CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

CIPFA Local Government Directors of Finance Section is the professional forum which comprises the Section 95 Officers under the Local Government (Scotland) Act 1973 of all 32 local authorities in Scotland. The Section provides opinions on matters concerning the management and operation of Scottish local government finance and also serves as a learning forum for the exchange of experience and information on these issues.

SLACIAG (Scottish Local Authorities Chief Internal Auditors Group) is the professional networking group for Local Authority Heads of Audit. The purpose of the group is to develop and improve the practice of Internal Audit in Scottish local authorities, police, fire and public transport bodies. It achieves this by meeting to discuss issues of common concern, commissioning work to develop ideas, sharing good practice, working in partnership with other professions/governing bodies and promoting SLACIAG as the representative body for internal audit in public authorities.

1. Introduction

1.1 This submission specifically addresses some of the key financial management foundations which are essential if good corporate governance is to be in place for both the police and fire national boards.

1.2 The Scottish Government expect that savings of £130M each year will be achieved by the proposed reform of both police and fire. The relatively short period of consultation has not allowed us to conduct a detailed examination of the financial benefits claimed within the business cases for reform. Our approach has been to focus upon the risks associated with reform of this scale and we have recommended appropriate measures.

1.3 However, we recognise that the achievement of that level of savings of that magnitude, along with achievement of the wider operational benefits from reform will be of significant public interest. There is a clear role for both the Scottish Parliament

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1 Statement by K. MacAskill MSP, Minister for Justice 8th September 2011
and the Auditor General to both validate and to track the realisation of both financial and non-financial benefits claimed by the proposed reform.

1.4 "Financial management is an essential element of good corporate governance and forms part of the firm foundations of an organisation, underpinning service quality and improvement and is the basis of accountability to stakeholders for the stewardship and use of resources"2

1.5 We share that view and reform in itself will present a series of risks to the financial management of the outgoing boards as well as to the incoming new bodies. Central to risk mitigation will be the maintenance of a sound control environment. Although, there is no prescribed timetable the 3 distinct risk periods in a hypothetical timescale could be:

- the period prior to reform – 2011/12,
- the ‘shadow’ period – 2012/13; and
- the post-reform/‘go-live’ period – 2013/14.

1.6 We have identified actions which should be taken to mitigate the risks. A shadow board can begin to take responsibility for determining the nature and extent of the significant risks that it is willing to take to achieve its strategic objectives. The boards can develop sound risk management and internal controls systems. And clearly, the newly formed boards will take responsibility for the “go-live” risks.

1.7 In the absence however of any shadow period and shadow board, consideration needs to be given to how these risks are managed. Central to the mitigation of risk is the assurance work undertaken by the internal audit function and the need for independent assurance on risk mitigation to those charged with governance.

1.8 The Chief Financial Officer and the work undertaken by the finance function is at the heart of the achievement of world class financial management and we also comment on the role of the Chief financial Officer. We have used some of the recognised themes of world class financial management to structure our categorisation of risks3:

- Financial planning;
- Financial monitoring and forecasting; and
- Financial Reporting.
- Financial governance and leadership

1.9 The consultation paper does not provide detail on a transition timetable or on ‘shadow’ period arrangements. A shadow period of operation would allow the new authorities to operate in parallel with the existing bodies while new governance arrangements are embedded and while resources are transferred and acquired.

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1.10 Prior to local government reorganisation in 1996, there was a shadow period of one year. There is however evidence that even with a one year shadow period, smooth transition proved to be challenging for local authorities.

1.11 We recommend that a shadow period commensurate with the scale of the change should be introduced. The shadow period will be a critical period for the incoming boards with opportunity to design and develop:

- A detailed plan of implementation with clear deadlines and milestones;
- The control environment both nationally and locally;
- Clarity on the extent to which financial management will be devolved;
- Development of internal financial rules both nationally and locally; and
- Appointment of a head of internal audit.

1.12 Finally, we observe that the funding and financial management of police and fire bodies have been inextricably linked to local government finance. It is essential that the scale of the task that will be required to extract police and fire from the current arrangements is not underestimated.

1.13 Throughout the remainder of this submission it will be assumed that there will in fact be an appropriate shadow period and that a detailed plan of implementation will be developed. We further recommend that a clear and prescribed timetable is set to enable the appropriate governance and financial management arrangements to be set out.

1.14 We begin our response with some commentary on the broader dimensions of corporate governance.

2 CORPORATE GOVERNANCE

Impact Upon Accountability

2.1 We have tested the proposed governance arrangements and have recognised that there are characteristics from two recognised models of governance:

- the policy governance model\(^5\); and
- the constituency/representative model.

2.2 The creation of national boards is consistent with the Carver/Policy Model. The clarity in terms of roles and responsibilities and accountability offered by this model is confused by the proposal within the consultation to create structures within local government for police and fire. The consultation paper indicates a level of discretion on the role of local authorities including whether a specific local authority committee should be formed or whether joint arrangements should be made with other local authorities.

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\(^4\) Overview Report on 1996/97 and 1997/98 Audits of Local Authorities

\(^5\) Dr John Carver, Policy Governance Model
2.3 Our concern with the proposal is that it will result in ‘abdicating’ behaviour rather than ‘accountable’ behaviour. For example, in the case of police, with a local commander, a local committee as well as the national police authority it could be difficult to recognise where accountability actually lies. The result could be that there is local tension with the national police board for adverse outcomes as a result of resourcing decisions taken by the national police board.

2.4 The proposal could also result in significant duplication. For example, the consultation paper anticipates that the national board and the local structures will be concerned with examining local performance.

**Board Membership**

2.5 The composition of a recently introduced public body resulted in adverse comment by Audit Scotland and provides useful lessons for the proposed reforms, in particular the proposed membership of each board.

2.6 Given the likely NDPB status of the two new boards we assume that the requirements for a designated accountable officer will be met by the Chief Constable and the Chief Fire Officer. The clear lesson learnt from this recent example is that the accountable officer should be a member of the board and we recommend that the proposed arrangements ensure board membership for the accountable officer.

2.7 We support the use of the Public appointments process to recruit non-executive members to the board but we acknowledge that this would be inappropriate for securing representative members.

2.8 Whilst diversity in board membership is important, this must be balanced against experience and expertise required at the early stages of both the police and fire boards. The capability and capacity of the board must be strong from the outset. The board will be required to make critical decisions which will determine its success. Critical experience and skills in this first round of board member appointment and nomination must be risk and change management. The audit committee will be vital in the early stages and therefore it will be essential to appoint board members with audit committee experience.

2.9 The role of the chair(s) of the boards and their relationships with accountable officers are both critical. We recommend the early appointment of the chair. Appointment of chairs with the required skills and experience of merger and reform will be essential. Membership of boards should include individuals who have been selected because they can display expert credentials and have experience of providing effective independent oversight and scrutiny of services.

**The Roles of Management and Governance**

2.10 A clear risk in any new governance arrangement is a blurring of the functions of management with the functions of governance. With specific regard to police

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6 The Scottish Police Services Authority, Audit Scotland (2010)
reform, we note that the forensic service will report to, and be directly accountable to, the police authority and not to the Chief Constable. In practice, this will require the police authority board to take on managerial oversight.

2.11 Audit Scotland also commented on the governance SPSA and its relationship with SCDEA which was effectively independent of the Chief Executive\(^7\). We recommend that the adverse governance comments made by Audit Scotland are addressed and that they are not replicated within the new arrangements.

3. **FINANCIAL PLANNING**

**Prior to Reform**

**Capital Financial Plans**

3.1 Risk: Prior to the start of the new bodies, the existing bodies are likely to be required to continue to operate through up to two financial years. Investment decisions will be taken by these bodies but, will in turn be different from the bodies which will ultimately be responsible for the long term revenue repayment of that investment. The risk is that capital investment is undertaken which results in assets which do not fit with the requirements of the successor board(s). In the current context, this is particularly important given that subsequent revenue consequences will fall to be met by the shadow and successor body.

3.2 Control: One means to alleviate this risk is to require critical review of immediate capital expenditure with any major forward capital investment (other than immediate business critical purchases) deferred until the successor board(s) can have an input into the transaction.

3.3 Risk: The failure to properly manage the transfer of assets is a risk. An essential part of ongoing asset management is the maintenance of comprehensive asset records, usually in the form of an asset register. The recent experience of a new public body\(^8\) evidences the weaknesses in information held on assets used to deliver services.

3.4 Control: Each body will have to ensure that its asset records are capable of transfer (to the shadow body) at a predetermined and coordinated date. We recommend that a clear timetable for finalisation of assets for transfer is agreed.

**Revenue Financial Plans**

3.5 Risk: The resource allocation for police and fire is currently embedded within the local government finance settlement. The risk is that extraction of police and fire from the local government finance settlement could be protracted. This could be particularly challenging for Fife and Dumfries and Galloway forces where the arrangements are effectively integrated within each local authority.

\(^7\) SPSA Audit Scotland Report (2010)
\(^8\) SPSA Report by Audit Scotland (2010)
3.6 Control: There is a need for an early and close working arrangement between the local government directors of finance, COSLA, ACPOS and CFOA to ensure an early focus on the implications.

3.7 Risk: The significant task that is faced in the practical dismantling of the current financial arrangements is brought further into focus when the likely budget timetable and the approach to budgeting are considered. There is a risk that, because of the potentially tight timescale, the first budget of the new boards could merely be an aggregation of historic budget approaches based on historic plans and are not keyed in to the objectives of the new board.

3.8 Control: We recommend that there is a realistic lead-in time and clear timetable for initial budget preparation by the new boards and that consideration is to adopting an outcome approach to budget development

**VAT**

3.9 Risk: The Scottish Police Services Authority (SPSA) was introduced in 2007, it was later established that the body was not in fact registered as a VAT exempt body. It is understood that this was an oversight of legislative drafting and that there was substantial financial and administrative consequences to the Scottish Government, the SPSA and to HMRC.

3.10 Examination of the outline business cases indicate that the impact of VAT is being considered and with an estimated annual transfer value of £26M this is a significant matter for early resolution.

3.11 Control: We recommend that, prior to commencement of the shadow period, the appropriate direction and confirmation from HMRC is finalised to enable the new police and fire authorities to properly account for VAT and that VAT status is properly reflected in legislation governing the reforms. We would further recommend that the specific asset transfer issue which recently faced a new public body are addressed in discussions with HMRC

**Balance Transfer**

3.12 The successor boards will need to have a clear view of all available resources. The balance sheets will ordinarily recognise the balances which, under normal circumstances, would be carried forward into the next financial year.

3.13 These balances will have been funded from local taxation. While the base premise of the consultation paper is that all assets (and liabilities) will transfer to the successor board(s) both local authorities and the Scottish government, will require to

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9 Value Added Tax Act 1994 Sections 33 and 96.
11 Scottish Police Services Authority, Report by Audit Scotland (2010)
establish the legal basis to enable balance transfer to new bodies or whether balances have legally to be returned to constituent authorities.

3.14 Risk: There is evidence from previous reorganisation that negotiations on closing balances continued after successor authorities had been formed\textsuperscript{12} with consequences for financial planning.

3.15 Control: We recommend that the necessary deliberations on balance transfer takes place at the earliest possible stage.

3.16 Risk: Outgoing bodies could seek to wind down balances in order to utilise funds with a risk that value for money is not obtained from short-term spending decisions which, in turn would have a direct impact upon the decision-making by the successor boards.

3.17 Control: In the meantime, existing Boards should have a clear strategy and policy position regarding the application of reserves as part of sound financial management and good corporate governance.

**Shared Resources**

3.18 It is likely that currently, between boards and local authorities there will be some evidence of shared staff resources. An early decision will be required for staff on whether their duties are to be transferred directly to the successor boards. Where contract termination is required an early decision will require to be made on whether any liability falls to be funded by the local authority (if it is the employer).

3.19 Risk: The police and fire forces which are financially administered within both Fife and Dumfries and Galloway Councils will present similar but separate issues for staffing and balance transfer. It is likely that these forces will have some element of shared services and/or shared resources. Practically, some local authorities will host historic loans fund debt.

3.20 Control: Early liaison will be required between the councils and the existing constabularies and fire services. Fundamental to this is ensuring that there is a consistency of approach in how all bodies are treated in the disaggregation process.

**The Shadow Period**

**Revenue and Capital Financial Plans**

3.21 Risk: The level of capital investment going forward can only become apparent when the new business objectives have been set out by the new board(s) to enable achievement of the policing plan. This will have to be supported by a comprehensive asset assessment as part of the new asset management strategy. This means that at an early stage the Board(s) will have to consider and approve the proposed level of investment. Similarly, for revenue expenditure plans, the boards will have to be in a

\textsuperscript{12} Overview Report on the 1996/97 Audits of Local Authorities para 7.1
position to approve the first year’s revenue budget prior to the commencement of 2013/14. To enable all of this, the forward financial plans, both capital and revenue will have to have been developed in order that the board can approve it formally prior to commencement of financial year 2013/14. The risk is that within a constrained shadow period, the budgets are merely an aggregation of the previous financial plans of the outgoing bodies and are not in a finalised position to allow board approval.

3.22 Control: This can be avoided by early appointment of an executive lead with responsibility for the development of revenue and capital financial plans accompanied by an asset management strategy.

The Post-Reform Period

The Continuing Cost of Police and Fire to Local Authorities

3.23 The requirement (or opportunity) for local authorities to consider whether there should be a police and/or fire committee (or to introduce other arrangements) means that some costs of uniformed services will continue to be borne by local authorities. Those costs will be in the form of staffing and other central costs required to govern committees. The present costs of administrative delivery will be met in part by the general revenue grant received from the Scottish Government. This is a funding source which will be ultimately withdrawn. This means that, after reform and in practice, costs will continue to be borne by local authorities without any associated funding. The risk is that, local authorities could elect not to maintain committees without an appropriate funding stream to meet the expectation within the consultation paper.

3.24 Control: Possible mitigating action could be the continued payment of an appropriate portion of general revenue grant to local authorities.

Capital Investment

3.25 Capital expenditure by the current boards and forces is undertaken under the Local Government (Scotland) Act 2003. That Act together with accompanying regulation, requires the application of the Prudential Code for Capital Finance in Local Authorities. Separate legislation provides the legal power to borrow. Although not specified, it is anticipated that the new Scottish Police Authority will no longer be a body defined by S.106 of the Local Government Scotland Act 1973 and will become either an agency or a non-departmental public body. Consequently, the Prudential Code will not apply and the police and fire services in Scotland will have lost access to borrowing to support capital investment.

3.26 Risk: The risk is that in the absence of the right to borrow to fund capital investment, there will be insufficient capital resources available to finance the new board’s capital plans.

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13 The Local Government (Scotland) Act 1975
3.27 Control: A robust asset management strategy should be developed which prioritises investment and sets out the forward costs of maintenance and includes a developed long term plan for disposal.

4. FINANCIAL MONITORING AND FORECASTING

The Shadow Period

4.1 Risk: Presently each board will have its own system of budgetary control in place which budget holders will be familiar with. For example, budget holders will receive budgetary control statements, will be required to review expenditure and will have access to business support personnel who help them to understand the control statements. The risk is that budgetary control fails during the transition period.

4.2 Control: the shadow period will be essential in finalising the design of the system of budgetary control (based on the desired level of devolved financial management) and it will be vital that the chief financial officer can communicate to all budget holders their responsibilities as well as what budget holders can expect from the finance function.

4.3 The system of budgetary control will therefore have to be embedded at an early stage to enable the successor boards to function effectively and to enable close monitoring of the use of resources. Any system will have to be carefully designed to support the board and any devolved system should adhere to the following core principles:

- the provision of high quality accurate information on a timely basis;
- coverage of appropriate financial and non-financial indicators: and
- use of integrated systems to both record and produce information.

The Post Reform Period/Go Live

4.4 Risk: We have already noted in this submission that the Scottish Government expect that savings of £130M each year will be achieved by reform of both police and fire. The successor boards are expected to deliver a high level of savings. Realisation of these savings will of course be a key success factor. A significant risk they face is not only the failure to achieve the savings anticipated within the outline business case but that without independent verification of the robustness of the business cases that unrealistic savings will be budgeted for.

4.5 Control: It is essential that the savings projections made in the outline business cases are robust and independent verification of the business cases along with Parliamentary committee challenge is recommended. It is also essential that a clear and transparent financial plan which itemises where savings are to be made is set out. This should be supported by management and governance attention which regularly focuses upon the realisation of savings.

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14 World Class Financial Management. Audit Commission, 2005, page 36
5. FINANCIAL REPORTING

Prior to Reform

Annual Financial Statements

5.1 At present, each police and fire force prepare and publish financial statements as required by the Local Government Scotland Act 1973 and as further directed by specific regulation. As a consequence of the statutory framework, each force adheres to the CIPFA/LASAAC Code of Practice on Local Authority Accounting. (the Code).

5.2 The financial statements are prepared against a timetable which requires that the statements are finalised and submitted to the Accounts Commission by 30\textsuperscript{th} June each year. This is followed by a period of statutory audit which is concluded by 30\textsuperscript{th} September each year (although this is not a statutorily driven date).

5.3 Risk: Depending upon the date of transition and the implementation timetable, the final financial statements will be undertaken and signed by the chief Financial Officer after each force has in fact been abolished and preparation will be undertaken by staff of the successor board(s). As evidenced during local government reorganisation in 1996, there could be significant delay with the production of the annual financial statements and an increased risk of qualification to the financial statements.\textsuperscript{15}

5.4 Control: Each body will have to plan appropriately to ensure that there is smooth transition and handover of final financial statements along with clear accounting policies and all supporting working papers are properly scheduled for transfer to the successor board(s). As part of the existing accounting standard setter organisation for these bodies, we would be prepared to assist with development of a detailed year-end schedule with clear trigger points to ensure that financial statements are completed on time.

Audit

5.5 Risk: The audit of the financial statements is largely undertaken in the period following 30\textsuperscript{th} June. Depending on the implementation timetable this will result in audit after each body has in fact been abolished. The practical risk is that staff will not be available to address issues that arise as a result of audit.

5.6 Control: Each body will have to plan to ensure that there is a continuity in responsibility and accountability with specific staff designated for this purpose.

5.7 Risk: The preparation and audit of the financial statements will be undertaken by officer and auditors with no clear governance framework of accountability.

\textsuperscript{15} Accounts Commission for Scotland, Overview Report on the 1996/97 Audits of Local Authorities, Section 5.
5.8 Control: There is a clear role for the outgoing audit committees to be retained to allow them to exercise governance responsibility for the financial statements of the outgoing bodies.

The Shadow Period

Annual Financial Statements

5.9 Although not specified within the consultation, the successor board(s) is likely to be a ‘sponsored body’ and therefore subsequently governed by the requirements of the Scottish Public Finance Manual rather than the requirements of the local authority accounting code.\(^{16}\) The timetable for preparation and laying of accounts and accountability arrangements will be different to that under the present local authority framework.

5.10 Risk: Inadequate consideration is given to the implications of migrating to the Scottish Public Finance Manual and the requirements of the FREM with possible risk of non-compliance and subsequent qualification to the initial financial statements (2013/14) of the new boards.

5.11 Control: During the shadow year, work needs to be undertaken which examines the differences between the financial reporting requirements of the SPFM and the local authority code in order that policies and in turn practices can be adapted to ensure compliance and that these are in place.

The Post Reform Period/Go Live

Timetable of Accountability

5.12 As indicated above, the present date for preparation of the annual financial statements is 30\(^{th}\) June. The SPFM requires sponsored bodies to prepare annual financial statements by 30\(^{th}\) September\(^{17}\). Clearly this means that an immediate effect of the proposed modernised governance and accountability arrangements will be to ‘design in’ delay to publication of the annual financial statements.

5.13 The spirit of the consultation paper is that of modernisation and simplification. It is an unfortunate by-product that annual financial statements will be produced three months later than under the present arrangements.

5.14 We recommend that consideration is given to maintaining the present timetable for production of the annual financial statements.

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\(^{16}\) Scottish Public Finance Manual, Scottish Government, para 23

\(^{17}\) Scottish Public Finance Manual, Scottish Government, para 29
6. **FINANCIAL GOVERNANCE**

The Period Prior to Reform

*Control Environment*

6.1 Risk: There is a risk that the existing bodies commit the new boards to levels of expenditure which would otherwise not have been committed or is unsustainable.

6.2 Control: A delegated authority structure is required supported by strategic procurement controls in order to that there is clarity on who has ‘authority’ to commit expenditure. It would also be advisable to have focused procurement delegation with clarity on procurement practices to be followed. There is a key role for internal audit to continue to provide independent assurance on the control environment.¹⁸

The Shadow Period

*Organisational Culture with a strong focus on Financial Accountability*

6.3 Risk: In the development of a new single organisation, the necessary focus on maintaining operational delivery could result in a low profile for financial accountability.

6.4 Control: A scheme of delegation which clearly sets out financial accountability from board level will be have to be developed. Central to this will be the extent financial accountability to be devolved to area commanders and to senior officers or to staff below that level. The arrangements must enable the creation of a culture where individual and collective responsibility for stewardship and use of resources are given a high priority.

*Financial Skills*

6.5 Risk: A high degree of financial literacy is required from board members, managers and all those through the organisation with a role in or an interest in finance. There is a risk that the basic financial literacy outwith the finance department is not part of the competencies for service delivery.

6.6 Control: A structured assessment is required of the competencies required for board members and management and which, somewhat crucially identifies where gaps need to be filled.¹⁹

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¹⁸ The Role of The Head of Internal Audit in Public Sector Organisations (CIPFA)
¹⁹ Improving Financial Literacy in Public Service Organisations, A Good Resource Pack, (CIPFA)
The Post Reform Period/Go Live

The System of Financial Management

6.7 Risk: The design and implementation of a strong system of financial management will be necessary. The system should foster a culture which enables continuing challenge on financial matters at board as well as at operational level. A failure to design that system appropriately could mean that the necessary financial foundations are not in place.

6.8 Control: Assessment of what requires to be considered for the design of the new system of financial management should be undertaken in a structured environment.

7. FINANCIAL MANAGEMENT GENERAL COMMENTS

Financial Timetable

7.1 The reform necessitates some significant alterations to the financial management cycle which existing bodies adhere to. Whilst a significant element of the cycle is routine, the scale of the task of implementation should not be underestimated. We would highlight the following observations:

- the system of financial planning is currently aligned to the local government budget setting timeline with funding announcements in November/December each year setting the basis for the forward year’s budget. The successor boards will now have to be aligned to the Scottish Government financial planning timescale;

- a range of financial returns are currently made by boards to the Scottish Government at prescribed periods throughout the financial year. Alignment to the financial returns that are required from agencies/NDPB’s will have to be made;

- the present date for preparation of the annual financial statements is 30\textsuperscript{th} June each year. The SPFM requires sponsored bodies to prepare annual financial statements by 30\textsuperscript{th} September each year. An immediate effect of the proposed modernised and governance and accountability arrangements will be to ‘design in’ delay to publication of the annual financial statements.

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\textsuperscript{20} CIPFA Financial Management Model
\textsuperscript{21} Scottish Public Finance Manual, Scottish Government, para 29
Marjory Stewart
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13 February 2012