

Internal Audit
Report 2015/16
Medium Term Financial Strategy

Ref no A.2


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Distribution List

For action	Ashley Wilson (Interim Head of Finance)
	Ilyas Bham (Accountancy Manager)
For information	Steve Atkinson (Chief Executive)
	Julie Kenny (Chief Officer, Corporate Governance and Housing Repairs)
	Sanjiv Kohli (Deputy Chief Executive, Corporate Direction)
	Bill Cullen (Deputy Chief Executive, Community Direction)

1. Executive summary

Report classification	Total number of findings					
	Critical	High	Medium	Low	Advisory	
 Low risk (1 point)	Control design	-	-	-	-	
	Operating effectiveness	-	-	-	1	1
	Total	-	-	-	1	1

Headlines / summary of findings:

Hinckley and Bosworth Borough Council has recently finalised an updated medium term financial strategy (MTFS) setting out how a balanced budget will be achieved over the period 2016/17 to 2019/20, spanning the remainder of the current administration’s term of office.

The MTFS was presented in its final form to a full Council meeting on 18th February 2016. It contains an analysis of the macroeconomic, central government, and local environment, and sets out relevant assumptions and viewpoints clearly. The Council has a policy of maintaining the general fund at 10% of net expenditure. Central to achieving this is a £5 increase in average band D council tax, and the introduction of a £24 charge for collection of green waste.

We have reviewed the arrangements in place for collating information and preparing the MTFS. Although some key officers have been absent during the preparation of the MTFS, we are satisfied that the process was robust and involved sufficient input by senior officers and members.

The MTFS is underpinned by a number of key assumptions over funding, other income, growth pressures and efficiency savings. Each of these assumptions has varying degrees of inherent uncertainty. With so many assumptions being applied there is an ongoing risk that one of the influencing factors may vary significantly from the assumptions the Council has applied. We have reviewed the Council’s assumptions taking into account our wider understanding of the sector, and we have also compared them to other local district authorities, similar to HBBC where possible (see Appendix 1). Overall, in our view the assumptions are reasonable taking into account the point in time at which the MTFS was prepared.

		2016/17	2017/18	2018/19	2019/20
Non-pay inflation	HBBC	0.00%	0.00%	0.00%	0.00%

	Average	0.57%	0.80%	0.80%	0.80%
Pay inflation	HBBC	1.00%	1.00%	1.00%	1.00%
	Average	1.14%	1.20%	1.20%	1.25%
New Homes Bonus change	HBBC	47.38%	7.74%	-19.56%	-15.78%
	Average	34.16%	-0.22%	-20.93%	-6.57%
Change to net budget	HBBC	5.7%	0.5%	-5.8%	-3.3%
	Average	1.4%	0.7%	1.2%	1.5%

We identified one low risk finding; there was an error in a working paper in which a rental figure had not been updated for new information. Further information is presented in the detailed findings section, however we are satisfied that the impact on the MTFS is not significant.

We have also raised an advisory point regarding a lack of clarity in the narrative for explaining calculations for inflation. Whilst we are satisfied that inflation has been correctly applied, the narrative for the assumptions used could have been more clearly displayed.

2. Detailed current year findings

1. Quality of working papers – operating effectiveness

Finding

We have extracted key assumptions from the MTFS and reviewed the source documentation and calculations behind them.

We identified a very small error in a working paper, in which a rental figure was not updated for new information. This error does not have a significant impact on the MTFS and represents only a very small amount in the context of the overall plan (approximately £18k per year of the plan) but highlights that review of working papers should be strengthened.

Implications

Assumptions included within the MTFS may not be reported accurately therefore cannot be effectively challenged by members.

Figures within the MTFS may be inaccurate leading to inappropriate decision making.

Action plan

Finding rating


Low risk

Agreed action

Officers will be reminded of the need for a thorough review of calculations. The review of calculations undertaken by a separate officer will be documented (officer and date) on the individual working papers.

Responsible person / title

Ashley Wilson (Interim Head of Finance)

Target date:

31st December 2016

Reference number:

MTFS01

Clarity in defining MTFS assumptions – operating effectiveness

Finding

The main narrative to the MTFP states that a 1% inflationary increase will be applied to contracts unless the terms specify otherwise, and other supplies and services will not be inflated. Our initial review of the corresponding working paper identified that inflation of 1% was applied to contracts in 2016/17, but 2% was applied in the following three years. It has subsequently been identified that there is a separate narrative within the MTFS which states in addition to the specific inflation rate on contracts, general assumptions will be applied to all forecasts. This includes RPI of 1.1% for 2016/17 and 2% then after. We have reviewed the calculation and are satisfied that it has been calculated correctly however confusion has arisen from the separation of the narrative.

Recommendation

MTFS narrative will be reviewed by an impartial individual to check the clarity of the documentation.

General assumptions narrative should be stated first to avoid confusion.

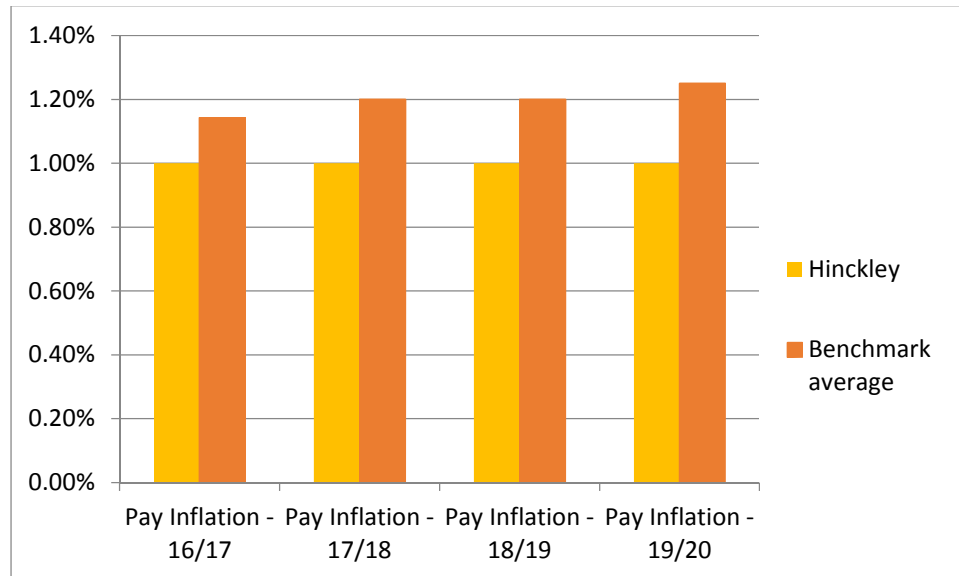
Appendix 1. Benchmarking of assumptions

We have reviewed the assumptions in your MTFS and where possible compared them to other local district authorities.

Inflation

You have assumed inflation of 0% on supplies and services for the MTFS period, as in previous years, unless specified within a contract. The same approach is taken by the majority of our benchmark group although some in the group have used an inflation rate of 2%. For contracts, you are anticipating inflationary costs of 1% for 2016/17 and 2% inflation thereafter. This is in line with current Treasury projections for CPI, the government's preferred measure of inflation.

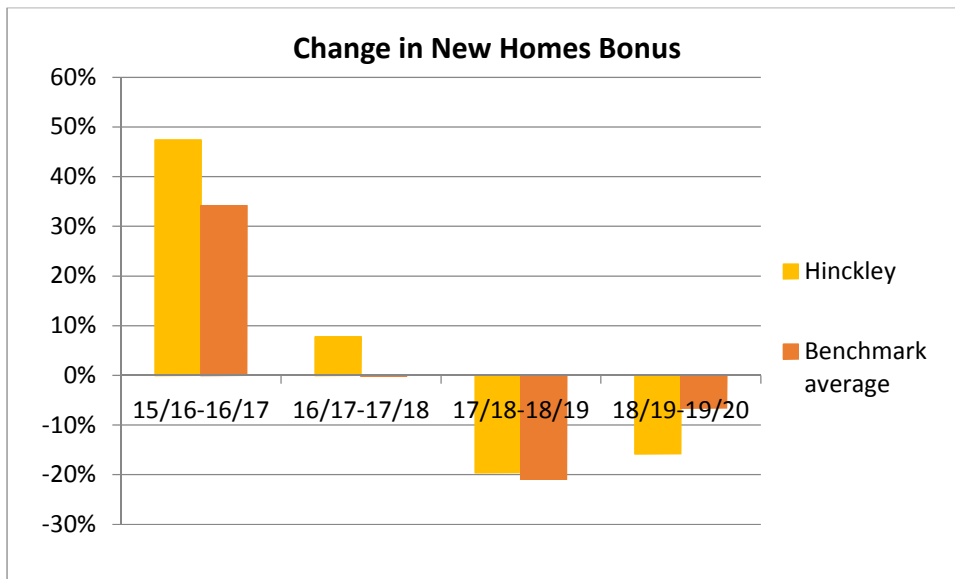
Together with the majority of the Local Authorities in our benchmark group, you have assumed pay inflation of 1% over the period in line with the recently agreed local government pay settlement for 2016/17 and 2017/18.



New Homes Bonus

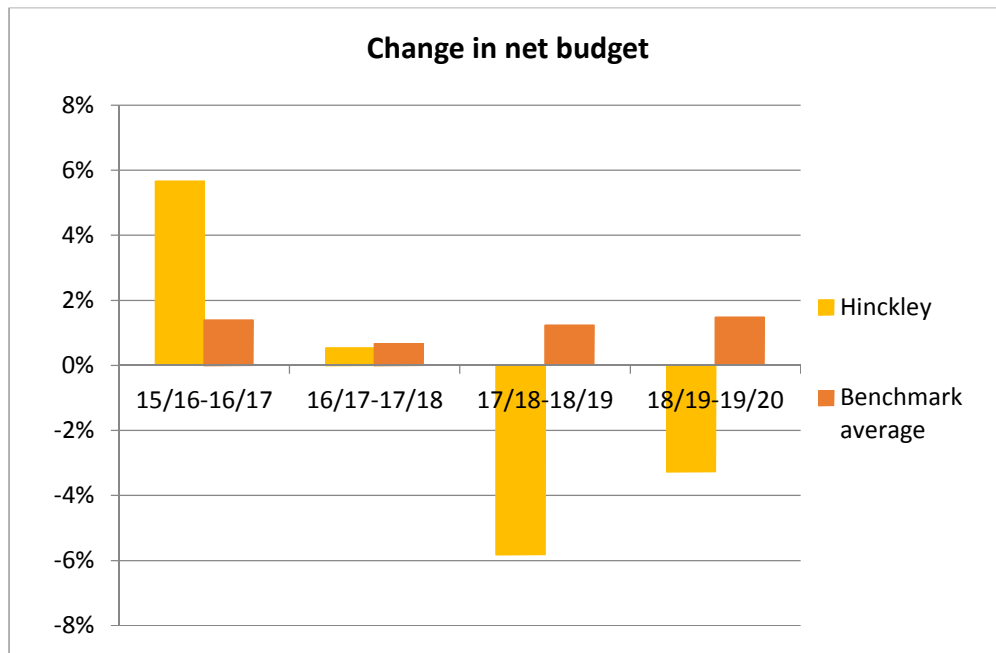
There is considerable uncertainty over New Homes Bonus. Under the current scheme for each new home built the government provides grant for six years based on council tax. Consultation is taking place on proposals to move from a six year payment term to a four year or even shorter payment term, and various options of phasing the change are being considered.

The changes you have modelled in your MTFS are based on the government's preferred option. You are forecasting a higher increase in income from New Homes Bonus in the years 2015/16 – 2017/18 of your plan than our comparator group, 2017/18 -2018/19 is broadly in line with our comparator group but this is offset by a sharper forecast decline in 2018/19-2019/20.



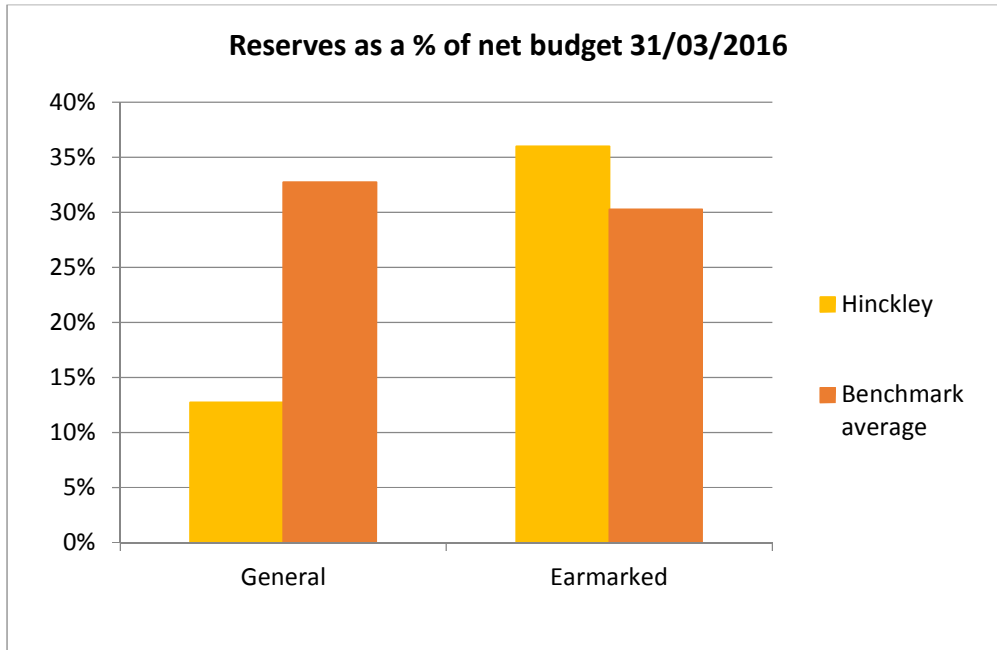
Efficiencies and additional income sources

In developing your MTFS you have considered additional income sources and efficiencies which could be made. Your net budget is increasing in 2016/17 by a higher level compared with our benchmark group, but this is offset by the greater savings planned and additional income you have identified in later years.

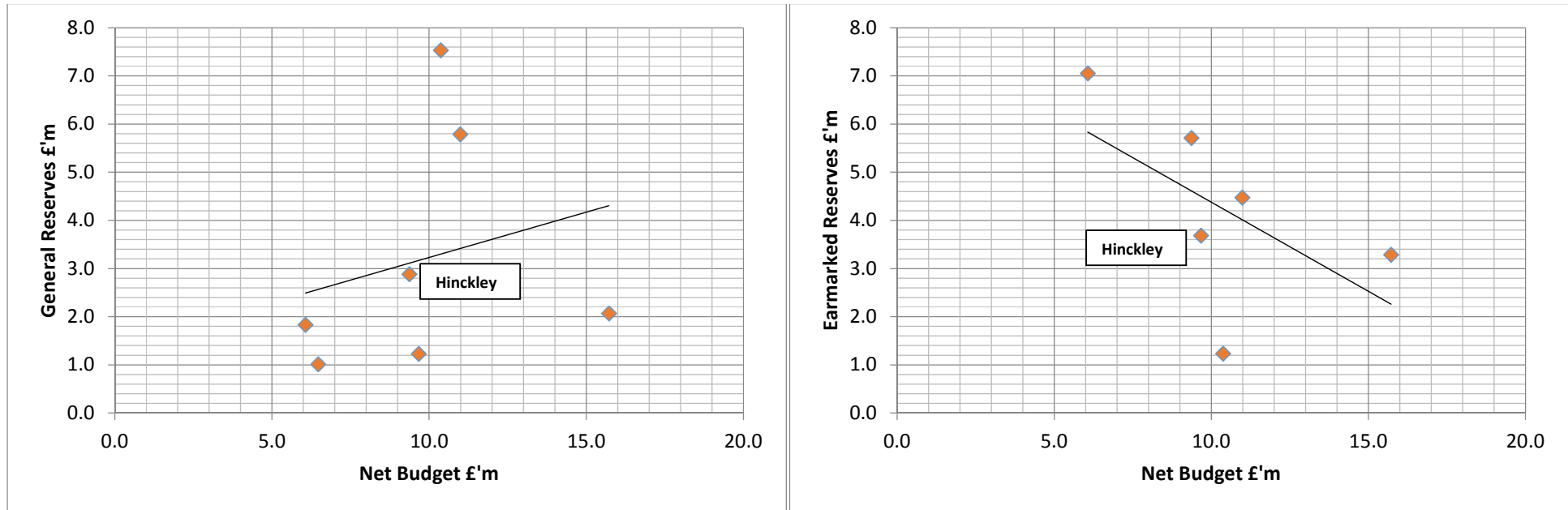


Reserves

Your forecast for the end of the 2015/16 financial year is to be holding £1.2 m of general fund reserves, which represents 12.7% of your net expenditure. You maintain a policy of holding a general reserve of 10% of net budget and this is forecast to be achieved throughout the period. The policies in our benchmark group of Local Authorities range from 5% of net expenditure to a target of no more than 30% of net expenditure. Your level of General Reserves remains relatively low when compared to others, but your policy is within our expectation for the level of general fund reserves which we would independently expect you to hold. In addition, you hold a higher level of earmarked reserves than the Local Authorities in our benchmark group which mitigates this difference to some degree.



The following graphs show the level of general reserves and earmarked reserves the authorities in our benchmark group held relative to their net budget:



Appendix 2. Basis of our classifications





Individual finding ratings

<i>Finding rating</i>	<i>Assessment rationale</i>
Critical	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Critical impact on operational performance; or • Critical monetary or financial statement impact; or • Critical breach in laws and regulations that could result in material fines or consequences; or • Critical impact on the reputation or brand of the organisation which could threaten its future viability.
High	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Significant impact on operational performance; or • Significant monetary or financial statement impact; or • Significant breach in laws and regulations resulting in significant fines and consequences; or • Significant impact on the reputation or brand of the organisation.
Medium	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Moderate impact on operational performance; or • Moderate monetary or financial statement impact; or • Moderate breach in laws and regulations resulting in fines and consequences; or • Moderate impact on the reputation or brand of the organisation.
Low	<p>A finding that could have a:</p> <ul style="list-style-type: none"> • Minor impact on the organisation’s operational performance; or • Minor monetary or financial statement impact; or • Minor breach in laws and regulations with limited consequences; or • Minor impact on the reputation of the organisation.
Advisory	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

Report classifications

The report classification is determined by allocating points to each of the findings included in the report

<i>Findings rating</i>	<i>Points</i>
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

<i>Report classification</i>	<i>Points</i>
 Low risk	6 points or less
 Medium risk	7– 15 points
 High risk	16– 39 points
 Critical risk	40 points and over

Appendix 3. Terms of Reference

Hinckley and Bosworth Borough Council Terms of reference – Medium Term Financial Strategy

**To: Ashley Wilson – Interim Head of Finance and Interim Head of Internal Audit,
Ilyas Bham – Accountancy Manager**
From: Chris Dickens, Internal Audit Senior Manager

This review is being undertaken as part of the 2015/16 internal audit plan approved in draft by the Finance, Audit and Performance Committee on 13th April 2015.

Background

Hinckley and Bosworth Borough Council's Medium Term Financial Strategy (MTFS) sets out the Council's financial position for the next four years covering the period from 2016/17 – 2019/20. The MTFS ensures that the Council's corporate targets are met by allocating resources effectively.

The MTFS is integral to the Council's financial planning since it forecasts how it will remain financially resilient as an organisation. The current MTFS applies the Council's policy of holding 10% of the net budget requirement in balances at the end of each financial year, and contains a number of efficiency savings to ensure that the Council does not place unreasonable pressure on local taxpayers.

Income and expenditure assumptions within the MTFS are based on the most likely scenario and with reference to assumptions made by other similar authorities.

The MTFS has undergone a series of reviews and iterations, and the final version will be presented to Council for approval on 18th February.

Scope

This review will cover the following scope. We will:

- Understand how the Council's Medium Term Financial Strategy is compiled, including the governance structure surrounding this
- Review the key assumptions included in the MTFS, comparing them with best practice and those used by other Local Authorities

Limitations of scope

The scope of our work will be limited to those areas outlined above. Our review will be performed in the context of the information provided to us. Where circumstances change the review outputs may no longer be applicable.

Review approach

Our audit approach is as follows:

- Obtain an understanding of the compilation process for the Medium Term Financial Strategy, through discussions with key personnel and review of documentation;
- Identify the key risks in the process and evaluate the design and effectiveness of controls in place to address these risks;
- Understand the assumptions used in the MTFS; and
- Test the robustness of these assumptions through comparison with best practise and other Local Authorities.

Appendix 4. Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken the review of the Medium Term Financial Strategy, subject to the limitations outlined below.

Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

Our assessment of controls is for the period specified only. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.