

Financial Management 2005-2008

Performance Select Committee, item 8

Committee:	Performance Select Committee	Agenda Item
Date:	27 September 2007	8
Title:	Financial Management 2005-2008	
Author:	Alasdair Bovaird, Chief Executive, 01799 510400	Item for decision

Summary

The report provides an account of the difficulties and issues in the council's financial management processes which have contributed towards the council's projected 2007-2008 overspend.

Recommendations

1. That the Performance Select Committee note and comment upon the account of events contained in this report;
2. That the Chief Executive be asked to bring a further report to the meeting of the Council on October 9 2007 detailing the proposed response to these circumstances having heard members views on the questions set out in paragraph 39

Background Papers

Budget reports to Policy Committees, Operations Committee and Council during the period 2005-8;

Director of Resources' report to Finance and Administration Committee meeting of September 20 2007

Introduction

1. In February 2007, Uttlesford District Council adopted a Medium Term Financial Strategy which set out its financial outlook for the period to 2011-12. This strategy identified the need to make savings in ongoing running costs of £2.179 million.
2. At the same time, the council set its budget for the financial year 2007-8.
3. Following the report received by the Finance and Administration Committee on 20 September 2007, it is now clear that the council now faces a significant shortfall in resources during this financial year. The Finance and Administration Committee agreed an action plan to resolve that shortfall during the year and also agreed adjustments to the Medium Term Financial Strategy to reflect the revised position. It also instructed the Chief Executive to bring forward a report to the forthcoming meeting of the council to set out a more detailed set of plans and targets for financial recovery. However, it falls to the Performance Select Committee – with its responsibility for

Financial Management 2005-2008

Performance Select Committee, item 8

reviewing council performance and in acting as the council's audit committee, to consider how this situation arose and what changes might need to be made as a result of these considerations.

4. As part of the compilation of this report, the Chief Executive has sought the advice and support of the Chief Executive and Director of Finance of Bedford Borough Council. This support has not taken the form of a formal report or investigation on their part. Instead there have been a number of discussions with Bedford on the issues that have arisen in the compilation of the report as they arose. However, responsibility for the conclusions drawn in this report rests with the Chief Executive.

Section 151 officer

5. Section 151 of the Local Government Act 1972 requires that *“every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs”*. This appointment is commonly referred to as the council's section 151 officer and all local authorities in England have such an officer, although titles vary. In Uttlesford the Director of Resources is the section 151 officer and the Head of ICT and OR is currently the acting deputy section 151 officer.
6. These provisions were significantly updated in section 114 of the Local Government Finance Act 1988. This section sets out specific responsibilities for the section 151 officer: including the requirement to alert the council and other bodies if he believes the council is about to incur expenditure which is unlawful or which might cause the council to be financially deficient. He is also required to present a report to the meeting of the council which sets the budget as to the soundness of the council's proposed budget and the processes by which it was developed. In practice, this Council adopts the widely used approach within local authorities of having a Head of Service who manages all the detailed work.

The current issue

7. The key issues which have arisen are:
 - the need to suspend the process of the closure of the council's accounts on June 26 2007 resulting in the statutory deadline of 30 June being missed.
 - the draft accounts for 2006-7 when they were finally adopted at the council meeting on July 31 2007 showed an overspend compared to original budget of £770,000.
 - The discovery in the months following the adoption of the budget for 2007/08 of a projected overspend on the general fund in 2007-8 of £1.1 million.

Financial Management 2005-2008

Performance Select Committee, item 8

Setting the 2007-8 budget

8. The intended arrangements for setting the 2007-8 budget were set out in a report to the Operations Committee in June 2006. This set out a timetable leading to a detailed consideration of spending pressures, efficiency saving and fees and charges by each committee in January 2007, with the Operations Committee having the task of bringing all committee recommendations together for a recommendation to Council in February 2007.
9. In fact, a number of elements of this programme did not happen according to plan.
 - concerns within the finance service about the robustness of the council's financial management system led the Head of Finance to take the decision not to use the financial system to construct the budget. It is clear that this decision was a mistake in that the use of spreadsheets rather than the council's main financial database meant that there was a need to transfer manually data between the systems, introducing additional complexity and opportunity for error. Concerns about the use of the main financial system to prepare the budget were in fact unfounded as it had been used successfully for the previous two years of budget build.
 - A key tool for the creation of a robust budget and for making adjustments to it effectively is the establishment of an accurate base budget upon which adjustments can be made. It is now clear that in a number of areas this did not happen. The principal responsibility for managing this process rested with the Head of Finance.
 - Public consultation on budget proposals was originally intended to take place between September and November – with committees receiving feedback on the consultation at their November meetings. In fact, most consultation happened in December 2006/January 2007.
 - In September 2006, it was identified that savings options totalling some £952,000 would be required were all spending pressures to be agreed. However, requisite savings proposals were not produced. Budget managers were asked to exemplify the effects of 2%, 5% and 10% cuts to their budget but in fact proposals for total savings of only around £120,000 were in fact produced.
 - The September 2006 report to Operations Committee identified six action points to reduce the gap between planned expenditure and available resources. These included: removing inflation provision from certain budgets; examining procurement practice, especially on large contracts; producing and examining the business case for all spending pressures. It cannot be demonstrated that these steps were in fact taken.

Financial Management 2005-2008

Performance Select Committee, item 8

10. As has been normal practice in Uttlesford, two meetings of the Operations Committee were scheduled in February 2007. The first of these (February 1, 2007) was to focus on the 'domestic' budget of the Operations Committee – that is the budget for those services which fall within the remit of the committee. The second, which was to be held on February 8, was to bring together the recommendations from each of the budget-holding committees (Operations, Community, Environment, Development Control and Licensing) together with all other elements of the council's overall budget and make an appropriate budget-setting recommendation to the council meeting on February 15.
11. The first of these two meetings happened as intended, but the second, due to adverse weather conditions, was cancelled. This meant that the council meeting on 15 February was presented with a less clear set of proposals than might otherwise have been the case. This caused confusion at the meeting. This confusion was increased when it was moved that the proposed council tax increase should be reduced from 4.5% to 2%.
12. Notwithstanding all the issues that had arisen during the process of developing the budget, the Director of Resources felt able to advise members that *"My conclusion is that the processes followed have been generally sound and similar to those that have produced robust estimates in the past. In the light of information made available during the budget process, there is sufficient capacity in the proposed overall budget to cope with the financial risks the Authority faces in 2007/8."*
13. In retrospect it is clear that there are some elements of the 2007-8 budget which were not robust:
 - as reported to the Finance and Administration Committee the actual amount built into the council's financial systems for savings on staff turnover equates to some 7% rather than the 5% reported;
 - the council estimated that it would receive £600,000 in Local Authority Business Growth Incentive and in fact received only £236,000
 - there is a variation between the amounts budgeted as savings targets for Organisational Reengineering and the anticipated savings set out in the documentation supporting the development of the OR programme.

Council tax and debt-free status

14. It is worth, at this point addressing two points that have caused some concern among members.
15. Firstly, issues and difficulties with the general fund are not the cause of the reducing availability of capital receipts and the increasing difficulty in maintaining the council's debt free status.
16. Secondly, the late announcement of the reduced increase in council tax clearly had the effect of reducing the resources available to the council. Had the full picture that is now known been known in February 2007, then

Financial Management 2005-2008

Performance Select Committee, item 8

perhaps the view taken by members of that proposal would have been different. However, there was no suggestion in the advice offered by officers to the administration, nor in the advice offered to the council as a whole, that the proposal to reduce the increase was not sustainable.

17. Had the base budget been robustly constructed then the change to the anticipated council tax increase would have caused no difficulty. The amendments to the proposed budget that were made on the night of the council meeting, in effect changed only two figures substantively, so without making comment on the financial or political desirability of that decision, it is more credible to suggest that the problem in this instance was that the decision was made on the basis of inadequate information, rather than that the decision contributed to the difficulties that are now being experienced.

Council Accounts

18. Once the budget is agreed, the next major task for the finance team is to lead the process of the closure of the council accounts and the publication of draft accounts. The council is required to complete this process by 30 June each year.

2005-2006

19. Before his extended sickness absence, and while the Executive Manager was absent on leave, the Chief Accountant and the newly appointed Principal Accountant (Technical) had discussed with the Chief Executive the difficulties they felt the council would experience in closing the 2005-6 accounts on time. As a result of that discussion the Chief Executive authorised the use of specialised agency staff to ensure that the closure of accounts was completed according to schedule. This was known to be likely to cause an overspend in the finance team's budget but was agreed on the basis that:
 - The reputational damage to the council in failing to close the accounts on time was significant;
 - The use of consultants would allow the permanent staff to focus their attention on ensuring that underpinning systems and documentation was in place to make future accounts processes more straightforward.
20. In the event the accounts were closed on time, but the subsequent audit revealed that one of the consultancy staff had made a significant error in assessing the value of the council's housing stock – thereby causing the auditors to pass adverse comment on the accounts. The experience of the account closure process in 2007 suggests that the objective of making the process more straightforward in future years was also not achieved.

2006-2007

21. It is a matter of record that the council failed to meet the June 30 deadline in 2007. This will result in significant adverse comment from our auditors.

Financial Management 2005-2008

Performance Select Committee, item 8

22. Before and during June 2007, staff in the finance service were heavily engaged in the process of closing the council's accounts. If the engagement the previous year of agency support had had the desired effect, then it ought to have been the case that the challenging process of closing the accounts should have been more straightforward. In the event, it became apparent during June that there was doubt as to whether the accounts would be closed in time for the statutory deadline. On June 21 a significant error came to light in the way in which Planning Delivery Grant had been budgeted for during 2006/07. This had the effect of overstating the Council's reserve strength by some £534,000.
23. The discovery of this error and subsequent actions made it impossible for the accounts to be presented on schedule with any assurance of their being accurate. Accordingly the decision to halt the process was taken on June 26 and a review of the whole of the underpinning information was begun.
24. The final draft of accounts – incorporating all known issues – was presented to the Council meeting on July 31 and adopted subject to audit. These accounts showed an overspend of £770,000 and an unplanned draw on balances of £200,000 to cover that part of the overspend for which no provision was available in contingency reserves.
25. The overspend that the council incurred in 2006-7 has knock on effects into the current year, which were set out in the report considered by the Finance and Administration Committee on September 20.

Budget monitoring

26. The third key process in sound financial management is the ongoing monitoring of budgets: knowing how much is being spent in comparison to what was expected. The systems in place for this are:
 - Individual service managers receive regular budget reports setting out their expenditure and their budgets. This should enable early warning to be raised if spending is out of line or if income is not being achieved. It should also enable budget managers to identify savings opportunities.
 - Monthly Strategic Management Board meetings receive performance updates including budget monitoring information – focussing on exception reporting (i.e, the identification of significant variations against expectation).
 - Committees should receive regular financial updates on spending and use of project or contingency funds.
27. With the exception of the error that arose as a result of the Planning Delivery Grant mis-statement, the significant overspends that occurred in 2006-7 were all reported both to SMB and to members. However, it is clear that the totality of the picture was not fully appreciated and that therefore there was a failure to address a significantly worsening financial position. Responsibility for that failure must be shared between those who failed to examine

Financial Management 2005-2008

Performance Select Committee, item 8

rigorously the information being provided and those who failed to provide the information in a way which made the overall picture fully clear.

28. The nature of the overspent items in 2006-7 were not – on the whole – the result of service managers failing to control their budget. Similarly, the position reported to Finance and Administration on September 20, demonstrates that while a number of services are struggling to meet their target for staff turnover, budgets are not overspending as a result of lack of managerial control. This is reassuring up to a point, but it does not resolve the need to ensure that there is a significant reduction in the council's projected overspend this year.

Developments in the Finance Team

29. In order to identify how this situation arose it is perhaps helpful to review events over recent years in the council's financial management.
30. In 2004, the council undertook a management restructure. The initial outline of this restructure was set in decisions made by the council at its December 2003 meeting. Among other things, council agreed that the post of the then Director of Resources be deleted with an implementation date for a new structure of Executive Managers by June 2004. This restructure subsequently took effect with the section 151 responsibilities passing to the Executive Manager (Finance and Asset Strategy). He was supported by a Chief Accountant who acted as the deputy section 151 officer, and a Principal Accountant. The Chief Accountant retired in May 2005 and following a recruitment exercise a new Chief Accountant, this time with full day to day responsibility for all staff and work of the section was appointed and began work at Uttlesford on 11th August 2005.
31. Since that time there has been significant 'churn' in the staffing of the finance team:
 - The Executive Manager (Finance and Asset Strategy) created a new structure of Chief Accountant and 2 Principal Accountants to give the four senior posts in total that he believed were needed to cope with the pressures at a senior level;
 - The only Principal Accountant in post at the time of the 2004 restructure left in November 2005;
 - The new Chief Accountant recruited to one of the Principal Accountant posts as a start to building his own team with effect from January 2006;
 - The remaining Principal Accountant post has been vacant since November 2005;
 - the HRA accountant was on long term sickness absence throughout 2004, finally leaving the council's employ in May 2005. Subsequent attempts to recruit a permanent replacement have failed and a series of agency and temporary arrangements have been filling this gap;

Financial Management 2005-2008

Performance Select Committee, item 8

- resources have been made available for four new posts in the finance service in the period 2004-7, but only two of those posts have been successfully filled.
 - Maternity leave throughout 2006 meant the loss of one of the Council's only two General Fund Accountants with the replacement arrangement not proving adequate
32. The newly-appointed Chief Accountant was absent on long term sickness during the spring and summer of 2006. However, he returned to work at the end of August 2006 and, having had no further sick leave, was subsequently appointed to the position of Head of Finance in the new management structure with effect from April 1 2007.
33. During the whole of the period that this report covers there have been gaps in the finance team. This has caused the Audit Commission to pass comment on occasion about the fragility of the council's capacity in this area. However, it should be remembered that while the staff have not been in place, the resources have always existed to enable those posts to be filled. The finance service has been a heavy user of agency and consultancy staff over the last two years due to the inability to fill their staff quota. This use has, in itself, contributed to the council's overspend in recent years.
34. There have been a number of attempts to recruit to positions, but success is far from guaranteed. For example, an advertisement was placed Public Finance and the Herts and Essex Observer to recruit to a newly established Principal Accountant post. There were only three applicants, none of which were felt suitable to interview. Other approaches have been taken – such as engaging a specialised recruitment agency – but with only partial success.
35. Conversely, there have been occasions on which there has been a failure to progress recruitment processes and opportunities to resolve the situation of some staff currently on temporary contracts have also been missed.

Summary

36. The combination of:
- Errors in the accounting process which meant that reserves were overstated;
 - An overspend on the general fund in 2006-7;
 - Failure to identify efficiency savings as a part of the routine budget process in preparing the 2007/08 budget; and
 - Over-optimistic assumptions and/or estimates in the 2007-8 budget

resulted in the significant financial issue which the council now faces and the significantly constrained room for manoeuvre (in terms of both time and resources available) to resolve the situation.

Financial Management 2005-2008

Performance Select Committee, item 8

37. There is no doubt that the instability in the finance team throughout this period was a significant factor in the failures set out in the account above. A lack of continuity in personnel, the doubtful performance of some individuals and the inability to fill key posts all led to a situation in which individuals were placed under significant pressure in terms of time and workload.
38. There are a number of issues which now need to be addressed:
- What changes in process now need to be put in place to avoid a repetition of these issues?
 - Do the difficulties experienced in recruiting appropriately skilled staff into the finance service call into question the strategic viability of a self-standing finance function within Uttlesford District Council? Or might a more sustained effort to ensure that a fuller staff complement was established have proved of more benefit than the various interim measures that were put in place?
 - What steps are necessary to restore the confidence of members, managers, staff and the public in the financial management team and the processes and information they prepare?
 - How does the Council move to a position where managers at all levels have a fuller understanding of financial management and their roles and responsibilities for it?
39. This report has sought to give as full as possible an account of the problems which arose during the period 2005-7. Some specific actions and some ongoing situations give rise to questions about the performance of individual members of staff and contractors. In order to ensure that those individuals are able to receive a fair hearing, and to avoid the risk of 'tainting' personnel processes which are currently underway, a further report has been prepared for the consideration of this committee in private session.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
That confidence in the financial management processes of the council remains low.	Medium	High	The fullest possible disclosure of the position which led to the current issues should be made; A clear action plan in response to these issues must be agreed and publicised; The council must monitor its ongoing financial position regularly and rigorously.

Financial Management 2005-2008

Performance Select Committee, item 8

<p>That the council continues to be unable to establish an effective team to manage its financial affairs</p>	<p>Medium</p>	<p>High</p>	<p>Any changes required to the current management and staffing arrangements must be put in place swiftly;</p> <p>If necessary, temporary assistance from outside the council should be put in place;</p> <p>All options for the future organisation of the finance function must be considered, including outsourcing, partnership working or the establishment of a shared service.</p>
---	---------------	-------------	--