

<b>Report of:</b>	Ian Wright - Director of Finance
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<b>Submitted to:</b>	Corporate Affairs and Audit Committee, 5 August 2021
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<b>Subject:</b>	Middlesbrough Council Long-Term Financial Sustainability
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**Summary**

**Proposed decision(s)**

- That the Corporate Affairs and Audit Committee note the contents of the report.
- That the Corporate Affairs and Audit Committee note the key points of the CIPFA Financial Management Code (FM Code) and the initial self-assessment of compliance with the Code, the associated actions arising to ensure full compliance, and the next steps.
- That the Corporate Affairs and Audit Committee note the results of the analysis of the CIPFA Financial Resilience Index 2021.

Report for:	Key decision:	Confidential:	Is the report urgent?
Information & Discussion	No	No	No

**Contribution to delivery of the 2021-24 Strategic Plan**

People	Place	Business
Compliance with the CIPFA Financial Management Code will contribute to sound decision making. This will support the Medium Term Financial Plan (MTFP), enabling Members to monitor progress against the Strategic Plan in a timely manner to ensure resources are allocated in line with the strategic priorities of the Council.		

**Ward(s) affected**

No direct impact on any wards.

## **What is the purpose of this report?**

1. To inform the Corporate Affairs and Audit Committee of the publication of the new CIPFA Financial Management Code (FM Code) which was applicable in shadow form during 2020/21 with the first full year of compliance being 2021/22.
2. To present to the Corporate Affairs and Audit Committee an initial self-assessment that has been undertaken of the Council's assessed level of compliance compared to the Standards contained within the CIPFA Financial Management Code and the associated actions arising to ensure full compliance (Appendix 1).
3. To provide the Corporate Affairs and Audit Committee with the results of the CIPFA Financial Resilience Index 2021 and a comparison and analysis with other local authorities (Appendix 2).

## **Why does this report require a Member decision?**

4. The report is for information and discussion.
5. The CIPFA Financial Management Code does however have implications for Members, in particular the Corporate Affairs and Audit Committee, due to its responsibility corporately for governance related issues. It also has a specific role in considering the findings of the external auditor in relation to the expected inclusion in the Statement of Accounts; and then approving those audited accounts for publication each year.

## **Report Background**

6. The tightening fiscal landscape has placed the finances of local authorities under intense pressure. While organisations have done much to transform services, shape delivery and streamline costs, for these approaches to be successful it is crucial to have good financial management embedded as part of the organisation, including the need for long-term financial sustainability. Good financial management is an essential element of good governance and longer-term service planning, which are critical in ensuring that local service provision is sustainable.

### **The CIPFA Financial Management Code (FM Code)**

#### ***Executive Summary***

7. Local government finance in the UK has been governed by primary legislation, regulation and professional standards as supported by regulation. The general financial management of a local authority, however, was not supported by a professional code or any best practice requirements.
8. This situation changed when, in December 2019, Chartered Institute of Public Finance and Accountancy (CIPFA) published its Financial Management code (FM Code) to provide guidance for good and sustainable financial management in local authorities. It has been produced to assist local authorities in demonstrating their

financial sustainability through a set of standards of financial management that the Council can assess and report to stakeholders.

9. The standards have different practical applications according to the size and different circumstances of individual authorities and their use locally should reflect this. The principle of proportionality applies to the FM Code and reflects a non-prescriptive approach to how each standard is met.
10. The COVID-19 crisis has seen local authorities placed under extreme pressure to respond to the needs of their communities by providing services and support to an unprecedented extent. Understanding these pressures, the CIPFA Financial Management and Governance Panel has considered these new requirements against workload, reprioritisation and resource issues facing local authority staff. It has concluded that while the first full year of compliance with the FM Code can remain as the 2021/2022 financial year, it can do so within a more flexible framework where a proportionate approach is encouraged. In practice this is likely to mean that adherence to some parts of the FM Code will demonstrate a direction of travel as opposed to specific outcomes.

### ***Background to the FM Code***

11. In response to recent concerns (even before COVID-19) around the financial resilience of Councils, CIPFA has introduced a new FM Code as part of a package of measures that it is putting in place. These measures have been driven by the exceptional financial circumstances faced by local authorities, having revealed concerns about fundamental weaknesses in financial management. In particular, there have been a small number of high-profile failures across local government which threaten stakeholders confidence in the sector as a whole.
12. The CIPFA Financial Management Code (FM Code) is designed to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability. For the first time the FM Code sets out the expected standards of financial management for local authorities.
13. CIPFA acknowledges the additional extraordinary burdens being faced by local authorities due to COVID-19 and has reflected on the extent to which it is appropriate to introduce a new FM Code at the current time. In February 2021 they provided clarification on compliance with the code to reflect COVID-19 pressures. This stated:

*Much of the existing Code requirements are based on statutory responsibilities, the timescales for which CIPFA is not able to influence. The Code does, however, allow for both flexibility and a proportionate approach:*

*“The manner in which compliance with the FM Code is demonstrated will be proportionate to the circumstances of each local authority.”*

*and that:*

*“Financial management standards are to be guided by proportionality.”*

CIPFA concluded that while the first full year of compliance can remain as 2021/2022, it can do so within a more flexible framework where a proportionate approach is encouraged. In practice this is likely to mean that adherence to some parts of the FM Code will demonstrate a direction of travel.

### ***Principles of the FM code***

14. The FM Code focuses on value for money, governance and financial management styles, financial resilience and financial sustainability. The FM Code identifies the risks to financial sustainability and introduces an overarching framework of assurance which builds on existing financial management good practice.
15. The FM Code has been designed on a principles-based approach which include the CIPFA *Statement of Principles of Good Financial Management*. These six principles have been developed by CIPFA in collaboration with senior leaders and practitioners within local government. These principles are the benchmarks against which all financial management practices should be judged. These will assist in determining whether, in applying standards of financial management, a local authority is financially sustainable.
16. The six principles of good financial management are:
  - **Organisational leadership** – demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture.
  - **Accountability** –financial management is based on medium-term financial planning, which drives the annual budget process supported by effective risk management, quality supporting data and whole life costs.
  - **Transparency** - Financial management is undertaken with transparency at its core using consistent, meaningful and understandable data, reported with appropriate frequency, with evidence of periodic officer action and elected member decision making.
  - **Professional standards** - Adherence to professional standards is promoted by the leadership team and is evidenced.
  - **Assurance** - Sources of assurance are recognised as an effective tool mainstreamed into financial management and include political scrutiny and the results of external audit, internal audit and inspection.
  - **Long-term sustainability** - The long-term sustainability of local services is at the heart of all financial management processes and is evidenced by prudent use of public resources.

17. In turn the FM Code is structured around 7 areas of focus:

- The Responsibilities of the Chief Finance Officer and Leadership Team
- Governance and Financial Management Style
- Long to Medium-Term Financial Management
- The Annual Budget
- Stakeholder Engagement and Business Plans
- Monitoring Financial Performance
- External Financial Reporting

Each of these areas is supported by a set of guidance standards against which Councils should be assessed. CIPFA's expectation is that authorities will have to comply with all the financial management standards if they are to demonstrate compliance with the FM Code and to meet its statutory responsibility for sound financial administration and fiduciary duties to taxpayers, customers and lenders.

18. Although the FM Code does not have legislative backing, it applies to all local authorities, including police, fire, combined and other authorities and is considered as best practice. The FM Code recognises that some organisations have different structures, legislative frameworks and internal management practices. Where compliance with this code is not possible adherence to the principles is appropriate.
19. The Council's external auditors (Ernst & Young) will from 2021/22 have regard to the FM Code and will be looking to ensure that the Council is meeting the FM Code as part of its value for money assessment. Furthermore, CIPFA guidance issued in February 2021 stated that the Council's Annual Governance Statement for 2020/21 should include the overall conclusion of the assessment of the organisation's compliance with the principles of the FM Code. Where there are outstanding matters or areas for improvement, these should be included in the action plan.
20. Each local authority must demonstrate that the requirements of the FM Code are being satisfied. However, the FM Code is not expected to be considered in isolation though and accompanying tools (such as the Council's Constitution and the Financial Procedure Rules) will form part of the collective suite of evidence to demonstrate sound decision making and a holistic view is taken across the organisation.
21. Demonstrating this compliance with the FM Code is a collective responsibility of elected members, the Chief Finance Officer (CFO) and their professional colleagues in the leadership team. It is for all the senior management team plus finance staff to work with elected members in ensuring compliance with the FM Code and so demonstrate the standard of financial management to be expected of a local authority. In doing this the statutory role of the section 151 officer will not just be recognised but also supported to achieve the combination of leadership roles essential for good quality financial management.

22. As a first step towards ensuring that the Council meets the FM Code in 2021/22, the Chief Finance Officer has produced a draft Initial Self-Assessment against the FM Code, as attached at Appendix 1. The Self-Assessment will be continually reviewed and refined on an ongoing basis, to ensure standards are maintained and any actions are implemented.
23. The Initial Self-Assessment has been undertaken using a RAG rating approach as set out below :

<b>RAG Rating</b>	<b>Progress Report</b>
<b>HIGH</b>	Full Compliance is being demonstrated
<b>MEDIUM</b>	Minor to moderate improvements are required to demonstrate full compliance
<b>LOW</b>	Moderate to significant improvements are required to demonstrate full compliance

24. The completion of this Initial Self-Assessment has identified a range of further actions required which are summarised below and detailed in Appendix 1:

<b>Standard</b>	<b>Action Required</b>	<b>Responsible Officer</b>	<b>Timescale</b>
A	To continue to implement the Ofsted Improvement Plan in order to remove the qualified VFM opinion.	Executive Director of Children's Services	31/3/24
B	Recruit to the vacant Chief Accountant post with a suitably qualified and experienced person, or if not possible to appoint to post then review across Finance to ensure that the appropriate skills are in place.	Head of Finance and Investments	30/9/21
B	Continue to offer finance staff training opportunities, and encourage them to undertake professional accountancy qualifications.	Head of Financial Planning & Support / Head of Finance and Investments	Ongoing
B	Continue with the current trainee accountant / accounting technician programme.	Head of Financial Planning & Support /	Ongoing

		Head of Finance and Investments	
B	Develop a plan and pathways to improve succession planning, and to address the age demographic of finance staff.	Director of Finance	31/3/22
B	Future vacant Finance Business Partner posts will target qualified accountant applicants.	Head of Financial Planning & Support	Ongoing
E	Continue to seek service improvement in provision of finance services by reviewing all tasks undertaken and systems used, and making improvements where required.	Head of Financial Planning & Support / Head of Finance and Investments	Ongoing
E	Strengthen the project management approach to ensure early involvement for finance, in project management business cases as part of the approval process, in order to ensure value for money.	Project Management Office / Director of Finance	31/3/22
E	Improve accountability of budgets by all budget managers and take corrective action where required.	Director of Finance / Leadership Management Team	31/3/22
F	Potential development of Medium Term Financial Plan (MTFP) to include specific reference to scenario testing.	Director of Finance/ Head of Financial Planning & Support	31/3/22
F	Key partners should be reviewed to ensure they maintain the same high standards of conduct with regard to financial administration and corporate governance that apply throughout the Authority and they contribute to the achievement of the Authority's objectives.	Director of Finance / Director of Legal and Governance	31/3/22

G	Development of longer term financial planning when greater certainty around future funding for local government is received.	Director of Finance/ Head of Financial Planning & Support	TBD
H	Assess any implications arising from any changes in the CIPFA Prudential Code of Capital Finance for Local Authorities (once consultation has been completed) – this is dependent on the final publication.	Head of Finance and Investments	TBD
H	Full review of condition of built assets to be completed and funding sought from MTFP and Investment Strategy where required.	Director of Environment and Community Services	31/10/21
M	Ensure option appraisal process makes reference to the IFAC/PAIB principles.	Director of Finance	31/3/22
M	Develop a consistent process for undertaking and documenting option appraisals.	Director of Finance	31/3/22
O	Consider if other major balance sheet items can be visible in the quarterly budget monitoring reports.	Head of Financial Planning & Support / Head of Finance and Investments	31/3/22

## CIPFA Financial Resilience Index 2021

### ***Background***

25. CIPFA's Financial Resilience Index is a comparative analytical tool designed to provide councils with a clear understanding on their position in terms of financial risk and their ability to respond to financial pressures.
26. It was developed by CIPFA as they understand that local authorities are feeling the financial pressure as the demand for services is becoming greater, with higher costs and delivery charges impacting on budgets. Local authorities are also facing higher levels of scrutiny over their decision-making amid an increasingly complex



delivery landscape. At the heart of this decision making has to be a clear understanding of possible areas of financial risk.

27. The CIPFA Financial Resilience Index may be used by Chief Finance Officers to support good financial management, providing a common understanding within a council of their financial position, the challenges faced and also help to support discussion, as well as constructive debate, using consistent information from a range of measures.
28. The Index is made up of set of 12 separate but linked indicators (derived from publicly available information – generally financial returns made by local authorities to central government), which can be used to compare against similar authorities across a range of factors.
29. The Index shows a council's position on a range of measures associated with financial risk. The selection of indicators has been informed by extensive financial resilience work undertaken by CIPFA over the past five years, public consultation and technical stakeholder engagement.
30. There is no single overall indicator of financial risk and therefore no overall comparison exists in the Index, therefore the Index instead highlights areas where additional scrutiny should take place in order to provide additional assurance. This additional scrutiny should be accompanied by a narrative to place the indicator into context. It should also be noted that some indicators are subjective, however they still provide a good feel to the medium to long term situation.
31. While the impact of COVID-19 resulted in a delay to the publication of the current Index, it is still able to provide a comprehensive pre-COVID baseline, illustrating the financial resilience of authorities as they entered the pandemic.

### ***Key Points from analysis of the CIPFA Financial Resilience Index***

32. An analysis of the various indicators has been made by comparing Middlesbrough Council's results for each indicator against its CIPFA Statistical Nearest Neighbours (a group of local authorities with similar characteristics to Middlesbrough Council) and the North East 12 Neighbours. This is shown in Appendix 2.
33. The key points of this analysis are as follows :
  - Middlesbrough's size and demographics will always leave the town vulnerable to financial shocks, therefore maximum mitigation is essential
  - Expenditure needs to be carefully controlled (Children's Social Care is the major risk here)
  - Council Tax Base needs to grow and have higher average values
  - Middlesbrough has a generally low level of reserves on the balance sheet compared to its nearest neighbours and the other North East local authorities. This is for a number of reasons:
    - Middlesbrough has used reserves to smooth savings proposals in previous years
    - Middlesbrough's unallocated Reserves (General Reserve) is relatively healthy but we have a very low level of Earmarked Reserves kept for a specific purpose

- Middlesbrough tends to make recurring provision within the budget rather than hold money on the balance sheet which does not show on these graphs
  - In the medium-term our level of reserves needs to be protected as a minimum and ideally grown to an appropriate and planned level
  - The Council is not over borrowed, although this needs to be monitored carefully.
34. In comparing Middlesbrough Council's position with other local authorities the following points should be noted about Middlesbrough Council's structural position :
- A very high proportion of Middlesbrough Council's budget is spent on Social Care, especially Children's Social Care
  - Middlesbrough Council has a very low Council Tax Base and the lowest in the North East
  - Fees and charges and Business Rates income are relatively low. This however protects Middlesbrough Council from large shocks such as Covid-19 pandemic
  - Middlesbrough Council is highly dependent on funding that is at the discretion of Central Government on an annual basis – this leaves Middlesbrough vulnerable because it is outside of our control and can change at short notice

#### **What decision(s) are being asked for?**

35. That the Corporate Affairs and Audit Committee note the contents of the report.
36. That the Corporate Affairs and Audit Committee note the key points of the CIPFA Financial Management Code (FM Code) and the initial self-assessment of compliance with the Code, the associated actions arising to ensure full compliance, and the next steps.
37. That the Corporate Affairs and Audit Committee note the results of the analysis of the CIPFA Financial Resilience Index 2021.

#### **Why is this being recommended?**

38. To contribute to ensuring the long-term financial sustainability of the Council.

#### **Other potential decisions and why these have not been recommended**

39. Not applicable.

#### **Impact(s) of recommended decision(s)**

40. Although the report does not contain any recommendations, the expectation is that the compliance to the CIPFA Financial Management Code will need to become part of auditing requirements; internal and external. As a result, the update is mainly for information at this stage with Members to monitor the position and any actions and legislative requirements that may arise.

## ***Legal***

41. It is CIPFA's intention that the Financial Management Code will have the same scope as the Prudential Code for Capital Finance in Local Authorities, which promotes the financial sustainability of local authority capital expenditure and associated borrowing and is deemed by the sector as best practice. Therefore, although it does not have legislative backing, compliance is considered to be mandatory for all local authorities.
42. In addition to its alignment with the Prudential Code the FM Code also has links to the Treasury Management in the Public Sector Code of Practice and Cross Sectoral Guidance Note and the annual Code of Practice on Local Authority Accounting in the United Kingdom. In this way, the CIPFA Codes support the Chief Finance Officer's statutory role.

## ***Financial***

43. The Chief Financial Officer (Section 151 Officer) has the Statutory Responsibility for the financial administration of the Council under the Local Government Act 1972. This includes appropriate measures in relation to financial management. Therefore, the Chief Financial Officer (Section 151 Officer) has the Statutory Responsibility (supported by the Corporate Leadership Team and Elected Members) for ensuring compliance with the FM Code.

## ***Policy Framework***

44. There are no implications at this stage for the policy framework of the Council.

## ***Equality and Diversity***

45. There are no equality and diversity issues as part of this report.

## ***Risk***

46. If compliance with the CIPFA Financial Management Code is not demonstrated, the Council's financial sustainability could be brought into question, which in turn could result in a negative impact on its reputation with stakeholders.

## ***Actions to be taken to implement the decision(s)***

47. Executive and Corporate Affairs and Audit Committee will receive regular reports on progress towards achieving full compliance with the CIPFA Financial Management Code, including progress on the actions identified from the Initial Self-Assessment where appropriate. An annual report will be taken to Full Council alongside the Statement of Accounts in late Autumn each year, commencing in 2022, following the first full financial year of compliance.

## ***Appendices***

- Appendix 1: CIPFA Financial Management Code: Initial self-assessment of compliance
- Appendix 2 : CIPFA Financial Resilience Index 2021 analysis

## ***Background papers***

No background papers were used in the preparation of this report.

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