent advice.”*

Merton – In contrast to Northamptonshire Merton has robust Scrutiny arrangements (of which this Task Group is one). This is highlighted below:-

Overview and Scrutiny Commission and Panels

The Overview and Scrutiny Commission is responsible for participating in pre-decision policy formulation and for scrutinising Cabinet decisions after they have been made and for holding the Cabinet to account. The Overview and Scrutiny Commission is also responsible for making recommendations on future policy options and for reviewing the general policy and service delivery of the authority.

Standards and General purposes Committee

This Committee is established by the full Council and is responsible for promoting and maintaining high standards of conduct amongst Councillors. In particular, it is responsible for advising the Council on the adoption and revision of the members' code of conduct, and for monitoring the operation of the code.

The Committee also oversees the Constitution (non-executive functions) and makes recommendations to full council; to approve the Statement of Accounts, Internal and External Audit Matters and Corporate Governance and deals with other specific matters related to finance, pension and personnel; and to discharges the functions related to Health and Safety, Elections and as Corporate Trustee where appropriate.

This committee is required to consider and make recommendations as appropriate in relation to the activities set out in the agenda item at that meeting concerned with internal and external audit matters and corporate governance and liaison with the Authority’s External Auditors

In addition to the Council reviews and scrutinises a range of internal and external assurances. These include:-

The Annual Governance Statement - This statement from the Leader and the Chief Executive provides assurance to all stakeholders that within Merton Council processes and systems have been established, which ensure that decisions are properly made and scrutinised, and that public money is being spent economically and effectively to ensure maximum benefit to all citizens of the borough. The statement is compiled in accordance with the best practice principles in the CIPFA/SOLACE Framework Delivering Good Governance in Local Government (2016). It sets out the arrangements for the governance of its affairs, facilitating the effective exercise of its functions, and which includes arrangements for the management of risk. The statement also sets out

a programme of improvement work for the following year and reviews progress against the work programme for the previous year.

The statement is reviewed annually by external audit.

External Audit

External audit has a statutory responsibility for certification of Merton's financial statements. As part of their certification of financial statements the external auditors will also draw attention to any instances of irregularity, impropriety or poor financial control.

Annually external audit undertake the closing of accounts audit and value for money review. In addition, as part of a rolling programme additional work is undertaken. In March of each financial year the audit scope and approach for the audit of the Council's statement of accounts is presented to Standards and General Purposes Committee. Once the Audit work is completed time is spent reviewing not only the outcomes but how processes for the delivery of financial and value for money information are reviewed and a detailed "Lessoned Learned" action plan devised. The outcome from 2017/18 Audit work is that an extensive review will be undertaken of the closure process both internally and with the External Auditor, in line with previous years. However it is already clear that some of those lessons will include:

- An even greater focus on upstream work that can be undertaken prior to the commencement of the audit.
- Where practical, to build up greater resilience in both teams (LBM and EY) to enable a timely approach to and delivery of the audit plan. It was clear from both teams that the earlier deadline sorely tested ours and our Auditors resilience during the audit.
- Improved protocols and continuity plans for operating the EY portal which was the desired mechanism for exchanging data and communications before and during the audit. This proved to be problematic at key times during the audit.
- The recognition that both sides need to improve communications and importantly the logging of key decisions and discussions throughout the audit process.
- Improved closure task lists and robust signoff processes.
- Closer liaison and scrutiny of the valuation process by managers within Environment and Regeneration and Corporate Services.

Internal Audit

Internal Audit is an assurance function that provides an independent and objective opinion on the control environment. It operates to defined standards as set out in the Public Sector Internal Audit Standards.

An annual internal review has been completed and concluded that the service is compliant. An external assessment was carried out in March 2014, which concluded that Merton's Internal Audit function complied with the standard.

An annual report is produced by the Head of Audit which provides an opinion on the adequacy and effectiveness of the internal control environment.

A review has been undertaken on the 5 elements of the CIPFA statement on the role of the Head of Audit in public sector organisations. These elements are all met.

Internal auditors do not focus only on financial statements or financial risks: much of their work is looking at reputation, operational or strategic risks. Internal auditors examine and evaluate internal controls put in place to manage these risks and that they are actually working as intended. Internal auditors are part of Merton's system of internal control and their scope includes ALL aspects of control, not just finance.

CIPFA

- 2.4.2 In considering their response to the current challenging financial environment in which local government operates CIPFA has drawn heavily on the National Audit Office report on financial sustainability in local authorities, published following the crisis at Northamptonshire County Council. The report indicates that there is a heightened risk of more councils over the next four years falling into special financial measures as a result of the unrelenting pressure on budgets. In response to the challenges outlined above, CIPFA is strengthening its range of guidance, tools and services to promote better financial management and provide an early warning system to senior officers and members. Through the development of a new Financial Management Code, they aim to support good practice in the planning of sustainable finances, including the continuing development requirements of chief financial officers, leadership teams, managers and elected members to embed the revised code.
- 2.4.3 CIPFA is also looking to develop a resilience index. In its consultation document CIPFA state *“The resilience index is a not a performance table of service outcomes or quality, and is not a comment on the quality of leadership in councils. It aims, however, to be an authoritative measure of councils’ financial resilience, drawing on publicly available information, intended to provide an early warning system where it is needed so that action can be taken at a local level in a timely manner. CIPFA believes that good governance best occurs when it is supported by well-founded evidence which is discussed objectively and we believe it is in all councils’ and taxpayers’ interests that a comparative resilience index is produced from which local government and its external auditors can draw.....As with all of CIPFA’s analytical products, the index will not be a predictive model but a diagnostic tool – designed to identify those councils displaying consistent and comparable features that will highlight good practice, but crucially, also point to areas which are associated with financial failure. The information for each council will show their relative position to other councils of the same type. Use of the index will support councils in identifying areas of weakness and enable them to take action to reduce the risk of financial failure. The index will also provide a transparent and independent analysis based on a sound evidence base which should be more useful than unattributed speculation informed by little more than anecdote.*
- 2.4.4 CIPFA’s proposals are currently being consulted on, but they are currently considering six indicators

| | Indicator | Note 1 | Reason for Inclusion | Commentary |
|---|---|--------|---|-------------------|
| 1 | The level of total reserves excluding schools and public health as a proportion of net revenue expenditure. | 0.25 | A low level means that there is little scope to draw on reserves should the budget not be met. Source: Revenue Outturn Returns | |

| | | | | |
|---|--|-------------|--|---|
| 2 | The percentage change in reserves, excluding schools and public health, over the past three years. | 0.25 | If a council is reducing its reserves it may not be achieving necessary savings to balance its budget. Source: Revenue Outturn Returns | |
| 3 | The ratio of government grants to net revenue expenditure. | 0.10 | If a council has a higher dependency on central government financing, it may face greater financial pressures than those with more local resources. Source: Revenue Outturn Returns | |
| 4 | Proportion of net revenue expenditure accounted for by children's social care, adult social care and debt interest payments. | 0.15 | A high proportion suggests that a council has little headroom to make cuts in expenditure on more discretionary expenditure. Source: Revenue Outturn Returns | |
| 5 | Ofsted overall rating for children's social care. | 0.15 | Councils with an "Inadequate" rating are likely to be under considerable pressure to increase spending in this area. | As at Summer 2017 Merton's Children's Social Care was rated as "Good" by Ofsted. |
| 6 | Auditor's VFM judgement. | 0.10 | An adverse or "except for" judgement may be indicative of poor financial management within a council. | As at 31-3-18 Merton "has in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources" |
| | Total | 1.00 | | |

Note 1 - Weighting

2.4.5 Merton would be categorised into a comparator group and for each indicator they would be allocated a score between 0 (lowest performing) to 1 (highest performing). The weightings are applied when adding performance results to achieve one overall score.

2.4.6 Authorities have expressed concern that:

- (i) the results of this calculation would be used as a performance indicator
- (ii) the allocated comparator group may not provide the best overall comparator
- (iii) whilst the revenue outturn provides a relatively consistent comparator it is backward looking and there is a time delay in producing the information

- (iv) have the right indicators been included - should information be included on service under/overspends against budget, unachieved savings and/or unidentified savings
- (v) Forward looking indicators from the medium term financial strategy should be included e.g. savings as a proportion of net expenditure, capital financing costs and income trends

2.5. Updated CIPFA Guidance – The following CIPFA Guidance was release by CIPFA in autumn 2018:

- (i) The Prudential Code for Capital Finance in Local Authorities (Guidance Notes for Practitioners), and
- (ii) Treasury Management in the Public Services (Guidance Notes for Local Authorities including Police Forces and Fire and Rescue Authorities)

2.6.1 These documents set out the framework which supports local strategic planning, local asset management planning, option appraisal, management of cash-flows, effective risk control and optimum performance consistent with those risks.

2.6.2 Officers are just revising Capital and Treasury Management Strategies it is envisaged that an Investment Strategy will need to be compiled to underpin the investment in the Housing Company. In addition, officers are currently completing Capital Strategy Self-Assessment Checklist released at the end of October 2018.

2.6.3 These changes will be incorporated into documentation developed as part of the 2019-23 Business Planning Process.

3 ALTERNATIVE OPTIONS

3.1. Developments would be in accordance with those required by legislation or best practice.

4 CONSULTATION UNDERTAKEN OR PROPOSED

4.1. None specific for this report

5 TIMETABLE

5.1. In accordance with those required by legislation and the 2019-23 Business Planning Process.

6 FINANCIAL, RESOURCE AND PROPERTY IMPLICATIONS

6.1. Included in the body of the report.

7 LEGAL AND STATUTORY IMPLICATIONS

7.1. Included in the body of the report.

7.2. There are no specific Human rights, equalities or community cohesion issues arising from this report.

8 CRIME AND DISORDER IMPLICATIONS

8.1. There are no specific crime and disorder implications arising from this report.

9 RISK MANAGEMENT AND HEALTH AND SAFETY IMPLICATIONS

9.1 Included in the body of the report.

10 APPENDICES – THE FOLLOWING DOCUMENTS ARE TO BE PUBLISHED WITH THIS REPORT AND FORM PART OF THE REPORT

- Appendix 1 – Progress Report on Risk Management
- Appendix 2 – Financial Governance arrangements within Merton

11 BACKGROUND PAPERS

11.1. Within Resources division

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