

**This paper relates to
Agenda Item 11**



Title/Subject: Financial Governance
Meeting: Integration Joint Board
Date: 5 February 2016
Submitted By: Chief Finance Office & Director of Finance
Action: For Decision

1. INTRODUCTION

- 1.1 The purpose of this report is to provide the Board with an update on progress on establishing a framework of Financial Governance for the Integrated Joint Board.
- 1.2 This report also details the various strands of work which will be coming to the Board over the course of the next few months for information and approval.

2. RECOMMENDATIONS

- 2.1 The IJB are asked to note the progress on establishing a framework for Financial Governance.
- 2.2 The IJB are asked to approve the arrangements proposed for the provision of Internal Audit services.
- 2.3 The IJB are invited to approve the reserves policy and strategy (Appendix 1).

3. BACKGROUND

- 3.1 The development of a Financial Governance framework is being carried out by the Finance Workstream which includes representatives from all Forth Valley partners. This report draws on the following documents:

- Integrated Resources Advisory Group (IRAG) Finance Guidance
- Scottish Government document Integration Financial Assurance
- Integration Scheme as agreed by the partners.

4. FINANCIAL GOVERNANCE

4.1 Financial Governance covers a broad range of areas, most notably:

- Annual Financial Statement/Strategic Plan Element
- Financial & Management Reporting
- Financial Regulations
- Internal Audit
- Audit Committee
- Final Accounts
- Reserves Policy & Strategy
- Staff Resources

4.2 An update on each of these areas is provided below.

4.3 The Integration Scheme recognises that the appointment of a Chief Officer and Chief Finance Officer will impact on Financial Governance arrangements. However, at this time, an appointment to the Chief Finance Officer role for the Falkirk partnership has not been made. It is recognised that proposals developed to date may change once this appointment is made.

5. ANNUAL FINANCIAL STATEMENT/STRATEGIC PLAN ELEMENT

5.1 The IRAG guidance and the Scottish Governments' Strategic Planning Guidance stipulate that an annual financial statement must be prepared which sets out the total resources that the Integration Authority intend to allocate under the provisions of the strategic commissioning plan. Further guidance on the format and content of this statement is anticipated. In addition the IJB is expected to produce an annual performance plan which will link financial resources to performance against the National Health and Wellbeing Outcomes. It is acknowledged by Scottish Government that this approach will take time to develop.

5.2 The resources available for 2016/17 will flow from both partners budget deliberations and are discussed in a separate report to this meeting of the IJB. As highlighted in that report, the Scottish Government settlement covered 2016/17 only and therefore any estimates within the Strategic Plan for future year resources are very tentative.

5.3 The budget report on the agenda for this meeting also highlights the impact of the financial settlement on the partners and the increasingly constrained resources available to partners in 2016/17 and forecast for future years. This will undoubtedly impact on the resources available to the IJB. Ultimately it is for the partners to determine what they can afford to contribute.

- 5.4 For financial years following 2016/17, the Integration Scheme sets out a process where the IJB will request funding based on the Strategic Plan and associated business cases. This will then be considered as part of each partners budget setting process. In order to align this with partners budget setting processes, the business case would have to be made available to partners by October/November of each year at the latest.
- 5.5 In order to allow the IJB to prepare future business cases, partners should inform the IJB Chief Officer and Chief Finance Officer of likely changes in funding levels as early as possible.
- 5.6 The IJB may also submit capital business cases to respective partners for consideration as part of their capital programme development processes.

6. FINANCIAL & MANAGEMENT REPORTING

6.1 The IRAG guidance recommends that:

- A process of regular in-year reporting and forecasting is agreed between the partners and the IJB Chief Finance Officer;
- Partners agree a consistent basis for the preparation of management accounts.

The guidance notes that these are matters for local decision making.

- 6.2 The Integration Scheme includes arrangements for quarterly reports to both the IJB and the Chief Officer.
- 6.3 Work is underway to look at how the financial information from the Health Board and the Local Authority can be consolidated to prepare a single meaningful report. The Integration Scheme requires consolidation protocols to be developed which will covers issues such as:
- Reporting on a cash (used by Local Authority) or accruals (used by Health Board) basis;
 - Structure of the reports, i.e. presentation of the operational arm, the full IJB etc.
 - Structure of the financial ledger, including who is going to host the financial ledger for the IJB.
- 6.4 Proposals are currently being developed and the aim is to report these to IJB before the start of the new financial year.

7. FINANCIAL REGULATIONS & SCHEME OF DELEGATION

- 7.1 Financial Regulations and the Scheme of Delegation form a key part of any organisation's Corporate Governance arrangements. They represent a framework of control that allows an organisation to demonstrate that it is doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.
- 7.2 The IRAG guidance confirms that the IJB should have its own Financial Regulations, approved by the IJB. However, once funds are delegated to the partners, the Financial Regulations of the partners will become relevant. The Financial Regulations of the partners will need to be updated to reflect the interaction with the IJB.
- 7.3 The Financial Regulations and the Scheme of Delegation of the IJB will need to cover a minimum set of controls, including:
- Financial stewardship
 - Budgetary control
 - Budget transfers (virements)
 - Information management and security
 - Segregation of duties
 - Internal audit
 - Risk management
- 7.4 Financial Regulations are in the process of being drafted, in line with the financial framework set out in the Integration Scheme. A critical element of the Scheme of Delegation will include the arrangements for budget transfers and this will have to be approved by the IJB.
- 7.5 It is anticipated that the Financial Regulations and Scheme of Delegation will be presented to the IJB in April 2016 for approval.

8. INTERNAL AUDIT

- 8.1 The IRAG guidance is clear that it is the responsibility of the Integration Joint Board to establish adequate and proportionate internal audit arrangements. This will include determining who will provide the internal audit service for the IJB and nominating a Chief Internal Auditor.
- 8.2 There are two approaches to the provision of the internal audit service:
- A joint service whereby both partners' Chief Internal Auditor split the role of Chief Internal Auditor for the IJB; and
 - A rotation based system where one partner's Chief Internal Auditor carries out the role of Chief Internal Auditor for the IJB for a specified period of time, before handing over to the other partner.

Whilst the IRAG guidance suggests that one partner should provide the service, the Scottish Government have confirmed that the service can be delivered jointly.

- 8.3 The Chief Internal Auditors for all partners have been meeting to discuss the most appropriate way forward. All partners have agreed that a three year rotation based approach would be most appropriate. This will be organised to ensure that the Health Board do not have to undertake this service for both partnerships in the same three year period. At this point it is anticipated that Health will lead on the audit for the Falkirk IJB in the first rotation but will draw on resources from both partners.
- 8.4 Once a Chief Internal Auditor is nominated, they will have to submit a risk based internal audit plan to the IJB for approval. This should be presented to the next meeting of this IJB. The IRAG guidance notes that the operational delivery of services within the Health Board and Local Authority on behalf of the IJB will be covered by their respective internal audit arrangements.
- 8.5 Given the IJB will have responsibility for commissioning and performance management, the Internal Audit service of the IJB is likely to focus on those areas, along with arrangements for governance, including Financial Regulations etc.
- 8.6 The Chief Internal Auditor of the IJB will be required to submit an annual audit report on Internal Audit activity to the Chief Officer and the IJB which will include a statement on the overall level of assurance to be provided.

9. AUDIT COMMITTEE

- 9.1 The IRAG guidance states that the IJB must have appropriate and proportionate arrangements in place for consideration of the audit provision and annual financial statements. The guidance notes that this could be done through the establishment of an Audit Committee which meets before the main IJB two or three times a year.
- 9.2 Proposals on arrangements will be brought to the IJB in due course. It should be noted that arrangements will have to be in place for consideration of audit reports and the annual accounts.

10. FINAL ACCOUNTS

- 10.1 The IJB is subject to the audit and accounts provisions of a body under Section 106 of the Local Government (Scotland) Act 1973. One of the implications of this is that the accounts of the IJB must be prepared along the same lines as those of a Local Authority and are therefore subject to a similar approval and audit process.

10.2 The financial statements of the IJB should be prepared by the CFO of the IJB and will contain the following:

- Management commentary
- Statement of responsibilities
- Annual governance statement
- Remuneration report
- Balance sheet
- Statement of income and expenditure account
- Statement of accounting policies and notes to the accounts; and
- Audit report

10.3 It is still to be determined who will produce these statements for the Falkirk IJB for the period ended 31 March 2016, recognising no IJB Chief Finance Officer is in place. These statements must be submitted for approval to Audit by 30 June 2016.

10.4 The IRAG guidance makes suggestions on the approval and signature of the statements. Recommendations on the process will be made to the IJB in due course.

10.5 The IJB will be subject to external audit and for the Falkirk partnership, Audit Scotland have been appointed to provide this service. At this stage, Audit Scotland have indicated a fee of c£5,000 for the 2015/16 audit work. However, at a recent Finance Leads Network meeting some questions were asked around this area and the Scottish Government is going to discuss these with Audit Scotland.

11. RESERVES POLICY & STRATEGY

11.1 The IJB has the power to hold reserves and the IRAG guidance recommends that a reserves policy and reserves strategy are agreed as part of the annual budget setting process and reflected in the Strategic Plan.

11.2 There are three main types of reserves:

- Earmarked reserves to plan for major expenditure or one-off significant payments;
- General reserves for use as the IJB sees fit; and
- Capital reserves – unlikely to be applicable to the IJB at this point.

11.3 Given the financial constraints that the partners are facing, it is not anticipated that the IJB will have general reserves available to it for some time. Once the IJB is in a position to build its reserves, it is recommended that a maximum level of general reserves is established. A maximum level of £0.5m is proposed.

- 11.4 A reserves policy and strategy is appended to this report for approval (appendix 1).

12. STAFF RESOURCES

- 12.1 This report highlights a number of Financial Governance strands which will be influenced by the appointment of a Chief Finance Officer. Following this appointment, and agreement of reporting frameworks etc, an estimate of the accounting staff resource which the Chief Finance Officer would need access to will be determined. Work will then have to be carried out to identify how best to provide this resource, taking into account the capacity of the partners to provide resource.

13. CONCLUSIONS

- 13.1 This report provides an overview on the arrangements for the financial governance of the IJB. A significant amount of progress has been made towards the establishment of a framework for financial governance albeit there is evidently still work to be progressed. Work will continue over the next two months to ensure that the necessary controls are developed. A further report will be presented to the IJB in April 2016.

Approved for Submission by: Chief Finance Officer, Bryan Smail

Author – Bryan Smail, Chief Finance Officer

Date: 28 January 2016

List of Background Papers: None.

Falkirk Integration Joint Board **Reserves Policy and Strategy**

1 Introduction

- 1.1 This document outlines the Falkirk Integration Joint Board's strategy for developing and holding financial reserves.
- 1.2 The strategy is linked to the Integration Joint Board's Strategic Plan objectives and medium term financial strategy which highlights the financial risks and challenges facing the Integration Joint Board and its constituent partners beyond the current financial year.
- 1.3 The strategy will be reviewed annually to ensure all financial changes and challenges facing the Integration Joint Board and its constituent partners are taken into account in determining the appropriate level of reserves to hold for the future.

2 Legislative/Regulatory Framework

- 2.1 The Public Bodies (Joint Working) (Scotland) Act 2014 establishes the framework for the integration of health and social care in Scotland. The Act empowers an Integration Joint Board to hold reserves subject to an agreed reserves strategy.
- 2.2 As the Integrated Joint Board is considered a Local Authority body under section 106 of the Local Government (Scotland) Act 1973, all relevant legislative and regulatory principles as applied to local authorities have been deemed equally applicable to the Integration Joint Board.
- 2.3 In Scotland, explicit statutory powers under Schedule 3 of the Local Government (Scotland) Act 1975 permit local authorities to establish a Capital Fund, alongside a requirement to maintain a General Fund Reserve. Within the General Fund Reserve, local authorities are allowed to earmark elements for specific intended purposes.
- 2.4 Local Authority Accounting Practice Bulletin 99 published in July 2014 provides advice from the Chartered Institute of Public Finance and Accountancy in respect of local authority reserves and balances. The principles and good practice examples contained within the Local Authority Accounting Practice bulletin have been applied in developing the proposed reserves strategy for the Integrated Joint Board.
- 2.5 Legislation also places a range of safeguards that help to prevent local authorities over-committing themselves financially as follows:
 - The balanced budget requirement, for Scotland this is derived from Section 93 of the Local Government Finance Act 1992;
 - The Chief Finance Officer's duty to report on robustness of estimates and adequacy of reserves when considering the annual budget requirement;
 - The Chief Finance Officer's duty to make arrangements for, in addition to having responsibility for, the proper administration of the Integration Joint Board's financial affairs; and
 - In line with the "Prudential Code" published by the Chartered Institute of Public Finance and Accountancy, the Chief Finance Officer's duty to have full regard to affordability when making recommendations about future capital programs, including giving due consideration to the level of long term revenue commitments.

3 Reserve Policies

- 3.1 Pressures on public finances now and over the medium term are intense with the result that the constituent partners do not currently have the capacity to provide extra resources to provide reserves. Therefore, the ability to build up and retain reserves for unforeseen events and circumstances becomes not only difficult, but something that requires careful consideration.
- 3.2 Having the right level of reserves is important. If reserves are very low, there may be little resilience to financial shocks and sustained financial challenges.
- 3.3 Reserves should not be used to fund material levels of ongoing operational costs as they are not a permanent funding solution for this type of expenditure. They may, however, be used for small-scale initiatives which do not impact on the overall reserves strategy.
- 3.4 Reserves should act as a “buffer” to absorb one-off pressures or to enable a short-term bridge to fill a gap until a sustainable funding solution is identified.
- 3.5 Contributions from reserves should only be used to set a balanced budget where reserves have been specifically earmarked for future projects as agreed by the Integration Joint Board.
- 3.6 The level of reserves to be held should be based on an assessment of the likelihood and impact of financial and operational risks.
- 3.7 In addition to maintaining an adequate reserves balance to protect against risks, it may also be necessary to plan for an increase in reserves as a means of meeting Strategic Plan objectives.
- 3.8 Reserves in excess of prudent estimated levels should not be held. This will ensure unnecessary cash balances do not build up which may impact on resources available for operational activities.

4 Types of Reserve

Earmarked Reserves

- 4.1 The purpose of an Earmarked Reserve is to set aside amounts for initiatives that extend beyond one year or as a contingency against a specific situation occurring. Earmarked Reserves will increase through decisions of the Integration Joint Board and will decrease as they are spent on their specific intended purposes.
- 4.2 Once an Earmarked Reserve has been established by the Integration Joint Board, it is the responsibility of the Chief Finance Officer of the Integration Joint Board to ensure funds are spent in line with their purpose. The purpose of each Earmarked Reserve should be reviewed annually to ensure that it is still relevant.

General Reserves

- 4.3 General Reserves represent non-earmarked elements of Integration Joint Board funds. The main purposes of General Reserves are to operate as a working balance to help manage the impact of uneven cash flows, and to provide a contingency to cushion the impact of emerging or unforeseen events or genuine emergencies.

- 4.4 Given the pressures on public finances now and over the medium term, constituent partners do not currently have the capacity to provide extra resources to provide for General Reserves. As such, the expectation for the foreseeable future is that General Reserves will not be available to the Integration Joint Board. However, ideally, the build-up of a robust level of General Reserves should still be considered as a target within the Integrated Joint Board's medium term financial strategy.

Capital Reserves

- 4.5 Capital reserves represent monies set aside to meet expenditure of a capital nature, as opposed to day to day expenditure on operational activities.

5 Principles of a Risk Based Approach to Reserves

- 5.1 In order to assess the level of reserves, the Chief Finance Officer of the Integration Joint Board should take account of the financial and operational risks facing the Integration Joint Board over the life of the medium term financial strategy. The estimate of these risks should include (but are not limited to):
- The reasonableness of underlying budget assumptions.
 - Inflationary pressures.
 - Realisation of income targets.
 - Trends and current spending patterns.
 - Known future legislative or other regulatory changes.
 - Ability to achieve Strategic Plan objectives.
 - Estimates of likely demand for demand-led budgets.
 - A review of any major risks associated with future years' budgets.
 - The availability of any revenue contingency budget.
 - Discussions and contributions from constituent partners.
- 5.2 The Chief Finance Officer should develop and implement proper arrangements to manage these risks, including adequate and effective systems of internal control.
- 5.3 The Chief Finance Officer's advice on the level of reserves should be set in the context of the Integration Joint Board's risk register and medium term plans, and should not focus exclusively on short-term considerations. Advice should be given on the level of reserves over the lifetime of the medium term financial plan, and should also take account of the expected need for reserves in the longer term.
- 5.4 Part of the risk management process involves taking appropriate action to mitigate or remove risks where this is possible, which in turn may lead to a lower level of reserves being required. A balance will need to be found between maintaining adequate levels of reserves and investing in risk reduction measures.
- 5.5 Whilst it will primarily be the responsibility of the Integration Joint Board and its Chief Finance Officer to maintain a sound financial position, external auditors will regularly express their views on the adequacy of the reserves of the Integration Joint Board for which they carry out the audit function. However, it will not be the responsibility of external auditors to prescribe the optimum or minimum level of reserves to be held.

6 Management of Reserves

Overview

- 6.1 The required levels of Earmarked and General Reserves and their purpose will be agreed as part of the annual budget setting process and reflected in the Strategic Plan agreed by the Integration Joint Board. The constituent partners will be able to review the levels of reserves held by the Integration Joint Board as part of this process.
- 6.2 The level of Earmarked and General Reserves to be maintained may change from year to year depending on any changes to the financial risks facing the Integration Joint Board, and/or resources needed for investment to meet Strategic Plan objectives and budgetary control.
- 6.3 Any in-year call on General Reserves will generally only be approved to meet the cost of unexpected and unforeseen expenditure, or where an opportunity has arisen which is time limited and/or meets an objective within the Strategic Plan.
- 6.4 The Integration Joint Board will allocate resources it receives from the constituent partners in line with the Strategic Plan. In doing this it will be able to use its power to hold Earmarked and General Reserves, so that in some years it may plan for an underspend to build up reserves, and in others to breakeven, or to use a contribution from reserves in line with the Reserve Policy and Strategy.

Use of Reserves

- 6.5 Decisions on the use of General Reserves should take account of the financial and operational risks that could impact on the Integration Joint Board's position, and should be made in a coordinated and planned way to ensure that best use is made of these resources.
- 6.6 For this reason it is important that any approval to use General Reserves complies with the Integration Joint Board's Reserves Policy and Strategy and a formal procedure facilitates this process.
- 6.7 The application to use General Reserves should be submitted to the Integrated Joint Board for approval and should include as a minimum:
 - How the application meets the requirements of the Reserves Policy and Strategy.
 - Why the use of reserves is considered to be the most appropriate form of funding.
 - Whether the use of reserves is required to meet an objective of the Strategic Plan, or is outside of this.
 - Whether the constituent partners been consulted on the proposal to use reserves.
 - A statement from the Integration Joint Board's Chief Finance Officer detailing the current level of reserves and projected year end position.
- 6.8 With reference to section 8 of the Falkirk Integration Scheme, the following in-year scenarios could impact on any General Reserves held by the Integration Joint Board:
 - **In-Year Overspend on the Operational Integrated Budget** - Where there is a projected overspend against an element of the operational budget, the Integration Joint Board may decide to increase the payment to the affected body by utilising the balance of the General Reserve of the Integration Joint Board (if available) in line with the Reserves Policy and Strategy.

- **In-Year Underspend on the Operational Integrated Budget** - Underspends on either arm of the operational integrated budget should be returned from the relevant constituent partner to the Integration Joint Board and carried forward through General Reserves (with the exception of underspends that arise due to material differences between assumptions used in setting the payments to the Integration Joint Board and actual events).

Reporting Arrangements for Reserves

- 6.9 In terms of reporting on Earmarked and General Reserves, all budget reports to the Integration Joint Board should include from the Chief Finance Officer of the Integration Joint Board (where applicable):
- A statement reporting on the annual review of Earmarked Reserves. The statement should list the various Earmarked Reserves, the purposes for which they are held and provide advice on the appropriate levels. It should also show the estimated opening balances for the year, planned additions/withdrawals and the estimated closing balances.
 - A statement showing the estimated opening General Reserve balance for the year ahead, the addition to/withdrawal from the reserve, and the estimated end of year balance.
 - A statement on the adequacy of Earmarked and General Reserves in respect of the forthcoming financial year and the Integration Joint Board's medium term financial strategy.

7 Level of Reserves

Earmarked Reserves

- 7.1 As mentioned previously, Earmarked reserves provide a means of accumulating funds for use in a later financial year to meet known or planned initiatives. As such, the level of any required Earmarked Reserve is likely to be known with reasonable certainty. The purpose of each Earmarked Reserve should be reviewed annually to ensure that it is still relevant.

General Reserves

- 7.2 There is generally no prescriptive basis for the level of General Reserves that should be held. The level of General Reserves will depend on the financial risks and challenges facing the Integration Joint Board and its constituent partners, but ideally as a minimum, should be capable of covering all estimated financial risks including contingent liabilities.
- 7.3 However, as mentioned previously, the pressures on public finances now and over the medium term are intense with the result that the constituent partners do not currently have the capacity to provide extra resources to provide for General Reserves. Therefore, the ability to build up and retain General Reserves for unforeseen events and circumstances will be extremely difficult.
- 7.4 Although there is no requirement or expectation placed on the Integration Joint Board to build up General Reserves, it is still appropriate to at least consider a prudent "target" level of reserves that may be achievable in the future when financial capacity of the constituent partners allows.

- 7.5 Setting a suitable target level of General Reserves provides its own difficulties. Many of the financial risks impacting on the Integration Joint Board will be difficult to estimate, and the ability to benchmark other Integration Joint Board reserve policies and strategies is currently not yet available.
- 7.6 It is recommended that a maximum target level of General Reserves for the Integration Joint Board be initially set at a cash value of £0.5million. This target will be subject to review as part of future annual budget setting processes.

Capital Reserves

- 7.7 It is currently not anticipated that the Integration Joint Board will require to hold a Capital Reserve.
- 7.8 The Integration Joint Board will identify the specific asset requirements to support the Strategic Plan. Where the Chief Officer of the Integration Joint Board identifies as part of the Strategic Plan new capital investment requirements, a business case should be developed and submitted to all constituent partners to consider.
- 7.9 Options may include one or more of the constituent partners approving the project from its own capital budget or where appropriate, using the hub initiative. The existing procedures in the constituent partners should be used to consider capital bids and business cases.

8 Conclusion

- 8.1 Robust financial management and control requires the Integration Joint Board to give consideration to the holding of General Reserves to provide protection against unforeseen and/or unavoidable costs arising.
- 8.2 Given the pressures however on the finances of the constituent partners currently and over the medium term, the expectation is that General Reserves will not be available to the Integration Joint Board.
- 8.3 Although there is no requirement or expectation placed on the Integration Joint Board to build up General Reserves, it is still appropriate to at least consider a prudent “target” level of reserves that may be achievable in the future when financial capacity of the constituent partners allows.
- 8.4 It is recommended that a maximum target level of General Reserves for the Integration Joint Board be initially set at a cash value of £0.5million. This target will be subject to review as part of future annual budget setting processes.
- 8.5 Where appropriate, Earmarked Reserves should also be considered to plan for major expenditure or one-off significant payments.
- 8.6 It is currently not anticipated that the Integration Joint Board will require to hold a Capital Reserve.