Wolverhampton City Council

Audit Committee Meeting

22 September 2014

Dear Councillor

Audit Committee – Monday, 22 September 2014

I am now able to enclose, for consideration at next Monday, 22 September, 2014 meeting of the Audit Committee, the following report that was unavailable when the agenda was printed.

Agenda No	Item
8	**Financial Resilience Report of PricewaterhouseCoopers (Pages 1 - 50)** [To note the report]

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Agenda Item No: **8**

Audit Committee

22 September 2014

Report Title	Financial Resilience Report of PricewaterhouseCoopers
Cabinet member with lead responsibility	Councillor Andrew Johnson Resources
Accountable director	Keith Ireland, Delivery
Originating service	Strategic Finance
Accountable employee(s)	Mark Taylor — Assistant Director Finance Tel — 01902 556609 Email — mark.taylor@wolverhampton.gov.uk
Report to be/has been considered by	None

Recommendations for noting:
The Committee is asked to note:

1. The report prepared by PricewaterhouseCoopers on the financial resilience of the council

1.0 Purpose

1.1 PricewaterhouseCoopers (PwC) as the Council's external auditors are required to assess the arrangements for securing economy, efficiency and effectiveness in the use of resources.

1.2 The Audit Commission guidance includes two criteria to be taken into account when making the assessment:

- the organisation has proper arrangements in place for securing financial resilience; and;
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

1.3. Based upon their planning risk assessment PwC identified that the Council had proper arrangements for challenging how it secures economy, efficiency and effectiveness but undertook a detailed programme of work that placed greater emphasis on addressing the financial resilience criterion. The conclusions from the report are:

- There are adequate Financial Planning, Governance and Control arrangements in place to secure financial resilience.
- We have not identified any material uncertainties relating to events and conditions that may cast significant doubt on the Council's ability to continue to operate for the foreseeable future.
- The use of the going concern assumption is appropriate in the preparation and presentation of the financial statements.
- The Council's systems and processes for managing effectively its financial risks , and to secure a stable financial position, appear to be operating adequately and have put the Council in a position to set a balanced budget for 2014/15 and are well placed to set a balanced budget for 2015/16.
- The longer term financial challenge has reduced significantly over the year due to pro-active financial planning and effective collaboration between Officers and Councillors through new and existing governance arrangements. Whilst there remains a budget gap in the later years of the MTFS this has reduced significantly to less than £30m from £123m at the start of 2014 and the Council has a plan and a process to continue to identify further savings.

A copy of the detailed Financial Resilience Report is attached at Appendix 1.

1.4 PwC intends to issue an unqualified value for money conclusion. The more detailed findings are outlined in the attached report.

2.0 Financial Implications

2.1 The report provides assurances on the arrangements the Council has in place to ensure effective stewardship and accountability for resources at a time of unprecedented financial pressures.
[NA/12092014/T]

3.0 Legal implications

3.1 Statutory authority for the external auditor role set out in paragraph 1.1 of this report which provides external accountability and control is currently contained in the Audit Commission Act 1998.
[TS/15092014/B]

4.0 Equalities implications

4.1 There are no equalities implications arising from this report.

5.0 Environmental implications

5.1 There are no environmental implications arising from this report.

6.0 Schedule of background papers

None

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Wolverhampton City Council

Financial resilience update

Government and Public Sector

September 2014

Report to the Strategic Director Delivery on work to September 2014

Contents

Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to directors or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any director or officer in their individual capacity or to any third party.

Executive summary

Background

Our value for money code responsibility requires us to carry out sufficient and relevant work in order to conclude on whether the Authority has put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources.

In 2013/14 our conclusion is based on two criteria:

- The organisation has proper arrangements in place for securing financial resilience; and
- The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

We determined a local programme of audit work based on our audit risk assessment, informed by these criteria and our statutory responsibilities.

Based on our understanding of the Council's financial position we have focussed the vast majority of our efforts on the following financial resilience point of focus. criterion:

- The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

Purpose of this report

This report summarises:

- the work undertaken to consider the adequacy of the Council's arrangements and financial outlook; and
- the findings of our work, incorporating information obtained from third parties where appropriate.

We look forward to discussing it with you.

Conclusion

We have completed our audit work on financial resilience as well as on economy, efficiency and effectiveness.

We will feedback our anticipated value for money conclusion to the Audit Committee in September through our *Report to those charged with governance* and subsequently in our *Annual Audit Letter* shortly thereafter.

We expect to issue an unqualified Value for Money conclusion by the statutory deadline of 30 September 2014.

Acknowledgements

Key contacts in the finance team have been available throughout the year and have always responded readily to our questions and requests for information. We would like to thank the Strategic Director Delivery, the Section 151 Officer and the Chief Accountant in particular for their openness and transparency and would like to commend the Senior Officers and Councillors for the work undertaken to address the savings requirements identified in the MTFS. There has been huge progress over a relatively short space of time this year.

Risk assessment – financial resilience

The Audit Commission's guidance requires us to carry out sufficient and relevant work in order to conclude on whether the Authority has proper arrangements in place for securing financial resilience.

What do we mean by financial resilience?

- The organisation has robust systems and processes to manage effectively its financial risks and opportunities, and to secure a stable financial position.
- The organisation's financial position should enable it to continue to operate for at least the foreseeable future.

What do we mean by 'foreseeable future'?

The definition of 'foreseeable future' for the purposes of the financial resilience criterion is traditionally taken to be 12 months from the date of the auditor's report on the relevant set of financial statements. This is broadly in line with the concept of 'going concern'.

However, this year for the first time the Audit Commission has explicitly indicated that given the continuing pressures on funding, auditors should also consider whether the body has appropriate arrangements to plan to secure and maintain its financial resilience in the medium term, typically the term of the Medium Term Financial Strategy ('MTFS').

What do we consider to be the main characteristics of proper arrangements for securing financial resilience?

This has three aspects:

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

We also need to consider specific risks that arise from our previous work on VFM and the work of others to form an opinion on the Council's arrangements for securing financial resilience in these three areas. We therefore also incorporated:

- Risks from other statutory obligations.
- Risks from our 2012/13 findings as set out in our 2012/13 'Report to Those Charged With Governance'.
- Risks from planning discussions with Officers and our Audit Plan.

Our full risk assessment can be found in appendix 1 to this report.

The result was a programme of work based on 11 key considerations as set out below:

Consideration 1 – The financial resilience criterion

This has three aspects:

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

We considered each aspect to identify any indication that proper arrangements are not in place.

Consideration 2 – Advisory notice

If the Council is unable to set a balanced budget for 2015/16 or if only able to do so by including an unlawful item of account I would be required to discharge my responsibilities in relation to The Act, potentially by issuing an Advisory

Notice under Section 19A. Although established for entirely separate purposes, there is a link between this responsibility and that of the S151 Officer under Section 114 of the Local Government Act. For this reason we have discussed the S151 officers' responsibilities regularly.

Consideration 3 - Budgetary control

The Council overspent against its General Fund budget by £3.6m in 2012/13 which exceeded the £2.5m forecast at the third quarter. Some 'controllable' items of expenditure were classified as 'non-controllable'. We concluded that weaknesses in budget monitoring should be addressed immediately and that more regular monitoring of such expenditure should be introduced.

Consideration 4 - Taking a radical approach to service provision

We concluded that it was of paramount importance that the Council continued to consider a broad range of alternative service delivery models where appropriate, and worked together to ensure there is a strong consensus about the need for change including considering options previously thought unpalatable.

Consideration 5 - Information for decision making

Officers need to ensure that sufficient, detailed information is made available to make informed and rounded decisions during resource prioritisation discussions.

Consideration 6 - Managing the financial impact of the redundancy programme

We recognised the need to consider reducing your pay bill and that the Council has a number of reserves which could be used to support the upfront costs of such a scheme. We also noted that Councillor approval must be obtained for any reduction in the General Fund below the £10m currently required by your existing reserves policy. We also stressed the importance setting a balanced budget with an appropriate level of reserves, even after allowing for one off costs.

Consideration 7 – Assumptions in the MTFS

We reviewed your updated MTFS and its key assumptions. We benchmarked your inflation, growth and efficiency projections as well as your reserve balances. We considered your financial resources and your future income assumptions.

Consideration 8 – In-year reporting updates

We reviewed your in-year finance reports and cash flow forecasts to identify key issues and consider their impact on budgets and plans.

Consideration 9 – Changes to MRP

We considered the amendments to the calculation of your Minimum Revenue Provision.

Consideration 10 – Other financial estimates and provisions

We considered the findings of our detailed testing on the Authority's estimates, provisions and journals undertaken as part of our final accounts audit work. We feed back the results of this work in our ISA 260 report to the Audit Committee.

Consideration 11 – Robustness of savings plans

The robustness of savings plans and response to the projected funding gap was a significant factor in our assessment of whether the Authority is able to demonstrate financial resilience.

Work undertaken

Consideration 1 – The financial resilience criterion

Our approach

This has three headings:

1. Financial governance;
2. Financial planning; and
3. Financial control.

We considered each of these headings, looking for indications that proper arrangements are not in place.

Findings

- Last year we completed an assessment of your arrangements against the Audit Commission's guidance, comprising 27 indicators of failure in financial resilience, and 23 indicators for other VFM considerations. These are listed in Appendix 3 to this report.
- Last year we identified four areas of concern in these 50 indicators. This year we reviewed progress on these, covered by considerations 3 to 6 below:
  - Budgetary control
  - Leadership on prioritising resources and spending reductions;
  - Information for decision making; and
  - The financial impact of redundancy schemes.
- We considered all the other arrangements to be adequate or better. It should be noted that these indicators focus on the 'arrangements' for achieving value for money as well as the resulting outcomes.
- We asked the Council to complete a self-assessment of the indicators and for supporting evidence for conclusions reached.
- We did not identify any significant deficiencies in the arrangements in place during 2013/14. We did conclude, however, that further work is required to clearly demonstrate that the Council meets the Audit Commission's expectation that it has a strong 'understanding of its income sources and their sensitivity to economic changes' in relation to fees and charges.

Below we set out some improvements since last year, with the heightened risk to financial resilience and the in-year developments to address the financial position.

1. Developments in financial governance

✓ We see a marked change in *culture* regarding financial governance. We have been concerned as to how the savings requirement became so large. Our benchmarking shows that your MTFS savings target is larger than most of our comparator Councils. Knowing the scale of the problem and the options for dealing with it are as important as the actual decisions and timing.

✓ We have always been able to conclude that the *governance arrangements* were operating because Officers were advising Councillors of the financial position with information to make informed decisions. Historically the Council has had higher reserves than similar Councils; the need to move fast on savings has only become pressing as savings required dwarfed available reserves.

✓ There were points at which the Council could have taken more *proactive action*, but the balance of savings required and reserves available meant that choices could be made about the pace of change and the level of the savings realised. Wolverhampton made its decisions about cuts with the full advantage of information on savings required and the level of reserves available, based on the extent of services which the Council wished to provide, and the impact cuts would have on staff and the people of Wolverhampton.

✓ This year the governance arrangements and *collaboration* between Officers and Councillors has improved further. An intense calendar of budget development days, consultation meetings, brainstorming sessions, group meetings, briefings and more formal reporting has ensured a shared understanding of:

- the scale of the financial challenge and the phasing of savings required
- the options available;
- the need to consider statutory and non-statutory requirements separately; and
- the Council's priorities with which to inform financial planning.

✓ *Milestones* were agreed by which plans needed to be developed; the scale of the savings plans is tribute to the effectiveness of the arrangements that have been in place during the year.

2. Developments in Financial planning

✓ The Council received an independent report from a Local Government Association (LGA) associate and senior local government finance professional on its financial planning. The report - '*Independent review of process for medium term financial strategy and budget'* – henceforth referred to as the Sullivan Report, concluded that:

'The approach by WCC looked exemplary and was among the best I've seen. I remain of that view after my interviews and further research. The approach is in line with good practice and encompasses:

- Medium term financial planning covering the next 5 years
- Regular updates and reports to Councillors
- Savings plans identified, agreed and profiled over the five year period to reflect when savings will be achieved
- The residual gap between available resources and spending plans – for the whole five years, with each year separately identified
- Annual reviews of the level and purpose of reserves (including earmarked reserves) and provisions
- Detailed savings plans by Cabinet portfolio
- Evidence of a reasonable track record on delivering against intentions but inevitably some areas where plans are not fully achieved or were used to address overspending elsewhere.'

✓ This has provided a significant level of comfort that the financial planning arrangements in place are robust and this has been clear from the ongoing work through the year to develop plans to address the funding gap in the MTFS. Throughout the year the financial planning arrangements have enabled Councillors to receive savings proposals based on robust financial and non-financial information.

One area where financial planning could be improved further is regarding fees and charges where further scrutiny and sensitivity analysis would be beneficial. We understand that plans are in place to address this during the 2015/16 budget setting process.

3. Developments in Financial control

✓ There have been some notable improvements in the financial monitoring and reporting arrangements on the savings plans. We set out under Consideration 11 below how the real time monitoring arrangements have allowed Councillors to take policy decisions across the year to reduce the budget gap on a timely basis, informed by detailed risk-assessed supporting information.

Conclusions

- We have assessed the Council against each of the Audit Commission's characteristics for Financial Planning, Governance and Control, obtaining evidence to support the response of the Council to each of the characteristics.

- We have obtained sufficient evidence to conclude that the arrangements in place for each of these characteristics are adequate or better and that these arrangements have been strengthened over the year.
- The Council ought to ensure that it delivers on plans to improve financial planning regarding optimising fees and charges.

Consideration 2 – Advisory notice

Our approach

If the Council is unable to set a balance budget for 2015/16 or if the Council is only able to do so through the inclusion of an unlawful item of account I would consider my responsibilities in relation to The Act.

Findings

- There is a time delay between the date we need to reach our conclusions on the Council's financial resilience and the statutory requirement to set a balance budget for 2015/16 before the start of the financial year in question.
- We needed to be satisfied that we had sufficient evidence that the Council has a realistic and robust plan to set a balanced budget in line with the statutory requirement.
- We reviewed your plans to deliver a balanced budget for 2015/16 and concluded that the plans are adequate (see Consideration 11 below). This conclusion is consistent with Sullivan report which stated that 'It would appear unlikely that [issuing a notice] will apply during 2014/15 unless there is significant in-year budget movement which might trigger their action'. No such in-year movement has been experienced to date.

Conclusions

We have not identified anything to indicate that the Council either has, or is about to, incur expenditure which is unlawful. An advisory notice is not required.

Consideration 3 - Budgetary control

Our approach

In 2012/13 the General Fund was overspent by £3.6m compared to a quarter three forecast of £2.5m, primarily because some 'controllable expenditure' was classified as 'non-controllable'. We concluded in our report last year that it was essential that weaknesses in budget monitoring were addressed immediately and that more regular monitoring of such expenditure should be introduced.

Findings

Review of action against prior year issues

Internal audit undertook two reviews into the issues that emerged after the 2012/13 year-end:

1) An investigation into the Education and Enterprise 2012/13 overspend resulted in a comprehensive action plan which was implemented during the year, with new systems and processes. No issues have since materialised and the weaknesses appear to have been addressed.
2) The report *Under Recovery of Property Services Recharges 2012/13* explored how recharging procedures had ceased to operate. A comprehensive action plan was agreed and implemented during the year, with new systems and processes. Disciplinary procedures were invoked. No issues have materialised in 2013/14 and the weaknesses appear to have been addressed.

Historic performance

As part of our consideration of the strength of budgetary control at the Council we reviewed historical financial performance. We considered historical variations from budget as a % of net budget requirement.

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Over the past three years the Council's outturn on the general fund has:

• never been more than 3.6 million over budget in any year;

• never been more than 1.5% overspent in any one year; and

• been underspent in aggregate terms.

Year	(Under)/ Overspend £m	Net Budget £m	(Under)/ Overspend as % of Net Budget
2013/14	2.3	255.6	0.9
2012/13	3.6	233.8	1.5
2011/12	(7.2)	244.3	(2.9)

2013/14

- Cabinet approved the 13/14 budget on 26 February 2013. The General Fund budget was balanced after the planned use of £3.716 million of general balances, after proposed savings of £17.264 million.
- A significant proportion of planned savings were delivered and, excluding the one-off costs of £4.6m relating to the redundancy programme, an underspend of £2.3m was achieved. This was an improvement on the quarter 3 forecast; largely as a result of Cabinet's decision to stop all but essential spend. As is typical with a range of savings schemes a number were not fully achieved but compensatory savings were identified elsewhere.

2014/15 year to date

- At the time of writing, reports show that:
  - The net overspend is projected at £613,000 (0.25%) against the General Fund net budget requirement of £247.8 million.
  - Only £0.4m of the £21.4m budgeted savings are at significant risk. A significant proportion (35.4%) has already been realised and a large proportion of the balance (48%) is estimated with a high degree of confidence.
  - £1.7m of future savings proposals have been accelerated.
- The Minimum Revenue Provision (MRP) policy is to be amended to provide a fairer charge to the general fund (see below). If approved this is expected to deliver further general fund savings in 2014/15 and beyond, providing an additional cushion should savings not materialise.

Conclusions

Based on the performance of the Council historically and current year to date, we can see that:

- The Council undertakes a process that delivers a realistic balanced budget.
- The budget is owned and monitored by the Council and the Cabinet, with regular RAG rated reports. Where shortfalls are identified, the Council has been effective in identifying and delivering mitigating savings.
- Where planned savings cannot be achieved, the Council recognises that these savings still need to be achieved and these are rolled forward into future years.
- Whilst the Council has not delivered all of its proposed savings in the last three years, mitigating savings have resulted in underspending in total whilst delivering well over £100m of savings over the five year period to the end of 2014/15.
- Issues identified in prior years appear to have been addressed and we saw no repeat of the significant unplanned budget variances in the outturn position.

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Based on a review of the historic performance and current performance we found clear evidence of arrangements in place that have delivered financial resilience during a period of significant budget cuts.

Consideration 4 - Taking a radical approach to service provision

Our approach

In our report last year we concluded that it was of paramount importance that the Council continued to consider a broad range of alternative service delivery models and worked together to build consensus about the need for change, including options previously thought unpalatable.

Findings

- Consideration 1 sets out how the Council's processes identified savings. A key element was the prioritisation of limited resources and this required considering radical approaches to service provision.
- In budget development days and other forums for Officers and Councillors, difficult discussions took place to split out Council expenditure between types of spend, including:
  - 'Statutory Minimum'
  - 'Discretionary but Strategically Vital for Regeneration'
  - 'Other Discretionary'
- This process focused on non-discretionary areas where spend could be reduced most significantly. Although staff cost reductions are essential given their proportion of total cost, the Council has identified opportunities to deliver services in a different way or to manage the costs more effectively by providing a different service.
- A detailed review of proposed changes to service provision identifies a wide variety of planned or confirmed changes in service covering:
  - Outsourcing;
  - Merging services;
  - Sharing services;
  - Closing services and facilities;
  - Channel shifting;
  - Changing the approach to commissioning;
  - Automation and self-service;
  - Exploring alternative service delivery models beyond delivery by Council-staff;
  - Active demand management;
  - Benchmarking to allow identification of areas suitable for renegotiation;
  - Reducing or cutting service provision;
  - Cost reduction through efficiencies; and
  - De-layering and reduction of management costs.
- The breadth of services the Council is considering delivering differently is increasing. Examples include:

✓ Contracting out in-house adult and children's care services (an approach supported by a report commissioned to identify the scale of savings achievable).

✓ Managing demand in Adult Services through the promotion of Independence for Older People, Younger Adults and Mental Health and preventing the need for statutorily eligible services, by:

- analysing spend in detail at each stage in the care pathway from referral to delivery;
- appointing a widely recognised expert to complement the Council's activity analysis;
- benchmarking against best practice to quantify the scale of the change and possible savings; and

- redesigning pathways to provide a more cost-effective service.

✓ Introduction of service re-design, joint delivery and improved joint working across Wolverhampton through The Better Care Fund.

✓ A Revenues and Benefits VFM review which considered:

- Review and redesign of the council tax reduction scheme for 2014/15 onwards
- A review of discretionary relief for business rates
- Transfer of revenues enquiries and counter services to City Direct
- Automating data input for new housing benefit and council tax reduction claims
- Developing a self-serve option for reporting council tax account changes
- Developing a self-serve option for housing benefit and council tax reduction claims
- Supporting corporate initiatives such as the Enterprise Zone and City Centre Business Improvement District

✓ A City Direct VFM review which considered both a VFM health check on the functions currently provided by the Council's contact centre "City Direct" and the opportunity to review other services across the Council to assess their viability to be offered through City Direct. A schedule of services suitable for merging within City Direct has been developed.

✓ A VFM review of risk management and insurance services which has identified areas ripe for renegotiation.

Conclusions

Driven by the scale of the savings required, the Council has significantly increased the consideration and implementation of alternative service delivery models. Effective collaborative working between Officers and Councillors has ensured that there is a broad consensus about the need for change and there is a growing body of tangible evidence of Councillors considering previously unpalatable options. The agreed initiatives and plans currently being considered will need to be seen through in order to continue to demonstrate financial resilience over the medium term.

Consideration 5 - Information for decision making

Our approach

Last year we emphasised that Officers needed to ensure that sufficient detailed information is made available to make informed and rounded decisions during resource prioritisation discussions.

Findings

- We have reviewed the findings of the in-year '*Independent review of process for medium term financial strategy and budget*' report.

- That report concluded that when it came to reporting financial information to Councillors 'the approach by WCC looked exemplary and was among the best I've seen'. The expert's report also identified that 'the approach is in line with good practice'

- The only real criticism on information presented to Councillors for decision making is that it was updated too frequently. Officers have since taken this on board. Our view is that the regularity and quality of information indicated a desire to ensure Councillors had the best information on the financial position and the consequences of action or lack of it.

- Our findings against Consideration 4 'Taking a radical approach to service provision' above confirm that the financial decisions being taken during 2013/14 and beyond have been informed by detailed information including benchmarking data and comparison against peers.

Conclusions

- The independent report is key assurance for the Council: that its approach is essentially sound, and that Councillors have the information needed to govern and plan the financial resilience of the Council.
- In-year budget consultations to address the savings required in the MTFS have only further increased the level of financial information available.

Consideration 6 - Managing the financial impact of the redundancy programme

Our approach

Last year, we recognised the need to consider reducing your pay bill and that the Council had reserves which could be used to support the upfront costs. However, reduction of reserves below £15m (now £10m) would require specific Councillor approval under the reserves policy. We also stressed the importance of a balanced budget with an appropriate level of reserves, even after allowing for one off costs.

Findings

Councillor approval for breaching the reserves policy

- The Council has a clear policy on the minimum level of its level of general reserves, recently set at £10 million. The minimum level was adjusted downwards from £15 million to £10 million as part of the October budget setting report following an assessment of the general level of reserves and budget risks by the S151 Officer. The risk assessment noted that there was a reduction in several key budget uncertainties:
    - Single status – to be largely resolved in 2013/14
    - Equal pay – settlements progressing and uncertainty reduced
    - Pay aggregation for NI purposes – HMRC claim has been resolved with nil payment.
- £10 million equates to some 4% of net expenditure which is midway in the "unofficial standard" of 3-5% (as noted in the 2012 Audit Commission report on reserves – 'Striking a Balance') which we do not consider unreasonable given the work elsewhere in this report to benchmark the Council's reserves against similar Authorities.
- The Policy was approved by full Council in November 2013.

Setting a balanced budget regardless of one off costs

- The 2014/15 budget was set in February 2014 and was balanced after the use of £11.8m reserves.
- £5m of redundancy costs are projected in 14/5, funded in total by a contribution from the Efficiency Reserve, following an earlier transfer from the General Fund.
- The approach of using general reserves to fund redundancies was approved by Council on 6 November 2013. The Council is complying with its own polices and has demonstrated it can afford the payments without breaching its own policy on reserves.
- Elsewhere in this report we set out the progress made towards setting a balanced budget for 2015/16. The Council anticipates a balanced budget for the year, even after accounting for expected redundancy costs.
- General fund reserves have remained above the level set in the Council's reserves policy; current financial forecasts continue to indicate that reserves will remain above that required by the policy through to 2016/17.

Conclusions

The Council has been able to demonstrate that it can afford the costs of redundancies and set a balanced budget with a level of reserves that it deems appropriate and is broadly comparable to similar Councils. The use of general reserves to fund a significant programme of redundancies is unlikely to prove sustainable alone so the delivery of savings beyond employee costs is essential.

Consideration 7 – Assumptions in the MTFS

Our approach

We reviewed your updated MTFS and its key assumptions. We benchmarked your inflation, growth and efficiency projections as well as your reserve balances. We considered your financial resources and your assumptions around future income streams.

Findings

We have reviewed your MTFS and the main assumptions which lie behind it. We have also compared you with similar Local Authorities and taken into account our wider understanding of the Local Government sector.

Our findings are set out in Appendix 2 to this report.

Conclusions

- Our work in this particular area has not identified any issues which would lead to an unqualified value for money conclusion.
- The key MTFS assumptions are broadly consistent with elsewhere in the sector; variations do not appear unreasonable given the specific circumstances and the scale of the financial challenge presented.
- The assumptions used to identify the potential gap appears reasonable, and there is a clear process being adopted by management to risk assess the services provided by the council to provide a platform for the Council to identify and cost specific savings plans to deliver the gap, by the completion of the plan.
- The one area where we have identified significant variation from our benchmark is the scale of the financial challenge that was presented in the February 2014 MTFS. The Council has a relatively tougher savings target than other Councils. Significant progress has been made over the last year in identifying and monitoring a significant proportion of the £123 million savings requirement but delivering against the remaining requirements and absorbing any future changes to government funding remains a priority.
- Despite the preparation you have undertaken and the prudent assumptions you have made, there continues to be a risk around delivery of your MTFS. The main risks you face as an organisation to non-achievement of your medium term financial strategy include:

Slippage: you may not be able to achieve the savings you identified either from a service reduction or through efficiencies.
Timing: The timing of savings, service reductions and funding announcements will impact how you deliver against your MTFS.
Assumptions: If the assumptions in your MTFS turn out to be inaccurate, this could have a significant impact on your ability to deliver a balanced budget over 5 years. In considering the budget it is of note that Council will not be aware of funding until December 2014, which may impact on the projected savings requirement.

- You need to ensure that you continue to monitor progress against the plan, paying particular attention to changes in the original assumptions you have made.

Consideration 8 – In-year reporting updates

Our approach

We reviewed in-year finance reports and cash flow forecasts to identify key issues and considered their impact on budgets and plans.

Findings

- We have met regularly with the Section 151 Officer, the Strategic Director Delivery and the Chief Executive to discuss the Council's financial position and plans, and understood why the Section 151 Officer concluded that issuing a report under the requirements of Section 114 of the Local Government Finance Act 1988 is not required.
- We received regular updates on the in-year financial position, the development of the MTFS and the progress against specific in-year savings programme and budget risk assessments.
- We regularly reviewed in-year finance reports and cash flow forecasts to identify key issues and consider their impact on budgets and plans.
- The most significant developments in year are addressed elsewhere in this report, namely:
  - The amendment to the reserves policy and in-year transfers to and from earmarked reserves based on relevance and adequacy.
  - Proposed changes to the method of calculating MRP.
  - Redundancy programme developments.
  - Accelerated in-year savings.
  - Development of savings plans over the MTFS.

Conclusions

We have been kept well informed by Officers and Councillors throughout the year. We have captured a number of in-year developments and consider their impact elsewhere in this report.

Consideration 9 – Changes to MRP

Our approach

We considered the amendments to the calculation of your Minimum Revenue Provision.

Findings

- On 5 March 2014 the Council approved an MRP policy for the 2014/15 year. It is a statutory requirement to approve a policy every year. The Council's historic MRP policy has resulted in a provision which, as noted in the '*Independent review of process for medium term financial strategy and budget'* report 'looks high at 5.5% of the Council's Capital Financing Requirement'.
- During August 2014 we were asked to comment on a proposed policy change which, if approved, would be implemented during the year and have full effect for 2014/15. The new policy is expected to reduce the value of the revenue provision in the early years after its adoption but the total value of the provision over the life of an asset would be the same as under the old method.
- The draft proposed policy was based on one of the methods advised by CIPFA (Option 3 – annuity method) but has then been tailored in two ways by Council Officers to reflect local circumstances.
- Our role in relation to MRP is not to determine the most reasonable method of calculation, but is to:
  - ensure that a policy is in place before the start of the financial year to which it relates or, where this is revised during the year, ensure that full Council approval is sought;
  - ensure that the provision is not imprudent or illegal; and
  - ensure that the resulting revenue charge is materially true and fair.

- We reviewed the proposed policy and concluded that:
  - the adoption of a new policy in year would only be reasonable if full Council approval was obtained. We understand that approval will be sought and the policy only implemented if obtained;
  - the adoption of Option 3 – annuity method would lead to a prudent provision; and
  - of the two proposed amendments to CIPFA's method of calculation one was prudent and reasonable and another was not appropriate.
- One aspect of the policy appeared to us to be imprudent and Officers agreed to amend it. The revised policy is set to be approved to take effect immediately, and a lower than budgeted charge would result in the short and medium term. The financial impact of this change is currently being quantified. Our calculations indicate that the impact will not be material, but this is subject to audit.

Conclusions

The adoption of a revised method of calculating a prudent revenue provision is reasonable. It is recognised, in CIPFA's 'Guide to Capital Finance' that the method chosen can provide '*a fairer charge… as it takes account of the time value of money, whereby paying £100 in 10 years' time is less of a burden than paying £100 now. The schedule of charges produced by the annuity method thus results in a consistent charge over an asset's life, taking into the real value of the amounts when they fall due.*'

Consideration 10 – Other financial estimates and provisions

Our approach

We considered the findings of our detailed testing on the Authority's estimates, provisions and journals undertaken as part of our final accounts audit work.

Findings

- We understood your methods for making significant accounting estimates and for posting provisions and journals because these are, typically, the areas where management may:
  - override the routine day to day financial controls in order to manipulate the financial statements.
  - adopt accounting policies or treat income and expenditure transactions in such a way as to lead to material misstatement in the reported revenue position.
- We tested a sample of provisions, accruals, manual creditors, debtors as well as reviewing the robustness of revaluations and impairments of assets. We considered the appropriateness of your assumptions regarding pension assets and liabilities.
- We also reviewed minutes of meetings (encompassing Council, Cabinet (Resources) panel and Audit Committee) as well as web-based searches to identify matters that could have been omitted from the accounts that could be relevant to the accounts or our use of resources opinion.
- We did not identify any financial transactions or balances that were materially misstated or any indicators that the transactions or balances were not materially complete.

Conclusions

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We did not identify any material adjustments in our audit work that would have a budgetary impact or require amendment in the MTFS.

Consideration 11 – Robustness of savings plans

Our approach

The robustness of savings plans and response to the projected funding gap will significantly factor into our assessment of whether the Authority is able to demonstrate financial resilience.

Findings

Our work on the robustness of savings plans is informed by our historical performance review that indicates a strong track record in delivery.

A savings target of £126m[1] has been identified to address the budget gap in the MTFS. For the purposes of this report we have split this balance in to three elements:

1. £66m of known savings schemes approved in the February 2014 MTFS over the medium term.
2. £25m of savings expected to be approved in the autumn of 2014.
3. £35m of savings expected to be required to address the known savings gap in the MTFS.

1) £66m

- The £66m is split over the period of the MTFS with £21.4m expected in 2014/15, £17.7m in 2015/16 and the balance due to be delivered between 2016 and 2019.

- All of these schemes are subject to detailed corporate monitoring of savings. This is built up from the individual directorate monitoring at a scheme level and demonstrates a robust monitoring and reporting process at an individual savings scheme level.

- We have reviewed the corporate monitoring data and a sample of individual directorate monitoring sheets. We have seen how the reporting and monitoring process works effectively and understood how the RAG ratings reported to Councillors have been assigned by the directorates, with oversight from directorate finance, and then the Section 151 Officer. The arrangements now benefit from direct involvement from services and more rigorous oversight and challenge from the central finance team and there are examples of overoptimistic positions being over-ridden. The approach to dealing with the savings plans appears to be markedly more proactive than in the past which is a reflection of a notable cultural shift.

- Progress is monitored monthly and reported quarterly and real time information is now available from the system Only £0.4m of the £21.4m 2014/15 savings plan target is now considered to be high risk and for the period of the MTFS only £1.4m of the £66m plan is rated Red although further work is needed to turn some Amber savings plans to Green. Further plans are still being developed including the proposed change to MRP which would have a positive impact.

- Given the track record of delivering savings; the low level of self-assessed risk; the scrutiny arrangements in place; the regular monitoring and reporting the Council seems well placed to meet, or even exceed the 2014/15 savings target.

- The '*Independent review of process for medium term financial strategy and budget'* report concluded that 'In line with good practice WCC maintains a sophisticated financial model to help manage its financial strategy over

[1] *The February 2014 MTFS identified a savings target of £123m based on the size of the budget gap over the MTFS at that snapshot in time. A savings target of £126m reflects minor changes to the budget gap since February 2014, including the 2013/14 outturn.*

the medium term' and that there are 'no doubts about the overall accuracy painted by the MTFS model and accompanying reports. The gap between likely revenues (which are forecast to drop) and future spending does not look exaggerated'. This report has provided the Council with further assurance about their plans.

2) £25m

- Following the thorough programme of budget development and prioritisation of resources that has taken place over recent months the Council agreed specific areas of income and expenditure for which to identify specific savings plans to deliver the £25m target that was identified for 2015/16.

- A lot of progress has been made: firstly, to identify the services that would be responsible for the savings and then to develop robust savings plans that are achievable. We have reviewed the details savings plans that have been prepared and although the finer details are being finalised in advance of the Cabinet meeting in October the Council is estimating with a high degree of confidence that total detailed savings proposals will have been developed to meet the £25 million target.

- A significant proportion of savings will come from Adult services and so the Council had engaged a national expert to feed the development of savings plans.

- It should also be noted that with potential changes to the MRP and acceleration of some schemes in to 2014/15 the revised budget gap for 2015/16 is likely to be lower than initially forecast so the Council is expected to be able to set a balanced budget for 2015/16.

- Whilst we cannot conclude with certainty yet that the plans will be finalised and will be approved in October we have seen evidence to conclude that the arrangements in place to identify and deliver savings plans at least equal to the budget gap are in place.

- Whilst a lot of the work so far has been owned by the SEB, the Cabinet and sub-groups, over the next few months of the timetable there are plans to undertake the following:
  - Number of presentations to Cabinet, throughout the process;
  - Staff presentations and consultations;
  - Trade union consultations;
  - Cabinet and Senior Leadership team away days; and
  - Public engagement and consultation panel.
- The process as set out provides the opportunity and environment to allow the identification of further savings schemes, whilst ensuring that there is appropriate consultation and involvement of key groups in the decision making process.

3) £35m

- This is currently expected to be split between years with targets of £8m in 16/7, £17.6m in 17/8 and £8.6m in 18/9 in order to balance budgets in every year without additional use of reserves.

- Officers have developed a plan of how this process could work in practice and this has been discussed with senior Councillors. The plans contain very clear information about the level of savings required and the level of discretionary services and non-discretionary services from which savings will need to be identified.

- The Council has decided to follow independent advice on breaking down the remaining savings by year and to focus efforts in the short term on the £66m and £25m. This seems reasonable and, given the political uncertainty of an election year is something many similar councils are doing.

- What is clear is that should the Council deliver the 2014/15 savings as is currently expected and the 2015/16 savings plans that are being finalised the Council could absorb the 2016/17 budget gap and even a proportion of the 2017/18 funding gap from reserves. This is not expected to be the approach taken but is something we need to factor in to our considerations of financial resilience.

- The Council has a plan to approach the savings requirement; is following advice to prioritise the 2015/16 savings before focussing on the identification and approval of the specific schemes that will make up the savings plan; and has contingencies available should plans take time to be developed. This is consistent with the position at other Councils

Conclusions

- The Council has historically been successful in implementing the majority of savings plans and where not met, they have successfully identified and delivered savings and underspends from within service lines.

- Based on our review of the process adopted by the Council, we note that there are savings plans identified that cover some £90 million of the £126m budget gap that exists, and a process in place that will identify the remaining savings needed.

- Based on this it would appear that the Council has arrangements in place to ensure financial resilience in part through the development of savings plans.

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Conclusions

- **There are adequate Financial Planning, Governance and Control arrangements in place to secure financial resilience.**
- **We have not identified any material uncertainties relating to events and conditions that may cast significant doubt on the Council's ability to continue to operate for the foreseeable future.**
- **The use of the going concern assumption is appropriate in the preparation and presentation of the financial statements.**
- **The Council's systems and processes for managing effectively its financial risks , and to secure a stable financial position, appear to be operating adequately and have put the Council in a position to set a balanced budget for 2014/15 and are well placed to set a balanced budget for 2015/16.**
- **The longer term financial challenge has reduced significantly over the year due to pro-active financial planning and effective collaboration between Officers and Councillors through new and existing governance arrangements. Whilst there remains a budget gap in the later years of the MTFS this has reduced significantly to some £35m from £123m at the start of 2014 and the Council has a plan and a process to continue to identify further savings.**
- **We intend to issue an unqualified opinion on your VFM conclusion.**

This view is informed by the Council's processes, financial position and further opportunities although the Council's financial resilience remains at risk if not managed effectively.

Processes:

We have considered the Council's track record in:
- setting realistic budgets;
- delivering services within budget;
- delivering planned saving targets; and
- maintaining adequate levels of reserve balances.

- You have been through a thorough risk assessment process using thematic review and consideration of statutory and discretionary services to identify a significant number of saving delivery plans to support the majority of the gap identified by the MTFS.

- You have produced a sound MTFS with appropriate assumptions and have updated the details behind it in year so that by October 2014 you will have identified a significant proportion of the savings required by the MTFS.
- You have a track record of historical performance that delivers against savings plans.
- You have a plan set out to deliver a balanced budget through due process and consultation, before the commencement of the financial year.
- You have a plan to undertake appropriate consultation, identifying further savings plans and integration with key stakeholders to deliver a budget plan for the two years 2015/16 and 2016/17.
- Effective collaborative working between Officers and Councillors has ensured that there is a broad consensus about the need for change and there is a growing body of tangible evidence of Councillors considering previously unpalatable options.
- Arrangements are in place to produce detailed balanced budgets and savings plans and undertake robust review during the year at management and Cabinet, and act quickly to resolve budgetary gaps.

Financial position:

The Council has:

- a strong net asset position of £398 million (pre-audit);
- demonstrated a continued ability to generate strong operating cash flows;
- a positive cash balance at year end of £4.1 million (pre-audit) and sufficient funds to meet forecast demand over the year;
- a reasonable level of reserves (general and earmarked) when compared with similar authorities;
- a generally good track record in recording surpluses and achieving financial targets, having identified savings totalling significantly over £100 million over the last five financial years and demonstrating solid financial management in achieving this;
- a strong 30-year HRA Business Plan that is not expected to draw on general fund reserves;
- a balance of £5.5m in the Efficiency Reserve;
- agreed a strategy to identify £25 million of savings for 2015/16 by October 2014 plus a further £35 million for the medium term period;
- delivered £7.6 million of the 2014/15 savings target of £21.4 million with a further £13.4 million having been estimated with a high or medium level of confidence and with acceleration and identification of 2014/15 savings proposals equating to £1.7 million; and

- a forecast outturn for 2014/15 of within 0.25% of the general fund budget requirement (£0.6 million) at the time of drafting this report.

Further opportunities:

- Significant uncertainties exist in the current climate and there remain risks associated with changes in government funding and the budget consultation process. It is important therefore that the Council has other options available to it to secure financial resilience, beyond those that are currently being considered. Should the planned savings not materialise the Council could consider options including:
  - The ability to borrow: Under section 3(1) of the Local Government Act 2003, the Council must approve an overall borrowing limit before the beginning of each financial year. The Council is within this limit so may conclude that is has the opportunity to borrow to cover budgetary short falls in capital expenditure in the short term.
  - The Council had opening cash reserves, General Fund reserves of £27m and earmarked reserves of £27.6m. These reserves could be used in the short term to mitigate any budgetary gaps.
  - The Council has developed a disposal programme which offers a significant opportunity to secure capital receipts in coming years.
  - The Council has historically evidenced an ability to identify other savings opportunities to negate budgetary gaps identified during the year, caused by schemes that have not delivered.
- Given the above, there are alternative arrangements in place to negate against some short term budgetary shortfalls against the Councils plans. This provides further information that there are suitable arrangements in place regarding securing economy, efficiency and effectiveness with regards to financial resilience.

Risks remaining:

Despite being able to conclude satisfactorily that the Council's going concern assumption is appropriate and that we do not require a revision to our value for money conclusion, our work on financial standing has identified a number of areas of concern that put the Council's financial resilience at risk if not managed effectively.

To continue to demonstrate that the Council has sufficient resources available to meet its commitments in the short term it is important that the Council:

- Focuses on translating the £10.4 million of 2014/15 savings that are estimated with a high level of confidence and the £3 million of medium level savings into realised, measurable savings and continues to identify opportunities to deliver the remaining £0.4 million from the initial savings target. Where savings are not likely to be met these expected variances should be reported to Councillors.
- Continues to monitor and report achievement of savings against target by scheme and not just report either exceptions or, has been the case at times historically, achievement of savings by Service or Directorate with no reference to the individual savings schemes approved by Councillors.

- Continues to identify one-off savings during 2014/15 or bring forward future savings scheme to address the currently projected over spend in, and reduce the call on, the General Fund.
- Ensures that the cost pressures in Looked After Children are actively monitored and variances are reported early and accurately.
- Continues to develop robust and granular plans to ensure the delivery of the £25 million savings target agreed to set a balanced budget in 2015/16. The more detailed these plans and the more accountability can be allocated the more likely it is that savings will materialise.
- Quantifies the remaining savings target for the period of the MTFS. The latest reported estimate was £35m but events have been identified that could affect the budget gap in the MTFS both positively and negatively. Once Councillors have been provided with information on the scale of the challenge, a plan must be finalised to set out how further savings will be identified and over what time period. We understand that advice has been received to tackle the 2016-2019 savings element in stages and this seems reasonable, but the plan to meet these stages must be clear and robust.
- Continues to take a radical approach to service provision. Future reductions to local government funding above and beyond those already known about are conceivable; a significant proportion of the savings remain politically sensitive and may experience difficulties at consultation stage. It would be advisable to identify and approve savings that exceed the known savings target to allow for removal of schemes, slippage and unforeseen costs relating to demand.
- Keeps it assumptions and estimates under review. Councils have an overarching responsibility to make prudent estimates but the Council should continue to ensure that estimates are appropriate and that pockets of contingency do not exist.

Fees update

We reported our 2013/14 fee proposals in our audit plan. This was based on the Audit Commission's scale fee and covered our statutory audit work as well as that required for our value for money conclusion.

We have subsequently reported to you that our programme of significant additional work on financial resilience will incur a small additional fee. We have discussed this with the Section 151 Officer and have agreed a fee of £12,024. We have sought approval from the Audit Commission to vary the scale fee for this amount and are awaiting confirmation from the Audit Commission whether this fee variation has been approved. We will confirm any variation from the scale fee as soon as we have a response.

Appendices

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Appendix 1: Risk assessment

Risks identified from the Audit Commission requirements

The Audit Commission's guidance requires us to carry out sufficient and relevant work in order to conclude on whether the Authority has proper arrangements in place for securing financial resilience.

1. *What do we mean by financial resilience?*

The organisation has robust systems and processes to manage effectively its financial risks and opportunities, and to secure a stable financial position. The organisation's financial position should enable it to continue to operate for at least the foreseeable future.

2. *What do we mean by 'foreseeable future'?*

The definition of 'foreseeable future' for the purposes of the financial resilience criterion is traditionally taken to be 12 months from the date of the auditor's report on the relevant set of financial statements. This is broadly in line with the concept of 'going concern'. However, this year for the first time the Audit Commission has explicitly indicated that given the continuing pressures on funding, auditors should also consider whether the body has appropriate arrangements to plan to secure and maintain its financial resilience in the medium term. We consider the period of your Medium Term Financial Strategy ('MTFS') to be the medium term.

3. *Why is this important?*

The significant financial management challenges for councils over the coming years will include:

- managing the implications of the current economic climate;
- the significant reductions in the level of future central government funding; and
- the impact of the funding changes set out in the Local Government Finance Act 2012 and elsewhere.

Councils continue to have to meet their statutory responsibilities within significantly reduced budgets. Increases in the demand for services linked to significant demographic changes, such as the ageing population and rising birth rate, are also contributing to financial pressures for public sector bodies. To meet these significant challenges, authorities must improve their efficiency and productivity, reduce their costs, and have sustainable financial plans to ensure they are financially resilient.

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4. What do we consider to be the main characteristics of proper arrangements for securing financial resilience?

Consideration 1 – The financial resilience criterion

This has three aspects:

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

We will consider each aspect of financial resilience and consider whether we identify any indicators that proper arrangements are not in place.

Risks identified from other statutory considerations

Your responsibilities

There are a range of safeguards in place that help to prevent local authorities over-committing themselves financially. These include:

- The balanced budget requirement as set out in sections 31A and 42A of the Local Government Finance Act 1992, as amended
- The Chief Finance Officers' duty to report on the robustness of estimates and adequacy of reserves (under section 25 of the Local Government Act 2003) when the authority is considering its budget requirement (England and Wales).
- The legislative requirement for each local authority to make arrangements for the proper administration of their financial affairs and that the Chief Finance Officer has responsibility for the administration of those affairs section 151 of the Local Government Act 1972.
- The requirements of the Prudential Code.

These requirements are reinforced by section 114 of the Local Government Finance Act 1988 which requires the Chief Finance Officer in England and Wales to report to all the authority's councillors if there is or is likely to be unlawful expenditure or an unbalanced budget. This would include situations where reserves have become seriously depleted and it is forecast that the authority will not have the resources to meet its expenditure in a particular financial year.

Our responsibilities
Whilst it is primarily the responsibility of the local authority and its Chief Financial Officer to maintain a sound financial position, external auditors will confirm that there are no material uncertainties about going concern. Even where as part of their wider role auditors have to report on an authority's financial position, it is not their responsibility to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.

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However, under the Local Government Finance Act S19 A (6) we are required to issue an advisory notice if we have reason to believe that the body or an officer of the body:

(a) is about to make or has made a decision which involves or would involve the body incurring expenditure which is unlawful,

(b) is about to take or has begun to take a course of action which, if pursued to its conclusion, would be unlawful and likely to cause a loss or deficiency, or

(c) is about to enter an item of account, the entry of which is unlawful.

We need to give consideration to your plans for setting a balanced budget for 2015/16.

Consideration 2 – Advisory notice

If the Council is unable to set a balance budget for 2015/16 or if the Council is only able to do so through the inclusion of an unlawful item of account I would be required to discharge my responsibilities in relation to The Act.

Risks identified from our 2012/13 findings

In our 2012/13 *'Report to Those Charged With Governance'* we commented that taking a broader view of your financial challenge made reaching a positive conclusion on your financial standing increasingly difficult. We highlighted the four priority areas that needed to be addressed over the coming 12 months for us to continue to assess the Council as complying with Audit Commission guidance regarding our value for money code responsibilities. These can be summarised as follows:

Consideration 3 - Budgetary control

The Council overspent against its General Fund budget by £3.6m in 2012/13 which exceeded the £2.5m forecast at the third quarter. This appears to have been primarily due to the incorrect classification of certain items of expenditure as 'non-controllable' when they should instead have treated as 'controllable'. We concluded that it was essential that weaknesses in budget monitoring are addressed immediately and that more regular monitoring of such expenditure is introduced.

Consideration 4 - Taking a radical approach to service provision

We concluded that it was of paramount importance that the Council continued to consider a broad range of alternative service delivery models where appropriate; and worked together to ensure there is a strong consensus about the need for change including considering previously unpalatable options.

Consideration 5 - Information for decision making

We set out that to be able to make appropriate decisions for local circumstances it was vital that the Officers ensured that sufficient, detailed information is made available to make informed and rounded decisions during the coming round of resource prioritisation discussions.

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Consideration 6 - Managing the financial impact of the redundancy programme

We recognised the need to consider reducing your pay bill and that the Council has a number of reserves which could be utilised to support the upfront costs of such a scheme. However, we noted that Councillor approval must be obtained for any reduction in the General Fund below the £15m current required by your existing reserves policy. We also stressed how important it was to still be able to set a balanced budget with an appropriate level of reserves, even after allowing for one off costs.

We will need to consider how far these priority areas have been addressed during 2013/14.

Risks identified from planning discussions with Officers and our Audit Plan

At the time of planning our VFM work we had significant concerns about the Council's financial resilience. In addition to the points already raised:

- The scale of the savings required (£123 million) were more significant than at most comparator Councils and there were serious concerns about whether the gap could be bridged over the medium term and whether it was realistic to expect to be able to set a balanced budget for 2014/15 and 2015/16.
- The February 2014 Medium Term Financial Strategy ('MTFS') identified a funding gap of £59.2m to 2018/19 even after assuming the successful delivery of £67m of savings over the period.
- There was concern over whether there was the broad political agreement needed to make the scale of changes required to meet the savings target. The Council was struggling to identify where savings were going to come from in order to set a balanced budget for 2015/16 without the Council's general fund reserves falling below its own required minimum level for an extended period.
- There had been an unexpected overspend at the end of the previous financial year and the Council was already forecasting a significant overspend for 2013/14.
- The Council was expecting to set a balanced budget for 2014/15 only through the use of a significant proportion of its General Fund ('GF') reserves.
- There remained uncertainty about the level of future government funding and so there was a risk that assumptions in the MTFS were a best case scenario.
- The Section 151 Officer was considering his obligations under Section 114 of the Local Government Finance Act 1988 so that if it appeared that the expenditure of the Authority incurred (including expenditure it proposes to incur) in a financial year was likely to exceed the resources (including sums borrowed) available to it to meet that expenditure, he would discharge his obligations.

In our 2013/14 Audit Plan we summarised the scale of the challenge as it existed at the time and set out a programme of work to address the risks. This included specific work to cover:

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Consideration 7 – Assumptions in the MTFS

We will review your updated MTFS and its key assumptions. We will benchmark your inflation, growth and efficiency projections as well as your reserve balances. We will consider your financial resources and your assumptions around future income streams. We will feedback our findings to the Section 151 Officer and the Audit Committee.

Consideration 8 – In-year reporting updates

We will review in-year finance reports and cash flow forecasts to identify key issues and consider their impact on budgets and plans

Consideration 9 – Changes to MRP

We will consider the amendments to the calculation of your Minimum Revenue Provision.

Consideration 10 – Other financial estimates and provisions

We will consider the findings of our detailed testing on the Authority's estimates, provisions and journals undertaken as part of our final accounts audit work. If any of these findings have a significant impact upon the Authority's financial plans we will feedback our findings to you.

Consideration 11 – Robustness of savings plans

The robustness of savings plans and response to the projected funding gap will significantly factor into our assessment of whether the Authority is able to demonstrate financial resilience.

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Appendix 2: Medium Term Financial Strategy review

Key assumptions

As part of our work on financial resilience we have reviewed your Medium Term Financial Strategy (MTFS), including comparing it with other similar plans, to review how you secure financial resilience. Your MTFS is underpinned by a number of key assumptions. These include:

- Inflation – for both pay and non-pay expenditure;
- Growth – your estimate of future cost and budget pressures from changes in demand and volume;
- Efficiency savings – the level and timing of the savings you need;
- Revenue grants and Council tax levels; and
- Changes in the level of reserves.

Each of these assumptions has varying degrees of inherent uncertainty. Assumptions applied to forecasts can often have a significant impact on balancing budgets. You have delivered a significant level of savings over recent years and have a track record of strong financial management and achievement of financial targets; for example the 2013/14 outturn was within 1% of budget despite non-recurring redundancy costs being incurred. In spite of this, the current economic climate is difficult and the future uncertain; with many assumptions required there is an increased risk that one of the influencing factors may vary significantly from the assumptions you have applied.

In the current economic and political climate there are clear difficulties in providing robust medium term forecasts, however contrasting key assumptions with those adopted by comparable organisations can provide a useful sense check of the consistency and robustness of the Council's projections.

We have reviewed key assumptions in your MTFS and compared them to our other External Audit clients. We have also taken into account our wider understanding of the sector, and the Council's financial performance for the year to date. A summary of our findings is included on the following pages.

Please note that the majority of figures and analysis within this report reference the MTFS as approved by Cabinet on 25 February 2014. Where relevant we have referenced subsequent updates to the strategy; we have clearly stated where this is the case.

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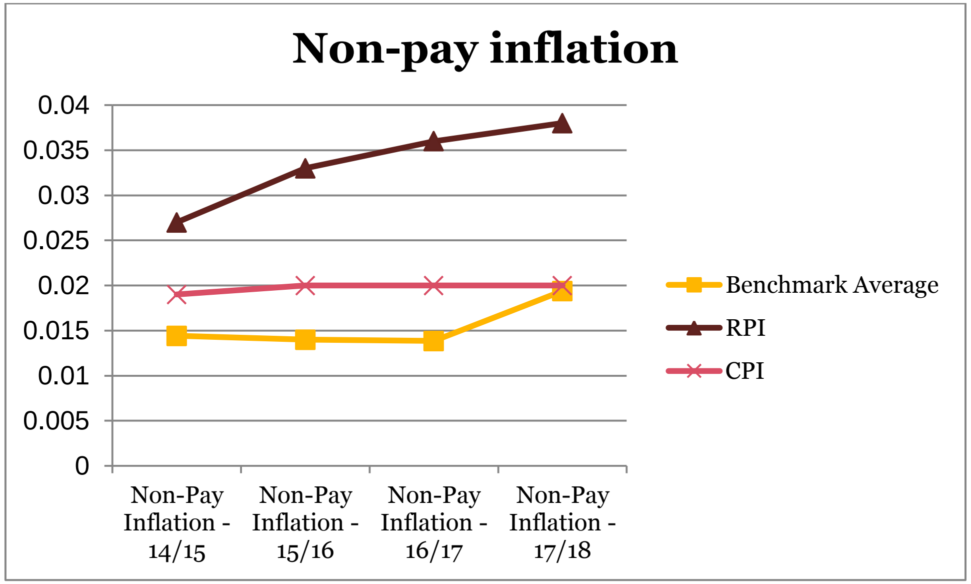
Inflation – non-pay costs

In your MTFS you have not allowed for any blanket increases in non-pay expenditure resulting from inflationary pressures.

Instead, you have recognised the need for inflationary increase to be fully absorbed by existing budgets where possible but have recognised where specific additional pressures are likely to be experienced. In addition, allowance has been made for gas and electricity, where annual increases of 5.7% and 2.5% respectively have been forecast across the period of the MTFS.

It has not been possible to determine a weighted average inflation rate for non-pay expenditure so we have not included Wolverhampton City Council in the graph below. Previous experience would indicate that your approach across the full five year forecast period except is likely to lead to a non-pay inflation forecasts not significantly lower than the benchmark average. It should be noted, however, in the chart below, that the Council's average budgeted forecast increases fall below current forecast levels of CPI and RPI which may partly reflect the nature of Council spend.



Whilst accepting the difficulties in forecasting inflation over the medium term, a relatively small shift in inflationary rates could have a significant impact on the achievement of budgeted outturn.

Inflation – pay costs

The Council has budgeted pay pressures over the five year forecast period totalling £36.4 million. This incorporates the impact of inflationary pay increases, alongside increases in NIC and Superannuation payments, and annual increments. The

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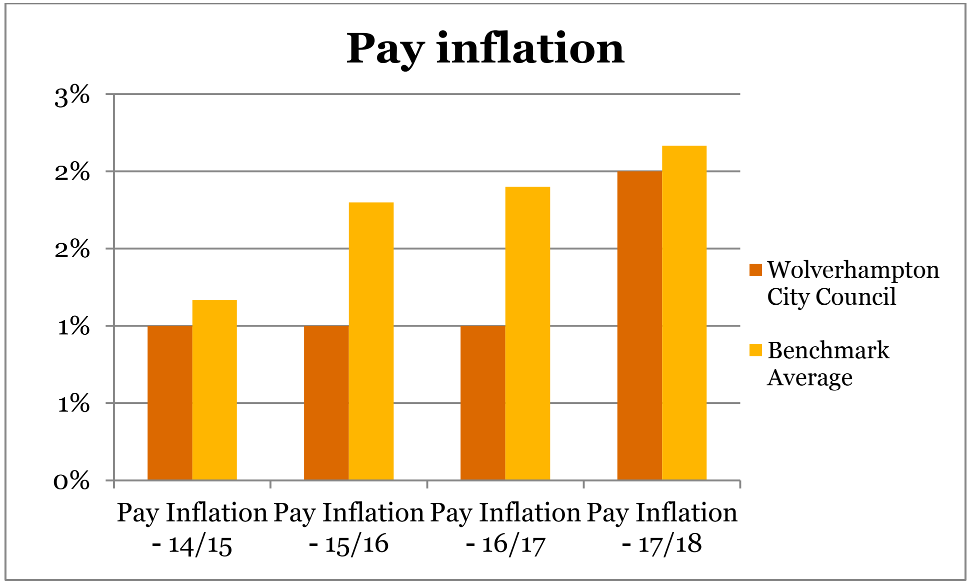
pay inflation element alone has been budgeted at 1% for 2014/15 to 2016/17 (largely reflecting Government policy), rising to 2% in 2017/18 and 2.5% in 2018/19:

Budgeted pay inflation across our clients within the sector is detailed in the graph below:



The graph would appear to indicate that Wolverhampton City Council's assumptions are less prudent than our benchmark group for the period 2015-2017. However there are two factors that have led us to conclude that this is not imprudent:

i – The Council has developed very detailed staffing and pay plans for the period and, given the scale of the financial challenge to be made, the Council has a high level of confidence that the assumptions are appropriate and consistent with other West Midlands Councils.

ii – In addition to the basic pay inflation assumptions the Council has made some significant additional assumptions about staff cost pressures including annual increments and costs associated with the increase in costs relating to the West Midlands Pension Fund.

Growth pressures

Although identifying savings and efficiencies is a key focus of the current financial planning, the process of setting the budget and MTFS allows services to identify emerging budget pressures, including those related to legislative requirements and demographic changes that cannot be contained. Where necessary these will result in new investment and budget allowance.

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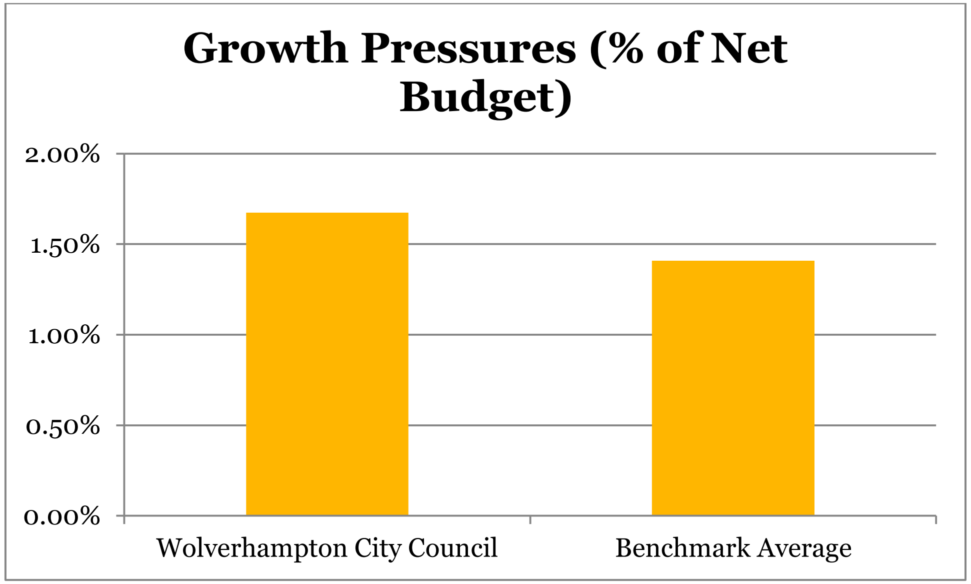
The budget pressures identified by the Council are broadly in line with our benchmark group although the impact of the national trend of increasing costs of Looked After Children seems to be of greater impact to Wolverhampton than the peer group:



Savings

The scale and nature of the Council's savings plans are set out in more detail elsewhere in this report. At the time of the February 2014 MTFS the Council included £66.7 million of expected savings within its MTFS. To balance its budget in the medium term, £59.2 million of additional savings were required based on the MTFS forecasts.

The graph below provides a comparison of how the total savings requirement at that point, as a proportion of net budget, compared against the average of our benchmark group:

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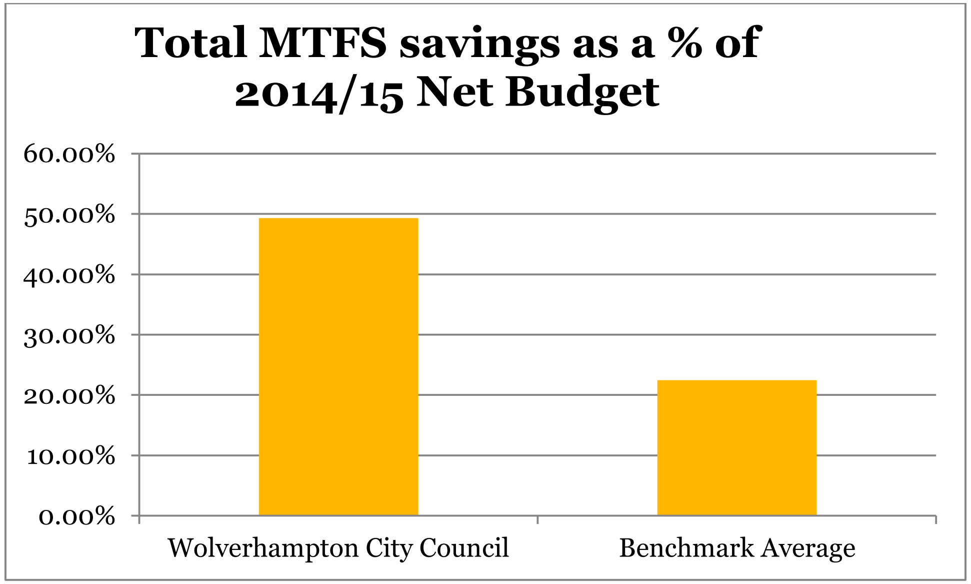

As is evident from the graph, the levels of savings included within your MTFS are significantly greater – proportionate to net budget – than our benchmark sample, even after allowing for the fact that your MTFS covers 5 years as opposed to our benchmark average of 4.3 years.

Change in Net Budget

To assist in our consideration of your plans for 2014/15 we compared the forecast reduction in your net budget compared to our benchmark group:

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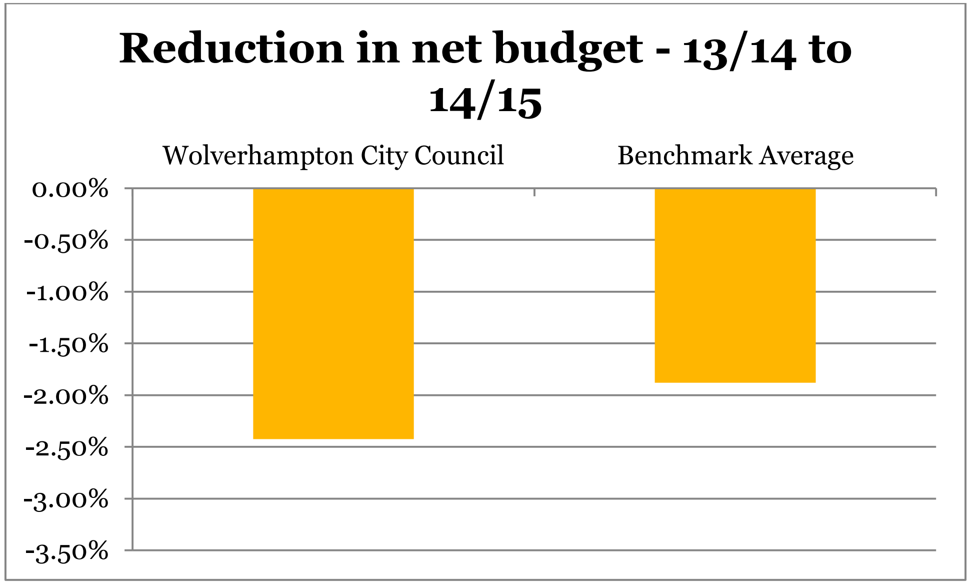

Relative to its peers, Wolverhampton City Council is showing a slightly greater than average increase in net budget requirement although the scale of the variation would indicate that it is in later years, and not 2014/15, that the Council faces a relatively bigger challenge than peers.

Level of Grant Funding

On 20 October 2010 the coalition government published the Spending Review 2010, which set out government department budgets for the period 2011/12 to 2014/15. The impact of the reductions in central government funding on individual local authorities in the two final years of this period was finalised in December 2012.

The Chancellor's Autumn Statement was given on 5 December 2013 and it described a medium term position characterised by lower than anticipated economic growth and, as a result, a higher forecast public sector borrowing requirement. The provisional Local Government Finance Settlement was released later in December 2013. The key points raised were that:

- The 'spending power' of the Council is to fall by 0.6% in 2014/15 and rise by 1.7% in 2015/16 (due to the Better Care Fund);
- Revenue Support Grant will fall by 15.4% in 2014/15 and by 25% in 2015/16 based on the illustrative settlement published by the Government in December 2013;
- The New Homes Bonus would continue to be received by the Council rather than be allocated to the Single Local Growth Fund; and

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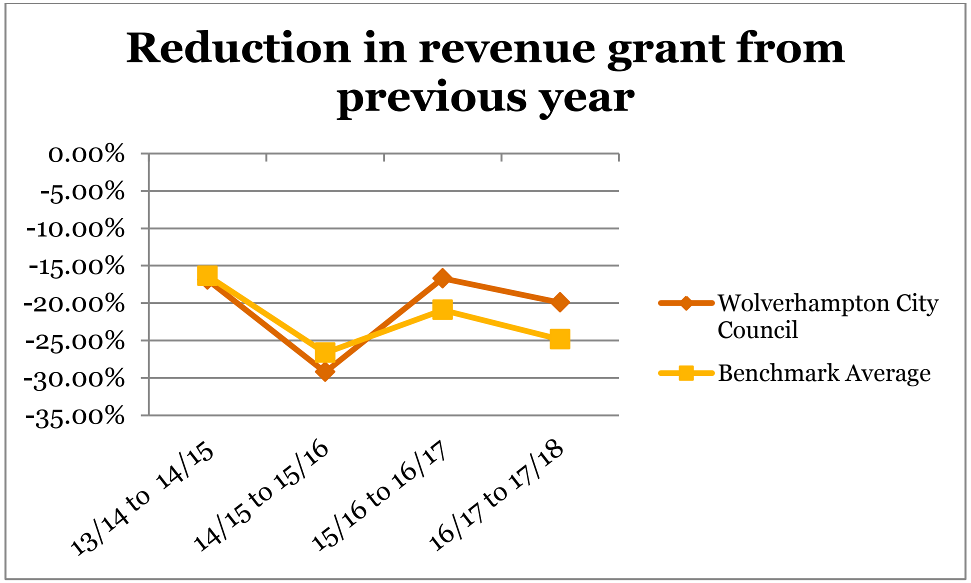
- A 1% council tax freeze grant will be available for 2014/15 and 2015/16.

Further significant reductions are forecast over the five year forecast period. Though funding allocations for 2016/17 onwards have yet to be finalised, significant reductions have been forecast in the MTFS, with core RSG funding (now incorporating a number of previously separate funding streams) reducing from £87 million in 2014/15 down to £30.5 million in 2017/18.



The graph above shows that for 2013/14 and 2014/15 your predictions in respect of core revenue funding are broadly in line with our benchmark sample. Subsequent years show a slightly greater variation, and whilst the overall trend is in line with your peers the data does suggest that the MTFS forecast assumes a slightly lower level of reduction in central grant funding than peers in this respect.

Although there are inevitable difficulties in forecasting government funding over the medium term, a relatively small shift in grant funding could have a significant impact on the achievement of budgeted outturn.

Council Tax

In the MTFS annual increases of 1.99% are predicted for 2014/15 onwards, representing a greater than average forecast increase. However, the data does show a clear discrepancy between a number of Councils that have assumed 1.99% each year and others who have chosen to assume an alternative approach so Wolverhampton City Council is far from unique in this regard.

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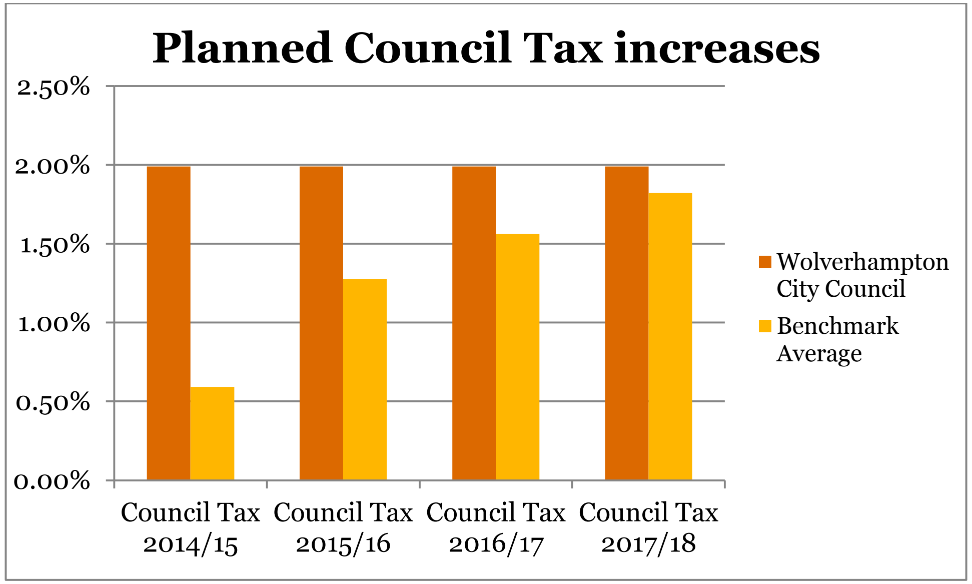

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The degree of uncertainty over any proposed increase is recognised; any proposal would first have to be ratified by Council and could be an unpopular decision with residents. Taking this into account, the Council needs to consider the impact of not being able to achieve a 1.99% increase in the event that the referendum threshold of 2% is reduced?

The Council has also assumed a 0.5% increase in the Council Tax Base. The Council must continue to review actual success against this forecast and continue to consider whether this remains appropriate.

1. Reserves

Due to the projected financial challenges facing the Council over the medium term, combined with the budget risks, the Council has long had a policy on reserves that stipulates reserves should only be called on in very specific circumstances and are not a viable funding option to reduce the projected budget deficit over either the short or longer term. In October 2013 the policy was updated to reflect the view of Officers that the previously stated minimum level of general balances of £15 million was too prudent. The current minimum level of general fund reserves allowable has been set at £10 million. However, allowance has been made for the level of general balances to fall below £10 million where the use of these balances is the only option to fund significant costs associated with downsizing the workforce in order to deliver significant on-going savings. Where this is the case the policy stipulates that balances should be replenished to the minimum level of £10 million within a maximum of two financial years.

As a result of the adoption of the new policy, and a detailed review of pre-existing specific or 'earmarked' reserves, there were a number of changes to the level of balances held in general reserves and earmarked reserves during the year.

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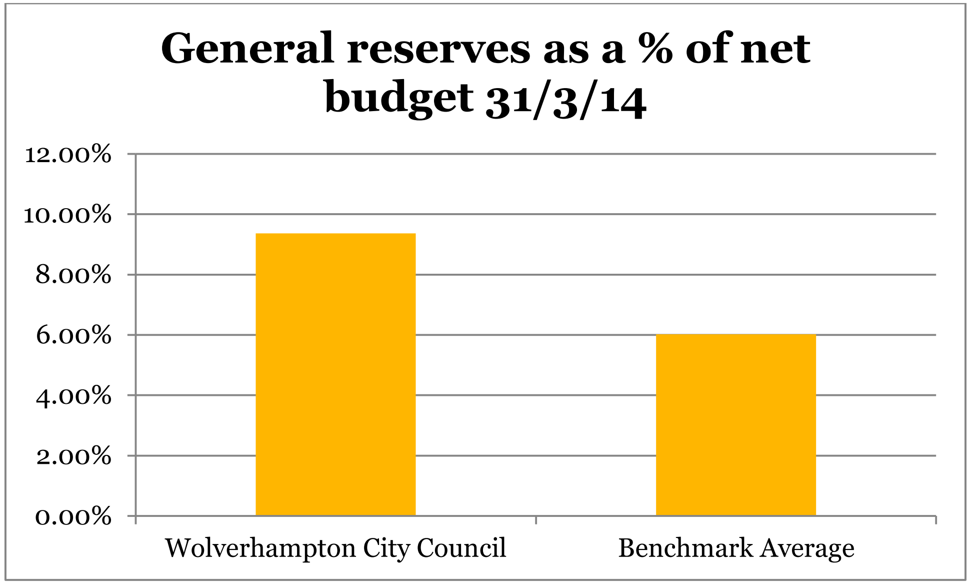
As of 31 March 2014 total Council reserves amounted to £54.6m. This was a slight reduction on the level assumed at February 2014 (£60.3m).

General Fund reserves

At the time of the February 2014 MTFS, the forecast balance for 31 March 2014 was £23.4m. This is the figure used in the graph below to provide a like-for-like comparison with our benchmark group. The actual outturn resulted in a closing balance of £27m.

The Council holds a favourable General Fund balance as a proportion of the Council's net budget requirements compared to our benchmark sample. This inevitably provides an additional level of contingency should savings plans not be fully realised, though as noted, the use of reserves to support financial performance is not a sustainable budgetary strategy.



The chart below provides a more detailed analysis of the comparison of general reserves against net budget by client in the benchmark group, confirming that for the size of the net budget the level of general reserves is above average. It should be noted that the 'trendline' would indicate that a balance of c.£14m would be proportionately average for our benchmark group.

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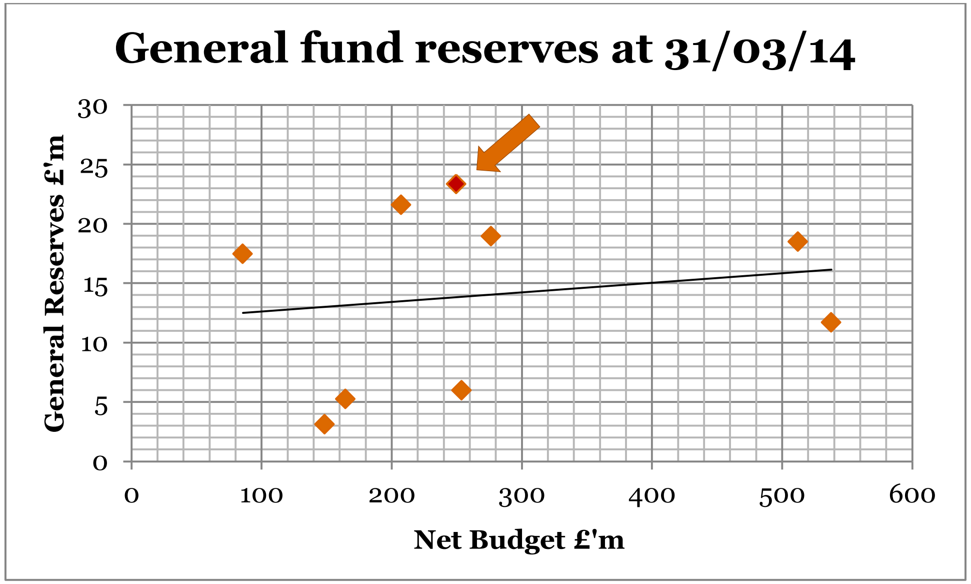

Earmarked reserves

At the time of the February 2014 MTFS, the balance was £36.9m. This is the figure used in the graph below to provide a like-for-like comparison with our benchmark group. The actual outturn resulted in a closing balance of £27.6m.

The Council has a relatively healthy level of earmarked reserves compared to our benchmark sample although the variation in the nature of the challenges faced make direct comparison difficult.

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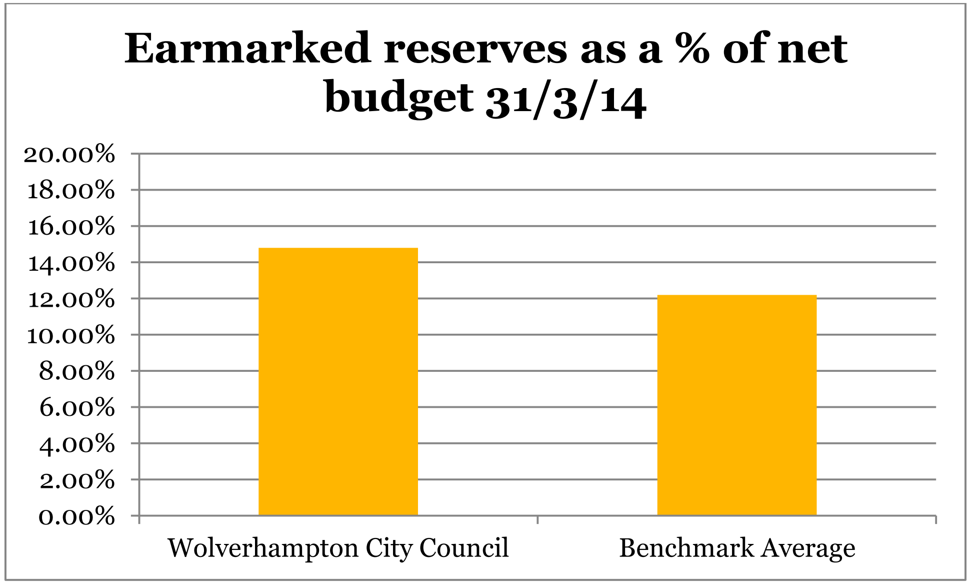

The chart below provides a more detailed analysis of the comparison of earmarked reserves against net budget by client in the benchmark group, confirming that for the size of the net budget the level of earmarked reserves is slightly above average. It should be noted that the 'trendline' would indicate that the Council's actual year-end balance is slightly lower than the proportionate average for our benchmark group.

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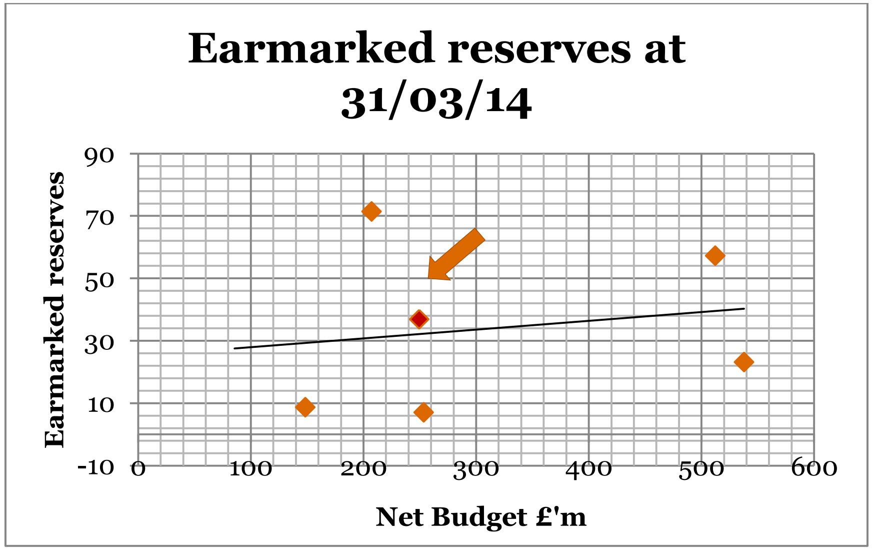

It is important to continue to focus on achieving sustainable savings to balance the Council's budget, and ensure that any proposed drawing of reserves is properly justified by management, and appropriately challenged.

2. Summary of Assumptions

The key assumptions supporting your MTFS are broadly consistent with those seen elsewhere in the sector, and where variations have been noted the assumptions employed do not appear unreasonable for the Council given the specific circumstances faced and the scale of the financial challenge presented.

The one area where we have identified significant variation from our benchmark is the scale of the financial challenge that was presented in the February 2014 MTFS. The Council has a relatively tougher savings target than other Council's. Significant progress has been made in recent months in identifying and monitoring a significant proportion of the £123 million savings requirement but delivering against the remaining requirements and absorbing any future changes to government funding remains a high risk to the Council.

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Appendix 3: Audit Commission indicators

The following tables set out risk indicators of failing to meet to the specified criteria. Auditors are encouraged to have consideration of these indicators as part of their risk assessment but the indicators are not exclusive or exhaustive, and their relevance and impact is expected to depend on the local circumstances of individual audited bodies.

The Audit Commission's risk indicators for failing to secure financial resilience are:

	Financial governance
1	Director of Finance/section 151 officer is not on the leadership team.
2	Lack of capacity in the finance department or high turnover of senior or specialist finance staff.
3	Lack of understanding by the leadership team of the current financial position and potential future implications.
4	A focus by the leadership team on short-term thinking and operating.
5	Poor communication by the leadership team to staff and external stakeholders of the medium- to long-term financial strategy, current financial position and likely financial challenges.
6	Failure by the audit committee to provide robust challenge on financial matters within its remit.
	Financial planning
7	Pending legal or regulatory proceedings against the body that may, if successful, result in claims that the body is unlikely to be able to satisfy without a significant impact on its financial stability.
8	Reliance on short-term fixes (for example asset sales) to improve the cash position.
9	Regular use of reserves and investment income to balance budgets or use of reserves to fund recurrent expenditure that is not, for example, part of planned invest to save initiatives.
10	Low level of general reserves (including reserves set below the authority's minimum) or significant unplanned fall in levels of reserves (general and earmarked) over the last two years.
11	Minimum reserve levels set as a percentage of expenditure which automatically reduce as savings are made, despite increased risks facing the authority as a result of the savings.

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12	Significant deterioration in the value of assets potentially being disposed of, the impact of which has not been recognised or is not being addressed in the MTFP medium-term financial plan or business plans.
13	Failure of the leadership team to understand fully the financial implications of risks.
14	Weaknesses in medium-to long-term financial planning, for example:
	- absence of an up-to-date, sustainable 3-5 year MTFP medium-term financial plan;
	- absence of realistic scenario planning;
	- absence of the consideration of the flexibilities and restrictions on government grants and funds; or
	- absence of a long-term financial strategy taking into account the financial impact of demographic trends or other economic, environmental or social pressures.
15	High dependence on one income source, poor understanding of income sources and their sensitivity to economic changes, or absence of a recent review of charging policies.
16	Financial risks are managed in the short term only with limited consideration of longer term implications.
17	Lack of robust plans to deliver savings required to balance the budget or failure to deliver savings plans.
18	Failure to consider the financial implications of delivering the organisations' statutory responsibilities.
19	Development of a financial plan which puts the body at risk of failing to deliver its statutory requirements, or at risk of legal challenge by service users or other bodies.
	Financial control
20	Poor in-year forecasting resulting in, for example, significant unexpected budget overspends or underspends in the last two years.
21	Non-compliance with capital or other statutory requirements, for example the Prudential Code, CIPFA The Chartered Institute of Public Finance and Accountancy Treasury Management Code.
22	Failure to consider current market conditions or actively manage counterparty and interest rate risks.
23	Overspending or shortfalls in income in one or more service area that requires spending reductions in another service area.
24	Significant prior year budget overspend.
25	Limited or no monitoring of key financial ratios.
26	Adverse key financial ratios.
27	Cash flow difficulties resulting in inability to pay creditors on due dates or inability to comply with loan agreement terms.

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The Audit Commission's risk indicators for failing to secure economy, efficiency and effectiveness are:

1	Lack of leadership from senior management and members on prioritising resources and spending reductions.
2	Limited action to review and challenge strategic priorities and cost-effectiveness of existing activities in the context of the MTFP medium-term financial plan, and the impact of changing circumstances, to identify where activities do not contribute sufficient value.
3	Lack of input from or consultation with front-line staff and local residents, partners, the voluntary and community sector and from small businesses, where appropriate, to determine local priorities for resources or opportunities for savings.
4	Decision-making not based on appropriate or adequate information.
5	Inadequate cost-benefit analysis, options appraisal or cost information to evaluate or support cost reduction plans.
6	Lack of, or limited, consideration of alternative, lower cost options for delivery.
7	Focus is on high cost activities, to the exclusion of other activities, or on short-term rather than longer term options for reductions.
8	Inability to identify or justify high levels of spending compared to other comparable bodies.
9	Lack of understanding of resources at the disposal of relevant partnerships.
10	Cost reductions create unintended impacts on activities and increased spending or capacity gaps in other departments, partners or other bodies.
11	Inadequate monitoring of the implications or impact of spending cuts leading to, for example, a detrimental effect on service quality and performance in priority areas.
12	Poor record of reducing expenditure on non-priority areas, or inadequate arrangements to monitor implementation of spending reductions.
13	Improving efficiency and productivity
14	Lack of, or limited, information on unit costs, transaction costs or whole life costs or poor understanding of what has driven changes in costs over time.
15	Inward-looking and not open to using comparative data and sources of good practice (including relevant Commission reports) to challenge arrangements for securing VFM value for money.
16	Poor understanding of how costs (including unit and transaction costs) and performance compare to those of other similar bodies (for example limited use of the Commission's VFM value for money profiles tool or other benchmarking information), or inability to justify higher costs.
17	Lack of robust efficiency plans, including timescales, setting challenging efficiency targets and how they will be delivered.

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18	Inadequate evaluation of options for making efficiencies and focus on achieving short-term efficiencies rather than on long-term sustainable savings.
19	Lack of input from front-line staff to the efficiency savings programme.
20	Not challenging the way activities are delivered or exploring innovative and new ways of delivering activities, for example through outsourcing or shared service arrangements, or in partnership with other bodies or by using the voluntary sector or local community groups. Not considering the possible risks of potential outsourcing or shared service arrangements.
21	Not considering the possible risks of delivery and financial performance of outsourcing, shared service arrangements or partnerships.
22	Inadequate arrangements to monitor achievement of efficiencies and reductions in unit costs, and the impact on service quality and provision. Lack of understanding of how savings impact on performance.
23	Poor record of achieving planned efficiencies or reductions in unit costs.

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