Date	24 February 2021
Agenda Item	12

INTEGRATED HEALTH AND SOCIAL CARE
WEST LOTHIAN
WORKING FOR WELLBEING

Report to West Lothian Integration Joint Board Audit Risk and Governance Committee

Report Title: CIPFA Financial Management Code

Report By: Chief Finance Officer

Summary of Report and Implications	
Purpose	This report: (tick any that apply). - seeks a decision ☐ - is to provide assurance ☑ - is for information ☐ - is for discussion ☑ This report sets out the CIPFA Financial Management Code which has been designed to support good practice in financial management and assist in demonstrating financial sustainability.
Recommendations	It is recommended that the committee notes and considers the following recommendations which are intended to be submitted to the Board for approval: 1. Note the CIPFA Financial Management Code and key messages included in the report 2. Agree the IJB will comply with the code for financial year 2021/22 3. Note the officer responses to demonstrate how existing processes in the IJB meet the standards of the code following the publication of the guidance notes 4. Agree the action plan to ensure full compliance with the code
Directions to NHS Lothian and/or West Lothian Council	A direction is not required.
Resource/ Finance/ Staffing	The CIPFA Financial Management Code provides a series of financial management standards and supports governance in local government bodies.
Policy/Legal	Section 12 of the Local Government in Scotland Act (2003) states that the authority must observe proper accounting practices that are signed off by auditors.
Risk	None.

Equality, Health Inequalities, Environmental and Sustainability Issues	The report has been assessed as having little or no relevance with regard to equality or the Public Sector Equality Duty. As a result, an equality impact assessment has not been conducted.
Strategic Planning and Commissioning	The requirements of the CIPFA Financial Management Code will assist in effective financial delivery of the IJBs Strategic plan.
Locality Planning	The requirements of the CIPFA Financial Management Code will assist in effective locality planning.
Engagement	Consultation with relevant officers.

Terms of Report

1. Introduction

1.1 The CIPFA Financial Management Code is designed to support good practice in financial management and assist in demonstrating financial sustainability. Compliance with the FM Code is the collective responsibility of Board members, the chief finance officer (CFO) and the leadership team.

1.2 The FM Code is based on a series of principles supported by specific standards which are considered necessary to:

- Financially manage short, medium and long-term finances
- Manage financial resilience to meet unforeseen service demands
- Manage un-forecast shocks in financial arrangements and circumstances

1.3 The IJB has a statutory duty to meet the requirements set out in the Local Government in Scotland Act 2003, whereby the IJB must comply with proper accounting practices that are confirmed by the external auditors to have been observed and complied with.

2. The CIPFA Statement of Principles of Good Financial Management

2.1 The principles of good financial management have been developed to focus on an approach which will assist in determining whether, in applying the standards of financial management, a body is financially sustainable. The principles are as follows:

- Organisational Leadership – demonstrating clear strategic direction based on a vision where financial management is embedded into organisational culture.
- Accountability – medium term financial planning that drives the annual budget process and is supported by effective risk management, quality supporting data and whole life costs.
- Transparency – financial management is undertaken with transparency, using consistent, meaningful and understandable data, reported frequently with evidence of officer action and Board member decision making.
- Standards – adherence to professional standards is promoted by the leadership team and is evidenced.
- Assurance – sources of assurance are recognised as an effective tool for financial management, including scrutiny and the results of internal and external audit and inspection.

- Sustainability – long term sustainability of services is at the centre of all financial management processes and is evidenced by prudent use of public resources.

3. The Application and Structure of the FM Code

3.1 Although the FM Code does not have legislative backing, it applies to local authorities and other authorities, such as integration authorities and covers bodies defined in Section 7 and Section 10 of the Local Government in Scotland Act 2003. The code recognises that some bodies have different structures and legislative frameworks that mean full compliance with the code is not possible but adherence to the principles is still considered appropriate. The Code is designed to be flexible to the nature, needs and circumstances of individual authorities. The guidance also notes that that the code is not intended to be prescriptive and it is up to each authority to determine the extent to which it complies, which should be in a way that is appropriate and proportional for an authority of its size, responsibilities and circumstances.

3.2 This flexibility is relevant to integration authorities given their role as a strategic planning body which does not employ staff or manage physical cash resources. For example, a key aspect of the new code is the alignment to the CIPFA Prudential Code but this does not apply to IJBs given they do not have responsibility for capital resources or cash investments and borrowing

3.3 Taking account of this, the IJB's compliance with the code will be proportionate to the nature of the IJB legal entity established but will seek to use compliance with the Code as a means of supporting good practice in financial management and achieving financial sustainability. The first full year of compliance for the Code is 2021/22.

4. The CIPFA Financial Management Standards

The CIPFA financial management standards are presented and explained in seven sections of the FM Code.

5. Section 1 – The Responsibilities of the Chief Finance Officer and Leadership Team

Financial Management Standard A – The leadership team is able to demonstrate that the services provided by the authority provide value for money

5.1 It is for the leadership team to ensure that the authority's governance arrangements and financial management style promotes financial sustainability. An important element of collective decision-making is to understand risks and the statutory responsibilities.

5.2 Consideration of the key elements of value for money; economy, efficiency, effectiveness and equity should be an integral feature in decisions taken by the leadership team in the delivery of services and allocation of resources.

Financial Management Standard B – The authority complies with the CIPFA Statement on the Role of the Chief Financial Officer (CFO) in Local Government

5.3 The requirements of legislation and professional standards should be fulfilled by the CFO in the performance of their duties. principles that define the core activities and behaviours of authority CFOs and the organisational arrangements needed to support them are noted in the code.

6. Section 2 – Governance and Financial Management Style

Financial Management Standard C – The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control

6.1 Proper governance and financial management arrangements are in place, including a scheme of delegation ensuring that frontline responsibility for internal and financial control starts with those who have management roles. Those responsible for the delivery of services are also held responsible for the financial management and associated expenditure and income.

6.2 Good governance is evidenced by actions and behaviours as well as formal documentation and processes. A successful leadership team has a culture of constructive challenge built on rigorous examination of goals, underlying assumptions and implementation plans.

Financial Management Standard D – The authority applies the CIPFA/SOLACE Delivering Good Governance in Local Government: Framework 2016

6.3 The authority should encourage sustainable delivery and improved accountability by establishing a benchmark for good governance. The CIPFA/SOLACE Delivering Good Governance in Local Government: Framework supports the development and maintenance of codes of governance and accountability for appropriate conduct of business. Reporting on compliance, effectiveness and improvement can usually be undertaken within the authority's annual governance statements, which must be published alongside financial statements.

Financial Management Standard E – The financial management style of the authority supports financial sustainability

6.4 CIPFA believes that the strength of financial management within an organisation can be assessed by a hierarchy of three financial management styles:

- Delivering accountability (economy)
- Supporting performance (efficiency)
- Enabling transformation (effectiveness)

6.5 The CIPFA Financial Management Model uses these styles to describe the different standards of financial management in authorities. They represent a hierarchy in which enabling transformation is only achieved by a financial management style that supports performance and in turn, delivers accountability. When these foundations are established, authorities need to move up through the hierarchy of financial management styles in response to increasing risk.

7. Section 3 – Medium to Long-term Financial Management

7.1 CIPFA does not believe that the time horizon of financial planning is determined by the time horizon of government grant settlements and, that to be able to demonstrate financial sustainability, a longer-term perspective is essential. The greater the uncertainty over central government policy then the greater the need to demonstrate long-term financial resilience given the risks attached to core funding.

Financial Management Standard F – The authority has carried out a credible and transparent financial resilience assessment

7.2 Authorities must critically evaluate their financial resilience. Existing strategies may be financially sustainable, but they must still have been tested and demonstrated in a financial resilience assessment. Requiring analysis of future demand and consideration of alternative options for matching demand to resources, focussing on key longer-term revenues and expenses and addressing key risks to which the authority will be exposed are important factors in considering financial resilience.

Financial Management Standard G – The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members

7.3 The authority will need to demonstrate a robust understanding of the risks to its financial sustainability and how the risks identified have informed a strategic plan and long-term strategy. There needs to be an over-arching strategic vision of how it intends to deliver outputs and outcomes, which should include a statement setting out the vision and the underlying strategy.

7.4 CIPFA is not prescriptive about the time period of the long-term financial strategy. However, CIPFA would promote ambition and the need for a financial strategy that matches the requirement for a strategic approach to service planning. The underlying key cost drivers, especially those linked to the age profile of a community can be foreseen in broad terms for at least a decade or more ahead.

Financial Management Standard H – The authority complies with the CIPFA Prudential Code for Capital Finance in Local Authorities

7.5 This is not directly relevant to integration authorities.

Financial Management Standard I – The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans

7.6 CIPFA does not anticipate that a long-term financial strategy would provide sufficient details to shape the annual budget setting process. Therefore, authorities will need to translate their long-term financial strategies into a medium-term financial plan (MTFP) that is consistent with and integrated into relevant service plans. The plan should be prepared on the basis of a robust assessment of relevant drivers of costs and demand and tested for resilience against realistic potential variations of those costs and demand drivers.

8. Section 4 - The Annual Budget

Financial Management Standard J – The authority complies with its statutory obligations in respect of the budget setting process

8.1 The annual budget report is a key document for the authority and the preparation process needs to be undertaken with detailed consideration at a time when difficult decisions may be necessary. Authorities need to be aware of the statutory obligations in respect of the budget-setting process.

Financial Management Standard K – The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves

8.2 This report should accurately identify and consider the most significant estimates used to prepare the budget, the potential for these estimates being incorrect and the subsequent impact should this be the case.

CIPFA highlights that a well-managed authority, with a prudent approach to budgeting, should be able to operate with a level of general reserves appropriate to the risks to which it is exposed to ensure financial sustainability for the foreseeable future.

9. Section 5 – Stakeholder Engagement and Business Cases

Financial Management Standard L – The authority has engaged, where appropriate, with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget

9.1 The FM Code sets out that stakeholder consultation helps to encourage community involvement in the design of services and their ongoing delivery, especially when an authority adopts an enabling approach to service delivery with active involvement of the third sector and could be beneficial in facilitating future service expenditure reductions.

9.2 Authorities should seek to engage with key stakeholders in the development process of the long-term financial strategy, medium-term financial plan and annual budget.

Financial Management Standard M – The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions

9.3 Financial sustainability is dependent upon difficult and often complex decisions being made. The authority's decisions must be informed by clear business cases based on appropriate option appraisal techniques. The chief finance officer is responsible for ensuring that all material decisions are supported by an appropriate option appraisal.

10. Section 6 – Monitoring Financial Performance

Financial Management Standard N – The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability

10.1 The FM Code notes the importance of translating policy decisions into actions to prevent unplanned overspends and/or preventing the non-delivery of savings. Non-financial performance measures can be used as another indication that resources do not match service user expectations. Trends should be used to inform the decisions taken on the medium-term and long-term financial planning.

Financial Management Standard O – The leadership team monitors the elements of its balance sheet that pose a significant risk to its financial sustainability

10.2 Contingencies and commitments should be monitored to identify any items where balance sheet provision may have been realised. Authorities should identify the elements of the balance sheet most critical to financial sustainability. Unplanned use of reserves should be reported to the leadership team in a timely manner.

11. Section 7 – External Financial Reporting

Financial Management Standard P – The chief finance officer has personal responsibility for ensuring that the statutory accounts produced by the local authority complies with the reporting requirements of the Code of Practice on Local Authority Accounting

11.1 Financial statements provide the accountability link between planned performance, resources and outcomes, financial and others, which are achieved.

11.2 The CFO should be aware of their responsibilities in terms of the preparation of the annual financial statements and these responsibilities should be included in the CFO's role description, personal objectives and other relevant performance management mechanisms. Financial statements should be prepared on time and in accordance with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom.

Financial Management Standard Q – The presentation of the final outturn figures and variations from budget allows the leadership team to make strategic financial decisions

11.3 A monitoring process should explain how material variances from initial and revised budgets to the outturn report in the financial statements have arisen and been managed. The success of these arrangements will be demonstrated by the ability of the leadership team to make decisions from them.

12. Implications for West Lothian IJB

12.1 The IJB has a medium term financial plan for which was initially for the period 2018/19 to 2022/23. The pandemic has impacted on the development of future medium term financial planning and this is a area where further work is required during 2021. The annual budgeting process ensures that financial planning assumptions are reviewed and updated each year. An update on MTFP assumptions for the period 2020/21 to 2022/23 was provided to the Board in June 2020.

12.2 A finance update showing the current year budget position against spend and highlighting key risks as well as progress towards delivery of savings is provided to the Board on a regular basis. The 2019/20 annual audit reports from the IJB's external auditors recognises the IJB's good practice in providing accurate financial reporting to the Board.

12.3 The IJB's approach is already largely consistent with the approach set out in the Code. Constrained financial resources continue to be a major risk and therefore a more strategic approach will be essential to meet the medium to long term challenges arising from growing demands and limited public sector funding.

12.4 The Code sets out a range of statements which the IJB should comply with and Appendix 2 details the existing processes, procedures and documentation currently used that are relevant to assessing IJB compliance. A number of action points, including reviewing the IJB's Financial Regulations and Scheme of Delegation, and further development of medium term financial planning are proposed to ensure full compliance with the code for financial year 2021/22.

Appendices	1. CIPFA Financial Management Code 2. CIPFA Financial Management Code Action Plan
References	Annual Code of Practice on Local Authority Accounting CIPFA Statement on the Role of the Chief Financial Officer in Local Government CIPFA/SOLACE Delivering Good Governance in Local Government: Framework
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financial management code

guidance notes

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Joanne Pitt,
CIPFA Policy Manager Local Government

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Introduction

With local authorities across the UK facing the challenges of reduced funding and increased demand for services, the need for robust financial management has never been more important.

But the high-profile issues faced by a number of authorities in recent times indicate that the principles of good financial management have not been embedded universally into the ways in which authorities operate.

Consequently, CIPFA has developed the Financial Management Code (FM Code), which sets out the principles by which authorities should be guided in managing their finances and the specific standards that they should, as a minimum, seek to achieve.

The FM Code is designed to be flexible to the nature, needs and circumstances of individual authorities. It is up to each authority to determine the extent to which it complies with the FM Code and to identify what action it may wish to take to better meet the standards that the FM Code sets out.

USING THESE GUIDANCE NOTES

These guidance notes seek to assist authorities in their efforts to comply with the FM Code, by exploring in more detail the themes addressed in the FM Code and by providing suggestions and ideas as to how it can be implemented in practice.

CIPFA recognises, however, that different authorities operate in different ways, face different challenges and have different levels of resources at their disposal. And so what may work well within one authority may not be relevant, practical or affordable for another.

These guidance notes are not intended to be prescriptive in any way and all authorities are encouraged to use the notes in a way that best reflects their structure, type, function and size.

Consequently, these guidance notes do not purport to set out the only way to comply with the requirements of the FM Code. They seek simply to provide ideas and suggestions as to how authorities might comply with the FM Code and how they might demonstrate that compliance has been achieved.

Ultimately, though, it is for each authority to ensure that it complies with the FM Code in a way that is appropriate – and proportional – to its own circumstances.

These guidance notes apply to all those to whom the Code applies including all local authorities, including police, fire, combined and other authorities, which:

- in England and Wales are defined in legislation for the purposes of Part 1 of the Local Government Act 2003

- in Scotland are defined in legislation for the purposes of Part 7 of the Local Government in Scotland Act 2003, or to the larger bodies (such as integration joint boards) to which Section 10 of this Act applies
- in Northern Ireland are defined in legislation for the purposes of Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

WHO MIGHT USE THESE GUIDANCE NOTES

The guidance notes aim to be a resource for those who are supporting their organisations with the implementation of the FM Code and may be particularly helpful to officers in those organisations including chief finance officers and senior finance professionals, so are written primarily from a financial – rather than a service – perspective.

However, each section also contains a summary overview, which may be useful for chief executives and other senior managers, as well as for members or other stakeholders.

Police bodies in England and Wales do not have elected members, but have a directly elected police and crime commissioner (PCC), and a chief constable. Both are separate legal entities and local authorities for the purposes of this document, with the PCC holding the chief constable to account for the delivery of policing in their area. The exceptions are in London and Greater Manchester where the mayor undertakes the role of PCC.

THE PURPOSE OF THE SECTION SUMMARY

Each section within the guidance notes starts with a summary of the topics addressed in that section, to allow readers to focus their attention on the topics that are of most relevance to them. As the guidance notes draw on a number of familiar publications it will be for the authority to decide on the level of detail they need from these notes. For some users the summary may meet all their requirements. Consideration of each topic concludes with a summary of key questions that authorities may wish to ask themselves in ensuring their compliance with the FM Code.

LINKS TO OTHER STANDARDS

Where the FM Code requires authorities to comply with other CIPFA standards, the guidance notes summarise the requirements associated with these standards, so as to ensure that comprehensive guidance is given. Authorities already familiar with the requirements of these other standards may wish to skip these sections of the guidance notes, which are identified clearly.

These guidance notes should be read in conjunction with the FM Code itself.

SUMMARY OF THE FM CODE

While authorities have done much to transform services, shape delivery and streamline costs, for these approaches to be successful it is crucial to have good financial management embedded as part of the organisation. Good financial management is an essential element of good governance and longer-term service planning, which are critical in ensuring that local service provision is sustainable.

The CIPFA FM Code is designed to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability. For the first time the FM Code sets out the standards of financial management for local authorities.

The FM Code has several components, including the CIPFA *Statement of Principles of Good Financial Management*. These six principles have been developed by CIPFA in collaboration with senior leaders and practitioners. These principles are the benchmarks against which all financial management should be judged. CIPFA's view is that all financial management practices should comply with these principles.

To enable authorities to test their conformity with the six principles, the FM Code translates these principles into financial management standards. The purpose of the FM Code itself is to establish the principles in a format that matches the financial management cycle and supports governance in local authorities. A series of financial management standards set out the professional standards to be met if a local authority is to meet the minimal standards of financial management acceptable to meet fiduciary duties to taxpayers, customers and lenders.

The principles of good financial management

The CIPFA Financial Management Code applies a principles-based approach. It does not prescribe the financial management arrangements that local authorities should adopt. Instead, the FM Code requires that a local authority ensures, and is able to demonstrate, that it satisfies the principles of good financial management for an authority of its size, responsibilities and circumstances.

The six underlying principles that inform the FM Code have been developed in consultation with senior practitioners from local authorities, local policing bodies and associated stakeholders. The principles have been designed to focus on robust financial management as a way of achieving both short-term financial resilience and long-term financial sustainability.

The principles are as follows:

- Organisational **leadership** – demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture.
- **Accountability** – financial management is based on medium-term financial planning, which drives the annual budget process supported by effective risk management, quality supporting data and whole life costs.
- Financial management is undertaken with **transparency** at its core using consistent, meaningful and understandable data, reported with appropriate frequency and with evidence of periodic officer action and elected member decision making.
- Adherence to professional **standards** is promoted by the leadership team and is evidenced.
- Sources of **assurance** are recognised as an effective tool mainstreamed into financial management and include political scrutiny and the results of external audit, internal audit and inspection.
- The long term **sustainability** of local services is at the heart of all financial management processes and is evidenced by prudent use of public resources.

It is not possible – or, indeed, desirable – for the FM Code to anticipate all eventualities. Consequently, if any doubt arises as to whether or how the FM Code should be applied, reference should be made to these principles of good financial management, to establish whether any proposed financial management practice is within the spirit of the FM Code.

A financial management practice that conflicts with one or more of these principles will not be acceptable practice even if it is not ruled out explicitly by the FM Code itself.

The CIPFA financial management code

The CIPFA Financial Management Code translates the principles of good financial management into a series of standards. These standards address the aspects of an authority's operations and activities that must function effectively if financial management is to be undertaken robustly and financial sustainability is to be achieved.

THE SCOPE OF THE FM CODE

The areas covered by the standards are:

- the responsibilities of the chief financial officer and leadership team
- governance and financial management style
- long to medium-term financial management
- the annual budget
- stakeholder engagement and business plans
- monitoring financial performance
- external financial reporting.

The financial management standards are designed to be sufficiently flexible so that they are relevant to the needs of the diverse range of authorities across the local government sector and to the varying circumstances in which these authorities operate and challenges that they face.

THE FINANCIAL MANAGEMENT STANDARDS

The detailed financial management standards set out in the FM Code are as follows:

Chapter 1	The responsibilities of the chief finance officer and leadership team
A	The leadership team is able to demonstrate that the services provided by the authority provide value for money
B	The authority complies with the CIPFA *Statement on the Role of the Chief Finance Officer in Local Government (2016)*
Chapter 2	**Governance and financial management style**
C	The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control
D	The authority applies the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016)
E	The financial management style of the authority supports financial sustainability

Chapter 3	**Medium to long-term financial management**
F	The authority has carried out a credible and transparent financial resilience assessment
G	The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members
H	The authority complies with the CIPFA *Prudential Code for Capital Finance in Local Authorities*
I	The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans
Chapter 4	**The annual budget**
J	The authority complies with its statutory obligations in respect of the budget setting process
K	The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement of the adequacy of the proposed financial reserves
Chapter 5	**Stakeholder engagement and business cases**
L	The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget
M	The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions
Chapter 6	**Monitoring financial performance**
N	The leadership team takes action using reports, enabling it to identify and correct emerging risks to its budget strategy and financial sustainability
O	The leadership team monitors the elements of its balance sheet which pose a significant risk to its financial sustainability
Chapter 7	**External financial reporting**
P	The chief finance officer has personal responsibility for ensuring that the statutory accounts provided to the local authority comply with the *Code of Practice on Local Authority Accounting in the United Kingdom*
Q	The presentation of the final outturn figures and variations from budget allow the leadership team to make strategic financial decisions

THE AUTHORITY'S RESPONSIBILITIES IN DETERMINING COMPLIANCE WITH THE FM CODE

It is for the individual authority to determine whether it meets the standards and to make any changes that may be required to ensure compliance. Authorities should be able to provide evidence that they have reviewed their financial management arrangements against the standards and that they have taken such action as may be necessary to comply with them.

It is important to note, also, that the financial management standards are minimum standards. Some authorities may feel, with justification, that their own financial management arrangements exceed by far the standards set out in the FM Code. Recent experience suggests, however, that the standards set out in the FM Code have been by no means universally achieved.

CHAPTER 1

The responsibilities of the chief finance officer and leadership team

Robust financial management is at the heart of the authority's ability to achieve its objectives and to deliver high quality services to its local community.

Indeed, after over a decade of reductions in funding and a consequent need to achieve significant cost and efficiency savings, it is no doubt at the top of the agenda for most, if not all, authorities.

Responsibility for managing the authority's financial resources and for ensuring its long-term financial sustainability lies with those responsible for making executive decisions and their advisors.

This chapter of the guidance notes considers:

- the way in which the authority's leadership team is able to demonstrate that its services provide value for money
- the extent to which the authority complies with the CIPFA *Statement on the Role of the Chief Finance Officer in Local Government.*

It starts by exploring the key elements of value for money – economy, efficiency, effectiveness and equity – as well as the importance of striking a balance between them.

It looks at how the authority can promote value for money, though strong governance, robust management of finances and risk, the review of service delivery arrangements, monitoring of service performance, and ensuring that services are accessible to all who can benefit from them.

It also considers how the authority can demonstrate that its services – including those delivered through outsourced or other mechanisms – represent value for money, such as through internal oversight and scrutiny, external assessment of performance and proactive communication with local stakeholders.

CIPFA's *Statement on the Role of the Chief Finance Officer in Local Government* sets out a series of principles that govern the activities and behaviours of an effective CFO. This chapter of the guidance notes explores these principles and explains what they mean in practice. For PCCs and chief constables, please refer to the equivalent CIPFA *Statement for Police.*

Financial Management Standard A:

The leadership team is able to demonstrate that the services provided by the authority provide value for money

The achievement of value for money is the collective responsibility of elected members and senior officers, who together make up an authority's leadership team. In policing, the chief constable has a legal duty to secure value for money and the PCC, who holds the chief constable to account, has a legal duty to ensure value for money.

While the nature of the governance and management arrangements across local authorities – and other bodies to which the FM Code applies – may vary, the responsibilities of the leadership team in respect of achieving value for money from the authority's resources do not.

This means that, in order to achieve compliance with the FM Code, consideration of value for money should be an integral feature to the decisions made by the leadership team, especially those relating to the allocation of resources or to the delivery of services.

EXPLORING VALUE FOR MONEY

Value for money is a subjective concept. It depends not only on what one values, but also on what one considers an acceptable price to pay. So the perception of what does and what does not constitute good value for money will vary from one individual to another.

To facilitate the assessment of value for money, the concept is commonly broken down into four 'pillars', which are more readily measurable.

These pillars are as follows:

Economy 'Spending less'	Economy is a measure of the resources that the authority puts into the delivery of a given activity or service. To be economical, the authority should procure these inputs at the lowest possible cost, subject to maintaining appropriate standards of quality. *For example, an economical highways development scheme will procure the necessary resources (labour, materials, plant hire, etc) at the lowest possible unit cost.*
Efficiency 'Spending well'	Efficiency is about how well the authority translates these inputs into the outputs of an activity or a service. To be efficient, the authority should use the minimum possible level of inputs to produce each output, again subject to maintaining appropriate standards of quality. *For example, an efficient highways development scheme will minimise the volume of resources required to construct each mile of road, eg through proactive scheduling and minimisation of waste.*
Effectiveness 'Spending wisely'	Effectiveness considers the extent to which the outputs that the authority has generated lead to the outcomes that it wants to achieve. To be effective, the authority's actions should have the desired positive impact on people's lives, such as greater opportunity, improved skills or changed behaviours. *For example, an effective highways development scheme will have a clear rationale for the road under construction and will construct the right road, in the right place and at the right time.*

Equity 'Spending fairly'	Equity is about the extent to which the outcomes generated by the authority have been made accessible to all those who could benefit from them. To be equitable, the authority should ensure that it takes account of the ability of different individuals and groups to access its services and that it makes arrangements to ensure that these services are accessible to all who could benefit from them. *For example, an equitable highways development scheme would be accessible to all forms of traffic – including pedestrians and cyclists – and might also feature suitable pedestrian crossing points (with facilities for visually-impaired pedestrians and wheelchair users) and appropriate street furniture.*

In making decisions, allocating resources and planning the delivery of services, the authority should seek to ensure that its services are economical, efficient, effective and equitable. The authority should also be able to demonstrate that it has taken these factors into account when making decisions, allocating resources and planning the delivery of services.

There is, however, a delicate balance to be achieved across these four pillars of value for money. For example, using cheaper materials can improve the economy of an activity, but will have a negative impact on efficiency if sub-standard materials generate higher levels of waste. And it is perfectly possible to undertake an activity that is highly economical and supremely efficient, but ultimately ineffective in that it does not achieve what the authority set out to do.

Consequently, the authority may wish to consider not only how it will achieve economy, efficiency, effectiveness and equity, but also how it will find the right balance between these potentially competing factors.

HOW TO PROMOTE ECONOMY, EFFICIENCY, EFFECTIVENESS AND EQUITY

There are a number of actions that the authority could – and, in fairness, probably already does – take to promote the economy, efficiency, effectiveness and equity of its services and to demonstrate its compliance with the FM Code.

The first of these take the form of high-level governance and management arrangements:

A clear governance structure	The authority has a clear governance structure, with well-defined roles for all members of the leadership team. The collective responsibility of the leadership team for the achievement of value for money is made explicit.
Scrutiny arrangements	The authority's activities – including, but not limited to, decisions made by the leadership team – are subject to appropriate levels of scrutiny, for example by an overview and scrutiny committee or an audit committee.
Audit arrangements	The authority has in place arrangements for external and internal audit. The external auditor confirms, as part of their annual audit opinion, whether the authority has in place suitable arrangements to secure value for money. The remit of the authority's internal auditors includes consideration of value for money.
Clear objectives and strategy based on local need	The delivery of the authority's services is guided by a corporate plan, or a similar document, which sets out the authority's objectives and how it will meet them. This corporate plan is based on an assessment of local need and is approved by the leadership team.

Effective service and financial planning	The authority has in place detailed plans and strategies for the delivery of its principal services, which are consistent with the achievement of the objectives in the corporate plan. The authority also has in place an annual budget, setting out how the delivery of these services will be funded.

The authority can also help to achieve value for money by having in place robust arrangements surrounding the commitment of expenditure, the oversight of contracts with third parties and the management of risk:

Financial regulations	The authority has in place a suite of financial regulations, which set out how the authority manages its finances, and implements suitable mechanisms to ensure compliance with these regulations. The financial regulations may be supplemented by further guidance to members and officers on the implementation of the regulations.
Procurement regulations	The authority has in place, either as part of its financial regulations or as a stand-alone document, specific regulations regarding the procurement of goods and services. These include arrangements for ensuring that goods and services are procured in an economic manner.
Contract management arrangements	The authority has in place specific arrangements regarding the management of contracts with third-party suppliers, to ensure that the goods or services to which the contract applies are delivered as agreed. Contract management arrangements are proportional to the value and significance of the contract.
Risk management	The authority has in place a systematic approach to identifying, assessing and managing risks to the achievement of its objectives. This approach is applied at a corporate level as well as at the level of the delivery of individual services. Significant risks, and the actions being taken to mitigate them, are reported to the leadership team.

The authority may also wish to assess the extent to which its services represent value for money by reviewing explicitly the ways in which these services are delivered or by comparing the authority's own services and service performance with those of other authorities:

Efficiency reviews	The authority undertakes a programme of efficiency reviews, designed to assess the extent to which its principal services are operating efficiently and to make recommendations for improvement. These reviews are undertaken in accordance with an appropriate methodology. They could be undertaken by suitably-trained officers or by third party suppliers.
Benchmarking	The authority uses benchmarking techniques to assess the economy and efficiency of its services and to identify opportunities for improvement, by comparing key performance measures across services internally or with other authorities. This could take the form of a mutual data-sharing arrangement with other authorities or participation in a formal benchmarking scheme.
Peer review	The authority invites representatives of other authorities to review the delivery of specific services, to use their experience to assess how well these services are performing and to make recommendations for improvement. This could take the form of an informal arrangement with other authorities or participation in a formal peer review scheme.

There are also ways in which the authority could help to ensure that its services are effective, in that they are achieving the authority's objectives and meeting the needs of service users:

Monitoring of performance data	The authority collects and monitors appropriately-defined performance data to assess the extent to which its services are achieving their objectives. High level performance data is reported regularly to the leadership team. Prompt action is taken to address any areas of poor performance.
Service reviews	The authority undertakes a series of service reviews, designed to assess the extent to which services are achieving their objectives and meeting the needs of service users. Like the efficiency reviews discussed above, service reviews are undertaken in accordance with an appropriate methodology. They could be undertaken by suitably-trained officers or by third party suppliers.
User surveys	The authority undertakes a periodic survey of users of particular services, designed to assess the extent to which these services meet users' needs and to identify opportunities for improvement.
External assessments	The authority engages with statutory and non-statutory external reviews of its services, such as Ofsted reviews of children's social care services, and seeks to use the results of these reviews to improve the operation and management of the services under review. It is worth noting, furthermore, that the results of such reviews are used frequently by external auditors when forming their own conclusions about the arrangements in place across the authority to secure value for money.

While equity is a relatively recent addition to the concept of value for money, there are nevertheless things that the authority could do to ensure that its services are accessible to all those who could benefit from them:

Equality impact assessments	The authority undertakes equality impact assessments of policies, activities and services, to ensure that they do not – deliberately or inadvertently – discriminate against certain groups or individuals, especially those that are disadvantaged or vulnerable.
Engagement with service users	The authority engages with survey users from different backgrounds – for example, though a service user panel or similar – to assess the extent to which services are accessible to all users and potential users and to identify opportunities for improvement.
Engagement with the voluntary sector	The authority engages with voluntary organisations working with disadvantaged and vulnerable groups and individuals, to identify barriers to accessibility and to explore how its services could be made more accessible to those who could benefit from them.

DEMONSTRATING VALUE FOR MONEY

It is not sufficient, however, for the authority to simply achieve value for money in the delivery of its services. The authority's leadership team needs also to be able to demonstrate, in line with the requirements of the FM Code, that value for money is being sought and delivered.

Indeed, under proposed changes to the National Audit Office's (NAO) *Code of Audit Practice,* the authority's auditors, in seeking to reach a conclusion on the extent to which the authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources, will henceforth place greater emphasis than previously on the actions taken by the authority to improve economy, efficiency and effectiveness, including how it has used information about its costs and performance to improve the way it manages and delivers its services. This will apply only to those authorities that fall within the scope of the NAO's *Code of Audit Practice.*

The most straightforward way to demonstrate the authority's commitment to achieving value for money is to undertake a range of activities designed to ensure that the authority's services are economical, efficient, effective and equitable and to retain evidence that these activities have been undertaken and that the authority has used them to identify and to realise opportunities for improvement.

This could include, for example:

- an overview of the authority's governance arrangements and examples of how decisions are scrutinised
- details of efficiency or service reviews undertaken, together with their findings and any subsequent improvement action taken
- details of economy and/or efficiency savings achieved, together with how they have been achieved and the impact on the relevant services
- the results of user surveys and/or engagement with service users or voluntary sector organisations.

The authority could also draw on the judgements of others as to whether its activities represent value for money, such as its internal and external auditors, statutory reviews of individual services and, for police and fire services, inspection reports by Her Majesty's Inspecorate of Constabulary and Fire and Rescue Services.

The authority may also wish to communicate proactively to local stakeholders its approach to value for money and its performance in ensuring that value for money is achieved. This could include, for example:

- addressing value for money explicitly in the narrative report or annual governance statement in the authority's annual financial statements
- preparing an annual value for money report, summarising the action that it has taken to ensure that its services deliver value for money and how it has sought to improve their economy, efficiency, effectiveness and equity
- providing information via its website or other medium explaining how the authority works to ensure that its services deliver value for money and how it has sought to improve their economy, efficiency, effectiveness and equity.

The authority may wish to present its activities in respect of value for money in the context of a broader consideration of how it creates value for its local community. It could do this, for example, by adopting an approach such as integrated reporting, which helps organisations to communicate how their strategy, governance, performance and prospects, in the context of the external environment in which they operate, lead to the creation of value in the short, medium and long term.

VALUE FOR MONEY AND ALTERNATIVE DELIVERY MECHANISMS

As the demands placed on the public sector become ever more challenging and complex, many authorities opt to explore alternative arrangements for the delivery of public services and assets.

However, while the authority can delegate the delivery of such services or assets to its partners, it remains responsible for ensuring that these services and assets are delivered. It also remains accountable for services and assets that are delivered in its name.

Consequently, it is imperative that the authority has in place appropriate arrangements for ensuring effective oversight of and accountability for any alternative delivery mechanisms in which it has engaged.

THE NATURE OF ALTERNATIVE DELIVERY MECHANISMS

Such arrangements can take a number of forms, including:

Outsourcing contracts	The authority contracts with an external partner to deliver a service on its behalf. The partner may be a commercial entity or, increasingly, a voluntary sector organisation. *For example, the outsourcing of the authority's refuse collection contracts to a commercial provider.*
Private finance initiative (PFI) contracts	The authority engages with an external partner – or a consortium of partners – to design, build, finance and operate an infrastructure asset and associated services. *For example, the construction of a new headquarters building and the provision of facilities management services.*
Joint ventures	The authority shares an equitable stake in an enterprise with a public or private sector partner, sharing both the risk and the reward in the delivery of a service or asset. *For example, working with a homelessness charity to set up an advice hub for local people threatened with homelessness.*
Shared services arrangements	The authority pools its resources with those of other public sector partners, to benefit from efficiency savings and to increase service resilience. *For example, sharing a senior post with another authority or sharing 'back office' functions between several organisations.*
Local authority trading companies	The authority establishes an entity that is owned and controlled by it, but that operates in a commercial manner and (potentially) competes with other providers. *For example, setting up a company that provides civil engineering services to the authority and to external customers.*
Public service mutuals	The authority 'spins out' a service delivery entity, which demonstrates a high level of employee control, influence or ownership. *For example, the operation of libraries by teams of employed and volunteer staff outside the direct control of the authority.*

It must be noted that not all of these routes are open to all types of local authority. For example, PCCs and chief constables do not have powers to trade and therefore the route of local authority trading companies is not directly open to them, though they may collaborate with others who hold such powers, such as fire and rescue authorities.

PRINCIPLES FOR OBTAINING VALUE FOR MONEY

In order to ensure that alternative delivery mechanisms represent value for money, it is important that the authority establishes them carefully and oversees them wisely.

This includes:

- focusing on long-term value creation and sustainable service delivery, rather than on the achievement of short-term savings
- understanding and controlling costs within the financial context, safeguarding financial arrangements with a clear line of oversight
- understanding the nature and extent of risk inherent to such arrangements and ensuring that such risk is managed proactively and robustly
- creating a culture of openness and mutual respect, in which the partners can raise issues and concerns without fear of penalty
- promoting a collaborative, problem-solving approach among the partners, rather than a reliance on contractual provisions
- being adaptable to evolving circumstances, adopting a flexible and considered approach and recognising that sometimes things need to change
- embracing creativity, drawing on the combined skills, experience and expertise of the partner organisation(s)
- maintaining transparent and accountable arrangements for effective scrutiny and oversight, which respects the need for commercial confidentiality but is not constrained by it.

MAINTAINING EFFECTIVE ‘LINE OF SIGHT’ ACCOUNTABILITY ARRANGEMENTS

The authority should have in place appropriate arrangements for the effective oversight of any alternative delivery mechanisms upon which it relies for the delivery of services or assets.

While these arrangements should be tailored to the arrangement in question, some elements that might form part of these arrangements are as follows:

Governance arrangements	The arrangement has some kind of governing body, which brings together all partners to oversee its work. This body meets regularly and has appropriate administrative support. The authority has suitable representation on this governing body and participates actively in its deliberations.
Ways of working	The partners in the arrangement agree and implement appropriate ways of working. These cover things like operational management, financial management and communication. These arrangements may be set out in a contractual arrangement, but they are sufficiently flexible to respond to changing circumstances.
Performance measurement	The authority agrees with its partner(s) in the suitable ways to measure the performance for the arrangement. This might include development milestones, process measures, output targets or quality metrics. The partners also agree how, when and by whom performance will be measured.
Progress monitoring	The authority engages in regular monitoring of progress and performance in delivering the relevant service or asset. This encompasses all aspects of performance, including governance, management, operational, financial, quality and user satisfaction. Any performance deficiencies are addressed promptly, positively and proactively.
Input from service users	The authority – or its partner(s) – seeks regular feedback from service users and potential service users (if relevant) on the delivery of the service or asset, to ensure that it meets their needs and that the partner(s) are not focusing solely on easy-to-reach service users at the expense of those with more complex needs.
Client-side capacity	The authority ensures that it has available sufficient and appropriate internal resources to manage effectively its involvement in the arrangement and to maintain effective oversight of it. This includes securing the engagement of the authority’s leadership team.
Financial transparency	The authority maintains oversight of the financial management of the arrangement. This might include regular financial reports and reporting against key financial performance metrics. The authority also seeks, where feasible, to implement open-book accounting arrangements, as they offer a transparent and fair way of procuring and delivering services and assets in the public sector.

Key questions

- Does the authority have a clear and consistent understanding of what value for money means to it and to its leadership team?
- Does the authority have suitable mechanisms in place to promote value for money at a corporate level and at the level of individual services?
- Is the authority able to demonstrate the action that it has taken to promote value for money and what it has achieved?

Financial Management Standard B:

The authority complies with the CIPFA *Statement on the Role of the Chief Finance Officer in Local Government*

This element of the guidance notes summarises the requirements set out within the CIPFA *Statement on the Role of the Chief Finance Officer in Local Government* or police equivalent.

The FM Code requires that the authority complies with CIPFA's *Statement on the Role of the Chief Financial Officer in Local Government*. This statement describes the roles and responsibilities of the chief financial officer (CFO). It also sets out how the requirements of legislation and professional standards should be fulfilled by the CFO as they carry out their duties.

If the authority adopts different organisational arrangements from those that are set out in the statement, the authority should set out in its annual governance statement why this is the case and how its arrangements deliver the same impact as those set out in the statement.

For the purposes of the FM Code, the CIPFA *Statement on the Role of the Chief Financial Officer of the Police and Crime Commissioner and the Chief Financial Officer of the Chief Constable* (2012) should be substituted for references to the CIPFA *Statement on the Role of the Chief Financial Officer in Local Government* in applicable authorities.

This section summarises the requirements of the statement. The statement also sets out further ideas for how these requirements can be implemented, to which authorities may wish to refer when assessing their adherence to the statement and to the FM Code.

THE CHIEF FINANCIAL OFFICER

The CFO is the authority's most senior executive role charged with leading and directing financial strategy and operations.

The statement sets out the five principles that define the core activities and behaviours that belong to the role of the CFO in local authorities and the organisational arrangements needed to support them.

Compliance with the FM Code requires that each of these principles is demonstrated reliably and consistently across the authority.

- **Principle 1:** The CFO in a local authority is a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver the authority's strategic objectives sustainably and in the public interest.
- **Principle 2:** The CFO in a local authority must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered and aligned with the authority's overall financial strategy.
- **Principle 3:** The CFO in a local authority must lead the promotion and delivery by the whole authority of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently, and effectively.

- **Principle 4:** The CFO in a local authority must lead and direct a finance function that is resourced to be fit for purpose.
- **Principle 5:** The CFO in a local authority must be professionally qualified and suitably experienced.

KEY MEMBER OF THE LEADERSHIP TEAM

Local authorities are required to have a suitably qualified CFO with defined responsibilities and powers. The governance requirements in the statement – and, therefore, the requirements of the FM Code – are that the CFO:

- should be professionally qualified
- should report directly to the chief executive or equivalent and
- should be a member of the leadership team, with a status at least equivalent to other members.

The leadership team is collectively responsible for setting the strategic direction for the authority, for the management of its finances and for the delivery of public services. While performing a key corporate role within the leadership team, the CFO also has a responsibility to advise those members not in executive or leadership roles.

In policing in England and Wales, the relevant CFO should report directly to the chief constable or the PCC. It is the PCC who sets the strategic direction working with the chief constable, with the support of their leadership teams.

The CFO must participate in the strategy development and implementation responsibilities of the leadership team. The CFO must also ensure that the members of the leadership team have the financial capabilities necessary to perform their own roles effectively.

As well as having a fundamental concern for probity and control, the CFO must be proactive in managing change and risk, be focused on outcomes, and help to resource the authority's plans for change and development in the public services it provides.

The CFO must contribute actively to organisational issues and to corporate decision making. They must also exercise a professional responsibility to intervene in spending plans in order to maintain a suitable balance of resources, so that the authority remains in sound financial health.

ACTIVELY INVOLVED IN ALL MATERIAL BUSINESS DECISIONS

The CFO should play a leading role in advising and supporting the leadership team in turning policy aspirations into reality, by aligning financial planning and resources with the authority's vision and strategic objectives.

The CFO has direct responsibility for leading the development and implementation of the financial strategy necessary to deliver the authority's strategic objectives in a sustainable manner. The CFO must therefore work closely with decision makers to establish a medium to long-term strategy that ensures the financial sustainability of the authority.

The CFO must also develop and manage resource allocation models to optimise service outputs and community benefits within funding constraints and any tax-raising limits. In implementing these models, the CFO must ensure that the financial and risk implications of policy initiatives are analysed and addressed appropriately.

The CFO should be actively involved in, and able to bring influence to bear on, all material business decisions whenever and wherever they are taken. The CFO also has an important role to play in ensuring that necessary financial information and advice is provided to the leadership team and decision makers at all levels across the authority.

LEAD THE PROMOTION AND DELIVERY OF GOOD FINANCIAL MANAGEMENT

The CFO must take the lead in establishing a strong framework for implementing and maintaining good financial management across the authority. The CFO must also promote financial literacy throughout the authority, so that the leadership team and managers can discharge their financial management responsibilities, alongside their wider responsibilities in relation to risk and performance management.

The CFO will need to take the lead in coordinating and facilitating a culture of efficiency and value for money. Better value for money releases resources that can be recycled into delivering more and better services, without increasing taxation. Helping to secure positive social outcomes within affordable funding therefore lies at the heart of the CFO's role in the local authority.

Furthermore, the CFO must lead the implementation and maintenance of a framework of financial controls and procedures for managing financial risks, and must determine accounting processes and oversee financial management procedures that enable the authority to budget and manage within its overall resources.

LEADING AND DIRECTING A WELL-RESOURCED FINANCE FUNCTION

The finance function must have a firm grasp of the authority's financial position and performance. The CFO must ensure that there is sufficient depth of financial expertise, supported by effective systems, to discharge this responsibility and to challenge those responsible for the authority's activities to account for their financial performance.

A strong customer focus both externally and internally must be a key feature of the way the finance function does business. The finance function must support the authority's broader development agenda, by appraising investment options and change programmes and contributing creative financial solutions within an effective risk management framework.

The CFO must promote financial literacy throughout the authority, including championing training and the development of relevant skills at all levels. However, the CFO has a particular responsibility for learning and development amongst finance staff, in order to ensure that both current and likely future finance skills needs are addressed.

PROFESSIONALLY QUALIFIED AND SUITABLY EXPERIENCED

The CFO must be able to exercise financial leadership throughout the authority. The CFO must adhere to the professional values of accuracy, honesty, integrity, objectivity, impartiality, transparency and reliability and must promote these throughout the finance function.

The CFO must communicate complex financial information in a clear and credible way. The CFO must also have the confidence to give impartial and objective advice even if it may be unwelcome, and be sufficiently forceful to intervene if financial or ethical principles need to be asserted or defended.

In England and Wales, the officer appointed as the CFO must be a member of a recognised accountancy body. There is no equivalent statutory requirement in Northern Ireland and Scotland although, in both cases, this is widely acknowledged to be good practice.

The CFO must have a good understanding of the principles of financial management and an understanding of, and commitment to, the wider 'business', looking beyond narrow financial objectives, to inspire respect, confidence and trust amongst colleagues, inspectors and stakeholders.

The CFO must also have a good understanding of public sector finance and its regulatory environment and must comply with relevant professional standards. Furthermore, the CFO must personally set the tone throughout the authority that financial management matters and that it is a key part of everyone's job.

Key questions

- Is the authority's CFO a key member of the leadership team, involved in, and able to bring influence to bear on, all material business decisions?
- Does the CFO lead and champion the promotion and delivery of good financial management across the authority?
- Is the CFO suitably qualified and experienced?
- Is the finance team suitably resourced and fit for purpose?

CHAPTER 2

Governance and financial management style

Good governance lies at the heart of the authority's ability to achieve its objectives, to manage its finances and to maintain the trust of those that it serves. It also encourages more robust decision making, greater scrutiny of decisions and better planning for the future.

This chapter of the guidance notes considers:

- how the authority's leadership team demonstrates in its actions and behaviours responsibility for governance and internal control
- the degree to which the authority applies the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016)
- the way in which the financial management style of the authority supports financial sustainability.

It starts by considering how the authority can establish a suitable framework for governance and internal control and how it can seek assurance that this framework is working effectively in practice. It also explores how the leadership team can espouse high standards of governance and internal control and how it can create, maintain and nurture a culture of robust governance and internal control throughout the authority.

The CIPFA/SOLACE *Delivering Good Governance in Local Government Framework* defines the principles that should underpin the governance of each local government organisation. This chapter discusses these principles and sets out how the authority can embed them into its activities and operations. There is a strong link between the principles of the good governance framework and the FM standards and reading both reinforces consistency and coherence.

Financial sustainability is about the ability of the authority to continue to fund its activities not just in the present, but also in an uncertain future. This chapter outlines some of the challenges that the authority may face to its financial sustainability. It also introduces the four dimensions of financial management set out in the CIPFA Financial Management Model and explores how these can be used to develop and embed a financial management style that helps the authority to address these challenges.

Financial Management Standard C:

The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control

In setting out the requirement for the authority's leadership team to demonstrate in its actions and behaviours responsibility for governance and internal control, the FM Code emphasises the importance of the 'Nolan principles'.

These principles have been set out by the Committee on Standards in Public Life and form the basis of the ethical standards expected of public office holders.

The principles are as follows:

1. Selflessness	Holders of public office should act solely in terms of the public interest.
2. Integrity	Holders of public office must avoid placing themselves under any obligation to people or organisations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family, or their friends. They must declare and resolve any interests and relationships.
3. Objectivity	Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.
4. Accountability	Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.
5. Openness	Holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.
6. Honesty	Holders of public office should be truthful.
7. Leadership	Holders of public office should exhibit these principles in their own behaviour. They should actively promote and robustly support the principles and be willing to challenge poor behaviour wherever it occurs.

The last of these principles is especially important for the purposes of the FM Code, as it highlights the need not only to acknowledge these principles, but also to ensure that the authority's leadership team – and, indeed, individuals throughout the authority – demonstrate them in their own actions and behaviours on a daily basis.

In order for the leadership team to demonstrate responsibility for governance and internal control, and therefore to ensure compliance with the FM Code, consideration should be given to the effectiveness of the arrangements in place including:

- establishing a clear framework for governance and internal control across the authority, including for those entities with which the authority works in partnership
- establishing clear arrangements for assurance and accountability
- espousing high standards of governance and internal control in its own activities
- creating, maintaining and nurturing a culture in which governance and internal control are embedded into the way in which the authority works.

As organisational complexity grows it is likely that there will also be an increase in partnership working or the use of other delivery structures. The leadership team must ensure appropriate arrangements are operating effectively. This is necessary to ensure that services are sustainable and to protect the authority from the risk associated with the failure of contracts with such partners.

Specific actions that the leadership might take in each of these respects, which will help it to comply with the requirements of the FM Code, are explored in more detail below.

ESTABLISHING A CLEAR FRAMEWORK FOR GOVERNANCE AND INTERNAL CONTROL

A clear framework for governance and internal control is a cornerstone of the authority's ability to operate effectively. Some key elements of this framework are as follows:

Constitution	The authority has in place a constitution that sets out how it operates, how decisions are made and how the authority ensures that its activities are appropriate, transparent and accountable to local people. This constitution is readily available to all members of the leadership team, officers and members of the public.
Governance structure	The authority has in place a formal governance structure that is appropriate to the way in which it operates. This includes relevant committees and reporting lines, including in particular the provision for scrutiny of the decisions and actions of the leadership team.
Terms of reference	All committees and other elements of the authority's governance structure have formal, agreed terms of reference, setting out the scope of their responsibilities. They also have a defined membership and a suitable, pre-agreed schedule of meetings and work plan.
Conduct of meetings	Each meeting of the committees forming part of the authority's governance structure is guided by an agenda and has its proceedings and decisions recorded in formal, written minutes. Members of the committee, and others who may reasonably wish to address the committee, are given adequate notice of such meetings.
Scheme of delegation	The authority has in place a formal scheme of delegation, which sets out which individuals or committees are entitled to make which decisions. Specifically, it details which decisions are reserved for the authority acting as a corporate body, which can be taken by its committees, specified individual members of the leadership team, the chief executive (or equivalent) and specific officers. Within their overall scheme of governance, PCCs and chief constables in England and Wales also have a scheme of consent, reflecting their relationship as two separate legal entities.
Robust processes and controls	The authority has developed and implemented formal processes for its key activities, to ensure that they are undertaken robustly, efficiently and effectively. These processes are subject to suitable controls, so that the authority can be sure that the processes are implemented as designed.
Partnership governance	Where the authority works in partnership with other organisations in the delivery of services, it has in place appropriate arrangements to oversee these partnerships, to ensure that they are operating effectively and to monitor the achievement of the partnership's objectives.

ESTABLISHING CLEAR ARRANGEMENTS FOR ASSURANCE AND ACCOUNTABILITY

The authority will wish to seek assurance that its governance and internal control arrangements are operating effectively and that those responsible for the effective operation of these arrangements are held accountable. Some ways to achieve this are as follows:

Internal audit	The authority has in place formal arrangements for the provision of an internal audit function, which conforms to the Public Sector Internal Audit Standards. Conformity with these standards is verified by external assessment at least once every five years.
Head of Internal Audit	The authority ensures that the head of internal audit is able to fulfil their role effectively, in line with the responsibilities set out in the CIPFA *Statement on the Role of the Head of Internal Audit* (2019).
Internal audit planning, reporting and resourcing	Internal audit works to an agreed plan, which is based on a robust analysis of the authority's governance and internal control arrangements, the environment within which the authority operates and the risks and challenges that it faces. Internal audit is resourced adequately and reports to an audit committee.
Risk management	The authority has in place a robust approach to the identification, assessment and management of risks to the achievement of its objectives and to the delivery of services. Responsibility for the management of individual risks is allocated clearly. The status of significant risks and their management is reported regularly to the audit committee and to the leadership team.
Audit committee	The authority maintains an effective audit committee in accordance with the principles in CIPFA's *Position Statement on Audit Committees in Local Authorities and Police* (2018) and the supporting guidance publication. Its responsibilities include receiving reports on and monitoring the implementation of internal and external audit recommendations. When threats to the financial sustainability of the authority are identified by auditors, the audit committee ensures that the recommendations are communicated to the leadership team and that the committee is informed of the effectiveness of the leadership team's response. Police audit committees are advisory, supporting the PCC and chief constable. See CIPFA's website for details about its support for audit committees.
External audit and inspection	Recommendations for corrective action made by the authority's external auditors are acted upon promptly. Furthermore, the authority welcomes – and, indeed, actively seeks out – peer challenge, reviews and inspections from regulatory bodies and implements any recommendations that result from them.

ESPOUSING HIGH STANDARDS OF GOVERNANCE AND INTERNAL CONTROL

The leadership team also needs to ensure that it maintains high standards of governance and internal control in its own activities. In addition to engaging proactively with the points outlined above, your arrangements are likely to include:

Code of conduct	The authority establishes formal codes of conduct for members of the leadership team, both officers and members. These codes of conduct are consistent with the Nolan principles, with the latest recommendations from the Committee on Standards in Public Life (reported in its 2019 report *Local Government Ethical Standards*) and with any other relevant principles or codes of practice. Members of the leadership team are required to confirm that they agree to comply with the relevant code of conduct. Any potential breaches are investigated promptly and proactively and suitable action is taken where breaches are found to have occurred.
Register of interests	The authority maintains an up-to-date register of interests for all members of the leadership team. This includes all interests that could potentially influence – or be seen to influence – a member of the leadership team's ability to act impartially in their role or when making decisions. Should a conflict of interests, either actual or perceived, arise, the authority takes appropriate steps to resolve it. The authority's approach to addressing conflicts of interests is recorded in a formal policy or document.
Constructive challenge	The leadership team espouses the principle of constructive challenge to all of its decisions and activities. Consequently, it has developed and implemented appropriate mechanisms to enable this challenge, such as: ■ engagement with relevant audit, scrutiny or oversight committees ■ engagement with the authority's internal auditors ■ consultation with relevant stakeholders prior to making decisions ■ consultation on new policies, plans and strategies. Being open to constructive challenge requires a degree of humility on the part of the leadership team. It does, however, result in better decisions for the authority.
Realism bias	The authority bases its decisions on a robust analysis of the current situation, rather than on what it would like the situation to be or what it needs the situation to be in order for a preferred option to work. This is demonstrated through: ■ detailed analysis of the current situation prior to significant decisions being made ■ a clear and robust decision-making procedure ■ engagement with relevant stakeholders ■ the seeking of appropriate professional advice ■ the use of realistic, evidence-based targets (eg for financial savings), rather than overly optimistic ones that may not be achievable in practice.
Balanced decision making	The authority seeks, in its decision making, to achieve a suitable balance between the desired social outcomes on the one hand, and the available financial resources and need for administrative efficiency, on the other. This is demonstrated through the use of, for example, suitable option appraisal techniques when making significant decisions as well as consideration of alternative models of service delivery.

CREATING, MAINTAINING AND NURTURING A CULTURE OF GOVERNANCE AND INTERNAL CONTROL

The 'tone at the top' is one of the main factors that influence the way in which the authority works. Consequently, the leadership team would be well advised to seek to create, maintain and nurture a culture of effective governance and internal control. In addition to the ideas discussed above, ways in which the leadership team can support such a culture include the following:

Walk the talk	The leadership team demonstrates a high standard of governance and internal control at all times and embraces conscientiously the authority's governance and internal control processes. Any suggestion that these standards do not apply to the leadership team is avoided. Indeed if anything, the leadership team holds itself to higher standards than it demands of the rest of the authority.
Strive for continuous improvement	The authority seeks to improve continuously its standards of governance and internal control. This could include, for example: ■ seeking to comply with new codes of practice as they are issued by relevant public or professional bodies ■ participating in quality mark schemes, award schemes and other development opportunities ■ responding appropriately to the findings of internal audit reviews, external audit recommendations and external inspections.
Reward good behaviours	The authority seeks to reward positive behaviours in respect of governance and internal control, for example by including such matters in role descriptions and individuals' performance goals and by assessing them in annual performance appraisals.
Don't tolerate bad governance or poor control	The authority ensures that any behaviour that falls short of the required standards of governance and internal control is identified and dealt with promptly and effectively. If poor governance or internal control is tolerated, it could percolate rapidly across the authority and dilute any messages that the leadership team might promote about the importance of high standards in these respects.

Key questions

- Does the leadership team espouse the Nolan principles?
- Does the authority have in place a clear framework for governance and internal control?
- Has the leadership put in place effective arrangements for assurance, internal audit and internal accountability?
- Does the leadership team espouse high standards of governance and internal control?
- Does the leadership team nurture a culture of effective governance and robust internal control across the authority?

Financial Management Standard D:

The authority applies the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016)

This element of the guidance notes summarises the requirements set out within the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* and will act as a reminder to those already familiar with these principles.

The framework was introduced in 2016 and from this time all annual governance statements (AGS) will have used the framework in line with requirements from the government's Accounts and Audit Regulations 2015 and the latest version of the CIPFA *Code of Practice on Local Authority Accounting in the United Kingdom.*

The CIPFA/SOLACE *Delivering Good Governance in Local Government Framework* defines the principles that should underpin the governance of each local government organisation. It is based on the CIPFA/IFAC *International Framework on Good Governance in the Public Sector* (2014).

The framework provides a structure to help the authority to ensure that it has in place robust and effective governance arrangements. In order to comply with the FM Code, the authority should ensure that it has implemented the guidance contained in the framework across its activities.

To ensure compliance with the FM Code, whatever form of governance arrangements are in place across the authority, the authority should assess its governance structures against the principles contained in the framework by:

- reviewing its existing governance arrangements
- developing and maintaining an up-to-date local code of governance, including arrangements for ensuring the ongoing effectiveness of this local code
- reporting publicly on an annual basis its compliance with the authority's local code of governance and how the authority has monitored the effectiveness of its governance arrangements, together with how it plans to improve these arrangements in the future.

This reporting on compliance, effectiveness and improvement can usually be undertaken within the authority's AGS, which must be published alongside its financial statements.

THE PRINCIPLES OF THE GOOD GOVERNANCE FRAMEWORK

The framework sets out a series of core principles, which underpin the notion of good governance across the authority and its partnerships.

These core principles are as follows:

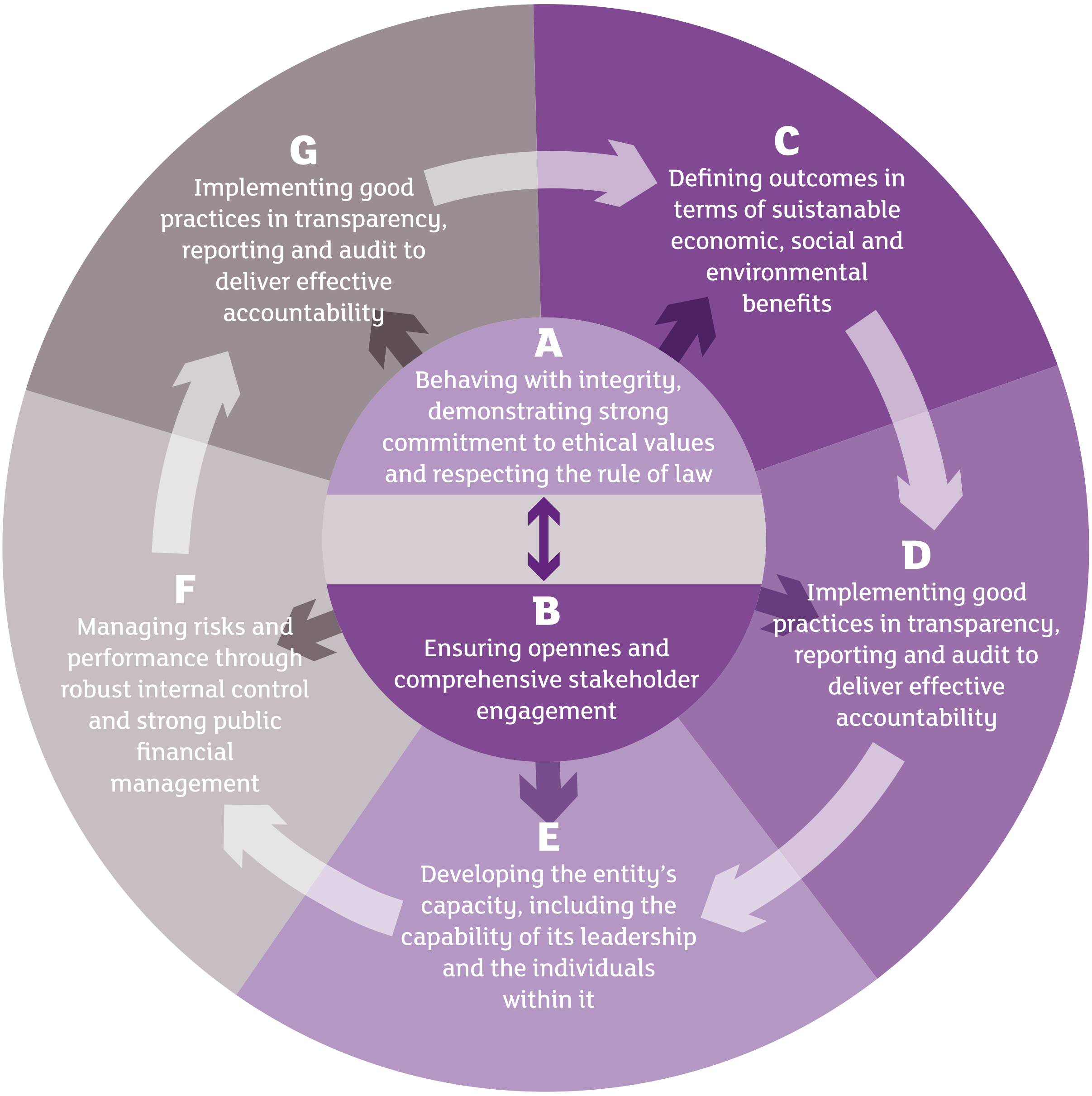
Principle A:	Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.
Principle B:	Ensuring openness and comprehensive stakeholder engagement.
Principle C:	Defining outcomes in terms of sustainable economic, social, and environmental benefits.
Principle D:	Determining the interventions necessary to optimise the achievement of the intended outcomes.
Principle E:	Developing the entity's capacity, including the capability of its leadership and the individuals within it.

Principle F:	Managing risks and performance through robust internal control and strong public financial management.
Principle G:	Implementing good practices in transparency, reporting, and audit to deliver effective accountability.

The intention of the framework is that principles A and B underlie the implementation of principles C to G. The idea is that good governance is dynamic and that the authority as a whole should be committed to improving governance on a continuing basis through a process of evaluation and review.

These core principles are displayed graphically in Figure 1 below.

Figure 1: The core principles of Delivering Good Governance in Local Government Framework



Source: CIPFA *Delivering Good Governance in Local Government Framework* (2016).

Each of the core principles of the framework encompasses a suite of sub-principles, which are in turn supported by a series of behaviours and actions, which aim to demonstrate good governance in practice.

These principles, sub-principles, behaviours and actions provide useful guidance and ideas as to how the authority can ensure that it complies with both the framework and the FM Code.

Integrity, ethical values and the rule of law

The authority is accountable not only for how much it spends, but also for how it uses the resources under its stewardship. This includes accountability for outputs, both positive and negative, and for the outcomes the authority has achieved.

In addition, the authority has an overarching responsibility to serve the public interest, by adhering to the requirements of legislation and government policies.

It is essential that, as a whole, the authority can demonstrate the appropriateness of its actions across all activities and that it has mechanisms in place to encourage and enforce adherence to ethical values and to respect the rule of law.

Openness and stakeholder engagement

Local government is run for the public good. The authority should, therefore, ensure openness in its activities. It should use clear, trusted channels of communication and consultation to engage effectively with all groups of stakeholders, such as individual citizens and service users, as well as institutional stakeholders.

Sustainable economic, social and environmental benefits

The long-term nature and impact of many of local government's responsibilities mean that it should define and plan outcomes and that these should be sustainable.

Decisions should further the authority's purpose, contribute to intended benefits and outcomes, and remain within the limits of its authority and resources.

Input from all groups of stakeholders, including citizens, service users, and institutional stakeholders, is vital to the success of this process and to balancing competing demands when determining priorities for the finite resources available.

Achievement of intended outcomes

Local government achieves its intended outcomes by providing a mixture of legal, regulatory and practical interventions. Determining the right mix of these courses of action is a critically important strategic choice that the authority has to make to ensure intended outcomes are achieved.

This requires robust decision-making mechanisms to ensure that the desired outcomes can be achieved in a way that provides the best trade-off between the various types of resource inputs while still enabling effective and efficient operations.

Capacity and capability

Local government needs appropriate structures and leadership, as well as people with the right skills, appropriate qualifications and mindset, to operate efficiently and effectively and to achieve intended outcomes within the specified periods.

A local government organisation must ensure that it has the capacity to fulfil its own mandate and the policies in place to guarantee that its management has the operational capacity for the organisation as a whole.

Because both the individuals working within the authority and the environment in which the authority operates will change over time, there will be a continuous need to develop the authority's capacity, as well as the skills and experience of individual staff members.

Managing risks and performance

Local government needs to ensure that the organisations and governance structures that it oversees have implemented, and can sustain, an effective performance management system that facilitates effective and efficient delivery of planned services.

Risk management and internal control are important and integral parts of a performance management system and are crucial to the achievement of outcomes. Risk should be considered and addressed as part of all decision-making activities.

A strong system of financial management is essential for the implementation of policies and the achievement of intended outcomes, as it will enforce financial discipline, strategic allocation of resources, efficient service delivery and accountability.

It is also essential that a culture and structure for scrutiny are in place as a key part of accountable decision making, policy making and review. A positive working culture that accepts, promotes and encourages constructive challenge is critical to successful scrutiny and service delivery.

Transparency, reporting and audit

Accountability is about ensuring that those making decisions and delivering services are answerable for them.

Effective accountability is concerned not only with reporting on actions completed, but also with ensuring that stakeholders are able to understand and respond as the organisation plans and carries out its activities in a transparent manner.

ANNUAL REVIEW AND REPORTING

The authority is required to prepare an annual governance statement, in order to report publicly on the extent to which it complies with its own code of governance, which in turn is consistent with the good governance principles in the framework.

This includes how the authority has monitored and evaluated the effectiveness of its governance arrangements in the year, together with any planned changes in the coming period. The process of preparing the governance statement should itself add value to the effectiveness of the governance and internal control framework.

The annual governance statement should provide a meaningful but brief communication regarding the review of governance that has taken place, including the role of the governance structures involved (such as the authority, the audit committee and other committees). It should be high level, strategic and written in an open and readable style.

The AGS should include:

- an acknowledgement of responsibility for ensuring that there is a sound system of governance (incorporating the system of internal control) and reference to the authority's code of governance
- reference to and assessment of the effectiveness of key elements of the governance framework and the role of those responsible for the development and maintenance of the governance environment, such as the authority, the executive, the audit committee, internal audit and others as appropriate
- an opinion on the level of assurance that the governance arrangements can provide and confirmation (if possible) that the arrangements continue to be regarded as fit for purpose in accordance with the governance framework
- an agreed action plan showing actions taken, or proposed, to deal with significant governance issues
- reference to how issues raised in the previous year's annual governance statement have been resolved
- a conclusion on the authority's governance arrangements and a commitment to monitoring implementation as part of the next annual review.

The AGS should be signed by the leading member (or equivalent) and chief executive (or equivalent) on behalf of the authority. The annual governance statement should be approved at a meeting of the authority or delegated committee (in Scotland, the authority or a committee with a remit including audit or governance). For police bodies in England and Wales, separate annual governance statements should be signed by the PCC and the chief constable as they are separate legal entities. No approval by committee is needed.

The authority is required to include the AGS with its statement of accounts. As the annual governance statement provides a commentary on all aspects of the authority's performance, it is appropriate for it to be published, either in full or as a summary, in the annual report, where one is published.

The production of a suitable AGS is a key piece of evidence that the authority has sought to comply not just with the framework and its own governance code, but also with the FM Code.

ADDITIONAL GUIDANCE ON THE IMPLEMENTATION OF THE FRAMEWORK

In recognition of the separate legislation applicable to different parts of local government and the impact that this will have on individual authorities' governance arrangements, separate guidance notes to accompany the framework are available for:

- local government in England
- local government in Wales

- PCCs and chief constables in England and Wales
- local government in Scotland.

The guidance notes are intended to assist the authority in reviewing its governance arrangements. They will also help the authority to interpret the overarching principles and terminology contained in the framework in a way that is appropriate to its governance structures, taking account of the legislative and constitutional arrangements that underpin them.

Key questions

- Has the authority sought to apply the principles, behaviour and actions set out in the framework to its own governance arrangements?
- Does the authority have in place a suitable local code of governance?
- Does the authority have a robust assurance process to support its AGS?

Financial Management Standard E:

The financial management style of the authority supports financial sustainability

Financial sustainability is about the ability of the authority to continue to fund its activities not just in the present, but also in an increasingly uncertain future. Developing a robust approach to ensuring the financial sustainability of the authority's activities is central to compliance with the FM Code.

Achieving financial sustainability requires the authority to have the capacity, the capability and the confidence to plan for the long term and to focus on the achievement of longer-term objectives, rather than to exist simply from year to year.

Unfortunately, authorities face a range of challenges that can impact on their ability to plan effectively for the future and to develop and maintain a sustainable financial strategy.

These include:

- changes to the nature and level of public funding
- an ageing population
- ongoing pressures on adult and children's social care and other service areas
- a drive for greater efficiency in response to resource constraints
- increased demand for affordable housing
- uncertainty regarding the UK's ongoing relationship with the EU
- new risks associated with commercialisation.

Critical to the authority's ability to address these and other challenges is to have in place a robust approach to financial management, together with the capacity and capability to implement this approach consistently over time.

This includes ensuring that those individuals with specific responsibility for aspects of the authority's governance and financial management arrangements have the delegated powers and the appropriate skills and training to fulfil these responsibilities.

THE HIERARCHY OF FINANCIAL MANAGEMENT STYLES

In its Financial Management Model, which seeks to help authorities to develop an effective financial management style, CIPFA identifies a hierarchy of three financial management styles, namely:

A financial management style that supports performance can only be achieved once the authority has developed and embedded a financial management style that delivers accountability. A style that enables transformation can only be achieved once the other two elements of the hierarchy are in place.

Consequently, this hierarchy represents a sort of maturity model, to facilitate the development of the authority's approach to financial management over time and to help it to enhance its capacity and capability to create a financial management style that supports – and, indeed, promotes – financial sustainability.

DIMENSIONS OF FINANCIAL MANAGEMENT

The Financial Management Model sets out four dimensions of financial management. These cover a blend of 'hard-edged' attributes – things that the authority can cost and measure – as well as softer features like communications, motivation, behaviour and cultural change.

The dimensions are:

- **Leadership**, which focuses on strategic direction and business management, and on the impact on financial management of the vision and involvement of the authority's leadership team. The tone set from the top is critical.
- **People**, which includes both the competencies and the engagement of staff, within and throughout the authority.
- **Processes**, which examines the authority's ability to design, manage, control and improve its financial processes to support its policy and strategy.
- **Stakeholders**, which acknowledges the relationships between the authority and those with an interest in its financial health. The authority interacts with a complex web of stakeholders, such as central government, inspectors, taxpayers, partners, suppliers, customers or service users. External stakeholders have legitimate expectations about the finances of the authority. This is enveloped by the public interest.

These dimensions are deliberately related to other well-used quality and performance management tools, such as the balanced scorecard and the European Foundation for Quality Management model.

Within each of these dimensions, the Financial Management Model sets out the attributes that collectively characterise each level of the financial management hierarchy. These attributes would also allow the authority to demonstrate that it has developed and embedded an appropriate financial management style in the way in which it operates.

Leadership

Delivering accountability	■ Financial capability is regarded as integral to supporting the delivery of the authority's objectives. The CFO (or equivalent) is an active member of the leadership team, is at the heart of corporate strategy/business decision making and leads a highly visible, influential and supportive finance team. ■ The authority has an effective framework of financial accountability that is understood clearly and applied throughout the organisation, from the leadership team through to front line service managers. ■ Within an annual budget-setting process the authority's leadership team sets income requirements, including taxation income, and allocates resources to different activities in order to achieve its objectives. The authority monitors its financial and activity performance in delivering planned outcomes.

Supporting performance	■ The authority has a developed financial strategy to underpin medium and longer-term financial health. The authority integrates its business and financial planning so that it aligns resources to meet current and future outcome-focused business objectives and priorities. ■ The authority develops and uses financial/leadership expertise in its strategic decision making and its performance management based on an appraisal of the financial environment and cost drivers.
Enabling transformation	■ The authority's leadership team integrates financial management into its strategies to meet future business needs. Its financial management approach supports the change agenda and a culture of customer focus, innovation, improvement and development.

People

Delivering accountability	■ The authority identifies its financial competency needs and puts arrangements in place to meet them. ■ The authority has access to sufficient financial skills to meet its business needs.
Supporting performance	■ The authority manages its finance function to ensure efficiency and effectiveness. ■ Finance staff provide business partner support by interpreting and explaining performance as well as advising and supporting on key business decisions. ■ 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 makers understand and manage the financial implications of their decisions.
Enabling transformation	■ The authority develops and sustains its financial management capacity to help shape and support its transformational programme.

Processes

Delivering accountability	■ Budgets are accrual-based and calculated robustly. ■ The authority operates financial information systems that enable the consistent production of comprehensive, accrual-based, accurate and up-to-date data that fully meets users' needs. ■ The authority operates and maintains accurate, timely and efficient transactional financial services (eg creditor payments, income collection, payroll, and pensions administration). ■ The authority's approach to treasury management is risk based. It manages its investments, cash flows, banking, money market and capital market transactions effectively, balancing risk and financial performance. ■ The authority actively manages budgets, with effective budget monitoring arrangements that ensure 'no surprises' and trigger responsive action. ■ The authority maintains processes to ensure that information about key assets and liabilities in its balance sheet is a sound and current platform for management action. ■ Management understands and addresses its risk management and internal control governance responsibilities. ■ Management is supported by effective assurance arrangements, including internal audit, and audit and risk committee(s). ■ The authority's financial accounting and reporting are accrual-based, comply with the *Code of Practice on Local Authority Accounting in the United Kingdom*, and meet relevant professional and regulatory standards.
Supporting performance	■ The authority's medium-term financial planning process underpins fiscal discipline, is focused upon the achievement of strategic priorities and delivers a dynamic and effective business plan. ■ Forecasting processes and reporting are well-developed and supported by accountable operational management. Forecasting is insightful and leads to optimal decision making. ■ The authority systematically pursues opportunities to reduce costs and to improve value for money in its operations. ■ The authority systematically pursues opportunities for improved value for money and cost savings through its procurement, commissioning and contract management processes. ■ The authority continually re-engineers its financial processes to ensure delivery of agreed outcomes is optimised. ■ The authority manages its finance function to ensure efficiency and effectiveness.
Enabling transformation	■ The authority's financial management processes support organisational change.

Stakeholders

Delivering accountability	■ The authority provides external stakeholders with evidence of the integrity of its financial conduct and performance, and demonstrates fiscal discipline including compliance with statutory, legal and regulatory obligations.
Supporting performance	■ The authority demonstrates that it achieves value for money in the use of its resources.
Enabling transformation	■ The authority is responsive to its operating environment, seeking and responding to customer and stakeholder service and to spending priorities that impact on its financial management.

In seeking to comply with – and to demonstrate compliance with – the FM Code, the authority may wish to have regard to the dimensions of the Financial Management Model and to the attributes inherent to each of these.

These attributes are not, however, mandatory requirements of the FM Code, unless required specifically by other standards within this FM Code. Consequently, the authority is free to determine its own financial style and how this style supports the achievement of financial sustainability.

In CIPFA's view, an assessment of an authority's financial management style can best be undertaken by means of peer review. While this is not a mandatory requirement for compliance with the FM Code, it can yield a more objective, more balanced and more insightful view than one resulting from an assessment undertaken by the authority itself.

Key questions

- Does the authority have in place an effective framework of financial accountability?
- Is the authority committed to continuous improvement in terms of the economy, efficiency, effectiveness and equity of its services?
- Does the authority's finance team have appropriate input into the development of strategic and operational plans?
- Do managers across the authority possess sufficient financial literacy to deliver services cost-effectively and to be held accountable for doing so?
- Has the authority sought an external view on its financial style, for example through a process of peer review?
- Do individuals with governance and financial management responsibilities have suitable delegated powers and appropriate skills and training to fulfil these responsibilities?

CHAPTER 3

Medium to long-term financial management

Effective governance and financial management is focused on ensuring that the authority is able to operate sustainably in the long term. This means that the authority needs to look beyond the limited time horizons of its funding arrangements and to consider the longer-term financing of its operations and activities.

This section of the guidance notes considers:

- whether the authority has carried out a credible and transparent financial resilience assessment
- the extent to which the authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members
- whether the authority complies with the CIPFA *Prudential Code for Capital Finance in Local Authorities*
- the degree to which the authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans.

This chapter explores what a financial resilience assessment is and how the authority can undertake one. It also considers symptoms of financial stress and how the authority can manage its finances more effectively. This includes explicit consideration of, among other things, capital resources, reserves, savings plans and the use of performance information.

The FM Code requires that the authority demonstrates how the risks identified through a financial resilience assessment have informed the development of its longer-term financial strategy. This section considers the authority's strategic plan and financial strategy and explores how the technique of scenario planning can be used to inform their development.

CIPFA's Prudential Code provides a framework for the self-regulation of the authority's capital financing arrangements. This section outlines the aims of the Prudential Code. It also considers how the authority can develop a suitable capital strategy and how it can set and review the various indicators required under the Prudential Code.

The medium-term financial plan translates the authority's financial strategy into the near future. This chapter considers how the authority can develop a robust medium-term financial plan that coordinates and integrates financial and service planning, capital financial management, risk management and asset management plans.

Financial Management Standard F:

The authority has carried out a credible and transparent financial resilience assessment

The FM Code sets out that if the authority has not tested and demonstrated its long-term financial resilience, then its financial sustainability remains an open question. The FM Code requires, therefore, that the authority assesses critically its finance resilience. This is undertaken by means of an explicit financial resilience assessment.

In the financial resilience assessment, the authority explores the sensitivity of its financial sustainability to alternative plausible scenarios for the key drivers of costs, service demands and resources. This will require an analysis of future demand for key services and consideration of alternative options for matching demand to resources.

This resilience testing should, the FM Code states, focus on the authority's principal longer-term revenues and expenses and the key risks to which the authority will be exposed. Without such stress testing, the authority cannot be regarded as financially sustainable and will be deemed to have failed that test.

Such a financial resilience assessment needs to be credible and transparent. To be credible, the assessment could be undertaken:

- by a suitably-qualified and experienced individual or team of individuals
- in an objective manner, ideally by an individual or team that is independent of the authority in question
- in accordance with an approach that is designed to focus on assessing the authority's financial resilience
- with consideration of an appropriate range of evidence, including interviews with key individuals and a review of relevant documentation.

In order to ensure transparency, the assessment could:

- be overseen by the authority's leadership team or by a suitable committee of the authority
- have clear terms of reference and a suitable methodology
- result in a clear and thorough report, including suitable conclusions and recommendations, that is reported to the authority's leadership team.

It would be beneficial for the leadership team to report to the authority on the action that it is taking in response to the assessment and to provide periodic updates on the extent to which this action has been taken.

In preparing a financial resilience assessment, the authority (for local authorities in England and Wales) may also wish to draw upon the report prepared by its section 151 officer, under Section 25 of the Local Government Act 2003, on the robustness of the estimates and the adequacy of reserves allowed for in the authority's annual budget.

SYMPTOMS OF FINANCIAL STRESS

The authority can exhibit financial stress in a number of ways. Some of the more common symptoms are as follows:

- **Running down reserves** – Using the authority's financial reserves to finance a deficit or to avoid difficult decisions around spending cuts provides temporary relief, but is not sustainable in the long term.
- **Failure to address financial pressures** – Refusing to make difficult decisions about how to reconcile funding and service pressures, or not recognising that such decisions

need to be made, is equally not a solution to challenges but instead simply increases the financial gap and the extent of change that will be required in future years.

- **Shortened planning horizons** – Long-term planning is more difficult in times of uncertainty, but it is still important, perhaps even more so than in more stable circumstances. A failure to plan is indicative of a lack of strategic thinking and an unwillingness to make difficult decisions.
- **Lack of investment in infrastructure resources** – When resources are scarce, it is tempting to defer the maintenance and enhancement of assets (such as buildings) to future periods, which can result in the failure of key physical resources.
- **Gaps in savings plans** – Knowing that savings are required is helpful, but knowing how these savings are going to be achieved is critical. Simply indicating that 'unidentified savings' will be made is not an acceptable strategy for financial resilience.
- **Unplanned overspends** – No budget is going to be absolutely spot-on. However, overspending against the budget is simply rolling over this year's problems into next year. It is a clear sign that the authority is failing to turn its financial policy decisions into action on the ground.

ASSESSING FINANCIAL RESILIENCE

There are a number of factors that drive the ability of the authority to withstand financial pressures. It would be helpful for these to be considered as part of any financial resilience assessment.

These factors include:

- getting routine financial management right
- planning and managing capital resources well
- using performance information effectively
- having clear plans for delivering savings
- managing reserves well.

We discuss each of these, together with how the authority could use them to ensure and to demonstrate its compliance with the FM Code, in more detail below.

GETTING ROUTINE FINANCIAL MANAGEMENT RIGHT

The first step is simply to ensure that the authority's basic financial management systems are working effectively and that the authority's financial performance and position is reported regularly and effectively to the CFO and to the leadership team.

This helps to ensure that the CFO and the leadership team all have a clear understanding of the authority's financial position and of the financial challenges and pressures that the authority faces.

It is important also that the leadership team, senior managers and service managers understand the authority's long-term financial strategy, what needs to be done to deliver it, and what their personal responsibilities are for helping to deliver it.

As a general rule, the authority might seek to:

- have in place robust arrangements for processing and recording income and expenditure in a timely manner
- prepare and agree an annual budget that breaks down income and expenditure targets to the level of individual services and budget holders
- provide budget holders with regular reports on their performance against their budget allocations, identify any significant variations from the agreed budget, and take prompt action to address them
- prepare regular, timely, accurate and comprehensible reports on the authority's financial performance and position for the leadership team.

PLANNING AND MANAGING CAPITAL RESOURCES WELL

The authority will have a range of capital resources at its disposal, which it uses to deliver services and to achieve its strategic objectives. These resources will include land and buildings, such as offices, schools, housing, parks and open spaces, leisure centres, libraries and much more.

The authority's ability to maintain these assets so as to ensure and to enhance their role in the delivery of services is crucial to its financial resilience. If housing, libraries or leisure centres fall into disrepair, for example, such that they are no longer able to fulfil their primary purpose, then the authority's ability to deliver the associated services is impaired and it has resources tied up in assets that it cannot use.

Consequently, planning and managing the use of the authority's capital resources – particularly its infrastructure assets – is vital. This includes understanding the role that these assets play in the delivery of services and ensuring that the authority's asset base remains fit for purpose.

As a general rule, the authority will seek to:

- have in place an agreed capital strategy, which is consistent with the authority's financial strategy and medium-term financial plan
- develop and agree a suitable asset management plan, which sets out how it will ensure that its asset base remains fit for purpose
- provide the leadership team with regular reports on the status of the authority's asset base and of any further action required to maintain and manage it.

In policing in England and Wales, the PCC has responsibility for property. The chief constable can hold assets, but is not permitted to own land or buildings. The PCC is responsible for producing a capital strategy and any borrowing undertaken in compliance with CIPFA's *Prudential Code for Capital Finance in Local Authorities*.

USING PERFORMANCE INFORMATION EFFECTIVELY

In order to assess the authority's ability to withstand financial pressures, it is important to understand how well it is performing currently and how any financial challenges are likely to impact on this performance.

Authorities have a broad range of internal performance information available to them, from income and expenditure data to information on activity levels and service user satisfaction. This information can be collated to understand critical factors such as the unit cost of services, trends in service user satisfaction, and many more.

Another practical way to assess the authority's financial and operational performance is to compare the authority's costs, income, activities and performance with those of similar authorities or organisations. This is especially useful for factors such as the unit costs of services, which are more readily comparable than absolute costs or activity levels.

This 'benchmarking' approach can be undertaken through a mutual arrangement with one or more other authorities, the use of standard sector datasets, participation in a sector-led benchmarking scheme, or subscription to a scheme operated by a commercial provider.

In addition to the use of benchmarking data to understand how the authority's income and expenditure – both overall and at the level of individual services – compares against that of its peers, authorities can seek also to benchmark structures, activity levels and per-unit income and costs against those of suitable comparators.

In addition to benchmarking, the authority can seek to compare itself with similar authorities through processes such as peer review, where one or more representatives of another authority review the authority's structures or processes in the light of their own ways of doing things, challenge existing practices and make suggestions for improvement.

Regardless of the approach that the authority adopts to better understanding its performance, it should seek to learn from this, to identify key risks to its resilience and to identify ways in which it can approach its own activities and operations more economically, efficiently, effectively and equitably.

As a general rule, the authority might seek to:

- make good use of internal performance information to identify risks to its ongoing financial resilience and the impact of financial pressures on service delivery
- identify and use suitable local or national benchmarking data against which to compare its overall financial performance and position
- identify and use suitable local or national benchmarking data against which to compare income, activity and costs for its principal services
- engage with similar authorities to instigate and to implement a process of peer review for key services and activities
- use the insight gained from its benchmarking or other performance-comparison activities to identify (a) where it is performing well and (b) where and how it can improve further the way in which it operates.

HAVING CLEAR PLANS FOR DELIVERING SAVINGS

The authority needs a single, consolidated and regularly-updated mechanism that tracks its savings plans. This should include the savings that have been agreed, how they will be monitored and the extent to which they have been achieved. These savings should also be built into the authority's annual budget and its medium-term financial plan.

In identifying financial savings, the authority needs to distinguish between the different 'stages' of savings in play, namely:

- those which have been agreed and for which there is a clear delivery plan
- those which have been agreed in principle but do not yet have a clear strategy for implementation
- those that have been proposed but not yet agreed, ie are simply ideas at this stage.

It is important not to blur the distinction between these different 'stages' of savings, to avoid giving a false impression of how much progress has been made.

The timescale for the achievement of savings, as well as the level of any investment required to achieve them, needs to be realistic. Restructuring a service to streamline activity or to change the way in which it is delivered can take months, if not years. So any associated savings are unlikely to be achieved for some time.

In this context, the classification of particular service costs as fixed, stepped, variable or mixed for a specified timeframe will be of assistance in identifying the nature, value and timing of savings that can realistically be made.

The authority's finance staff need to exercise suitable challenge to individual managers' and teams' savings plans, to ensure that these plans are achievable. Robust oversight of savings plans will also be required, to ensure that the savings identified are actually achieved in practice.

As a general rule, the authority might seek to:

- have a central record of targeted savings, which is linked clearly to its annual budget and its medium-term financial plan
- categorise savings activities by the extent to which they have been agreed, planned, implemented and achieved
- have in place mechanisms to challenge the viability of savings plans before they are agreed
- have in place suitable mechanisms to oversee the implementation of savings-related activities and the achievement of the savings themselves.

MANAGING RESERVES WELL

The aim of the authority's financial reserves is to provide funding for investment in future activities and to act as a safety net in case of short-term financial challenges. Consequently, limited use of reserves to support the delivery of a clear and transparent savings programme is perfectly acceptable.

Using reserves to fund otherwise-unsustainable services or to defer the need to make difficult decisions about service delivery, on the other hand, is to be avoided. Such an approach does nothing to enhance financial resilience. It also serves to make those difficult decisions even more difficult, when they inevitably have to be made in the future.

The authority should also be extremely wary of any savings plans that target ‘easy’ savings now, but that include larger, unspecified savings in future years. This may be politically expedient, but does not represent good financial management and is likely to have a negative impact on the authority’s reserves when such savings inevitably prove challenging to identify and to realise.

As a general rule, the authority might seek to:

- have a policy as to the level of reserves it wishes to retain and how these reserves may be used
- be able to demonstrate that it has used its reserves only for investment in future activities or in the implementation of savings plans, rather than to plug funding gaps in the delivery of services.

For policing in England and Wales, it is the PCC who has responsibility for financial reserves and must publish a reserves strategy including details of current and planned reserves. Stand-alone fire and rescue authorities must also publish a financial reserves strategy with details of current and planned reserves.

CARRYING OUT A CREDIBLE AND TRANSPARENT FINANCIAL RESILIENCE ASSESSMENT

A financial resilience assessment can be undertaken by members of the authority’s finance and leadership teams, though it may be more objective if it is undertaken by peers from different authorities or by some other external partner.

The assessment should consider principally whether the authority has in place a credible plan and planning process that gives confidence that it can deliver a sustainable budget over the medium term. The scope of this assessment might include, for example:

- the authority’s current financial position
- the authority’s own assessment of its future financial prospects
- the extent to which the authority has embraced the financial resilience factors discussed above
- the key financial risks facing the authority, for example by drawing on potential future scenarios including ‘best’ and ‘worst’ case scenarios – for the environment in which the authority operates and for the services that it provides
- the use of independent, objective measures to assess the risks to the authority’s financial resilience and sustainability
- the authority’s understanding of the risks associated with all resources used for service delivery, including its workforce, its physical assets, its strategic business partners (including ‘group’ entities such as leisure trusts), its information technology infrastructure, etc

- the robustness of the plans that the authority has put in place to address these risks
- the capacity and capability of the authority, its leadership team and its officers to manage the authority's finances in a sustainable manner.

Those undertaking the assessment are advised to review, as a minimum, the following documents:

- medium-term financial plan, including capital and revenue elements
- medium-term savings and growth plan
- capital strategy and/or investment strategy
- 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 the budget process
- recent monitoring reports and recent out-turn reports and accounts
- workforce strategy plans and expected pension commitments
- group entity financial forecasts
- asset management plan
- key governance documents, eg annual governance statement, risk register, etc.

Those undertaking the assessment should also engage with key members of the leadership team and with other relevant individuals, such as:

- the authority's leader and finance portfolio holder
- minority party leaders
- for police in England and Wales, the PCC and chief constable
- chief executive
- monitoring officer
- chief financial officer
- service directors
- external auditor and chair of audit committee
- one or more service accountants.

The scope of the financial resilience assessment is likely to extend also to an understanding of the risks associated with the authority's most significant partners. This is necessary to ensure that services are sustainable and to protect the authority from the risk associated with the failure of contracts with such partners.

When, as is common, a significant number of authorities are dependent on a single supplier then it may be valuable for those authorities to co-operate in this assessment in order to fully understand the associated risks.

A financial resilience assessment should result in a clear report to the authority's leadership team, setting out an assessment of the authority's financial resilience, together with areas for improvement and how these could be addressed.

Key questions

- Has the authority undertaken a financial resilience assessment?
- Has the assessment tested the resilience of the authority's financial plans to a broad range of alternative scenarios?
- Has the authority taken appropriate action to address any risks identified as part of the assessment?

Financial Management Standard G:

The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members

The FM Code sets out that, having carried out a finance resilience assessment, the authority should demonstrate how the risks identified have informed the development of its longer-term financial strategy. The authority should, furthermore, report the implications of these risks on its future financial sustainability to its leadership team, including its elected members.

This requires consideration of how financial resilience is integrated into the authority's strategic plan and into the financial strategy associated with the delivery of this strategic plan.

One way in which this can be achieved in an uncertain and dynamic operating environment is through the use of scenario planning, which is introduced here as a suggestion as to how the authority could seek to meet its requirements under this part of the FM Code.

This is, however, just a suggestion. Other approaches to complying with this financial management standard are available. It is up to the authority to select an approach that is commensurate with its own requirements and with the resources that it has available, while meeting the requirements of the FM Code.

THE STRATEGIC PLAN

In terms of longer-term planning, the authority will have in place an overarching strategic plan, which sets out its vision for the future and how it plans to achieve this vision. Because of electoral cycles and other factors, strategic plans tend to cover a rolling period of five years or so.

The authority will also – in most cases – have in place a financial strategy, setting out how it plans to finance the aims, strategies and activities set out in the strategic plan. This financial strategy may be a part of the strategic plan itself, though it may also be a separate document.

While a five-year planning horizon is acceptable for medium-term planning, long-term planning really needs to look further ahead, albeit at a significantly reduced level of detail. Up to ten years is a reasonable horizon for longer-term financial planning, though up to 20 or 25 years is not unheard of.

CIPFA is not at present prescriptive about the time period for longer-term financial planning. Different authorities will face different levels of political and financial stability, which may have become embedded in different management cultures.

However, CIPFA promotes ambition and stresses the need for a financial strategy that matches the need for a strategic approach to service planning. The underlying drivers of service demand, especially those linked to the age profile of the community, can usually be foreseen at least in broad terms a decade and more ahead. The need to respond to the climate change agenda is also an area where longer-term planning is necessary.

THE FINANCIAL STRATEGY

The primary aim of the authority's financial strategy is to enable the delivery of the authority's overall strategy. More specifically, it seeks to ensure that the authority has the financial capacity and capability to achieve its strategic aims. It is about the long-term financial sustainability of the organisation.

Consequently, the financial strategy might include consideration of a broad range of factors that influence the authority's long-term financial success. These include:

- the nature, level and balance of the authority's sources of income
- the authority's exposure to volatile income streams
- the authority's cost base, especially its overhead costs
- the extent to which costs are fixed, stepped or variable within the timeframe being considered
- the anticipated changes in the assets and liabilities of the authority supporting balance sheet management
- the authority's asset base and its asset management priorities
- the authority's capital programme
- the financial structure and staffing of the authority
- the authority's financial management policies, systems and processes
- the authority's relationships with key financial stakeholders.

An effective financial strategy will include consideration of where the authority is now from a financial perspective, where it would like to be and how it plans to get there:

Where the organisation is now	An analysis of the authority's current financial situation, including its main sources of income, its main financial commitments, its capital asset portfolio and priorities, and the level of reserves that it holds. This analysis also addresses a range of other relevant factors, such as the authority's financial structure and its relationships with key financial stakeholders.

Where it would like to be	An assessment of how the authority envisages its financial capacity and capability to facilitate the achievement of its strategic aims. This provides a longer-term financial 'vision' for the authority, which is consistent with the authority's overall strategic vision. It may include, for example, consideration of changes to the nature, level and balance of income streams, the structure and management of the authority's cost base, changing demand for capital assets (including physical resources) and the skills and expertise of its finance staff.
How it plans to get there	A series of agreed actions designed to take the authority from where it currently stands, from a financial viewpoint, to where it would like to be. These actions are clear, coherent and consistent with the delivery of the authority's overall strategy. They also have clear timescales, so that they can be integrated appropriately into the authority's medium- and short-term financial plans.

However, given the tendency for government funding to be allocated on an annual basis and for the funding regime itself to be subject to regular revisions, financial planning over even a relatively short five-year time horizon can be challenging for the authority.

Other strategic, operational or financial challenges, such as demographic changes or changes to relevant legislation, can also significantly impact on the authority's ability to achieve and to finance its strategic aims.

Consequently, the authority may wish to use scenario planning techniques to consider a number of potential scenarios for (a) the funding regime and (b) other factors influencing the demand for or the delivery of its activities.

THE AIMS OF SCENARIO PLANNING

The development of longer-term financial strategies can be characterised by the use of scenarios, rather than of forecasts based on the continuation of the status quo. In contrast to forecasts, scenarios are not predictions of the future, but distinct and still plausible visions of that future.

Scenario planning moves beyond sensitivity analysis and similar techniques by describing alternative, internally-consistent, possible future economic and political environments, together with the resource and regulatory implications that are likely to flow from them.

For the authority, a shift from forecasting to scenario planning may prove beneficial at a time of continuing economic and political uncertainty. Scenarios are well-suited to highly complex situations with many unquantifiable factors, highly uncertain situations or situations where there is little or no reliable data for quantitative models.

Scenarios allow the authority to test the viability of alternative financial strategies against a representative and realistic set of internally consistent possibilities. They are an alternative to conventional forecasting that is better suited to an environment with numerous uncertainties or imponderables.

Traditional forecasting encourages organisations to focus on a narrow range of possibilities centred on a single view about the most likely future outcome. Scenario building, in contrast, does not attempt to use a series of static assumptions to predict the future. Instead, it generates a suite of plausible outcomes that seek to represent the most likely future environments in which the organisation could find itself operating.

Unlike forecasting, which relies on the forward projection of existing trends, scenarios can explicitly recognise the discontinuities and abrupt changes that result from political change. At a local, national and sometimes an international level, significant changes in the balance of political control often represent important points of discontinuity in financial strategies that cannot be incorporated into planning based on conventional forecasts.

Another advantage of the scenario-based approach that makes it particularly relevant to the political environment is that it does not demand consensus. Scenario building can instead recognise different visions of the future and then define them more clearly in a range of internally-consistent but still very different scenarios. Such an approach also allows the authority to consider how it would respond to a wholesale revision of its previous assumptions in favour of a completely fresh set of parameters. Crucially, it can also provide an indication of situations or circumstances which may pose the greatest challenges to the authority's financial resilience.

BUILDING EFFECTIVE SCENARIOS

For scenarios to be effective, they need to be plausible. However they also need to be challenging, in that they force the authority to consider potentially 'uncomfortable' situations. Scenarios invite people to explore what might happen, rather than what they want to happen.

For this reason, it is important to avoid falling into the trap of developing three scenarios that broadly correspond to the status quo, the ideal scenario and the worst case scenario. This taxonomy invites decision makers to reject the extreme scenarios as simply unlikely to occur and so to retreat into considering only the status quo.

The best case/worst case/status quo nomenclature is acceptable in sensitivity analysis, but it should not be imported uncritically into scenario building.

The scenarios used in developing a financial strategy must be based on a rigorous and credible analysis of the wider environment in which the authority operates. Generally, the best approach is to set up at least four scenarios that represent plausible alternative combinations of circumstances.

Ideally, these scenarios should not simply represent the input of extreme parameters into a financial model. Each should, instead, be embedded in a plausible analysis that draws attention to the major technical, economic and political uncertainties upon which the success of each option depends. With this approach, it is wholly reasonable that a pessimistic view may be taken on one element of the option and combined with an optimistic view on another element.

USING SCENARIOS TO UNDERSTAND THE AUTHORITY'S PROSPECTS FOR FINANCIAL SUSTAINABILITY

While scenarios have an important role to play in helping the authority to understand the future environment in which it may need to operate, they also impose an invaluable 'reality check' on the authority's prospects for future financial sustainability by ensuring that its financial strategy is able to meet the full range of these future challenges or opportunities.

Consequently, the authority can gain a deeper understanding of its prospects for financial sustainability in the longer term, as required under the FM Code, by (a) developing a longer-term financial strategy and (b) assessing the viability of this strategy under a range of potential future scenarios.

Furthermore, these scenarios can incorporate specific risks, challenges or vulnerabilities identified in the authority's financial resilience assessment, thus allowing the authority to assess the resilience of its financial strategy – and, therefore, its own future financial sustainability – to the specific issues that it is likely to face both now and in the future.

REPORTING TO MEMBERS

The FM Code also requires that, in addition to taking action to understand its prospects for financial sustainability in the longer term, the authority must communicate these prospects to those charged with its governance such as elected members or, in the case of policing, to PCCs and chief constables.

In communicating with members, the authority should take care to present its prospects for future financial sustainability in a clear way, which does not require specific financial or other expertise in order to be understood.

Key things to communicate include:

- what financial sustainability is and why it is important
- key threats to the authority's financial sustainability, eg funding cuts, increased demand for services
- what the authority is doing to address these threats and the likelihood of it being able to address them effectively
- any threats that are beyond the authority's control, how it will know if these threats are realised and what the impact would be on the authority
- any other actions the authority is taking to improve its financial sustainability
- the requirement for prudence, especially in terms of the Prudential Code and the authority's borrowing arrangements
- an overall assessment of the authority's prospects for financial sustainability in the longer term.

The aim here is to present a balanced assessment of the authority's future financial position. The nature of the environment in which the authority operates means that it is always going to face challenges to its future financial sustainability. Members also need to be aware of the specific threats that the authority is likely to face, the impact of these threats on the authority, and what the authority can do – both now and in the future – to address them.

Key questions

- Does the authority have a sufficiently robust understanding of the risks to its financial sustainability?
- Does the authority have a strategic plan and long-term financial strategy that adequately address these risks?
- Has the authority sought to understand the impact on its future financial sustainability of the strategic, operational and financial challenges that it might face (eg using a technique such as scenario planning)?
- Has the authority reported effectively to the leadership team and to members its prospects for long-term financial sustainability, the associated risks and the impact of these for short and medium-term decision making?

Financial Management Standard H:

The authority complies with the CIPFA *Prudential Code for Capital Finance in Local Authorities*

This element of the guidance notes summarises the requirements set out within the CIPFA *Prudential Code for Capital Finance in Local Authorities*.

The FM Code requires the authority to comply with the CIPFA *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code), though there is an exception for chief constables in England and Wales as they only have very limited and specific borrowing powers

CIPFA's Prudential Code provides a framework for the self-regulation of the authority's capital financing arrangements. It requires local authorities to determine that capital expenditure and investment decisions are affordable, prudent and sustainable, and to set limits on the amount they can afford to borrow in the context of wider capital planning.

Authorities are required by regulation to have regard to the Prudential Code when carrying out their duties in England and Wales under Part 1 of the Local Government Act 2003, in Scotland under Part 7 of the Local Government in Scotland Act 2003 and in Northern Ireland under Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

THE AIMS OF THE PRUDENTIAL CODE

The framework established by the Prudential Code is designed to support local strategic planning, local asset management planning and proper option appraisal.

The Prudential Code sets out:

- a clear governance procedure for the setting and revision of a capital strategy
- a suite of prudential indicators against which the authority is to monitor its performance in maintaining the affordability and prudence of its capital activities
- a series of matters to be taken into account when the authority sets, revises and monitors performance against its prudential indicators.

This strategy and these indicators are to be scrutinised and approved by the same body that takes the decisions for the authority's budget, usually the full council or equivalent body.

The authority's CFO is responsible for ensuring that all matters required to be taken into account are reported to the decision-making body for consideration, and for establishing procedures to monitor performance.

The Prudential Code does not itself set out indicative limits or ratios for the indicators to be set and monitored by the authority, as these are for the authority to determine for itself, given its own particular circumstances.

DETERMINING A CAPITAL STRATEGY

The authority should have in place a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and that gives due consideration to both risk and reward and to the impact of the strategy on the achievement of the authority's priority outcomes.

As set out in the guidance notes that accompany the Prudential Code (CIPFA's *The Prudential Code for Capital Finance in Local Authorities: Guidance Notes for Practitioners*, 2018) the authority's capital strategy might address a number of themes, including:

Capital expenditure	■ An overview of the governance process for approval and monitoring of capital expenditure, including links to the authority's policies on capitalisation. ■ A long-term view of capital expenditure plans, where long term is defined by the financing strategy of, and risks faced by, the authority with reference to the life of projects/assets. ■ An overview of asset management planning, including the cost of past borrowing, maintenance requirements and planned disposals. ■ Any restrictions that the authority may face in respect of borrowing, funding or capital finance.
Debt, borrowing and treasury management	■ A projection of external debt and the use of internal borrowing to support capital expenditure. ■ Provision for the repayment of debt over the life of the underlying debt. ■ The authorised limit and operational boundary for the following year (see discussion of prudential indicators below). ■ The authority's approach to treasury management, including processes, due diligence and defining the authority's risk appetite.
Commercial activity	■ The authority's approach to commercial activities, including the processes in place to ensure effective due diligence and definition of the authority's risk appetite in respect of such activity.
Other long-term liabilities	■ An overview of the governance process for approval, monitoring and ongoing risk management of any other financial guarantees and long-term liabilities.
Knowledge and skills	■ A summary of the knowledge and skills available to the authority and confirmation that these are commensurate with the authority's risk appetite.

The capital strategy forms an essential part of the authority's integrated revenue, capital and balance sheet planning. It should be consistent with the authority's longer-term financial strategy, its medium-term financial plan and its annual budget. It should also be consistent with the authority's asset management plan, including the acquisition of new assets and the disposal of those that are no longer required.

The capital strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services, along with an overview of how associated risk is managed and the implications for future financial sustainability. The CFO is expected to report explicitly on the affordability and risk associated with the capital strategy.

The capital strategy should be tailored to the authority's individual circumstances, but should include – as a minimum – consideration of capital expenditure, investments, liabilities and treasury management. The capital strategy should include sufficient detail to allow the authority's leadership team (including its members) to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.

The capital strategy forms the basis for the capital programme, which contains the capital projects that the organisation intends to undertake in the medium term. Robust processes need to be put in place for potential projects to be proposed, evaluated and prioritised, and for approving the programme and the resources to fund it. Delivering the capital programme requires efficient programme management, project management and procurement, as well as appropriate systems for corporate monitoring, control and scrutiny.

In developing the capital strategy, the authority should seek to strike a suitable balance between the amount of detail included and accessibility to the strategy's intended audience. Where detailed information is required, thought should be given to how this is made available, its format and the training needs of members to encourage active engagement.

SETTING PRUDENTIAL INDICATORS

The authority should set the prudential indicators for the forthcoming and following years before the beginning of the financial year. They may be revised at any time, following due process, and must be reviewed, and revised if appropriate, when the prudential indicators are set for the following year.

The authority's CFO is required to establish procedures to monitor performance against all forward-looking indicators. Consequently, the CFO will need to establish a measurement and reporting process that monitors performance and that highlights significant deviations from the agreed indicators.

The prudential indicators for prudence

Capital expenditure

- **Estimates of capital expenditure** – Estimates of the total of capital expenditure that the authority plans to incur during the forthcoming financial year and at least the following two financial years.

- **Actual capital expenditure** – The actual capital expenditure incurred during the financial year.
- **Estimates of capital financing requirement** – Estimates of the total capital financing requirement at the end of the forthcoming financial year and the following two years.
- **The actual capital financing requirement** – The actual capital financing requirement for the financial year, calculated directly from the authority's balance sheet.

External debt

- **Authorised limit** – An authorised limit for the authority's total gross external debt, separately identifying borrowing from other long-term liabilities, for the forthcoming financial year and the following two financial years.
- **Operational boundary** – An operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities, for the forthcoming financial year and the following two financial years.
- **Actual external debt** – The closing balance for actual gross borrowing plus (separately) other long-term liabilities, obtained directly from the authority's balance sheet.
- **Gross debt and the capital financing requirement** – In order to ensure that over the medium term debt will only be for a capital purpose, the authority should ensure that debt does not, except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

The prudential indicators for affordability

- **Estimates of financing costs to net revenue stream** – Estimate of the proportion of financing costs to net revenue stream, for the forthcoming financial year and the following two financial years.
- **Actual financing costs to net revenue stream** – The proportion of financing costs to net revenue stream, calculated directly from the authority's income and expenditure statement.

The authority's prudential indicators, both prospective and retrospective, should be scrutinised and approved by the same body that takes the decisions for the authority's budget, usually the full council or equivalent body.

To this end, these indicators should be set out in a suitable paper or other document, together with explanations for why they are important and what they mean for the prudence and affordability of the authority's capital expenditure and financing activities.

MATTERS TO BE TAKEN INTO ACCOUNT

In setting or revising its prudential indicators, the authority is required to have regard to the following matters:

- service objectives, eg strategic planning for the authority
- stewardship of assets, eg asset management planning

- value for money, eg option appraisal
- prudence and sustainability, eg risk, implications for external debt and whole life costing
- affordability, eg implications for council tax/district rates
- practicality, eg achievability of the forward plan.

The Prudential Code also requires that, in making its capital investment decisions, the authority should have explicit regard to option appraisal and risk, asset management planning, strategic planning for the authority and achievability of the forward plan.

Key questions

- Has the authority prepared a suitable capital strategy?
- Has the authority set prudential indicators in line with the Prudential Code?
- Does the authority have in place suitable mechanisms for monitoring its performance against the prudential indicators that it has set?

Financial Management Standard I:

The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans

The FM Code does not anticipate that a longer-term financial strategy will – or, indeed, should – provide sufficient detail to allow for it to be translated directly into an annual income and expenditure budget.

To bridge this gap, therefore, and to allow the authority to ensure that its annual budget is in alignment with its longer-term financial aims, the FM Code requires the authority to prepare a multi-year medium-term financial plan.

Furthermore, this plan should also be consistent with associated service plans for the authority's principal services.

THE MEDIUM-TERM FINANCIAL PLAN

The medium-term financial plan is a translation of the authority's financial strategy into the near future. It is also the critical link between the authority's financial strategy and its plans for service delivery.

For some authorities, the planning horizon of the medium-term financial plan may represent the limit to which the authority can realistically plan for the future. In such circumstances, the long-term financial strategy and the medium-term financial plan might well be one and the same thing. The development of a longer-term financial strategy is, however, encouraged.

The medium-term financial plan breaks down the authority's financial strategy into key actions to be taken in the next few years, so that the authority is able to plan its activity over this period in more detail. It also contains income and expenditure projections and sets out how the delivery of services will be funded sustainably.

The medium-term financial plan usually covers a multi-year period, but generally no more than five years. Any more than this and the level of uncertainty becomes too great for realistic financial planning. Due to the reduced level of uncertainty inherent to planning in the medium term, the authority is generally able to use more traditional forecasting and analysis techniques when preparing such plans.

The medium-term plan should be rolled forward either every year or after two to three years, to ensure that it still projects a multi-year planning horizon. When the plan is rolled forward, any deviations from the current plan should be identified, understood and integrated in the authority's planning for future periods.

In order to be effective, the authority's medium-term financial plan should:

- be integrated with the authority's service plans and its capital strategy
- respond to uncertainty in the authority's funding regime
- translate the authority's longer-term aims into the medium term
- be developed in a robust manner, taking into account a credible baseline of activity
- integrate suitable drivers of demand and cost
- be subjected to sensitivity analysis to allow any vulnerabilities to be identified.

INTEGRATING FINANCIAL AND SERVICE PLANNING

Especially in this age of austerity, the key concern for financial planning is allocating finite resources over time, to reach the goals set out in the authority's longer-term strategy. It is not, however, enough for the authority to demonstrate simply that it is financially viable, it must go on to demonstrate that they have been brought together in a transparent way within the budget.

Moreover, it is in medium-term financial planning that the authority demonstrates how it will finance the delivery of its services and the operation of the authority as a whole.

For this reason, the financial plan cannot be allowed to become wholly a financial document – it must be integrated fully with service planning, capital financial management, risk management and asset management plans. Medium-term financial planning is not just about forecasting financial flows – it has an important role to play in integrating and harmonising financial and other corporate activities.

A good medium-term financial plan acts as the authority's route planner that plots the path ahead by focusing on policies and priorities in an organised, coherent and systematic manner. Furthermore, it seeks not simply to give provisional budget figures, but also to provide an insight into prevailing trends and their impact on the organisation.

TRANSLATING THE AUTHORITY'S LONGER-TERM AIMS INTO THE MEDIUM TERM

Regardless of the funding environment in which the authority operates, robust medium-term planning is essential to keeping the authority on track and moving towards the achievement of its strategic aims. This is especially important as most effective budget decisions are essentially strategic long-term ones rather than short-term ones focused only on the year ahead.

Furthermore, not everything can be achieved within one short-term planning period. Outsourcing to the third sector or social enterprises, for example, or rationalising property and other assets and working in partnership with other authorities, will take longer than the annual budget cycle to see through to completion and to the realisation of the desired benefits.

For these reasons, it is in medium-term (and longer-term) financial planning that the pursuit of value for money improvements will be most prominent. Such financial planning is not simply an end in itself, but also a means to furthering the delivery of other plans, such as those for asset management, capital investment or income generation.

Where the authority is engaged in a significant transformation programme, such as one that is designed to reconfigure the way in which it provides services, this should be subject to the same rigorous planning, monitoring and oversight arrangements that are applied to the authority's other financial and operational planning and delivery processes. In particular, such transformation projects might sensibly be focused on and structured around the achievement of specific strategic, operational or financial outcomes, the achievement of which can be measured with confidence.

DEVELOPING A ROBUST MEDIUM-TERM FINANCIAL PLAN

The starting point for the medium-term financial plan is a robust and credible baseline plan that identifies and quantifies known commitments and financial pressures by profiling income, expenditure and cash flow over the chosen time period.

The baseline position is established first so that the authority can determine whether its existing policies are financially credible. This also allows the authority to ensure that prudent parameters are placed on future plans.

Expressed at its simplest, the baseline is the authority's financial position in the future if it takes the minimum action necessary to meet its existing commitments and to respond to immediate financial pressures.

To this baseline are added any further actions – and their financial implications – anticipated by the authority's financial strategy or service delivery strategies. Also included in this enhanced plan are the financial implications of any other pressures, such as increased demand for services or the implications of social or demographic change.

The development of the medium-term financial plan in this way may highlight a disparity between the level of resources available and the amount that needs to be done with these resources. In such circumstances, it is vital that the authority finds a way meet service and corporate requirements and statutory duties in the future.

UNDERSTANDING DRIVERS OF DEMAND AND COST

In determining the financial impact of changes to service delivery or other pressures, the authority will benefit from a robust understanding of what drives the costs associated with different aspects of service delivery (including those related to the provision, maintenance and management of related physical assets) and of the management of the authority itself.

For a specific activity, a driver is a factor that can cause a change in the cost of the activity, by impacting on either the volume of activity required or the unit cost of that activity. For financial planning purposes, the same concept is applied to the authority as a whole. These financial drivers are the factors that will determine the cost to the authority of delivering its services.

Some financial drivers, for instance those associated with general price inflation, national pay awards or mandated efficiency improvements, may have an impact across the whole authority. Others may have an impact only on specific services or activities.

The drivers relevant to the authority's financial planning activities fall into two broad types: firstly, demand drivers that determine the level of resources that need to be devoted to meeting demand for a service, and secondly, cost drivers that determine the price or cost of securing those resources.

The medium-term financial plan should be based on credible assumptions and forecasts about the economy and about relevant socio-demographic trends, since these are the principal determinants of the financial pressures on the authority. While it is difficult to forecast such trends when developing a long-term financial strategy, this task is much more feasible when planning for the medium term.

IDENTIFYING RELEVANT DRIVERS

The process for identifying and collecting information on drivers of cost and demand will depend on the nature, size, structure and culture of the authority. A sound starting point for this work is the authority's existing budget and records of service and financial performance, as these will allow the identification of trends in previous periods.

Information on local trends and issues can be obtained from relevant data sources, from partner organisations, by conducting interviews with key stakeholders or by convening focus groups. In addition, various sector umbrella bodies, think tanks and consultancy firms routinely publish analysis of the different pressures facing authorities of different types.

PESTLE ANALYSIS

For a more comprehensive and robust insight into cost and demand drivers, the authority may benefit from undertaking an analysis of the political, economic, social, technological, legal and environmental factors that may impact on service delivery. This is known as a PESTLE analysis.

Some examples of factors that might feature in the authority's PESTLE analysis are as follows:

Political	Technological
■ Public policy	■ Technological change
■ Tax policy	■ Automation
■ Regulatory requirements	■ E-commerce
■ Political instability	■ Online service delivery

Economic	Legal
Economic growth	Authority's legal powers
Interest rates	Discrimination law
Inflation rates	Employment law
Exchange rates	Health and safety requirements
Social	**Environmental**
Population growth	Extreme weather
Age distribution	Sustained periods of low temperature
Health consciousness	Flooding
Public attitudes	Climate change

The principal long-term pressure facing authorities in most developed countries is demographic change, namely an ageing population, caused by increasing life expectancy, declining fertility and the 'demographic bulge' created by the post-war 'baby boom'.

The effects of this are unlikely to change significantly from year to year as projections are rolled forward. It creates sustained upward pressure on health spending, state pension costs and social care costs. Furthermore, these pressures cascade down to a local level, and can have differential impacts according to the authority's individual circumstances.

Not all demographic factors are, however, so stable net migration assumptions, for instance, depend both on the employment market and on government policy. In addition, the national picture can mask a wide variation in the positions across different regions or among different migrant groups.

SENSITIVITY ANALYSIS

Sensitivity analysis in this context is an exploration of the impact on the viability of the authority's medium-term financial plan of varying the driver-related assumptions that have been made in the development of that plan.

Effective sensitivity analysis is based on a sound understanding of how the various drivers identified impact on the authority's financial position. It also benefits considerably from insight into the likely parameters within which such drivers could vary in reality over the period covered by the medium-term financial plan.

By varying different drivers within their likely parameters, the authority is able to assess the extent to which its medium-term financial plan will remain viable under different sets of circumstances. It will also allow the authority to take appropriate action at an early stage to address any potential weaknesses and to enhance the resilience of this plan.

The authority may also wish to use 'Monte Carlo' analysis – which provides a 'probability spread' indication of potential situations (ie a range) rather than a specific 'point' estimate – to understand the likely future impact of current or proposed courses of action. This is a complex analytical approach, however, and may need specialist support.

THE ROLE OF ASSET MANAGEMENT PLANS IN THE MTFP

An asset management plan sets out how the authority will seek to ensure that its infrastructure and other assets contribute effectively to the delivery of services and to the achievement of the authority's strategic aims. This will include maintaining and enhancing existing assets, developing or purchasing new ones, and decommissioning or selling assets that are no longer required.

The asset management plan is a forward-looking document with a medium to long-term planning horizon.

An asset management plan places the authority's asset portfolio (usually properties and land, but also for highways authorities infrastructure assets) into the context of the authority's objectives, priorities and challenges. It also links closely to the authority's capital strategy, investment strategy and treasury management strategy.

The development of the asset management plan is informed by:

- the nature and extent of assets held by the authority
- the ways in which the assets that the authority holds contribute to service delivery and to the achievement of the authority's strategic objectives
- the condition of the authority's assets, including any action that is required to maintain them to an acceptable standard
- how the authority measures the performance of its assets, including the data that are required to undertake this measurement
- the authority's key priorities for optimising the contribution that its assets make to service delivery and to the achievement of its strategic objectives
- the financial and resources implications of the achievement of these priorities
- the governance arrangements surrounding the authority's asset portfolio, including assets held by or with partner organisations and those for which the authority is a corporate landlord.

The asset management plan also takes into account relevant policies of the authority, including policies that the authority has adopted for the management of its assets (including assets of heritage value).

The asset management plan might include:

- an overview of the authority's asset portfolio
- an assessment of the condition and performance of the assets held
- the authority's priorities for maintaining, enhancing, adding to, and divesting from its asset portfolio
- the actions that will be taken to achieve these priorities, together with the outputs and outcomes that are to be achieved
- the resources that are necessary to maintain and improve the authority's assets portfolio and how it will be secured
- timescales and responsibilities for the actions identified.

The asset management plan would normally be scrutinised by an appropriate committee of the authority, with specialist external support if required, and approved by the authority. Progress in the implementation of the plan is reviewed regularly and reported to the authority's leadership team. Any issues identified as a result of this review are addressed promptly.

Key questions

- Does the authority have in place an agreed medium-term financial plan?
- Is the medium-term financial plan consistent with and integrated into relevant service plans and its capital strategy?
- Has the medium-term financial plan been prepared on the basis of a robust assessment of relevant drivers of cost and demand?
- Has the medium-term financial plan been tested for resilience against realistic potential variations in key drivers of cost and demand?
- Does the authority have in place a suitable asset management plan that seeks to ensure that its property, plant and equipment including infrastructure assets contribute effectively to the delivery of services and to the achievement of the authority's strategic aims?

CHAPTER 4

The annual budget

The annual budget is a detailed allocation of resources for the immediate future. Usually covering a period of one financial year, the budget provides the financial basis – through projections of income and expenditure at a high level for the authority as a whole and in more detail for individual services – for the allocation of resources, the delivery of services and the management of the organisation over the planning period.

This chapter of the guidance notes considers:

- the way in which the authority complies with its statutory obligations in respect of the budget setting process
- whether the budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement of the adequacy of the proposed financial reserves.

This chapter summarises the statutory requirements regarding budget setting and considers the chief finance officer's responsibility for setting a suitable budget for the year. It explores how a robust and sustainable budget can be developed. And it sets out how the authority can implement a spending freeze and, if necessary, issue a Section 114 notice.

It also explores the nature of the estimates, assumptions and judgements that form part of the annual budget-setting process and considers how assurance can be sought as to their reliability. It also discusses how the authority can determine the adequacy of its proposed reserves and how any proposed use of these reserves can be communicated effectively.

Financial Management Standard J:

The authority complies with its statutory obligations in respect of the budget setting process

One of the principal objectives of the FM Code is to end the practice by which the annual budget process has often become the focal point of, if not the limit to, authorities' financial planning.

The annual budget should be merely one element in a longer-term approach to ensuring financial sustainability. However, the annual budget preparation process must nevertheless be protected at a time when the need to make difficult decisions may threaten its integrity.

The FM Code requires the authority to be familiar with its statutory obligations in respect of the budget-setting process, to comply with these requirements, and to be able to demonstrate that it has complied with them.

While, in times of routine business, compliance is straightforward, it is in times of financial stress – when there may be pressures for delay or obfuscation in budget setting – that a comprehensive understanding of these statutory requirements is crucial. The same is true in placing reliance on information for budget-setting purposes from other authorities, such as independent precepting bodies.

Consequently, this element of the guidance notes considers not only the authority's statutory obligations in respect of setting a budget, but also other actions that it may wish to take – or, indeed, be required to take – should it experience financial challenges. These include implementing spending controls and issuing a Section 114 notice.

The authority's chief finance officer (CFO) will need to work closely with the chief executive, the monitoring officer and the entire leadership team, to ensure that the authority complies with its statutory obligations in respect of the budget-setting process, and that it does so within the required timescales.

STATUTORY REQUIREMENTS REGARDING BUDGET-SETTING

There is a considerable volume of legislation surrounding the budget-setting process for authorities. The specific legislation and associated compliance requirements will depend on (a) the nature of the authority and (b) the UK home nation in which it is situated.

In general, authorities are required by statute to set and agree an income and expenditure budget prior to the beginning of the financial year to which the budget relates.

For local authorities in England and Wales, for example:

- the Local Government Act 2000 requires the full council to approve the annual budget, on the recommendation of the executive or equivalent, together with the associated council tax demand
- the Local Government Act 2003, Section 25 requires the authority's section 151 officer (an individual appointed under Section 151 of the Local Government Act 1972 to administer the authority's affairs) to report to the council on the robustness of the estimates made in the annual budget and on the adequacy of the proposed financial reserves assumed in the budget calculations.

In exceptional circumstances:

- the Local Government Finance Act 1988, Section 114 requires the section 151 officer to report to all of the authority's councillors if there is, or is likely to be, unlawful expenditure or if the expenditure incurred by the authority (including expenditure it proposes to incur) in a financial year is likely to exceed the resources available to it to meet that expenditure
- the Local Government Act 1999, Section 15 states that failure to set a legal budget may lead to intervention from the secretary of state.

The Local Government Finance Act 1992 (amended) sets out, furthermore, an authority's obligations when setting council tax. It requires that billing authorities set their council tax requirements before 11 March (for a financial year running from 1 April to 31 March). The equivalent deadline for precepting authorities is 1 March.

For local policing bodies in England and Wales the statutory requirements are found within the Police Reform and Social Responsibility Act 2011 and its related statutory instruments.

SETTING A ROBUST AND SUSTAINABLE BUDGET

The CFO must use their professional judgement to ensure that the authority's budget is robust and sustainable. The FM Code supports the role of the CFO in complying with Section 25 of the Local Government Finance Act 2003.

In accordance with the Local Government Finance Act 1992, the authority's budget requirement for the year must include:

- the expenditure that the authority estimates it will incur in the year in performing its functions
- an allowance for contingencies in relation to this expenditure
- the financial reserves that the authority estimates it will need to raise in the year to meet its estimated future expenditure
- such financial reserves as might be required to fund deficits generated in previous periods.

A prudent definition of a robust and sustainable budget for the authority would be a financial plan based on sound assumptions, which shows how income will equal expenditure over the short and medium-term. Plans would take into account deliverable cost savings and/or local income growth strategies as well as useable reserves.

The authority's CFO must interpret the definition of what constitutes a robust and sustainable budget based on the circumstances of their own authority and should monitor income and expenditure throughout the year to make sure that the finances are on target as required by the Local Government Finance Act 2003.

Any significant variation in income or expenditure may impact on the authority's ability to manage its resources in line with the agreed budget. Factors having such an effect on the authority's income or expenditure could include:

- natural disaster
- sudden policy change
- demographic pressures
- unexpected funding pressures or
- failure to realise planned savings.

In the case of such an eventuality, it would be necessary for the authority to find an alternative way to manage its resources in line with the agreed budget. This would usually be through the introduction of an emergency savings programme.

RESPONSIBILITY FOR SETTING THE BUDGET

The responsibility for the preparation of a suitable budget rests with the CFO, who will also work with the leadership team to set the medium-term financial plan as the framework within which the annual budget-setting process takes place. This medium-term financial plan allows the authority to deliver its long-term goals by ensuring that a suitably robust and sustainable budget can be set for each of the years covered by the plan.

The CFO is also responsible for ensuring that the finance team constantly monitors the financial health of the authority. The CFO cannot, though, work in isolation. They should be supported by the chief executive and the rest of the leadership team, so that the vision and strategies of the authority are sustained through a strong financial plan.

The chief executive is ultimately responsible for the success of the organisation and it is their task to bring the leadership team together. This role is particularly important during a time of financial crisis, when spending restrictions may be imposed. Spending restrictions will be more challenging for services which are demand-led and those that include statutory duties, such as adult social care and children's services.

In such circumstances, the chief executive's role will be to support the CFO in identifying solutions and working with the leadership team to produce a measured response. It is important that the chief executive maintains an ethos of proactive communication and collaboration throughout the authority.

Any approach to remedying financial difficulties will only be successful if there is a consistent and clear message from the leadership team. The chief executive will be responsible for ensuring that this message is also communicated to external stakeholders and delivery partners.

In policing, it is the PCC and chief constable who are responsible in their different ways for ensuring the success of their local police force and Office of the Police and Crime Commissioner (OPCC). They will work together and with their respective CFOs to ensure the PCCs' vision, police and crime plan and force strategies are sustained through a strong financial plan.

IMPLEMENTING SPENDING CONTROL

Implementing spending control is a way of helping to balance the books in-year. It sits alongside all the planned approaches and strategies set out in the budget when it was first approved. The need for a spending control in-year may arise because of an unplanned event or an unexpected set of circumstances, which mean the authority is heading for an unmanageable overspend at year-end or in future years.

How a spending control is implemented in practice will vary between authorities, though it will invariably mean having to navigate a path between the requirements of statutory service delivery and meeting the terms of current service contracts.

The most common approach is where expenditure is limited or stopped altogether. A series of spending gateways will most likely need to be introduced, with specific approval required where spending over a certain figure occurs. For example, the CFO might be required to sign any commitment above a certain threshold.

However, it must be recognised that temporary suspension of spending can still accommodate an emergency release of funding if specified in advance. Some services, such as adult social care and children's services, will still have to spend during the period of control.

It is necessary, therefore, for the CFO, supported by the chief executive, to work collaboratively with others to identify an approach to minimise spend or to exclude certain areas from the spending freeze. While this adds additional pressures to the authority as a whole, it will help to ensure that statutory duties to vulnerable service users are met.

Examples of short-term measures incorporated into a spending control include not filling non-essential job vacancies, not renewing computer equipment or not spending on routine repairs, staff training, and highways and pavement maintenance. Budget holders would be asked to consider if the expenditure is absolutely necessary, if it can be deferred or if an alternative is available.

ISSUING A SECTION 114 NOTICE

Under Section 114 of the Local Government Finance Act 1988, the section 151 officer shall issue a report if it appears to them that the expenditure incurred by the authority (including expenditure it proposes to incur) in a financial year is likely to exceed the resources available to it to meet that expenditure.

The process for issuing such a notice is governed by the Act, which states that, once the notice has been issued, the authority has 21 days to consider a response. However, during that time, spending and other financial activity is suspended.

A number of reasons could cause a Section 114 notice to be issued and these include:

- the authority has failed to heed previous warnings from the CFO about the financial risks to the authority
- the authority has failed to appreciate the seriousness of the budgetary position or
- the CFO has failed to warn of the risks.

For policing in England and Wales, there is the added complication of having two separate legal entities in their PCC and chief constable, each with their own CFOs (or a shared CFO role undertaken by the same person). Both CFOs have Section 114 responsibilities.

Issuing a Section 114 notice should not be seen as a failure, but it will result in the loss of financial control by the leadership team. The Section 114 process should be seen as a last resort.

Key questions

- Is the authority aware of its statutory obligations in respect of the budget-setting process?
- Has the authority set a balanced budget for the current year?
- Is the authority aware of the circumstances under which it should issue a Section 114 notice and how it would go about doing so?

Financial Management Standard K:

The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement of the adequacy of the proposed financial reserves

In line with Section 25 of the Local Government Act 2003, the FM Code requires the authority's section 151 officer (for authorities in England and Wales) to report alongside the annual budget, when it is submitted for approval, on the robustness of the estimates and the adequacy of reserves allowed for in the budget proposals. For local policing bodies in England and Wales this would be the responsibility of the PCC's section 151 officer.

The aim of this report is to provide information and assurance in respect of the estimates included within the annual budget, so that those responsible for scrutinising and approving the budget can take these into account as part of the scrutiny and approval process.

UNDERSTANDING BUDGET ESTIMATES

All budgets are an estimate of income to be received and expenditure to be incurred over the course of the financial year in question. However, there are numerous aspects of the budget in which specific estimates will have to be made, including:

- whether specific transactions will occur
- when transactions will occur
- the financial value associated with such transactions.

Some of the more significant estimates that the authority will need to make as part of the budget-setting process include:

- the level of demand for individual services
- staff pay levels and pension scheme contribution levels
- interest rates, likely returns on financial investments and other capital finance issues
- pressures on major capital projects
- the level of funding received through council tax and other sources
- receipts from the sale of capital assets
- the achievement of savings plans and targets.

PROVIDING ASSURANCE IN RESPECT OF BUDGET ESTIMATES

In order to comply with the FM Code, the authority might wish to identify within its report the significant estimates that have been made as part of the budget-setting process and to set out how these estimates have been made.

This could include specific consideration of the information that has been used to make each estimate, the reliability of this information and the authority's confidence in the estimate.

Where possible, the authority may wish to provide additional information to support the estimates that it has made or to give assurance on its track record in making such estimates. This could include, for example:

- information on historical trends to support the estimates made, such as council tax collection rates in previous years
- guidance from professional advisors, such as forecasts from treasury management consultants in respect of future interest rates and/or investment returns
- details of levels of service demand experienced by the authority in previous years, perhaps linked to underlying demographic trends.

The authority could also provide assurance by setting out the process of internal scrutiny to which the budget has been subject prior to being submitted for approval. This could include, for example, review by service managers, the CFO and specialist advisors.

While most estimates can be made with a relatively high degree of confidence, there will, inevitably, be some budget estimates where considerable uncertainty remains. The authority would be well-advised to highlight these in the report and to explain the reason for the uncertainty. Where possible, the authority might also undertake and provide the results of sensitivity analysis, so that those approving the budget are aware of the potential impact of the underlying uncertainty.

THE ADEQUACY OF THE PROPOSED RESERVES

While the authority's financial reserves can, in theory, be called upon to help balance the budget in the short-term by managing fluctuations in income and expenditure, to use reserves in this way is far from ideal.

In general, reserves should only be used for:

- planned investment
- capital projects
- change programmes
- unexpected events such as natural disasters
- other reasonable uses for which they have been 'earmarked'.

The authority's reserves should not generally be used to pay for day-to-day expenditure. They should not, except in the most exceptional circumstances, be used to fund a budget shortfall either, without a plan in place to address the underlying deficit and to replenish the reserves.

The authority will, ideally, have in place a policy setting out the reserves that it maintains, a prudent balance at which it seeks to maintain them (taking into account the nature of the financial risks that the authority faces), and the broad purposes for which these reserves should be used.

A summary of this policy can be included in the report required under Section 25 of the Local Government Act 2003.

The report might also include confirmation of the adequacy of the reserves currently held or, where current reserves fall below the desired balance, the impact of this shortfall and how it is to be addressed.

Where is it proposed that reserves be drawn upon during the financial year, this could be set out within the report, together with an indication of how these resources will be spent and whether, and how, they will be replenished.

If the reserves are to be used to fund an in-year shortfall in revenue resources, the report could explain why this is the case, what alternatives have been considered and how the longer-term impact of the revenue shortfall is being addressed.

PCCs and fire and rescue authorities in England are required, by the Home Office Revised Financial Management Code of Practice for the Police Forces of England and Wales and

Fire and Rescue Authorities, created under Section 4A of the Fire and Rescue Services Act 2004, to establish and publish a policy on financial reserves. It also requires them to publish information on their current and planned reserves, including general and earmarked reserves.

Key questions

- Does the authority's most recent budget report include a statement by the CFO on the robustness of the estimates and a statement of the adequacy of the proposed financial reserves?
- Does this report accurately identify and consider the most significant estimates used to prepare the budget, the potential for these estimates being incorrect and the impact should this be the case?
- Does the authority have sufficient reserves to ensure its financial sustainability for the foreseeable future?
- Does the report set out the current level of the authority's reserves, whether these are sufficient to ensure the authority's ongoing financial sustainability and the action that the authority is to take to address any shortfall?

CHAPTER 5

Stakeholder engagement and business cases

Financial sustainability requires citizens to understand that resources are not limitless and that decisions have to be made about both the relative priority of different services and the balance between service provision and taxation levels. Furthermore, the authority must make decisions in respect of the allocation of resources in a robust and transparent manner.

This chapter of the guidance notes considers:

- the extent to which the authority has engaged with relevant stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget
- whether the authority uses an appropriate option appraisal methodology to demonstrate the value for money of its decisions.

It starts by considering how the authority can identify relevant stakeholders with whom to consult, using the power/interest matrix to inform and to prioritise its consultation efforts. It then discusses how the authority can engage effectively with these stakeholders and, perhaps most critically, how it can use the results of the consultation process to improve its approach to financial planning.

This chapter discusses what option appraisal is and how it works, from understanding the authority's requirements through to generating and assessing options and making a decision on a suitable course of action. It also considers when an option appraisal should be undertaken and how financial and non-financial factors can be factored into the appraisal process. It also explores how the results of the option appraisal can be communicated effectively.

Financial Management Standard L:

The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget

The FM Code sets out clearly that stakeholder consultation can help to set the authority's priorities and to reduce the possibility of legal or political challenge. Furthermore, stakeholder consultation helps to encourage community involvement not just in the design of services but in their ongoing delivery.

This is especially the case when the authority adopts an enabling approach to public service delivery which, along with the active involvement of the third sector and other partners, may facilitate future reductions in service costs.

Stakeholders are the individuals, groups and organisations that have an interest in how the authority operates, the services that it delivers and how it delivers them. Not only may stakeholders be affected by what the authority does, they may also have the power to influence how it goes about its activities.

In many cases, authorities seek to develop and maintain long-term strategic relationships with key stakeholders, which they use to drive the delivery of efficiency and effective services that meet the needs of their local community.

The FM Code requires the authority to engage, where appropriate, with key stakeholders in developing its long-term financial strategy, its medium-term financial plan and its annual budget. In complying with this element of the FM Code, there are a number of things to consider, namely:

- how to identify key stakeholders
- how to engage effectively with these stakeholders
- how to use the results of this engagement wisely.

Where the authority already enjoys productive strategic relationships with its key stakeholders, this level of explicit engagement when developing the authority's long-term financial strategy, medium-term financial plan and annual budget may not be necessary, provided the needs of these stakeholders are already sufficiently well understood. Where this is not demonstrably the case, however, more focused engagement at this stage may be required.

IDENTIFYING KEY STAKEHOLDERS

The first step in engaging with the authority's stakeholders is to identify who they are.

The easiest way to do this is to make a list of (a) everyone – be it individuals, groups or organisations – who is affected by what the authority does, (b) everyone who has an influence on what the authority does, and (c) anyone else whose support is important to the authority's ability to achieve its objectives or who has an interest in how well the authority delivers its services.

These, then, are the authority's stakeholders. But not all of these stakeholders will be 'key' to the authority's ability to achieve its goals.

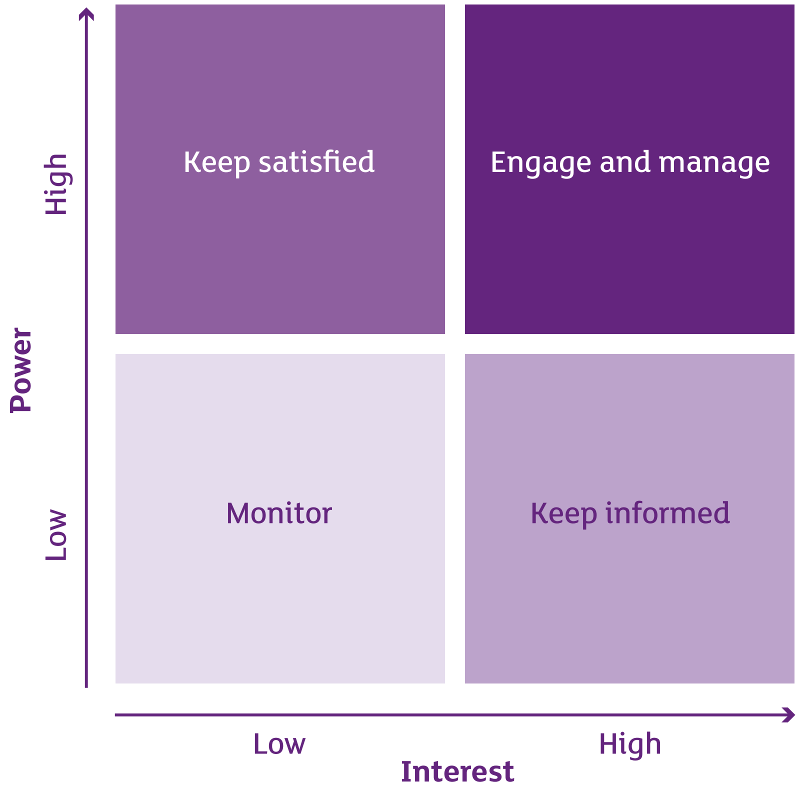
In an ideal world, the authority would be able to have an engaged and personalised relationship with each of its stakeholders. It is more likely, however, that the authority has many stakeholders and limited resources to engage with them. In such cases, the authority needs to prioritise its engagement.

A simple way to prioritise and to inform engagement with the authority's stakeholders is the 'power/interest matrix'. The matrix consists of two axes and four boxes and allows the authority to categorise each of its stakeholders in two ways, each of which features on one of the axes of the matrix:

- the stakeholder's **power** to influence the authority's activities
- the stakeholder's **interest** in influencing the authority's activities.

By allocating a 'high' and a 'low' option to each of these criteria, the authority ends up with a two-by-two matrix like the one in Figure 2 below.

Figure 2: The power/interest matrix



The authority can then use the matrix to decide how – and how much – it should engage with each of its stakeholders:

Low power/low interest	The authority should **monitor** these stakeholders, in case their level of power or interest changes, but does not need to spend too much time engaging with them or to subject them to unnecessary communications.
Low power/high interest	The authority should keep these stakeholders **informed** and draw on their expertise when it can, but should not allow these stakeholders to wield undue influence on its activities.
High power/low interest	These stakeholders can cause the authority problems if they have reason to do so, so the authority should seek to keep them **satisfied** and to avoid causing them any consternation.
High power/high interest	These are very much the authority's key stakeholders. The authority should **engage** with them, **manage** its relationship with them carefully and do everything it can to keep them on board.

ENGAGING EFFECTIVELY WITH STAKEHOLDERS

Engagement is a two-way process. Simply sending a copy of the authority's long-term financial strategy, medium-term financial plan or annual budget to its key stakeholders is not sufficient. Neither is sending these stakeholders a draft copy of the strategy, plan or budget and asking for their thoughts.

Effective engagement begins when the authority first starts to think about the development of its long-term financial strategy, its medium-term financial plan or its annual budget. It then continues throughout the development, agreement and implementation of this strategy, plan or budget.

Ideally, key stakeholders will be engaged at the following stages:

- when the authority is determining its priorities for the period covered by the strategy, plan or budget
- when it is prioritising its activities and seeking a balance between its service delivery aspirations and the available resources
- when it is agreeing the strategy, plan or budget
- when it is reviewing formally its performance against the strategy, plan or budget, with a view to identifying learning points for the preparation of future strategies, plans or budgets.

As a bare minimum, the authority might wish to engage with key stakeholders at the second of these stages, ie when it is prioritising its activities and seeking a balance between its service delivery aspirations and the available resources.

As to how best to engage with key stakeholders, the easiest way to determine this is simply to ask them how they would like such engagement to work. Some may favour personal contact to discuss the authority's plans face-to-face, while others may prefer written papers upon which to comment.

In reality, engagement with key stakeholders is likely to take the form of a combination of different modes of engagement, such as:

- one-to-one conversations
- informal group discussions
- structured focus groups
- surveys
- town hall meetings or drop-in sessions
- discussions at committee meetings
- review of a written document and provision of verbal or written feedback.

The key is to choose the mode of engagement that works best for the stakeholder or stakeholder group with which the authority wishes to engage, not what works best for the authority.

It is also helpful for the authority to define what it seeks to gain as a result of the engagement. This might be, for example, assistance in determining priorities for the next five years or an indication of what level of council tax increase might be acceptable if it is linked to the delivery of specific outcomes. In addition to allowing the authority to focus on the issues in which it is interested, this sort of targeted engagement is also more cost-effective for both the authority and those with whom it seeks to engage.

In these financially straitened times, the authority may not have the capacity or the resources to adopt the level of stakeholder engagement that it would normally wish to. In such circumstances, it is for the authority to decide how best to prioritise its capacity and resources to achieve the most meaningful stakeholder engagement and to secure the maximum benefit of this engagement.

USING THE RESULTS OF THE ENGAGEMENT

The authority may wish to put in place a suitable mechanism to respond to the results of its engagement with stakeholders and to be in a position to demonstrate that it has done so.

The way in which the results of the engagement process are used will depend on:

- the stakeholders involved
- the focus of the engagement
- the authority's specific aims in engaging with the stakeholder(s)
- the mode of engagement
- the results of the engagement process.

In many cases, it can be helpful to produce a separate report as a result of the engagement process, setting out its key findings. This allows the results of the engagement process to be assessed, analysed and presented in a useful format, ideally highlighting key points and recurring themes.

In an ideal world, the authority would be in a position to identify clearly the impact of the engagement process on the development of its long-term financial strategy, its medium-term financial plan or its annual budget.

In reality, though, things are rarely this simple. The authority might, however, ensure as a minimum that the main findings from the engagement process are integrated demonstrably into the development of the strategy, plan or budget.

The authority might also find it beneficial to communicate with the stakeholders with which it has engaged, setting out how the results of the engagement process have informed its thinking. If the authority does not feel able to do this, this may well be a sign that it has not engaged sufficiently conscientiously with the engagement process itself.

Key questions

- How has the authority sought to engage with key stakeholders in developing its long-term financial strategy, its medium-term financial plan and its annual budget?
- How effective has this engagement been?
- What action does the authority plan to take to improve its engagement with key stakeholders?

Financial Management Standard M:

The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions

Option appraisal is about making informed choices and better decisions. Nowhere is making good decisions more important than within authorities of all types, as the choices they make dictate how public funds are spent and impact on how people live their lives. Consequently, a robust approach to undertaking option appraisals is crucial to securing value for money.

DEFINING OPTION APPRAISAL

Option appraisal is a robust and systematic approach for the authority – and, indeed, all organisations – to find the best way of doing something, whether that is restructuring a failing entity, providing a new service to the local community, financing the construction of a new municipal building, or creating an innovative public service delivery partnership.

Whatever the authority is seeking to achieve, there will inevitably be many different ways of achieving it. Option appraisal is about how the authority identifies these options, assesses them and finds the one that will work best in the particular set of circumstances in which the authority finds itself.

Clearly, the approach taken to the identification and appraisal of options should be proportional to the nature, size, importance and complexity of the activity to which the options relate. Not all appraisals need to be subjected to a formal option appraisal as detailed here.

In order to ensure that decisions benefit from an appropriate level of appraisal, it would be beneficial for the authority to set out clearly when such an option appraisal should be implemented and the circumstances in which a lighter-touch approach would be acceptable.

HOW OPTION APPRAISAL WORKS

There are many different ways of doing an option appraisal, depending on the nature of the project or activity and the specific appraisal tools and techniques that the authority chooses to use. However, all option appraisals work in essentially the same way, in that they follow the same four steps.

Understanding what the authority wants to achieve	It is vital that the authority has a clear understanding of its aims in undertaking the project or activity that is the subject of the option appraisal. It will help to identify the available options and to assess them. It will also allow the authority to identify whether the project or activity has been successful.
Generating options	The authority identifies a range of different options to consider in more detail. The more comprehensive the list of options that can be generated, the more likely it is that the authority will be able to find an option that will work well. This means engaging with different stakeholders to ensure that a wide range of options is identified.
Assessing the options	Once a range of options has been identified, the authority develops a set of criteria against which these options can be assessed. These criteria should relate back to the aims of the project or activity and may include both financial and non-financial considerations. The assessment of options may take place in more than one stage to allow a small number of more promising options to be assessed in greater detail.
Making the decision	Once the options have been assessed, the authority makes its decision on a preferred option. This can then be implemented or, in the case of a business case or plan, taken forward for further consideration.

The authority may have a formal approach to option appraisal with which it is required to comply. There is certainly merit in the authority having a consistent approach to option appraisal, not least because it allows the development of standard processes and documentation.

Nonetheless, this should not be at the expense of overlooking special characteristics of each decision, or the need to review and improve the methodology over time.

As a general rule, the approach taken by the authority to option appraisal should comply with the guidance set out in the IFAC/PAIB publication *Project and Investment Appraisal for Sustainable Value Creation: Principles in Project and Investment Appraisal* (2013).

Consequently, rather than preparing its own documented appraisal methodology, the authority might prefer to record simply that any option appraisals that it undertakes should comply with the guidance set out in this publication, or in CIPFA's own guide to undertaking an option appraisal: *Option Appraisal: A Practical Guide for Public Service Organisations* (2017 Edition).

WHEN TO UNDERTAKE AN OPTION APPRAISAL

Option appraisal becomes necessary when the decision is a difficult one or will have important financial or service implications. For any significant decision, option appraisal should be considered mandatory. Option appraisal should also form an essential part of the development of an authority's capital programme.

As a rule of thumb, decisions displaying any one or more of the following characteristics might reasonably be subject to a comprehensive option appraisal.

Strategic importance	Conflicting time horizons
■ Due to its size or other characteristics, the decision has an impact on the future financial viability of the authority. ■ The decision involves partnership with another organisation, including the transfer of services or functions to the private or not-for-profit sectors. ■ The decision represents a material change to the strategic direction or mission of the authority. ■ The decision involves a fundamental change in the scale of the authority's activities. ■ The decision involves the procurement or disposal of material non-current assets.	■ The long-term options for the project or activity are based on significantly different business models than those available in the short term. ■ A balance has to be struck between an initial outlay and a stream of future financial or non-financial benefits. ■ There are material variations in the timing of the financial implications associated with the different options available.

Conflicting priorities	Risk and uncertainty
■ The costs and benefits of different potential courses of action are not all quantifiable in cash terms. ■ Limited resources mean that activities will need to be prioritised within budgetary constraints. ■ There is a choice to be made about the quality, scale, location or timing of a service. ■ There are a wide range of stakeholders or stakeholders with diverging or conflicting interests.	■ There are options with a high level of risk and uncertainty in their delivery. ■ There is doubt as to whether or not any action should be taken. ■ Some of the potential options – such as new delivery models – are unfamiliar to the authority. ■ There is likely to be significant public interest in the chosen course of action.

This list does not, of course, capture all of the circumstances in which an option appraisal is necessary. When faced with circumstances not covered by this list, the authority might wish to consider the risks involved with getting the decision wrong. If these are significant, then a formal option appraisal is advisable.

THE APPRAISAL PROCESS

The key to reducing uncertainty in decision making is clarity about what the authority wants to achieve. Consequently, the starting point for an effective option appraisal is a clear, concise and specific statement of the objectives to be achieved by the decision.

The next step is to generate a broad range of options for how these objectives could be achieved. These options should always include the 'base case', which is the minimum action necessary to meet statutory requirements and unavoidable policy commitments.

Once a suitable 'long list' of options has been generated, the authority can decide which criteria it will use to undertake an initial assessment of the suitability of these options.

This sifting process will allow the authority to identify a 'short list' of technically feasible and politically acceptable options for further consideration. This is when the detailed appraisal of these options begins in earnest. This detailed appraisal may draw on a number of financial and non-financial techniques.

It is unlikely that the authority will plan or deliver projects or activities where money is no object. Consequently, consideration of income, expenditure and the associated cash flows forms a significant part of most option appraisals.

One common approach to the financial analysis of options – and the one that might currently be used – is net present value analysis. Using this approach, all incremental future cash flows are discounted to their present day value to calculate a net present value for each option as a whole. The option with the highest net present value (which may, in some cases, be the least negative net present value) is the optimum from a financial perspective.

The authority might also consider the affordability of the options under consideration. In doing so, the authority will need to explore a range of issues concerning the income and expenditure generated by the project, including their nature, timing and amount.

It is also important to consider the implications of these for the authority's financial strategy and, where capital investment or financing is required, for the authority's compliance with its prudential indicators. In addition, the authority may wish to consider the appropriate accounting treatment associated with the options under consideration, together with any implications of this for the authority and for the appraisal process.

As the authority's activities focus, in the main, on the delivery of non-financial outcomes, it is not sufficient for a selected option to simply be the most financially advantageous. It must also achieve the authority's objectives in respect of service delivery. Consequently, the non-financial aspects of option appraisals are just as important as the financial ones.

There are a number of common approaches to the consideration on non-financial factors in an option appraisal, including:

Economic appraisal	A financial evaluation that considers the costs and benefits of a proposed course of action for the economy as a whole, rather than just for a particular authority.
Cost-benefit analysis	An extension of the economic appraisal, which also considers the social costs and benefits of a project or activity.
Multi-criteria analysis	An approach that allows the impact of various non-financial factors on the relative desirability of different options to be assessed through a methodical weighting and scoring of different criteria.
Impact assessments	A technique that allows the impact of a proposed course of action in different areas (eg promoting equality, safeguarding human rights, protecting the environment) to be assessed in a robust way.

These approaches will not all be feasible in all circumstances. It is for the authority to decide which, if any, approach is most relevant to the option appraisal being undertaken and to ensure that it undertakes sufficient analysis to arrive at an informed decision.

ADDRESSING UNCERTAINTY

The authority operates in an uncertain world. Consequently, it is important that the authority reflects this uncertainty in its option appraisals. It is equally important that it puts into place appropriate mechanisms to learn from its experiences.

There are a range of techniques that the authority can use to address uncertainty and to facilitate learning, including:

Risk and uncertainty	Using adjusted discount rates to compensate for the inherent uncertainty surrounding cash flows for higher-risk projects or activities.
Sensitivity analysis	Identifying key assumptions made in the option appraisal and quantifying the impact on the appraisal of variations in these assumptions.
Optimism bias	Compensating for the unwitting tendency of organisations undertaking option appraisal to understate the cost of options and to overstate the benefits.
Peer reviews	Using independent external review both during and after the option appraisal to scrutinise, challenge and improve the quality of the option appraisal process.

Post-implementation reviews	Testing the reasonableness of the assumptions and judgements made at the time of the original appraisal through a post hoc assessment of the decision-making process and the results, benefits and outcomes of the decision.

REPORTING THE RESULTS OF THE OPTION APPRAISAL

The reporting requirements for an option appraisal will have an impact on the nature and scope of the work to be undertaken, so it is sensible to consider a reporting framework at the outset of the appraisal itself.

By considering the messages and information that need to be conveyed, as well as to whom they need to be communicated, the authority can generate a work plan for the option appraisal that sets out the issues that must be addressed.

The focus of the report should be on providing the leadership team or other decision-making body with the information that it needs to make the necessary decision. Most importantly, however, the report should provide a robust and balanced assessment of the different options, before coming to an informed and evidence-based conclusion.

While the authority will need to tailor the appraisal report to the needs of the particular decision to be made, the following elements might usefully be included.

Approach	■ An overview of the approach adopted for undertaking the option appraisal. ■ Details of any assumptions made and how these assumptions have been reached. ■ Information on any specialist advice that has been sought. ■ An overview of how relevant stakeholders have been identified and engaged in the appraisal process. ■ The accounting treatment of the proposed options and the implications of this for the authority and for the appraisal process.
Constraints	■ A summary of the main constraints, including contractual commitments, affordability and the scope for fundamental business change. ■ An explanation of the implications of not proceeding.
Long and short list of options	■ A statement of the base case. ■ The long and short lists of options. ■ A statement explaining the short-listing process. ■ A summary of the full analysis of (ideally) at least three options for meeting the business need.
Financial analysis of short-listed options	■ An evaluation of the net cash flows anticipated from the alternative options. ■ An assessment of the affordability of the selected option, including an explanation of any special financial arrangements. ■ A record of technical details, such as the price basis and the base date for discounting.

Non-financial analysis of short-listed options	■ An assessment of the non-financial elements of the project or activity, using economic appraisal, cost benefit analysis, multi-criteria analysis or some other appropriate technique. ■ Identification and discussion of any unquantifiable costs and benefits and their implications for the appraisal. ■ The results of relevant impact assessments and their implications for the appraisal.
Risk	■ Identification and assessment of the risks associated with the project or activity and the arrangements to be put in place for their management and mitigation.
Sensitivity analysis	■ An analysis of the implications of variations in the drivers determining the outcome of the appraisal, with an explanation of how any significant implications will be addressed.
Optimism bias	■ An account of how the appraisal process has addressed the systematic tendency for people and organisations to be overly optimistic about the outcome of planned actions.
Peer review	■ An account of any peer review processes carried out during the appraisal process.
Post-implementation review	■ An outline plan for implementing the project or activity and for achieving the desired outcomes, with key milestones and timescales. ■ An explanation of the mechanisms in place for a post-implementation review, if required.

In all cases, it is important that the report remains objective and that it provides a robust and balanced assessment of the different options, before coming to an informed and evidence-based conclusion.

Even the most comprehensive and diligent option appraisal can come into question if it is reported poorly. Therefore, a high-quality report can provide considerable assurance to all stakeholders that the resulting decision has been made openly, honestly and with due regard to the issues involved.

Key questions

- Does the authority have a documented option appraisal methodology that is consistent with the guidance set out in IFAC/PAIB publication *Project and Investment Appraisal for Sustainable Value Creation: Principles in Project and Investment Appraisal*?
- Does the authority offer guidance to officers as to when an option appraisal should be undertaken?
- Does the authority's approach to option appraisal include appropriate techniques for the qualitative and quantitative assessment of options?
- Does the authority's approach to option appraisal include suitable mechanisms to address risk and uncertainty?
- Does the authority report the results of option appraisals in a clear, robust and informative manner that gives clear recommendations and outlines the risk associated with any preferred option(s)?

CHAPTER 6

Monitoring financial performance

The authority's long-term financial strategy, medium-term financial plan and annual budget set out its financial plans for the periods that these documents cover. Unexpected pressures can, nevertheless, impact on the authority's ability to manage its financial resources in line with these plans. It is important, therefore, that the authority is able to identify such pressures and to take prompt action to address them.

This chapter of the guidance notes considers:

- the way in which the leadership team takes action using reports, enabling it to identify and correct emerging risks to its budget strategy and financial sustainability
- how the leadership team monitors the elements of its balance sheet which pose a significant risk to its financial sustainability.

This chapter considers the things that the authority's leadership team needs to be aware of if it is to be able to identify and to respond to risks to its budget strategy and financial sustainability, such as deviation from planning assumptions, expenditure against budget, service pressures and the implementation of savings initiatives. It also discusses the characteristics of an effective report and the need for reports to be prepared in a timely manner.

It is a requirement of the FM Code that authorities should monitor closely the material elements of their balance sheet that may give indications of a departure from financial plans. This chapter outlines good practice for balance sheet management from a governance perspective and considers the risks that could arise from the different elements of the authority's balance sheet. It also discusses how the authority can seek to identify, monitor and respond to such risks.

Financial Management Standard N:

The leadership team takes action using reports, enabling it to identify and correct emerging risks to its budget strategy and financial sustainability

The earlier the authority identifies that it is deviating from its plans, the easier it is to get things back on course. Consequently, proactive review of focused financial and activity performance reports should be a regular task for the leadership team.

In order for the leadership team to have access to the information it needs to identify emerging risks, the authority needs to ensure that its leadership team:

- receives reports about the right things
- receives reports at the right time
- receives reports in the right format
- takes action in respect of any issues identified.

RECEIVING REPORTS ABOUT THE RIGHT THINGS

The earlier the authority becomes aware of a potential risk to the achievement of its financial strategy, medium-term financial plan or its annual budget, the sooner – and the more effectively – it can take action to address that risk and to mitigate its impact on the authority.

Consequently, the authority might seek to include in its reporting, where possible, forward-looking indicators of financial and operational performance. This is not to say that backward-looking performance information is not important – it is simply that, by its very nature, it is less useful in identifying problems that may arise in the future.

Useful forward-looking indicators do not necessarily need to relate to the authority's own performance. Information in respect of the environment in which the authority is operating can also be a helpful way of identifying issues or trends that may impact on the authority's ability to deliver its services and to maintain financial sustainability.

Some examples of information and other factors that it might be helpful to report to the authority's leadership team include:

- the key **planning assumptions** used in developing the financial strategy, the medium-term financial plan and the annual budget, together with a review of these assumptions that highlights any significant deviation from the initial estimates used and assesses the impact of any such deviation on the achievability of the authority's financial plans
- ongoing **financial performance against budget** across different service areas, including capital projects and programmes, which can allow the leadership team to identify potential financial issues – provided the budget is profiled effectively or a forecast outturn position is provided
- the **significant risks** to the achievement of the authority's financial plans in the short, medium and long term, together with an indication of the current status of each of these risks (ie are they 'crystallising') and any action that the authority should take to mitigate them
- performance in **implementing savings initiatives** and in realising targeted savings or efficiency gains
- the authority's **performance in delivering its key services**, including things like service performance indicators, capacity issues, backlogs, etc, which will allow the leadership team to identify any pressures on these services and to assess the implications for the authority's ability to achieve its financial plans
- the **performance of key partners**, especially those involved in the delivery of critical services including contract monitoring information which will allow risk to be managed and
- **staff and service user feedback**, which can be a helpful indicator of financial and operational pressures and can allow the leadership team to address such pressures before they impact on the authority's ability to deliver its services effectively and to maintain financial sustainability.

RECEIVING REPORTS AT THE RIGHT TIME

In order to be effective, information reported to the leadership team needs to be timely. This means that data included in reports to the leadership team needs to be collected, analysed and reported within suitable timescales.

It has become normal for authorities to collect a range of financial and performance data on a monthly basis and to report this to the leadership team in line with the meeting schedules of its constituent elements, such as senior leadership team meetings, finance committee meetings, full council meetings, etc.

In times of considerable financial pressure, however, where issues can arise that need to be addressed urgently, the authority may wish to consider whether such timescales allow information to be reported to the leadership team in a sufficiently timely manner.

In some circumstances it may be more appropriate to report critical information on a more frequent basis. For example, in a critical service area facing significant financial pressure and with limited capacity to manage demand, daily reports on capacity, demand and performance may be desirable. Where services are commissioned or delivered in partnership there should be a clear understanding around such reporting requirements.

Such situations may require the authority to develop suitable reporting lines to provide the leadership team with the information that it requires.

There should also be minimal delay between the period to which the performance information relates and the reporting of this information to the leadership team. This may require the authority to streamline the way in which it collects, collates, analyses and reports performance information.

RECEIVING REPORTS IN THE RIGHT FORMAT

The authority will wish to ensure that reports to the leadership team are:

Clear	Reports are written in clear and understandable language, with any technical terminology defined or explained. Key information is highlighted. Graphs, charts and tables are used, where suitable, to present information effectively.
Accurate	Information provided in reports is free from material errors. Where estimates have been included, this is made clear. Care is also taken to ensure that the presentation of any data is not misleading.
Timely	The leadership team receives reports in a timely manner, so that they can identify issues and risks before these become critical to the achievement of the authority's budget strategy and to its financial sustainability.
Relevant	Reports focus on what the leadership team needs to know. Clear statements of fact are more useful than pages of discussion or long tables of data. Extraneous detail is avoided. Any necessary supplementary information is put in an annex.
Well-structured	Reports have a clear structure and a strong narrative flow. The main point(s) of the report are set out at the beginning, so that the reader knows why they are reading the report. Those writing reports consider the questions that the reader may have and how these questions can best be answered.
Concise	Reports are as brief as possible.

Reports that allow the monitoring of financial performance against budget, in particular, might include sufficient information for the leadership team to understand how well the authority is performing against budget and, where relevant, the reasons for any significant variations against budget.

Such reports could include, for example:

- the budget for the period under consideration
- accruals-based income and expenditure to date
- a forecast for the remainder of the year and an estimate of the year-end position
- relevant underlying service activity data
- action to be taken to address any variation from budget
- who to contact for further information (eg the relevant budget holder).

TAKING ACTION IN RESPECT OF ISSUES IDENTIFIED

Critical issues raised in respect of the authority's financial sustainability need to be acted upon promptly.

It is, ultimately, up to the leadership team itself to ensure that it takes appropriate action in response to reports that it has received. However, the authority can facilitate the taking of such action by setting out, when presenting information to leadership team, recommendations as to what action is required.

Under some circumstances, it may be apparent that the authority's activities or the environment within which it operates may have changed to such an extent that its financial plans, for example the annual budget, are no longer realistic. In such cases, it may be prudent to recalibrate such plans.

The leadership team may wish to keep a record of action that it has taken in response to reports that it has received, whether through minutes of its meetings or other mechanisms. It might also gain benefit from reviewing the impact of the action that it has taken, to ensure that it has had the desired effect.

Key questions

- Does the authority provide the leadership team with an appropriate suite of reports that allow it to identify and to correct emerging risks to its budget strategy and financial sustainability?
- Do the reports cover both forward and backward-looking information in respect of financial and operational performance?
- Are there mechanisms in place to report the performance of the authority's significant delivery partnerships such a contract monitoring data?
- Are the reports provided to the leadership team in a timely manner and in a suitable format?
- Is the leadership team happy with the reports that it receives and with its ability to use these reports to take appropriate action?

Financial Management Standard O:

The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability

The CIPFA publication *Balance Sheet Management in the Public Services: A Framework for Good Practice* (2017) outlines a number of elements of good practice for balance sheet management from a governance perspective.

These are as follows:

1. In organisational culture, appropriate emphasis is placed on balance sheet management activities and considerations.
2. Balance sheet management requirements are addressed coherently and comprehensively across all relevant strategies and plans.
3. Balance sheet management responsibilities are identified and assigned to appropriate people.
4. The authority's decision-making framework is effective and requires appropriate consideration of balance sheet implications.
5. Appropriate levels of assurance are provided over all aspects of balance sheet management.
6. Financial and operational risk management activity pays due regard to balance sheet drivers and impacts.

The authority might seek to comply with the FM Code by engaging with these elements of good practice, as they allow it to create an environment within which effective management of the balance sheet is promoted and valued.

In order for the leadership team to be able to monitor the elements of the authority's balance sheet which pose a significant risk to its financial sustainability, a more targeted approach may be required.

Consequently, to comply with the FM Code, the authority might choose to:

- determine which elements of its balance sheet pose a significant risk to its financial sustainability, through a comprehensive review of its assets and liabilities
- put in place mechanisms to monitor these elements of its balance sheet
- respond promptly and proactively to any issues that these mechanisms identify.

While this financial management standard focuses specifically on the authority's balance sheet, it is worth recognising that the various elements of the authority's balance sheet do not exist in isolation. Rather, they are linked to other aspects of the authority's activities, such as service provision asset management, capital investment, treasury management, etc.

Consequently, while the monitoring of risk inherent to the authority's balance sheet can be undertaken as a stand-alone activity, it should also usefully be integrated into other aspects of the authority's performance monitoring and risk management processes. The main thing is that any such risks are identified and managed.

DETERMINING RISK ON THE BALANCE SHEET

The elements of the balance sheet that pose a risk to the authority's financial sustainability will depend on the authority's activities and on the assets and liabilities that it holds on its balance sheet.

It is useful, therefore, for the authority to review its balance sheet in the light of its financial strategy and its medium-term financial plan and to identify those elements that are critical to the achievement of its long and medium-term objectives.

Some aspects of the balance sheet that may be critical to the authority's financial sustainability include:

Non-current assets (ie fixed assets)	Where the authority uses its physical assets (eg buildings such as housing and schools) to deliver services, it is important that these are maintained in a suitable condition and the right assets to deliver services.
Long-term and short term investments	Where the authority holds investments it must operate within current guidance and reflect a clear understanding of the implications of these on its financial planning and risk management arrangements, since they can have a significant impact on an authority's financial sustainability (see CIPFA's *Prudential Property Investment* (2019)).
Debtors	The collection of payments from service users and other 'trade' debtors provides valuable income to support the authority's services. Should the authority experience difficulty in collecting this debt, the financial sustainability of the associated services could be threatened.
Cash	The maintenance of a sufficient cash balance to pay the authority's expenditure and debts as they become due is imperative. A shortfall in cash represents a fundamental and imminent problem and could threaten the authority's very ability to function.
Current liabilities	Where payments are due to be made to creditors in the short term, it is vital that the authority has sufficient cash – or assets that can quickly be converted to cash – to ensure that such payments can be made.
Provisions	The risk is not just existing provisions and the potential for their value to increase, but also events that may give rise to provisions that the authority was not expecting. While such provisions may not require immediate cash settlement, they can reduce the usable reserves of the authority on the balance sheet. This effectively means that assets, for example cash, are being held by the authority in case settlement is required. It may only become clearer later if settlement is absolutely required, and how much the cash outlay will be.
Pensions Liabilities	Authorities will normally have a liability to fund part or all of the future pensions which are payable to retired employees. The measurement of these liabilities is reflected on the balance sheet, but authorities are not normally required to fund them (ie reduce usable reserves) when the liabilities are incurred. Instead such liabilities are normally managed in the longer term, including adjustments to the employer's annual contributions to the pension scheme involved. The legal commitments to fund pension liabilities, and the profile of those payments over future years, will need to be considered in financial sustainability assessment.
Long-term borrowing	Long-term borrowing has become a normal part of authorities' balance sheets. The critical risk here, though, is the authority's ability to make interest or other payments when they are due.

Service concession arrangements	If the authority benefits from service concession arrangements operated under the private finance initiative, it may rely heavily on these concessions for the delivery of services to the public. It will also be required to make regular payments to the provider organisation. A failure to make these payments will have a significant impact on service delivery and on the authority's continued ability to function.
Usable reserves	Usable reserves may be held for variety of reasons, including to balance out uneven cash flows or unexpected events. They are also a means of funding strategic developments, especially those for which it would be difficult to secure external funding or borrowing. An insufficient – and especially an insufficient and falling – level of reserves is reason for additional scrutiny.

MONITORING RISK ON THE BALANCE SHEET

In monitoring elements of the balance sheet that could pose a risk to its financial sustainability, the authority might opt to operate a two-pronged approach of prevention and detection.

The prevention element of monitoring risk addresses the way in which the authority avoids risk arising in the first place.

It includes the following (this list is not intended to be exhaustive):

- treasury management policies and how the authority selects approved counterparties for its investments
- credit control policies for trade debtors and how the authority pursues unpaid debts
- cash management strategies
- how the authority identifies the need for new provisions
- management of borrowing, including the setting of the authority's prudential indicators
- management of service concessions arrangements
- policies on levels of reserves and what reserves may be used for.

The detection element of monitoring risk, on the other hand, concerns how the authority identifies when such risk has 'crystallised', ie when it has turned from a theoretical threat to a practical problem.

To ensure that the crystallisation of such risks is identified promptly, the authority might usefully develop suitable 'early warning' mechanisms for the elements of the balance sheet that it considers to be critical to its financial sustainability.

This could include, for example:

- close monitoring of the authority's financial performance and of its impact on the authority's reserves
- reporting to the leadership team of any unplanned use of the authority's reserves
- monitoring of investment returns and the forecasting of future cash inflows
- regular review of aged debtors and of the actions being taken to secure recovery
- forecasting of cash balances and of the authority's ability to pay amounts coming due

- regular monitoring of performance against the authority's prudential indicators
- forecasting of service concession arrangement payments and modelling of their future affordability
- inclusion in regular management accounting reports of relevant balance sheet information.

For each element of the balance sheet that poses a threat to the authority's financial sustainability, the authority could seek to develop a suite of preventative and detective measures that, together, (a) reduce the likelihood of the risk occurring and (b) maximise the chance of the authority detecting it should the risk crystallise.

This means that the balance sheet is not something that the authority can worry about just at year end when it is preparing its financial statements. Instead, it needs to receive the same level of regular attention as the authority's income and expenditure records.

RESPONDING TO RISK INHERENT TO BALANCE SHEET ITEMS

It might also be sensible for the authority to seek to mitigate the potential impact on its financial sustainability should one of more of the identified balance sheet risks crystallise. This is, however, difficult to achieve in practice. As such it is important for the authority to respond promptly when risks crystallise.

The action that the authority takes will depend on:

- the element of the balance sheet in question
- the risk or issue that has arisen
- the impact that it is likely to have on the authority.

In some cases, the authority may be able to reduce the risk to which it is exposed relatively quickly and easily. In other cases, the issue may be less tractable and might require a more engaged response. In some cases the authority may not be able to respond effectively acting alone, so may need to work with other authorities or branches of government to resolve the issue.

The key, though, is for the authority to identify the issue and to take action promptly. This can only happen if the leadership team knows what is important, knows what to look for and monitors the critical elements of its balance sheet proactively and effectively.

Key questions

- Has the authority identified the elements of its balance sheet that are most critical to its financial sustainability?
- Has the authority put in place suitable mechanisms to monitor the risk associated with these critical elements of its balance sheet?
- Is the authority taking action to mitigate any risks identified?
- Does the authority report unplanned use of its reserves to the leadership team in a timely manner?
- Is the monitoring of balance sheet risks integrated into the authority's management accounts reporting processes?

CHAPTER 7

External financial reporting

The publication of financial information is one of the primary ways in which the authority demonstrates accountability to service users, taxpayers, to citizens and to other organisations across the public sector. Furthermore, the authority's statutory financial statements provide a definitive audited record of its financial position and financial performance, as well as a secure foundation for effective financial management.

This chapter of the guidance notes considers:

- the extent to which the chief finance officer has personal responsibility for ensuring that the statutory accounts provided to the local authority comply with the *Code of Practice on Local Authority Accounting in the United Kingdom*
- the degree to which the presentation of the final outturn figures and variations from budget allows the leadership team to make strategic financial decisions.

This chapter starts by summarising the statutory basis for local government financial reporting in the UK and by exploring the purpose of the annual financial statements.

It then considers explicitly the role of the authority's chief finance officer in the preparation and publication of the financial statements and how the authority can ensure that the chief finance officer has met their obligations in this regard.

Effective financial reporting is key to ensuring that the authority and its leadership team understand how effectively its resources have been utilised during the year. This chapter considers how financial outturn information can be reported effectively and sets out some key questions that the leadership team should ask when presented with such information.

Financial Management Standard P:

The chief finance officer has personal responsibility for ensuring that the statutory accounts provided to the local authority comply with the *Code of Practice on Local Authority Accounting in the United Kingdom*

The external financial reporting process for authorities is prescribed by statute. Local authorities are required to produce their statutory accounts on an annual basis in accordance with:

- the Accounts and Audit Regulations 2015 for English Authorities
- the Local Government (Accounts and Audit) Regulations Northern Ireland 2015
- the Local Authority Accounts (Scotland) Regulations 2014 or
- the Accounts and Audit (Wales) Regulations 2014, as amended.

The *Code of Practice on Local Authority Accounting in the United Kingdom* (the local authority accounting Code) is prescribed by the above-mentioned statutory instruments as proper (accounting) practices to specify the principles and practices of accounting that are required to give a 'true and fair' view of the authority's financial position, financial performance and cash flows (including the group accounts where the authority has material interests in subsidiaries, associates or joint ventures).

THE PURPOSE OF THE STATUTORY FINANCIAL STATEMENTS

The local authority accounting Code specifies that the objective of local authority financial statements is to provide information about the authority's

- financial performance (income and expenses)
- financial position (assets, liabilities and reserves)
- cash flows.

That is useful to a wide range of users for assessing the stewardship of the authority's management and for making economic decisions. They should therefore be able to give electors, service users, those subject to locally levied taxes and charges, members of the authority (as representatives of service recipients) and other interested parties clear information about the authority's finances.

The financial statements should answer such questions as:

- What did the authority's services cost to deliver over the course of the year?
- Where did the money to fund the authority come from?
- What were the authority's assets and liabilities at the end of the year?

It is important that two particular aspects are understood clearly. First, all financial statements should reflect a common pattern of presentation, although this does not necessarily require them to be in an identical format. One of the main aims of the local authority accounting Code is to narrow the areas of difference and variety in accounting treatment and thereby to enhance the usefulness of published statements of accounts.

Secondly, interpretation and explanation of the accounts are important mechanisms to ensure that the messages in the financial statements are communicated effectively to the users of the financial statements. The local authority accounting Code requires that there should be a narrative report to accompany the financial statements, which should explain the more significant features of the accounts. It should be based on the information contained in the financial statements and should not contain material inaccuracies or misleading statements.

The narrative report (management commentary in Scotland), however, has another important function. Its purpose is to provide information on the authority, its main objectives and strategies and the principal risks that it faces. The narrative report should provide a commentary on how the authority (including the group accounts) has used its resources to achieve its desired outcomes in line with its objectives and strategies. It will support the financial statements in responding to the three questions set out above.

Wherever possible, the financial statements and the supporting notes should be written in clear, comprehensible language. Technical terms or jargon should be used only sparingly. Where the use of technical terms cannot be avoided, they should always be explained clearly.

Where the authority also publishes a summarised or simplified version of its financial statements, this should contain a clear reference to the existence of the full financial statements and should explain how the full financial statements can be accessed.

THE ROLE OF THE CHIEF FINANCIAL OFFICER

CIPFA's *Statement on The Role of the Chief Financial Officer in Local Government* states that it is the responsibility of the authority's CFO to publish annual financial statements on a timely basis, in order to communicate the authority's activities and achievements, its financial position, financial performance and cash flows.

Furthermore, the local authority accounting Code requires the authority to provide in its financial statements a 'statement of responsibilities' setting out the responsibilities of the authority and the CFO in respect of the financial statements. The statement of responsibilities must confirm that the financial statements have been prepared in accordance with the requirements of the local authority accounting Code.

For local authorities in England, Wales and Scotland, the following wording is recommended, but not mandatory:

The authority's responsibilities

The authority is required to:

- make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the chief financial officer
- manage its affairs to secure economic, efficient and effective use of resources and safeguard its assets
- approve the statement of accounts (England and Wales only).

The chief financial officer's responsibilities

The chief financial officer is responsible for the preparation of the authority's statement of accounts in accordance with proper practices as set out in the CIPFA/LASAAC *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code).

In preparing this statement of accounts, the chief financial officer has:

- selected suitable accounting policies and then applied them consistently
- made judgements and estimates that were reasonable and prudent
- complied with the local authority Code.

The chief financial officer has also:

- kept proper accounting records which were up to date
- taken reasonable steps for the prevention and detection of fraud and other irregularities.

In England and Wales, the chief financial officer should sign and date the financial statements, stating that they give a true and fair view of the financial position of the authority at the reporting date and of its expenditure and income for the year ended 31 March 20XX.

In Scotland, the proper officer is required to submit the unaudited accounts to the authority and to its appointed auditor by 30 June. The audited financial statements must be laid before a meeting of the authority or a committee of that authority whose remit includes audit or governance functions no later than 30 September.

For authorities in Northern Ireland, the following wording of the statement of responsibilities is proposed:

The council's responsibilities

Under Section 1 of the Local Government Finance Act (Northern Ireland) 2011, the council shall make arrangements for the proper administration of its financial affairs. Under this section, the council is required to designate an officer of the council as its chief financial officer. Arrangements for the proper administration of its financial affairs shall be carried out under the supervision of its chief financial officer.

The council is required to approve the statement of accounts.

The chief financial officer's responsibilities

Under Regulation 8 of the Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015, the chief financial officer is responsible for the preparation of the council's statement of accounts in the form directed by the Department for Communities (NI).

The accounts must give a true and fair view of the expenditure and income and cash flows for the financial year and the financial position as at the end of the financial year.

In preparing this statement of accounts, the chief financial officer is required to:

- observe the accounts direction issued by the Department for Communities (NI), including compliance with the *Code of Practice on Local Authority Accounting in the United Kingdom*
- follow relevant accounting and disclosure requirements and apply suitable accounting policies on a consistent basis, and
- make judgements and estimates that are reasonable and prudent.

The chief financial officer is also required to:

- keep proper accounting records which are up to date, and
- take reasonable steps for the prevention and detection of fraud and other irregularities.

The chief financial officer should sign and date the statement of accounts, stating that it gives a true and fair view of the financial position of the authority at the reporting date and of its expenditure and income for the year ended 31 March 20XX.

THE CFO'S RESPONSIBILITIES FOR THE ACCOUNTS OF THE AUTHORITY

In order to demonstrate compliance with the requirement of the FM Code that the authority's CFO has both personal and statutory responsibilities for ensuring that its financial statements comply with the local authority accounting Code, the authority could:

- ensure that the preparation and submission of annual financial statements that comply with the local authority accounting Code is included within the CFO's job/role description and annual performance management objectives

- consider the extent to which the CFO has prepared and submitted annual financial statements that comply with the local authority accounting Code as part of the CFO's performance management review (or equivalent) and used to inform any performance management ratings or judgements
- challenge the CFO in the event that the annual financial statements are not prepared and submitted in line with the required timescales or if the review of the financial statements by the authority or its auditors identifies any other issues in respect of their preparation.

The authority should, however, also ensure that the CFO is provided with sufficient resources – including a suitably-resourced finance team – to fulfil their personal and statutory responsibilities under this element of the FM Code.

Key questions

- Is the authority's CFO aware of their responsibilities in terms of the preparation of the annual financial statements?
- Are these responsibilities included in the CFO's role description, personal objectives and other relevant performance management mechanisms?
- Have the authority's financial statements hitherto been prepared on time and in accordance with the requirements of the *Code of Practice on Local Authority Accounting in the United Kingdom?*

Financial Management Standard Q:

The presentation of the final outturn figures and variations from budget allow the leadership team to make strategic financial decisions

The FM Code states that effective financial reporting is key to ensuring that the authority and its leadership team understand how effectively its resources have been utilised during the year, including how material variances from initial and revised budgets to outturn have arisen and been managed.

The success of these arrangements will be demonstrated by the ability of the leadership team to use them to make informed decisions about the authority's future financial strategy and plans. In some circumstances, such reporting might lead to a reappraisal of the achievability of the long-term financial strategy and of the financial resilience of the authority.

PRESENTING EFFECTIVE FINANCIAL OUTTURN INFORMATION

The key to presenting financial outturn figures and budget variations so that they can allow the leadership team to make strategic financial decisions is to ensure that this information is:

Accurate	Information on financial outturn and variation from budget needs is robust and reliable. If it cannot be relied upon, then it should not be used to inform strategic decision making. The authority also ensures that budgets are set – and profiled – in a robust and realistic manner.
Relevant	The information is relevant to the decisions to be made and provides the leadership team with the information that it needs to make these decisions. It also seeks to give an insight into the drivers of the cost of the service and how actual figures for these drivers have compared against planning estimates.
Granular	The leadership team is able to 'drill down' into the data to gain greater insight into the authority's financial performance. For example, if the leadership team is interested in the success of the authority's savings plans, it is able to look beyond the headline figures into the specific savings achieved – or not achieved – by individual activities and projects.
Analysed	A robust analysis of the financial information provided is vital. For example, if a particular service has overspent against budget, it is important to know why this is the case. Has demand been higher than anticipated while unit costs have remained on budget? Or have unit costs risen beyond expected levels?.
Put into context	Financial information is put into the proper context. This means that it is presented in the context of relevant internal and external factors such as: ■ changes to legislation ■ changes to the way in which a service is delivered ■ changing patterns of demand ■ service demand and performance. It may also be helpful to present financial information in the context of performance by other authorities or of relevant performance benchmarks.

The authority might usefully choose to take these factors into account whenever outturn figures and variations from budget are presented to the leadership team.

SPECIFIC QUESTIONS FOR THE LEADERSHIP TEAM TO ASK

When reviewing financial outturn figures and variations from budget, there are a number of key questions that the leadership team might usefully ask. Asking these questions will help the authority to comply with the FM Code, by ensuring that outturn figures and variations from budget are presented in a manner that facilitates strategic decision making.

These include:

- **Is the final outturn position broadly in line with the budget?**

While the authority should prepare its annual budget diligently, variations in income and expenditure budgets will inevitably arise. If the budgeted outturn position and the actual outturn position differ significantly, however, the leadership team will need to review the authority's approach to setting its budget.

- **How well have different services performed against budget?**

It is reassuring if services have performed in line with budget, as this is an indication that income, activity and expenditure are (probably) in balance. If services have overspent against budget, either because of a shortfall in income or an excess of expenditure, this is a concern and should be addressed. Similarly, if a service has spent less than budgeted or has generated more income than expected, the reason for this should be determined.

- **Have any issues been highlighted prior to the end of the year?**

There should be no real surprises in the year-end financial outturn of budget variance information, as any significant issues should have been communicated to the leadership team as and when they became apparent. Where issues are raised only in the year-end reports, this is indicative of a problem in the way in which financial information is reported throughout the year.

- **Has the authority achieved its savings targets?**

If the authority has set savings targets for specific services or activities, the leadership team should ensure that these targets have been achieved. This is especially the case when such savings have been integrated into service budgets, as it is easy for them to 'disappear' in the overall figures for the service as a whole.

- **Is the authority's capital programme on track?**

Where the authority has a programme of capital projects and expenditure, the leadership team should ensure that progress against the programme – in terms of expenditure and timescales – is in line with what has previously been agreed. Where projects are exhibiting cost overruns or delays in the completion schedule, these should be addressed promptly.

The leadership team might also usefully undertake a critical examination of the financial outturn figures and budget variations and assess them against the picture of the authority's performance that it has received from other sources of information, such as service reports, inspection reports, feedback from staff and service users, etc. If these sources of information do not all present a consistent picture of the authority's performance, the leadership team may wish to take action to understand why this is the case.

Key questions

- Is the authority's leadership team provided with a suitable suite of reports on the authority's financial outturn and on significant variations from budget?
- Is the information in these reports presented effectively?
- Are these reports focused on information that is of interest and relevance to the leadership team?
- Does the leadership team feel that the reports support it in making strategic financial decisions?

Other sources of guidance and support

CIPFA has produced or contributed to a range of publications upon which the authority may wish to draw when considering the extent to which it complies with the FM Code and when thinking about how it might wish to improve its financial management arrangements.

- *Balance Sheet Management in the Public Services: A Framework for Good Practice (2017)*
- *Capital Strategies and Programming (2014)*
- *CIPFA Prudential Property Investment (2019)*
- *CIPFA Standard of professional Practice on Ethics (2018)*
- *CIPFA/IFAC International Framework: Good Governance in the Public Sector (2014)*
- *CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom*
- *Delivering Good Governance in Local Government Framework (2016), along with the associated guidance notes for local authorities and other public sector organisations*
- *Leadership Matters (2020)*
- *The CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, Guidance Notes for Practitioners*
- *The Prudential Code for Capital Finance in Local Authorities (2017)*
- *The Prudential Code for Capital Finance in Local Authorities: Guidance Notes for Practitioners (2018)*
- *The Role of the Chief Financial Officer in Local Government (2016)*
- *The Role of the Chief Financial Officer of the PCC and the Chief Finance Officer of the Chief Constable (2012)*
- *Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (2017)*
- *Treasury Management in the Public Services: Guidance Notes for Local Authorities including Police Forces and Fire and Rescue Authorities (2018)*

Beyond these titles, CIPFA has also published guides to a range of related topics that may help the authority to improve its financial management arrangements, such as developing a financial strategy and undertaking an option appraisal.

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APPENDIX 2 – CIPFA FINANCIAL MANAGEMENT CODE EVIDENCE OF CURRENT COMPLIANCE AND PROPOSED ACTION PLAN

The CIPFA Financial Management Code is intended to support good practice in financial management and assist in demonstrating a body's financial sustainability. The code sets out the standards of financial management for local government bodies. The table below provides an assessment of how West Lothian IJB currently complies with the Code and sets out proposed actions to ensure compliance with the code for 2021/22.

Section 1 – The responsibilities of the chief finance officer and leadership team

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard A – The leadership team is able to demonstrate that the services provided by the authority provide value for money.	The leadership team of the IJB utilise a number of frameworks and documents to ensure that the IJB provides value for money. These include: • Ensuring compliance with the IJB's Best Value Framework • Review of financial business cases for service projects • Ensuring compliance with Financial Regulations and Reserves Policy • Monthly financial monitoring and risk based monitoring providing necessary and required scrutiny and feedback.	Continue with the existing systems of internal control and the management of risk. The Financial Regulations will be reviewed to ensure that they fully reflect the requirements of the Code, and the amended regulations reported to the Board for approval.

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard B – The authority complies with the CIPFA Statement on the Role of the Chief Financial Officer in Local Government.	The role description of the Chief Financial Officer for West Lothian IJB, complies with the principles set out in the CIPFA statement; this is evidenced by the role, responsibilities and status of activities undertaken. **Principle 1** – Is a key member of the Leadership Team (at West Lothian this is as a Board member and a member of the Health and Social Care Partnership Management Team) **Principle 2** – Takes lead role in the IJB's financial strategy (the CFO reports to the Chief Officer and the Board on all financial strategy matters)	Update the Scheme of Delegation, including the section 95 officer role and responsibilities, to demonstrate compliance with the CIPFA statement, following consideration of the Code by the Board.

	Principle 3 – Leads and promotes good financial management (the CFO encourages and emphasises sound financial management via a variety of means) **Principle 4** – Leads and directs the finance functions of the IJB which is fit for purpose (the CFO manages and is responsible for the financial management and reporting in respect of the IJB) **Principle 5** – Is professionally qualified with suitable experience (the Section 95 Officer is a qualified accountant, with significant relevant experience)	

Section 2 – Governance and financial management style

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard C – The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control.	The governance structure of the IJB demonstrates the actions and internal controls in place. This includes the IJB's Financial Regulations, Standing Orders, the Local Code of Corporate Governance and the Scheme of Delegation.	The relevant governance documents are reviewed per timescales agreed by the Board.
Financial Management Standard D – The authority applies the CIPFA/SOLACE Delivering Good Governance in Local Government: Framework 2016.	The IJB has a Code of Corporate Governance and a compliance process which is aligned to the CIPFA/SOLACE Delivering Good Governance in Local Government: Framework 2016. The Code of Corporate Governance is reported annually to the Audit, Risk and Governance Committee and is reviewed on a bi-annual basis.	None. The IJB fully applies the CIPFA/SOLACE Delivering Good Governance in Local Government Framework 2016.
Financial Management Standard E – The financial management style of the authority supports financial sustainability.	The financial management style of the IJB has been recognised by external auditors Ernst and Young who are satisfied with the financial management arrangements in place although financial sustainability continues to be a risk.	Continue to work with partner bodies around financial sustainability of the IJB and further development of the medium term financial strategy.

Section 3 – Medium to long-term financial management

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard F – The authority has carried out a credible and transparent financial resilience assessment.	The IJB is presented with regular finance updates from the Chief Officer which consider key budget risks both operational and strategic. A financial assurance process is undertaken each year on budget resources provided by partner bodies to identify any funding risks to the IJB which could impact on financial resilience.	Building on existing activities, it is proposed that from 2021/22, the budget report will include a section that notes the position on financial resilience and sustainability.
Financial Management Standard G – The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members.	The IJB's Strategic Plan and commissioning plans set out the vision for the delivery of the IJBs priorities, the Strategic Plan and associated commissioning plans have gone through the necessary scrutiny and approval processes and take account of MTFP budget assumptions.	The IJBs Strategic Plan is currently for the period 2018/19 to 2022/23. Although the code is not prescriptive it notes the importance of a long term strategy and strategic vision. An updated two year budget to 2022/23 will be presented to the Board in June 2021. Going forward, a five year financial strategy will be developed in conjunction with the Strategic Plan for 2023/24 to 2027/28 setting out a range of assumptions on expenditure and funding.
Financial Management Standard H – The authority complies with the CIPFA Prudential Code for Capital Finance in Local Authorities.	Not applicable.	Not applicable.

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard I – The authority has a rolling multi-year medium term financial plan consistent with sustainable service plans.	The IJB has a medium-term financial plan for the period 2018/19 to 2022/23 with budgets updated annually to ensure they reflect the latest circumstances and most up-to-date information. Commissioning plans are prepared that are consistent with financial resource assumptions and align with the IJB's Strategic Plan.	The IJB's MTFP financial plan covered a five year period, 2018/19 to 2022/23. A new financial plan will be prepared for the next five year period 2023/24 to 2027/28 and will take account of the new Strategic Plan and commissioning plans.

Section 4 - The annual budget

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard J – The authority complies with its statutory obligations in respect of the budget setting process.	The IJBs annual budget report, including issue of Directions, complies with statutory requirements included in the Public Bodies (Joint Working) (Scotland) Act 2014.	Continue to met statutory obligations by approving Directions associated with annual budget resources agreed.
Financial Management Standard K – The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves.	The budget report undertakes financial assurance on the robustness of estimates and assumptions for the annual budget. Given the IJB has not had any uncommitted reserves the budget report has not to date included a statement on the adequacy of financial reserves.	Currently there is no specific statement from the chief finance officer on the adequacy of reserves. Therefore, the annual budget report to the IJB will be updated to include a statement in respect of IJB reserves.

Section 5 – Stakeholder engagement and business cases

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard L – The authority has engaged where appropriate with key stakeholders on long-term financial strategy, medium-term financial planning and annual budget.	The IJB engages on a collaborative basis with NHS Lothian and West Lothian Council in respect of medium term financial planning and the annual budget process.	The IJB will continue to engage on financial plans and on specific elements of the financial plan. In particular, there will be engagement on new plans for 2023/24 onwards

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard M – The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.	The utilisation of business cases is an essential element of service delivery plans and transformation. The IJB considers key business cases related to IJB functions for agreement. (e.g. REH and St John's Hospital business cases)	The IJB will continue to review and approve relevant strategic outline business cases to prioritise resources and demonstrate value for money.

Section 6 – Monitoring Financial Performance

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard N – The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability.	The IJB has Financial Regulations and an approved Integration Scheme which includes the process for monitoring and reporting of budgets and the identification of risks which allows for mitigating actions being undertaken. This is completed in conjunction with reports being presented on the outcome of UK and Scottish Government budget announcements.	There are regular reports to the HSCP SMT and Board on the progress on the current year budget and any changes to budget assumptions for future years. These will be reviewed to identify any potential improvements.
Financial Management Standard O – The leadership team monitors the elements of its balance sheet that pose a significant risk to its financial sustainability.	The IJB adopts a monthly approach to monitoring with budget monitoring reported to each Board meeting during the year. Any balance sheet areas posing a risk to financial sustainability, are identified through the budget monitoring process. The Audit, Risk and Governance Committee receive regular reports on high risks areas and risks relating to the delivery of the financial plan.	In addition to regular monitoring, a statement on any risks to elements of the balance sheet will be included in the covering report to the IJB's final accounts for 2020/21 which will be reported in June 2021.

Section 7 – External financial reporting

Financial Management Standard	Evidence of Compliance	Actions and Timescale
Financial Management Standard P – The chief finance officer has personal and statutory responsibility for ensuring that the statement of accounts produced by the local authority complies with the reporting requirements of the Code of Practice on Local Authority Accounting in the United Kingdom.	The Scheme of Delegation includes the role and responsibility of the chief finance officer for ensuring that the IJB complies with relevant legislation and guidance including the Code of Practice on Local Authority Accounting. The outturn and final accounts are reported to the Audit, Risk and Governance Committee for review and any recommendations prior to being reported to the Board for approval, with the final accounts being audited and signed off by an external auditor.	This responsibility is clearly set out in the IJB's governance arrangements. Accounts will continue to be produced in accordance with the Code of Practice.
Financial Management Standard Q – The presentation of the final outturn figures and variations from budget allow the leadership team to make strategic financial decisions.	The final outturn figures are presented to the IJB annually, as part of the unaudited accounts report presented in June each year. The accounts provide information on performance against budget and identify reasons for key variances.	There is a robust process in place for reporting final outturn figures to the IJB, and this allows Board members to consider strategic financial matters.