The Chartered Institute of
Public Finance & Accountancy

balance sheet management

in the Public Services

A Framework for Good Practice
(2017 Edition)

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Published by:

CIPFA \ THE CHARTERED INSTITUTE OF PUBLIC FINANCE AND ACCOUNTANCY

77 Mansell Street, London E1 8AN

020 7543 5600 \ customerservices@cipfa.org \ www.cipfa.org

© May 2017 CIPFA

ISBN 978 1 84508 482 0

Designed and typeset by Ministry of Design, Bath
(www.ministryofdesign.co.uk)

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Foreword

Since 2006, when CIPFA last sought to promote a greater awareness of balance sheet management across the public sector, the fiscal environment has been transformed. In particular, given the pressures on revenue budgets, public service organisations have sought to realise the service potential represented by their balance sheets. Balance sheet management forms a fundamental part of overall financial management frameworks and, when performed effectively, can generate real savings and deliver assets where they are needed to enable effective front-line service delivery.

Since 2006, owing to the move to IFRS-based financial reporting, there have also been important improvements in the financial information available to inform decisions about public sector balance sheets. This shift to IFRS in the last decade or so has not been a narrow academic or technical exercise, but rather a development to promote better financial management. An important characteristic of effective balance sheet management is the interplay between sound balance sheet accounting and improvements in financial efficiency and operational and service delivery performance.

The framework used here was originally aimed mainly at public sector finance professionals, to support use of more dynamic and proactive balance sheet management techniques. But it has become increasingly important for its key messages to be understood and promoted by other senior managers and directors (executive and non-executive) who are keen to optimise the performance of their organisations.

The opening sections set the core self-diagnosis elements of this publication into context, especially to remind practitioners of the scale and diversity of issues that fall within the rubric of balance sheet management. Equally, it encourages practitioners to have in mind the common issues shared across the public sector as well as understand the different statutory and regulatory environments of their partners. With this mind-set, practitioners are invited to use the self-diagnostic tools and techniques for balance sheet management that form the bulk of this publication.

Acknowledgements

CIPFA would like to record that the starting point of this publication is an earlier version developed in conjunction with the government financial management team at PricewaterhouseCoopers (PwC), *Balance Sheet Management in the Public Services: A Framework for Good Practice* (PwC/CIPFA, 2006).

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CHAPTER 1
Executive summary

1.1 INTRODUCTION

Effective balance sheet management can generate real savings for organisations – savings which can be redeployed to help to achieve service priorities. Importantly, the assets contained in the balance sheet can also be mobilised directly in support of an organisation's objectives – for instance as a stake in a partnership with the private sector. Balance sheet considerations stretch across organisational hierarchies, meaning that effective balance sheet management practices can also assist in developing stronger communications between finance and operational teams. Furthermore, balance sheet management can extend beyond a single organisation to the pooling of assets in a region or urban area. These relationships based on shared information can enhance decision making by ensuring that the full financial implications of decisions are taken into account.

In the private sector businesses are interested in their balance sheets, and especially the value of the equity measured by the balance of assets and liabilities. For a profit maximising entity the balance sheet not only provides information about current performance, but also about the relative risks and future prospects. This information will be of interest to a wider range of stakeholders than simply the owners and customers of the business. Since the banking crisis, for instance, regulators have had a particular interest in the balance sheets of retail banks.

Public sector organisations differ from commercial enterprises in that their primary objective is to deliver services rather than to produce a return to shareholders. The taxpayer has an equity interest, measured by the balance sheets of taxpayer funded organisations aggregated in Whole of Government Accounts (WGAs), but this is not the prime motivator of public sector balance sheet management. The size of public balance sheets is determined largely by political decisions about the size of the state, and size is not itself a measure of performance. Balance sheet management in the public services is therefore about better management of assets and liabilities to support service delivery, rather than the maximising of the public equity reported within it. Nonetheless, it is clear therefore that public service organisations have real incentives to manage their balance sheets well.

There is an important distinction to be made between public sector and public service organisations. Universities, for instance, may be considered as public service organisations since public money is provided to them in order to create economic and educational benefits. Their financial memorandums place on them a general responsibility in terms of risk management, accounting for public funds and maintaining financial viability, which in turn is expressed by various policies and procedures within each university. It is the statutory, regulatory and financial reporting regimes that distinguish different types of public service organisations; but these differences should not be allowed to obscure the existence of shared

good practice. In all sectors, an organisation that manages its assets and liabilities well is better placed to deliver effective financial management and robust accounting and financial reporting.

This good practice framework concentrates on the financial management of the balance sheet, but there are strong linkages to operational service outcomes. For example, many public service organisations have made great progress in recent years in asset management planning, for which there is now extensive guidance aimed at improving services. These issues are considered in this self-assessment tool, but its distinctive feature is that it takes as its starting point the complete balance sheet of the organisation.

The availability of guidance and literature to support improved financial management practices has increased in recent years. The CIPFA FM Model, launched in 2004 and updated in 2016, creates a framework within which an organisation can develop a profile of the strengths and weaknesses of its financial management, and plan an improvement path for further development. The content of this assessment tool is consistent with the model and provides the user with some insights into its self-diagnostic based style of analysis.

Taken together, these demands for effective balance sheet management reflect its importance for any credible assessment of an organisation's future prospects. The balance sheet reports the assets and liabilities that the organisation has accumulated in its operations up to that time. Nonetheless, despite reporting the results of past activities, it is still the starting point for sound medium term financial planning. In order to develop an effective financial plan, an organisation must be aware of its overall financial position, including in particular the assets and liabilities on its balance sheet. It is only by accounting and budgeting on an accruals basis, matching expenditure and income to the time periods to which they relate, that such a credible assessment of the financial position can be made. This in turn ensures that the forward financial sustainability of an organisation is established from a rigorous starting point.

1.2 WHAT IS BALANCE SHEET MANAGEMENT?

There is no single, universally accepted definition of balance sheet management. On the one hand, it could be defined simply as the management of all the assets and liabilities found on the face of a balance sheet. Viewing balance sheet management from this perspective immediately generates a long list of areas requiring consideration, to ensure that balance sheet management is comprehensive.

On the other hand, however, balance sheet management may be defined from a broader perspective:

The active assessment and management of all the organisational, operational and financial activities and transactions that determine or influence balance sheet values to promote effective stewardship of public money and value for money in use of resources.

This definition seeks to go beyond balance sheet values in isolation, to reflect the operational and financial activities that ultimately lead to balance sheet transactions and amounts. It presents a framework for analysing the wide range of functions and activities that have balance sheet management implications, and for assessing the organisation's performance

against benchmarks of good practice. This assessment is conducted across four categories, which are introduced in Figure 1.1 and considered in more detail in the next section.

Figure 1.1: Categories for assessing balance sheet management

1.3 OVERVIEW OF THIS GUIDANCE

The purpose of this publication is to help organisations to understand their balance sheets better, and the issues and challenges associated with managing them effectively. It provides tools and techniques to help identify the areas where greater focus is required. The framework also offers ideas for improvement.

The application of this framework should not be seen as a ‘box-ticking’ exercise. As described below, the benefits of using this framework are derived from developing a good understanding of the operational context of the assets and liabilities of the organisation, and applying finance and broader business skills in assessing balance sheet management.

The framework is not intended to be overly rigid or prescriptive. Different organisations should focus on those elements most relevant to the characteristics, importance and scale of their balance sheet. Because some public service entities may not have discretion over all the issues considered in the self-assessment, some questions may not be applicable to all.

Chapter 2 reflects on the sheer financial scale of most public sector balance sheets, showing how net asset values often dwarf annual operating costs. It then introduces the types of issue that need to be considered in the context of public sector balance sheets. This is not intended to be exhaustive but to illustrate the range and complexity of the issues to be addressed.

Chapter 3 introduces an approach whereby public sector organisations can self-assess their current practices related to balance sheet management and identify and implement improvements.

Chapter 4 contains the tools and techniques to apply this framework. It includes an analysis tool to help understand more about the nature and characteristics of the organisation’s

balance sheet, highlighting areas of particular financial or operational significance. This section also includes a detailed self-assessment tool to compare current balance sheet practices against good practice. Chapter 4 concludes with suggestions for using this analysis to identify areas for improvement and to develop an action plan to address these areas.

Chapter 5 contains information on the CIPFA FM Model. This uses the same methodology based on self-diagnostic questions as used here. It will therefore be of interest to those who find this approach to be productive in revealing the scope for improvement with their own organisation and its partners.

CHAPTER 2

Understanding and managing your balance sheet

2.1 THE SCALE OF BALANCE SHEET VALUES

In many organisations, balance sheet values are far greater than annual operating costs. This is a common feature in both the public and the private sector. In 2015 the UK government was responsible for assets and liabilities of over £1,455bn and £3,558bn respectively. The sheer scale of resource which is often tied up in balance sheet values provides a strong case for greater consideration of the impact of an organisation's activities and decisions on its balance sheet.

Although many public sector organisations are 'asset rich', in contrast others have levels of net assets which only represent a relatively small percentage of operating costs. However, whatever the materiality of balance sheet values, it is important to undertake a periodic review of an organisation's balance sheet management capabilities.

Examples of the relationship between assets and operating costs in a diverse range of public sector organisations are detailed in Table 2.1.

Table 2.1: The diversity of balance sheet scale across public sector organisations

Public sector organisation	Net operating costs (£bn)	Gross assets (£bn)	Gross liabilities (£bn)
Ministry of Defence	41.2	136.7	29.3
Department for Work and Pensions	178.9	5.9	7.8
Birmingham City Council	0.9	5.7	6.5
Surrey County Council	0.9	2.1	1.3
South Tees Hospitals NHS Trust	0.4	0.3	Below £0.1bn

Source: Figures taken from 2015/16 accounts

Figure 2.1 identifies typical components within public sector balance sheets, along with examples of areas to be considered in managing the balance sheet. The sheer breadth of this list confirms both the importance of balance sheet management activities and the need for a structured approach for identifying the areas of most significance to an organisation's operations and resources. The areas highlighted in Figure 2.1 impact widely on an organisation's operations and the way it delivers its services.

Figure 2.1: Balance sheet components and considerations

Significantly, the balance sheets of private sector companies show a similarly diverse financial picture, although no UK company has an asset base approaching that of the MoD, for example. Private sector good practice is, when relevant, applicable to public sector organisations of all sizes. There is a lot of good practice that can be shared, as for public sector organisations many of the challenges are similar to those of the private sector, albeit with a different stakeholder group and other measures of financial and operational performance. It should be added that while the focus of this publication is on public sector organisations, the balance sheets of private sector partners will also be of interest to those responsible for public service. Those who have management responsibility for essential public services, or who have a democratic or fiduciary responsibility to service recipients and taxpayers, will need to be satisfied with the financial and operational sustainability of those private sector organisations responsible for the service provision.

In terms of external interest in the balance sheet, it is probably fair to say that private sector organisations are subject to greater scrutiny of their ability to manage balance sheets effectively than the public sector. In large PLCs, this scrutiny is mainly due to the interest of a wide range of stakeholders such as the financial markets, the specialist media and shareholders. As a consequence, many of these organisations have developed and implemented sophisticated, dynamic and proactive balance sheet management strategies. In developing the approach set out in this publication, good practice from both the private and the public sector (in the UK and internationally) has been drawn upon.

The informative analysis of public service organisations is critically dependent on an understanding of the different legislative and accountability frameworks of each of the public service organisations contributing to it. Taking an example of such a contrast, on the one hand in the NHS the impact of the financial year on the organisation's reserves is reported as a statement of changes in taxpayer equity. On the other hand, UK local authorities have to budget for a positive general fund balance but not a positive net worth when stated according to the requirements of the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code). When a local authority has a negative net worth, this indicates that future taxpayers (whether through council tax or indirectly through government grants) will be funding some of the cost of providing services in the past. A negative net worth does not result in any going concern issues for an authority if this is a consequence of statutory requirement. This may not be evident to a reader of the accounts who is unfamiliar with the statutory environments within which local authorities operate. When considering the balance sheet of any type of public service organisation these types of legislative and regulatory issues must be kept in mind.

2.2 THE SCOPE OF BALANCE SHEETS

While the starting point for balance sheet management is the organisation, to gain a perspective which provides the necessary insight it may be necessary to consolidate the balance sheet with other entities. A public sector organisation must give careful attention to the envelope of assets and liabilities that are relevant to an assessment of its balance sheet. Most local authorities have subsidiaries that must be consolidated into their annual accounts. In addition, they may be exposed to the risks of loan guarantees or other instruments used to develop and support innovative service delivery models. The consolidation therefore takes

place at local authority level. Local authorities' accounts are not consolidated together except at the highest level – in the WGAs.

A recent development is that of combined authorities, starting with one for the Greater Manchester conurbation. These authorities produce a single set of accounts and balance sheet, but within these there are some ringfenced funds – such as those for policing and transport. A more detailed analysis of these distinct funds will be necessary to gain an understanding of the strength of the balance sheet.

In the NHS the requirement is for individual NHS bodies' accounts to be included in a consolidated set of accounts with other bodies under common control. A common example in provider organisations is where a related healthcare charity has the same management structure and therefore needs to be consolidated into an overall group. All foundation trust and clinical commissioning group accounts are in turn consolidated before both categories of NHS bodies are consolidated in the Department of Health's accounts.

Moving on from these sector based differences, recent interest has been in place based consolidation that does not combine organisations in their entirety but only those elements relevant to a particular geographic area. The alignment of local public services to both achieve efficiency savings and improve services to the end user has stimulated an interest in regional balance sheets consolidating those for the multiplicity of public sector organisations based and operating in any geographical locality (*Aligning Local Public Services: Overview Report* (CIPFA, 2015)). The ambition is to promote the interests of the residents of a 'place' rather than the interests of the public service organisations operating within it.

For the same reason, CIPFA has constructed high level balance sheets for devolved administrations in the UK. To be useful for decision making, these need to capture those elements of the public sector balance sheet that can be controlled locally. There are, however, limitations to the scope of these local balance sheets. The liabilities for the pension entitlements of civil servants, NHS staff and teachers, which are managed by central government control, cannot be attributed to a specific geographic area. Equally the value of material assets of vital importance to a region, such as the rail network, cannot be attributed to a specific region or place.

This interest in local balance sheets for different geographical areas has emerged at the same time as public sector balance sheets are being aggregated at a national level in the WGAs. Sound decision making has been seen to require aggregated balance sheets for places and regions as well as for the public sector as a whole. WGAs were originally developed to provide better information for fiscal management purposes and the Office for Budget Responsibility (OBR) uses the WGAs balance sheet as the starting point for developing the long-term fiscal projections in its annual assessment.

At the same time the WGAs have delivered important headline messages on important liabilities. At the end of 2014/15 the government's pension liability for current and future public sector workers stood at £1.5trn and was the largest single liability in the WGA balance sheet. The other most significant provisions relate to nuclear decommissioning (£83bn in 2014/15) and clinical negligence claims against the NHS (£28bn in 2014/15).

HM Treasury has been challenged on whether it gives equal importance to managing changes in the balance sheet which are not cash and which would not therefore affect net debt (*Public*

Accounts Committee Oral Evidence: Government Balance Sheet, HC 485, 7 July 2016). In response it has acknowledged that more use could be made of WGAs across government. CIPFA believes that further work needs to be done to demonstrate that the accrual approach is well-embedded in the management of the UK public finances and so deliver the full potential of WGAs (see Whole of Government Accounts: Delivering their Full Potential (CIPFA, 2015)).

As with any balance sheet, the value of WGAs depends on clarity about the scope or envelope of the balance sheet under consideration. During the banking crisis the government acquired significant stakes in RBS and the Lloyds Banking Group. Even though these assets fall within the public sector according to the Office for National Statistics boundary used to define the scope of the WGAs, and would be consolidated under IFRS, they have not been included in the WGAs balance sheet.

2.3 ASSET MANAGEMENT

The infrastructure assets reported on in the balance sheet are fundamental to service delivery. Most of the non-financial assets held by public service organisations consist of buildings and civil engineering works – including the road network. In recent decades there has been a steady decline in the value of such assets as a result of privatisation, but the year on year changes continue to reflect trends in land and property prices. An understanding of an organisation's latest balance sheet provides up-to-date information on the relative values of the assets it holds and so provides a sound starting point for establishing an informed asset management strategy.

Regardless of the specific nature of the asset, the preparation of high quality financial information for presentation in the balance sheet is not therefore an end in itself. The availability of such information should inform decision making. This has been the case for the local highways network, which represents one of the biggest capital assets that the UK public sector holds. Many authorities do not have the detailed information they need to drive down costs and improve service delivery. As a consequence of these service delivery benefits, CIPFA supports an asset management-based approach to the provision of financial information about the local authority Highways Network Asset as set out in the Code of Practice on the Highways Network Asset (2016 Edition) (CIPFA, 2016). This supports good evidence based asset management, including the development of more cost effective maintenance and replacement programmes to deliver efficiency savings and service improvements.

Highways assets, like hospitals, student accommodation and research centres, are specific to particular parts of the public sector. But other asset categories are common to all. It is for this reason that place based asset management offers a solution by taking a collaborative approach to managing public land and buildings (see Place-based Asset Management: Managing Public Sector Property to Support Aligned Local Public Services (CIPFA, 2015)). This approach has the potential to deliver significant savings, support better aligned local public services and create new opportunities for joint working. The value of this information for cross-sector asset management is increased by it being reported on the common basis reflected in international accounting standards.

Nonetheless, the user of balance sheet information needs to take account of sectoral differences in specific valuation techniques used to produce it. To take one example, the valuation of property, plant and equipment in the balance sheets of social landlords, universities, colleges and academies is by depreciated historic cost while in local government (with exceptions) and health it is done on a fair value basis.

In working through the asset and balance sheet management implications of joint working, it is important to appreciate the different restraints on capital investment by the different sectors. In the NHS a capital resource limit (CRL) is determined annually by the Department of Health for each NHS trust and by NHS England for the clinical commissioning groups. It limits the amount that may be spent on capital purchases and takes account of monies owed by and to the organisation in relation to capital, as well as the sale or disposal of assets. In contrast, local authorities have local discretion on capital investment, subject to meeting CIPFA's Prudential Code. Education bodies can finance capital expenditure through their own cash, borrowing (where permitted) and grants allocated by the relevant funding body or local enterprise partnership (LEP) (for further education in England). In all cases, effective capital budgeting requires budgets to be prepared over the longer term.

Turning to current assets, in all public service organisations it is commonplace for debtors to attract considerable attention because a large debtors balance, especially if outstanding after the date by which the payment was due, may be an indicator of poor financial health. But for more sophisticated financial management, the modelling of future balance sheets will establish the anticipated level of cash available to finance future needs. Organisations may also consider balance sheet ratios as measures of balance sheet performance. A common one is the ratio of current assets (for example, stocks, debtors, cash and short-term investments) to current liabilities (creditors due to be paid in under a year). In the education sector some funding councils may prescribe this ratio and good practice would be to maintain it at around 1.5:1, but no lower than 1:1. See Guide for Finance Committee Members in Academies, Colleges and Universities (2015 Edition) (CIPFA, 2015).

As well as fixed assets, local authorities and universities, for example, hold reserves as a working balance as well as to finance anticipated expenditure. Universities also hold endowment funds. In contrast, health bodies do not hold reserves. Clinical commissioning groups and trusts cannot access cash in advance of when it is needed. But when considering any organisation, such as local authorities, that does hold reserves it is important to understand that some of them may be earmarked and therefore unavailable as a source of discretionary finance to reduce the net demand on the taxpayer. Prudence will have demanded that some balances be earmarked for specific purposes. The planned use of and contributions to or from reserves are determined as part of the annual budget setting process.

In academy trusts, the balance sheet will also make a distinction between restricted and unrestricted funds. The former will predominately be government funds received, but may include other funds from a sponsor or other donations. This fund can represent unexpended cash received for capital purposes or the carrying value of a funded fixed asset. The pension reserve will be another restricted fund. The unrestricted fund would include any amounts not included in the above funds and which are available for general use at the discretion of the trustees. Again, the lesson to be drawn from these details is that an informative analysis

of any organisation's balance sheet needs to be sensitive to its regulatory and financial reporting context.

2.4 MANAGING LIABILITIES

The amount of long-term liabilities (loans and lease repayments) could undermine the financial solvency of any public service organisation. Some classes of liability are common to many public service organisations, but often it will again be important to understand the features of the regulatory regime under which the organisation operates. Public service liabilities will include financial commitments such as leases but only some public service bodies, notably local authorities and social landlords, have the power to borrow from the market. Local authorities do not, however, borrow against the security offered by their assets, but rather against the security given to their future incomes by their tax raising powers.

Some material liabilities may need to be the subject of a separate analysis if the accounting treatment used in the preparation of the balance sheet does not provide a complete analysis of the risks faced by the organisation. For instance, local authorities need to understand the funding levels, deficit contributions and recovery periods that underpin the financing strategies of the Local Government Pension Fund to which they belong, if they are to fully grasp the implications of future scheme costs for their ability to provide statutory services.

Some liabilities, such as PFI contracts, similarly raise complex and often bespoke technical and legal issues. PFI contracts have been drawn up to ensure that the private sector bears most of the risk, typically ensuring that the unitary charge is related to factors such as service availability, performance and levels of usage. An important part of balance sheet management is therefore to ensure that these are thoroughly understood and that potential savings from re-financing are not being neglected. Toolkits exist to identify the cost savings in PFI projects.

Other liability risks are specific to particular types of public service organisations. Local authorities, for example, face increasing risks associated with backdated business rates appeals, a situation becoming more acute with the 2017 valuation and the forthcoming 100% business rate retention scheme. Generally, where an authority has used a less sophisticated estimating process then provisions have been relatively higher – presumably because, lacking confidence in the precision of its estimates, the authority has taken a prudent approach. This would suggest that a more careful calculation of the provision would ease budget pressures since excessive provision would no longer be required to compensate for poor estimating techniques. There is a general lesson to be drawn from this experience: a more refined analysis of the contents of the balance sheet allows the organisation to have a more agile financial strategy that more closely matches its circumstances.

2.5 FINANCIAL AND SERVICE DELIVERY PERFORMANCE

An organisation's financial performance will have important implications for its approach to balance sheet management. Since 2010/11, local authorities have faced less pressure on their resources to support capital expenditure relative to revenue. An NAO report, *Financial Sustainability of Local Authorities: Capital Expenditure and Resourcing* (National Audit Office, 2016), has observed that in the current context of falling revenue incomes, local authorities'

ability to borrow to support long term investments that do not deliver a direct revenue saving is restricted, even if it is needed to maintain key assets. The primary challenge facing authorities in managing their capital spending and resourcing has been to minimise the revenue cost of their capital programmes.

The fiscal environment does not only impact on investment in fixed assets, but also on shorter term assets and liabilities. The cash flow projection is the link between the revenue budget and the balance sheet, and the two should not be prepared in isolation from each other. Across all public service organisations there is in this way a close relationship between the balance sheet and the reporting of financial performance.

In April 2016 the Department of Health issued guidance on financial accounting, aiming to provide a reminder of and to highlight correct treatment, including IFRS compliant valuations, and to achieve consistency of treatment across the entities within the departmental reporting group. See 2015-16 Year End Supplementary Accounting Guidance (Department of Health, April 2016). This was done in the context of earlier joint guidance with Monitor on collective action to ensure that the aggregate deficit of NHS providers was contained within the £1.8bn control total in 2015/16 – see *Joint Letter on the 2015-16 Outturn and 2016-17 Plan* (Monitor and the NHS Trust Development Authority, 15 January 2016). It outlined areas that included both operational efficiencies and technical and one-off measures to improve the financial position, while ensuring that safe care continues to be delivered.

One general point of principle stressed in the Department of Health guidance was that entities should ensure that their approach to recognising income and expenditure, and related assets and liabilities, is consistent with IFRS principles, including those set out in the Conceptual Framework. Recognition should be based on the probability of future economic benefits flowing to or from the entity and the reliability with which cost or value can be measured. In addition, the guidance addressed a number of specific NHS related accounting treatments, such as for accruals for locum and agency staff at year end, and NHS Continuing Healthcare packages legal claims, where the outcome or amount of eventual settlement is uncertain.

In his subsequent report, the Comptroller and Auditor General noted that while “these adjustments are in line with accounting standards, the guidance was focused on finding adjustments with a positive impact, rather than a full review of all areas which could result in adjustments which have both a positive and negative impact on their final outturn position” – see Explanatory Report of the Comptroller and Auditor General to the House of Commons (Department of Health, 12 July 2016). In these circumstances it is important for accountants to recognise their professional responsibilities and ensure that they exercise their best professional judgement in determining the accounting treatment of a transaction. While service delivery performance is the final arbiter of public service organisation performance, this has to be sustained by sound balance sheet management.

Balance sheet management for sustaining public services is especially important for bodies such as social landlords, which operate on a self-financing model. Capital assets can be purchased with the security offered by future revenue income. Universities are also largely self-financing and must not only demonstrate continued financial solvency, but also that the annual budget and the capital programme remain affordable. Finance committee members are most likely to concentrate on current assets and current liabilities and be concerned if the ratio between these, the current ratio, varies significantly from that forecast in the

institution's financial plan. But equally, if an institution is failing to generate sufficient cash to finance its annual budget and/or capital expenditure, then the budget and/or capital programme will need to be scaled down.

More recently, this emphasis on self-financing has spread to organisations, such as local authorities, for which income is principally from local or national taxation. One response to the loss of government grants is to develop a portfolio of investments in properties. With this has to come an understanding that these strategies bring with them risks, particularly in relation to a fall in property values. Authorities have sought to protect themselves by designing schemes around rental incomes rather than sales.

For some authorities the potential benefit for these types of initiatives is perceived to be limited because of the nature of their local economy and property market. For these authorities, local growth and economic development may be an important driver of capital investment. The availability of land is a key factor for housing development in particular, so local authorities are increasingly releasing their own land for housing development. One way of doing this has been through committing land to a special purpose vehicle and having the homes built with private finance. In the longer term this will pay a dividend to the authority which can be used to support revenue service spending. All these wide-ranging and diverse developments can be characterised as having been motivated by a desire to leverage the balance sheet to deliver service benefits.

2.6 FINANCIAL REPORTING AND FASTER CLOSURE

In an age of time and resource constraints, public sector organisations need ways of broadening the conversation about the services they deliver and the value they create, not only to meet short term demands but for the longer term. From the perspective of integrated reporting conventional balance sheet management has too narrow a focus as it addresses only the organisation's financial capital. A process founded on integrated reporting would allow periodic reporting of the non-financial value that an organisation creates. Integrated reporting is being promoted by CIPFA as a means for organisations to also consider the manufactured, intellectual, human, social and relationship, and natural capital that they commit to the achievement of their objectives. See Integrated Thinking and Reporting; Focusing on Value Creation in the Public Sector: An Introduction for Leaders (CIPFA, 2016). Integrated reporting seeks to communicate how an organisation's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term.

While recognising the merits of integrated reporting, this publication considers the financial balance sheet as a well-informed starting point for developing a broader outlook on balance sheet management. From a financial accounting perspective, the driver of balance sheet management will be high quality financial reporting which, by complying with best practice, will enable stakeholders to assess whether the organisation has an effective stewardship of the assets that it holds for the performance of its statutory duties and its wider public service. The faster production of the balance sheet is essential if the information it contains is to inform decision-making. See Easing the Pressure: The Incentive for Early Accounts Closedown (CIPFA, 2015).

The FTSE 100 companies achieve impressive results in the completion of accounts and audit processes, with the average performance from accounts closedown to finalisation of audit opinion being 58 days. In some cases, this process was concluded within one month of the year end. There are also examples of good practice within the public sector. NHS bodies have historically worked to tighter closure deadlines than local authorities. The deadline for the submission of draft financial statements is in April for health bodies as the parliamentary reporting requirements place an urgency upon health bodies which results in summarised accounts for NHS health bodies in total. These are then laid before Parliament and published.

The existence of these deadlines is a key factor in ensuring that accounts are prepared at a comparatively early date. Agreement of inter-NHS balances, that is all inter-NHS debtors and creditors and inter-group revenue and expenditure, must be agreed between health bodies by the middle of March. This follows agreement exercises for inter-NHS debtors and creditors at month six and at month nine which are designed to identify areas of difference at an early stage and to allow good time for resolution. Deadlines for notifying other health bodies of amounts owing and certifying these returns are set out in the Department of Health NHS Finance Manual. These values are significant in terms of the overall balances.

As in the private sector, one common feature of this rapid closure in health bodies is closedown at period ends, raising journals for accruals, which are then reversed out in the following period. This preparation of comprehensive management accounts and year-end projections, based on accruals, rather than cash accounting, is not only an aid to early closure, but also a major element of effective financial governance. Few local authorities currently apply such practices, but the incentive to do so is increasing, and there is little doubt of the potential benefits.

It is recognised good practice in universities for the monthly management accounts to include at least an abridged version of the balance sheet covering the net current assets position shown in at least as much detail as that included in the financial statements. This would mean a breakdown of current assets (including bank balances as well as debtors and stock) and current liabilities (including bank overdraft and creditors). Universities may also update fixed assets, provisions and long-term liabilities on a monthly basis. Alternatively, it would be appropriate for institutions to report to governors significant changes in these balances during the year.

Regardless of the sector specific detail, the more rapid production of the balance sheet brings with it, among others, the following benefits:

- the relevance of reliable financial information for users is greater the earlier it is available
- good governance requires assurance that weaknesses, errors or omissions in financial systems have been identified and corrected at the earliest opportunity
- early and effective publication of the statement of accounts can be promoted as a key indicator of good financial management by authorities that wish to improve their accounts production performance.

The challenge to improving the speed and quality is cost. This cost of reporting and providing assurance on stewardship is one that has largely been hidden or has been absorbed within the wider corporate costs of organisations. Accounts closedown can cost as much as £500,000

in a local authority. At the same time, it is hard to obtain more resources unless the benefits of high quality and prompt financial reporting can be demonstrated. These costs also, however, reflect traditional methods of delivery. Each year, for typically three to six months, the whole finance team may be tied up consolidating the data required to produce the end of year accounts. In these circumstances, local authorities are seeking new more innovative and less expensive models of assurance and accountability. CIPFA offers software solutions as well as assistance to local authorities who have chosen to outsource the process.

2.7 A FRAMEWORK FOR DEFINING BALANCE SHEET MANAGEMENT

Figure 2.1 illustrated the large number of potential considerations if balance sheet management is viewed as a list of issues related to individual items found on the face of a balance sheet. An alternative to this perspective, however, is to consider the broader organisational, operational and financial activities and transactions that can determine and influence balance sheet values.

It is worth remembering that balance sheet amounts ultimately end up as either future costs in the income and expenditure account or cash payments and receipts. The timing of these conversions varies from the immediate to the very long term. A detailed understanding of balance sheet behaviour is therefore vital as part of short- and longer-term financial planning and financial management.

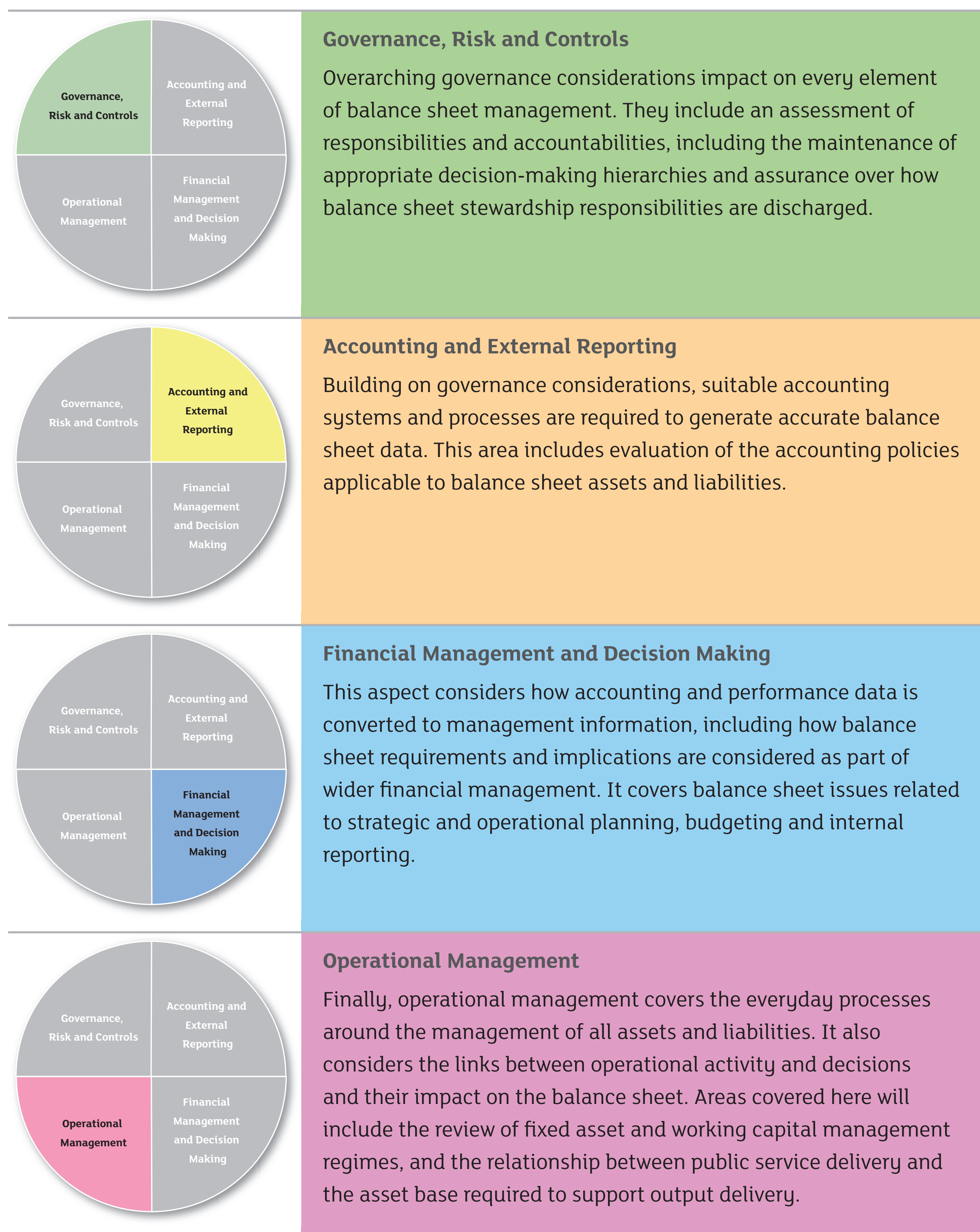
To address the broader view, this framework presents balance sheet management as the review of the functions and activities that have balance sheet implications across four categories, set out below.

Figure 2.2: Categories for assessing balance sheet management

Each of these categories contains important characteristics that impact on the effectiveness of an organisation's balance sheet management. These are explained in Figure 2.3 and

explored in more detail in Chapter 4, which provides a self-assessment tool to review capability and current practices under each of these categories.

Figure 2.3: Category characteristics



An organisation with effective balance sheet management will be able to demonstrate a good balance of activities that address objectives and considerations across all four of the categories identified above.

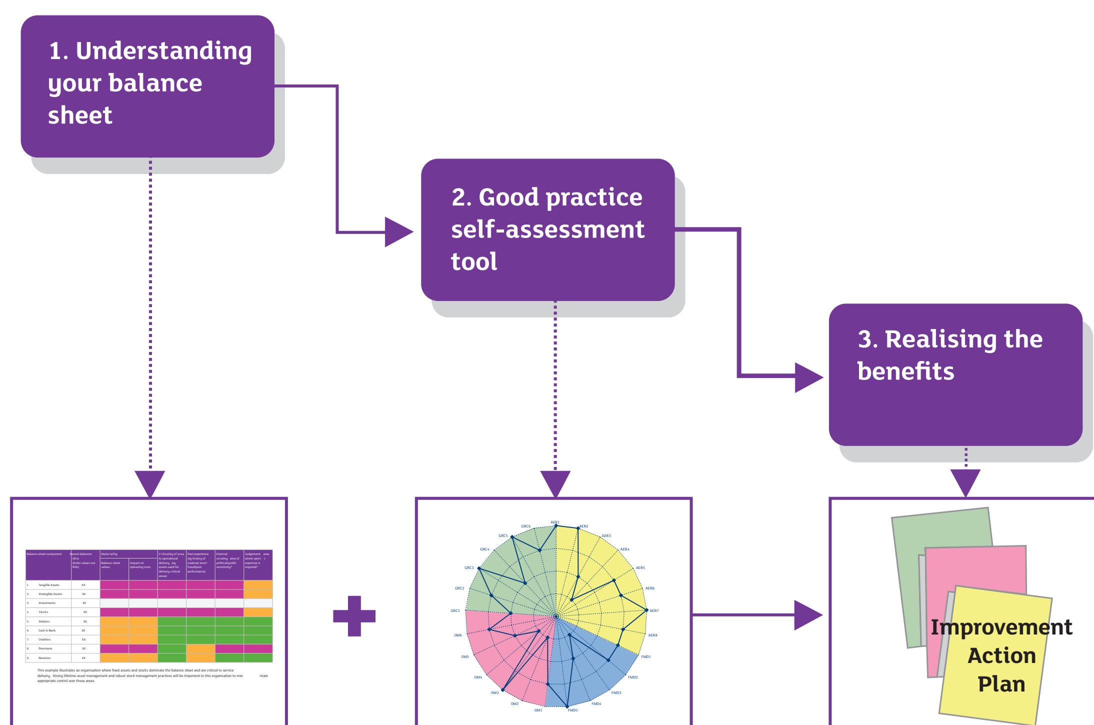
CHAPTER 3

A framework for improving balance sheet management

3.1 FRAMEWORK OVERVIEW

This publication proposes a framework, summarised in Figure 3.1 below, for public sector organisations to assess their current practices related to balance sheet management and to identify and implement improvements. The diagram sets out the three elements or stages of this framework, and the associated deliverables. This section explains these stages.

Figure 3.1: Framework for improving balance sheet management



The three elements of this framework are:

1. Understanding your balance sheet

This is a practical approach to identifying and reviewing the characteristics and material areas of your balance sheet. In Section 4.2, we set out an approach for assessing the nature and importance of each component of your balance sheet. Red, amber and green (RAG) traffic light indicators are allocated to each component, across a range of criteria, including

materiality (financial and operational), the extent of external scrutiny of each area, and your organisation's recent experience of managing issues related to this area.

Output: The results from this exercise create a highly visual one-page diagram, which uses traffic lights – red, amber and green shading – to highlight clearly the particular areas of significance for your organisation's balance sheet.

2. Good practice self-assessment tool

Once you have analysed the nature and key characteristics of your balance sheet, it is necessary to consider the effectiveness of the practices and processes used in your organisation for balance sheet management.

Section 4.3 includes a self-assessment tool, which asks you to rate your organisation's current practices against benchmarks of good practice. It assesses your current balance sheet activities and processes against good practice statements in each of the categories presented in Chapter 2.

Output: The ratings you allocate are plotted on a scoring chart. This highlights the areas where there is scope for improvement in balance sheet management practices.

3. Realising the benefits

The areas identified for improvement in the self-assessment tool should be considered in the context of the priority areas identified in the traffic light balance sheet analysis. This will show where improvement activity should be targeted to have the most impact on the organisation. Section 4.4 suggests a process for analysing the results of your balance sheet review to provide structure to the development of an improvement action plan to address areas of weakness.

Output: Following this approach will help you to create a prioritised improvement action plan, including specific actions that will improve your balance sheet management practices, leading to benefits including financial savings, operational efficiencies and reduced risks.

CHAPTER 4

Improving balance sheet management – tools and techniques

4.1 INTRODUCTION

This section introduces tools and techniques to underpin the framework for improvement summarised in Chapter 3.

4.2 UNDERSTANDING YOUR BALANCE SHEET

It is important to understand the nature and individual characteristics of your organisation's balance sheet before considering the practices and processes by which your organisation manages it. The following pages present a simple approach for reviewing the significance of each component of your balance sheet. This approach results in a visual summary of your balance sheet that instantly highlights the important or material areas that warrant further consideration and analysis.

This approach involves the creation and completion of a matrix (see Tables 4.1 and 4.2), where each component of your balance sheet is assessed against a number of dimensions, both financial and non-financial. Each cell in the matrix should be considered and awarded a status of red, amber or green, using the following scale:

- Red: highly material/significant area of focus
- Amber: medium level of materiality/significance
- Green: low materiality, no history of issues, no significant external scrutiny, etc.

Where more relevant to your organisation, additional or alternative definitions for the red/amber/green ratings could be used. Similarly, the criteria against which you assess your balance sheet can be amended or expanded, to be more relevant for your organisation. For example, you may already be analysing your balance sheet in a different, but equally appropriate way.

If required, the individual balance sheet components could be analysed further. An example here might be to split tangible assets into land and buildings, plant and machinery, IT equipment, etc if the amounts involved in each subcategory are material, or have different attributes in the context of this analysis. Where cells in the matrix are not relevant for your organisation, they should be left blank.

This format could be used to discuss the features and characteristics of an organisation's balance sheet with the executive management board or equivalent. It would also be valuable to compare the results of this assessment with related risk management activity. For example, this could include discussion of this analysis with the organisation's internal and external auditors, to compare with their independent views of the nature of the balance sheet.

In applying this standard template, it will be important to appreciate the differences between different types of public sector organisations.

Table 4.1 shows a sample template, which has been designed for a large central government department, as an illustrative example. This matrix should not necessarily be considered as a prescriptive template. Each axis of the matrix should be tailored to provide the level of balance sheet analysis, and balance sheet attributes, that are relevant for the specific organisation under review.

Table 4.2 shows this example matrix once it has been completed.

Table 4.1: Balance sheet analysis matrix – example template

Balance sheet component	Recent balances[1] (£m) (Enter values not RAG)	Materiality		Criticality of area to operational delivery (eg assets used for delivery-critical areas)	Past experience (eg history of material error/ fraud/poor performance)	External scrutiny: area of political/ public sensitivity?[2]	Judgement: area where specific expertise is required?[3]	Other
		Balance sheet values	Impact on operating costs					
1. Tangible Assets								
2. Intangible Assets								
3. Investments								
4. Stocks								
5. Debtors								
6. Cash and Bank								
7. Creditors								
8. Provisions								
9. Reserves								
10. Other								

1 Use appropriate balances – eg last annual report, or last management accounts that included a full balance sheet.

2 Eg pensions, nuclear decommissioning, debt collection, powerful lobbying groups involved, etc.

3 Eg valuations, useful lives, provisions for liabilities and charges, working capital provisions, etc.

Each cell in the table above should be assessed using the following scale:

- Red: highly material/significant area of focus
- Amber: medium level of materiality/significance
- Green: low materiality, no history of issues, no significant external scrutiny, etc.

Table 4.2: Example completed balance sheet analysis matrix – large central government department

Balance sheet component	Recent balances (£m) (Enter values not RAG)	Materiality		Criticality of area to operational delivery (eg assets used for delivery-critical areas)	Past experience (eg history of material error/ fraud/poor performance)	External scrutiny: area of political/public sensitivity?	Judgement: area where specific expertise is required?
		Balance sheet values	Impact on operating costs				
1. Tangible Assets	XX						
2. Intangible Assets	XX						
3. Investments	XX						
4. Stocks	XX						
5. Debtors	XX						
6. Cash and Bank	XX						
7. Creditors	XX						
8. Provisions	XX						
9. Reserves	XX						

This example illustrates an organisation where fixed assets and stocks dominate the balance sheet and are critical to service delivery. Strong lifetime asset management and robust stock management practices will be important to this organisation to maintain appropriate control over these areas.

4.3 GOOD PRACTICE SELF-ASSESSMENT TOOL

The good practice self-assessment tool is designed to help you to review and assess the balance sheet practices and activities operating in your organisation. The tool is not designed to measure or promote an unachievable or theoretical standard of best practice. Level 4, the highest 'score' in this tool, should be treated as attainable. Its exact nature will depend on the circumstances and needs of your organisation.

The four categories of balance sheet management introduced in Chapter 2 are:

1. **Governance, Risk and Controls (GRC)**
2. **Accounting and External Reporting (AER)**
3. **Financial Management and Decision Making (FMD)**
4. **Operational Management (OM)**

The self-assessment tool contains a series of statements of good practice under each of these categories. Each statement is supported by a series of bullet points, illustrating positive characteristics underpinning that statement. You should use these characteristics to help to assess your organisation's performance against each statement using the following scale:

Good practice being achieved?	Rating on scale	Definition of rating
Hardly	**1**	Significant area of concern: widespread poor practice leading to failure to address basic balance sheet management considerations.
Somewhat	**2**	Some good practice characteristics in place, but substantial scope for improvement.
Mostly	**3**	Practices are generally acceptable but improvement would enhance organisational performance.
Strongly	**4**	Practices are strong, fully effective and fit for purpose for the nature and operations of your organisation.

These ratings are consistent with the ratings scale used in the CIPFA FM Model.

How to use the tool

You should assess and rate each **good practice statement**. All the statements are listed below to provide an overview of the assessment tool. You **do not need to rate the individual characteristics** underneath each good practice statement. These characteristics are provided to help you consider which rating (1 to 4) to give your organisation for each statement.

Depending on the nature of your organisation, not all of the statements/characteristics may be relevant. Any such statements can be left blank.

Summary of good practice statements included in the self-assessment tool

Governance, Risk and Controls

Code	Statement
GRC1	**In organisational culture**, appropriate emphasis is placed on balance sheet management activities and considerations
GRC2	Balance sheet management requirements are addressed coherently and comprehensively across all relevant **strategies and plans**
GRC3	**Balance sheet management responsibilities** are identified and assigned to appropriate people
GRC4	The organisation's **decision-making framework** is effective and requires appropriate consideration of balance sheet implications
GRC5	Appropriate levels of **assurance** are provided over all aspects of balance sheet management
GRC6	Financial and operational **risk management** activity pays due regard to balance sheet drivers and impacts

Accounting and External Reporting

Code	Statement
AER1	The **relevant accounting framework** is understood and applied correctly
AER2	**Accounting systems** and processes, including related feeder systems, are fit for purpose
AER3	**Complex accounting areas** are considered and addressed
AER4	**Judgemental areas** are underpinned by appropriate analysis and management review
AER5	**Accruals and prepayments** are calculated on a timely and appropriate basis
AER6	**Provisions for liabilities** and charges, contingent liabilities and commitments are identified and treated correctly
AER7	All balance sheet **external reporting requirements** are identified and addressed
AER8	**Audit trails and evidence** are accurately recorded and maintained

Operational Management

Code	Statement
OM1	**Asset management** is effective in supporting the delivery of the organisation's outputs
OM2	**Stock management** is effective in supporting delivery of the organisation's outputs
OM3	**Debt management** processes are effective
OM4	**Creditor and liability management** processes are effective
OM5	**Provisions for liabilities and charges** are properly managed
OM6	**Treasury management** processes are effective

Financial Management and Decision Making

Code	Statement
FMD1	Balance sheet considerations are properly addressed in financial **planning and budgeting**
FMD2	**In-year management accounting** properly considers balance sheet impacts in determining current position and forecast outturn
FMD3	**Internal reporting** properly reflects balance sheet impacts and issues
FMD4	**Activity analysis and costing** consider balance sheet impacts
FMD5	**Financial support to decision making** includes appropriate consideration of balance sheet issues and impacts

As explained earlier, the assessment against the good practice statements should not be seen as a 'box-ticking' exercise. In each of the good practice statements that follow, the bullet points are typical areas to be considered in forming a view on balance sheet management performance. They should not, however, be seen as an exhaustive list; rather, they should serve as pointers to the areas that should be considered and act as a prompt for applying judgment in identifying those specific drivers of good balance sheet management that are relevant to each organisation.

Governance, Risk and Controls (GRC)

Governance, Risk and Controls considers the overarching governance considerations that impact on every element of balance sheet management. These include an assessment of responsibilities and accountabilities, including the maintenance of appropriate decision-making hierarchies, and assurance over how balance sheet stewardship responsibilities are discharged.

NB: Throughout this tool, the bullet points are the factors to consider in assessing what rating to allocate to the good practice statement above them.

Good practice statements and illustrative characteristics	Rating (1 to 4)
GRC1 Organisational culture: appropriate emphasis is placed on balance sheet management activities and considerations ■ The 'tone from the top' promotes the importance of robust balance sheet management ■ Learning and development activities provide skills and experience to support balance sheet management activity ■ Organisational and individual performance targets and metrics include appropriate balance sheet objectives ■ The organisation has processes for and a track record of sharing good practice and lessons learned from all aspects of balance sheet management	
GRC2 Balance sheet management requirements are addressed coherently and comprehensively across all relevant strategies and plans ■ All strategies and plans that should contain information on and considerations of balance sheet aspects are identified ■ Activities to develop these strategies and plans include work to identify and assess balance sheet impacts ■ The acquisition, use and replacement/disposal of assets required to deliver the organisation's outputs are properly considered and reflected in strategies and plans ■ There is coherence between the operational and financial balance sheet aspects of strategies and plans	

Good practice statements and illustrative characteristics	Rating (1 to 4)
GRC3 Balance sheet management responsibilities are identified and assigned to appropriate people ■ Responsibilities covering all aspects of balance sheet operational and financial management are identified and cascaded to the appropriate level in the organisation ■ Responsibilities are only assigned to those with appropriate skills, experience and capacity ■ Periodic review of responsibilities is performed to reallocate if necessary	
GRC4 The organisation's decision-making framework is effective and requires appropriate consideration of balance sheet implications ■ Appropriate review, scrutiny and approval are required for material decisions to ensure that balance sheet implications have been considered ■ Decisions primarily related to the creation, movement or removal of balance sheet assets and liabilities include input from all appropriate functions (eg operations, finance, legal, estates) ■ A reserves policy is in place, with appropriate decision-making processes covering the creation, level and application of reserves ■ Decisions not directly related to balance sheet assets and liabilities still include appropriate consideration of any balance sheet implications	
GRC5 Appropriate levels of assurance are provided over all aspects of balance sheet management ■ The board has identified its balance sheet assurance requirements, covering the nature and level of assurance over the management of all assets and liabilities ■ Options for sources of this assurance are assessed and selected (eg internal and external audit, relevant subject matter experts/professionals, stock-taking function) ■ Processes are in place to review and respond to findings from assurance providers	
GRC6 Financial and operational risk management activity pays due regard to balance sheet drivers and impacts ■ Risk management activity involves appropriate functional input to ensure balance sheet risks and impacts are identified and mitigated ■ Controls and other mitigating actions related to balance sheet risks are owned and actioned by appropriate people ■ Relevant internal and external lessons learned are considered in identifying balance sheet risks ■ Balance sheet related risks are monitored and updated on a regular basis	

Accounting and External Reporting (AER)

Building on governance considerations in the previous section, AER statements consider the suitability of the accounting systems and processes which underpin the generation of accurate balance sheet data. This category includes evaluation of accounting policies applicable to balance sheet assets and liabilities, and the adequacy of external reporting relating to balance sheet areas.

NB: Throughout this tool, the bullet points are the factors to consider in assessing what rating to allocate to the good practice statement above them.

Good practice statements and illustrative characteristics	Rating (1 to 4)
AER1 The relevant accounting framework is understood and applied correctly ■ Accounting policies related to balance sheet categories are properly described and applied correctly ■ The accounting policies applied are reasonable for the nature of the organisation ■ The organisation is fully compliant with the relevant accounting framework and related accounting rules (eg covering the basis of accounting for fixed assets, and financial instruments) ■ The interface between fixed asset and revaluation reserve accounting is understood and properly implemented ■ On disposal, appropriate elements of the revaluation reserve related to the disposed asset can be readily identified in order to effect the release from the revaluation reserve ■ Horizon scanning activity is adequate to provide early identification of potential changes to accounting rules or policies and to understand their potential impacts	
AER2 Accounting systems and processes, including related feeder systems, are fit for purpose ■ Links between finance and operational systems, either through integration or other data transfer methods, deliver robust financial information (eg interfaces between asset management systems, fixed asset registers and the related general ledger asset information) ■ Underlying chart of accounts structures are appropriate, for example suitable accounts coding is in place to meet fixed asset reporting requirements ■ The speed of processing is appropriate for the organisation's needs ■ System reliability meets the needs of the business ■ Balance sheet processes and procedures are sound ■ Weaknesses, errors or omissions in financial systems are identified and corrected at the earliest opportunity	

Good practice statements and illustrative characteristics	Rating (1 to 4)
AER3 Complex accounting areas are considered and addressed ■ All complex accounting policy and treatment areas have been identified (eg PFI issues around on/off balance sheet treatment and sophisticated barter calculations, foreign exchange, pensions, and valuation issues) ■ Where consolidated/group accounts are prepared, the associated eliminations and adjustments are understood and effected correctly ■ Those involved in complex accounting issues have suitable levels of skills, knowledge and experience ■ Appropriate levels of management review and sign-off are applied to all complex balance sheet accounting areas	
AER4 Judgemental areas are underpinned by appropriate analysis and management review ■ Areas of the balance sheet where judgemental assessments and calculations are required are identified and marked for appropriate scrutiny (common judgemental balance sheet areas include asset lives, valuations and residuals, stock and debtor provisions, and provisions for liabilities and charges) ■ Judgemental calculations and decisions are performed by people with appropriate skills, knowledge and experience ■ Where additional or external skills, knowledge or experience are required, they are identified and appropriately sourced ■ Appropriate levels of management review and sign-off are applied to all judgemental balance sheet areas	
AER5 Accruals and prepayments are calculated on a timely and appropriate basis ■ Significant accruals and prepayments are calculated at appropriate points throughout the year, either monthly or, where conducted less frequently, on a basis that supports in-year financial management processes ■ Policies and guidance inform which categories should be accrued. Coverage is appropriate to the nature of the organisation's financial management and reporting requirements ■ In areas where accruals or prepayments are required, appropriate rigour and underlying analysis are applied to supporting calculations and other evidence ■ Appropriate management review processes are in place to assess the completeness and accuracy of accruals and prepayments	

Good practice statements and illustrative characteristics	Rating (1 to 4)
AER6 Provisions for liabilities and charges, contingent liabilities and commitments are identified and treated correctly ■ The difference between provisions for liabilities and charges, contingent liabilities and commitments is understood by those involved in their identification, management and accounting ■ Movements between these categories are identified on a timely basis and processed appropriately ■ Related classifications between provisions, creditors and accruals are appropriately applied	
AER7 All balance sheet external reporting requirements are identified and addressed ■ Balance sheet related elements in all external reports are identified and mapped to the processes and systems that will provide relevant information ■ Processes are in place to deliver necessary information to meet time and quality requirements ■ All balance sheet information in external reports is subject to appropriate scrutiny and sign-off prior to issue (including by non-executives and the audit committee for the annual accounts) ■ External reporting conveys clearly and presents fairly the balance sheet position of the organisation	
AER8 Audit trails and evidence are accurately recorded and maintained ■ Evidence to support all balance sheet transactions, classifications, calculations and judgemental assessments is documented and maintained ■ Evidence is sufficient to provide assurance to management, and to internal and external audit, on the accuracy and valid treatment of balance sheet items ■ Appropriate management review of audit evidence is performed to provide management assurance of the appropriateness of balance sheet treatments	

Financial Management and Decision Making (FMD)

The third category of the self-assessment tool considers how accounting and other data is converted to management information, including how balance sheet requirements and implications are considered as part of wider financial management. It covers balance sheet issues related to strategic and operational planning, budgeting and internal financial reporting. It also assesses whether balance sheet considerations are embedded in decision making in areas which have balance sheet implications.

NB: Throughout this tool, the bullet points are the factors to consider in assessing what rating to allocate to the good practice statement above them.

Good practice statements and illustrative characteristics	Rating (1 to 4)
FMD1 Balance sheet considerations are properly addressed in financial planning and budgeting ■ Plans and budgets are prepared sufficiently in advance of the period to which they relate to enable effective balance sheet management from the start of the period ■ Balance sheet plans and budgets link to broader business plans and other relevant plans and strategies (eg capital investment, estates) ■ Balance sheet plans and budgets are prepared in the context of anticipated and available funding (eg capital expenditure, cash and operating cost control totals) ■ Reserves and balances are maintained (when the statutory operating framework permits) at a level appropriate for the profile of the organisation's cash flow and the prospect of having to meet unexpected events from within its own resources	
FMD2 In-year management accounting properly considers balance sheet impacts in determining current position and forecast outturn ■ Management accounts include either a full balance sheet or an appropriate level of balance sheet information to meet business needs ■ Balance sheet information is presented on a basis consistent with, and reconciles to, other management accounting information ■ Variance analysis of the overall balance sheet position, and relevant balance sheet accounts, is prepared and necessary corrective actions are identified ■ Specific cost statement elements driven by balance sheet items are properly identified, reported and considered (eg asset write-offs and impairments, capital charges, and changes to provisions) ■ Cost variances driven by balance sheet assets/liabilities are identified and necessary corrective actions are agreed	

Good practice statements and illustrative characteristics	Rating (1 to 4)
FMD3 Internal reporting properly reflects balance sheet impacts and issues ■ The interface between performance and financial reporting properly reflects balance sheet considerations ■ Relevant balance sheet performance indicators are in place, reported and monitored (eg debtor/creditor days) ■ Exceptional or unusual balance sheet impacts are reported and considered	
FMD4 Activity analysis and costing consider balance sheet impacts ■ Analysis of cost drivers and levers includes relevant balance sheet factors (eg depreciation, cost of capital) ■ Cost drivers and levers recognise the potential for unplanned balance sheet impacts such as impairments and write-offs	
FMD5 Financial support to decision making includes appropriate consideration of balance sheet issues and impacts ■ Teams involved in providing financial decision support have sufficient understanding of the balance sheet impacts of relevant operational decisions ■ Effective communication channels are in place between finance and operations to ensure that the impacts of balance sheet matters are properly considered ■ Appropriate tools and techniques (eg investment appraisal, balance sheet modelling, acquisition options analysis and cost/benefit analysis) are utilised in support of decision making ■ The organisation's medium term financial plan is informed by balance sheet issues	

Operational Management (OM)

This category of the good practice self-assessment tool considers the requirement for effective operational management across all areas of the balance sheet.

In this section of the assessment tool, and for the purposes of this publication, we have taken the operational management boundary as the management of assets and liabilities that are already on the balance sheet. Accordingly, the tool does not address areas such as asset acquisition strategies.

There are a number of good practice common themes that apply to operational management of each balance sheet area. Rather than repeat these common themes for each good practice statement, they are listed below and should be considered as:

- overarching principles for the assessment of operational management across the balance sheet as a whole ('Do we have the foundations to support effective operational management?')
- context for the assessment of each specific balance sheet area (OM1 to OM6 below).

These overarching, common themes should be considered when assessing performance in each area, OM1 to OM6.

NB: No separate rating is allocated for these common themes; instead, they set the context for each of the good practice statements that follow.

Good practice statements and illustrative characteristics
Common themes ■ Policies are in place for all aspects of balance sheet operational management ■ Responsibilities and accountabilities for all areas of balance sheet operational management are identified and allocated ■ Operational management data and information meet business needs ■ Operational systems, for example facilities management and logistics systems, are fit for purpose, and interface appropriately with financial systems ■ The organisation has the right skills and capacity to deliver effective operational management (including accessing external expertise where necessary) ■ Operational management activity supports value for money objectives and targets (economy, efficiency and effectiveness) ■ Operational management targets and key performance indicators are set, measured and monitored ■ Policies exist for write-offs, and processes are in place to review the nature and reasons, including the capture of lessons learned from such items ■ The organisation measures itself against relevant, external operational management benchmarks, and takes action accordingly ■ Good practice guidance is prepared, disseminated and complied with ■ The organisation is engaged with partners for the common aim of a place based asset management of the collective public estate

NB: Throughout this tool, the bullet points are the factors to consider in assessing what rating to allocate to the good practice statement above them.

<table>
<tr><th>Good practice statements and illustrative characteristics</th><th>Rating (1 to 4)</th></tr>
<tr><td>OM1 Asset management is effective in supporting the delivery of the organisation's outputs
■ The organisation's processes provide the information about key assets and liabilities necessary for proper decision making.
■ The operational need and planning horizon for each class of tangible asset are understood and factored into asset strategies and plans
■ An asset management plan, or equivalent document, is in place, and aligned with the business strategy
■ Property and other tangible assets support business delivery objectives
■ Programmes and plans for asset maintenance, repair and refurbishment meet business needs
■ Asset utilisation is measured and monitored, and action taken where required (covering, for example, accommodation occupancy and equipment use)
■ Assets held under lease/PFI arrangements are managed in accordance with the terms of the related contracts or agreements (covering both on- and off-balance sheet deals)
■ Information on surplus and underutilised assets is monitored, in order to inform disposal and asset-sharing strategies (eg making surplus office space available to other public sector bodies)
■ Disposal plans have regard to the total costs of disposal (selling/scrapping costs, asset impairment and crystallisation of any other cash or cost obligations, such as remediation provisions)
■ Asset stewardship and security are robust (eg asset tagging, tracking, fixed asset counts and a reliable asset register supporting balance sheet figures)
■ The specific features and complexities of intangibles (eg intellectual property rights, licences and development expenditure) are reflected in the operational management of these assets</td><td></td></tr>
<tr><td>OM2 Stock management is effective in supporting delivery of the organisation's outputs
■ The types and levels of stocks required to deliver outputs are identified and form the basis for stock management activity
■ Stockholding levels are based on appropriate stock optimisation tools and techniques
■ Stock locations are optimised, having regard to delivery time and stockholding cost considerations
■ Logistics, supply chain and stock management systems and processes meet business needs
■ Stock-taking processes meet the needs of the organisation regarding reliable quantity information
■ Levels and trends in stock provisions and write-offs are monitored and appropriate action taken</td><td></td></tr>
</table>

Good practice statements and illustrative characteristics	Rating (1 to 4)
OM3 Debt management processes are effective ■ Debt recovery processes and targets, across all categories of debt, meet the needs of the organisation ■ Credit period and payment terms are set and enforced ■ Levels and trends in bad and doubtful debts are monitored and appropriate action taken ■ 'Other' debtors, not recorded on core accounts receivable systems, are subject to appropriate scrutiny and management (eg staff loans and advances) ■ Lessons learnt from debt write-offs are captured, with appropriate responses ■ VAT recovery processes are managed by staff with appropriate skills and supported by reliable data-capture processes	
OM4 Creditor and liability management processes are effective ■ Accounts payable processes meet the needs of the organisation ■ Payment terms, covering due dates and payment methods, are monitored and adhered to ■ 'Other' liabilities, not recorded on core purchase to payment systems, are subject to appropriate scrutiny and management ■ Fraud risks associated with liability recognition and settlement are recognised and managed	
OM5 Provisions for liabilities and charges are properly managed ■ Operational activities that have, or may, give rise to associated provisions are identified ■ Events that may give rise to the recognition of a provision are understood by all staff involved in that area of operations ■ Key drivers of provisions (eg asset decommissioning decisions, legal claims, reorganisation activities) are monitored to identify whether an actual or constructive obligation has arisen ■ Contingencies and commitments are monitored to identify any items where a balance sheet provision may have crystallised ■ Operational decision making takes into account any implications on provisions	

Good practice statements and illustrative characteristics	Rating (1 to 4)
OM6 Treasury management processes are effective ■ The organisation's treasury management is risk based. It manages its investments and cash flows, its banking and capital market transactions, balancing risk and financial performance ■ The organisation's funding, borrowing, cash flow and foreign exchange requirements are understood and documented ■ The organisation has adopted treasury management practices approved in an annual treasury management strategy, produces monitoring reports at appropriate intervals (at least half-yearly), and prepares an annual report reviewing performance ■ All actual and potential funding and cash generation sources are identified and managed in a coherent way ■ The treasury/cash management function is suitably structured and resourced ■ Treasury management processes deliver reliable cash forecasting information, for an appropriate forward period ■ More complex aspects of treasury management, for example foreign exchange and financial instruments, are properly identified, documented, managed and controlled	

When assessing OM6 organisations should supplement the above common themes, good practice statements and illustrative characteristics with the key general principles of the CIPFA Treasury Management Code *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (CIPFA, 2011).

Key principles from *Treasury Management Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (CIPFA, 2011)

Key principle 1

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

Key principle 2

- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisation. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing those funds.

Key principle 3

- They should acknowledge that the pursuit of value in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Analysis of results

A scoring chart can be completed manually by using the format shown in the illustrative example below.

Illustrative example

Example ratings for the GRC statements:

Governance, risk and controls good practice statements	Your rating (1 to 4)
GRC1 Organisational culture: appropriate emphasis is placed on balance sheet management activities and considerations	2
GRC2 Balance sheet management requirements are addressed coherently and comprehensively across all relevant strategies and plans	3
GRC3 Balance sheet management responsibilities are identified and assigned to appropriate people	4
GRC4 The organisation's decision-making framework is effective and requires appropriate consideration of balance sheet implications	2
GRC5 Appropriate levels of assurance are provided over all aspects of balance sheet management	4
GRC6 Financial and operational risk management activity pays due regard to balance sheet drivers and impacts	3

This immediately highlights the relative weaknesses at GRC1 (organisational culture) and GRC4 (decision-making framework) compared to the other areas. By reviewing the

characteristics of good practice that supported statements GRC1 and GRC4, areas for potential remedial action can be identified.

The organisation represented in the example results above appears to lack a structured decision-making framework (GRC4). When combined with the poor internal financial reporting (FMD3), and weaknesses in areas requiring judgemental assessment (AER4), it is perhaps no surprise that this results in poor stock (OM2) and liability (OM4) management. This could be the result of poor communication between operational and financial managers.

Links to results from balance sheet analysis

Comparisons should also be made to the results of the balance sheet analysis in Section 4.2. If the areas of relatively poor practice identified by the self-assessment tool are also areas of high materiality or importance to the organisation, urgent remedial action is required to address probable risks related to balance sheet values or practices.

4.4 REALISING THE BENEFITS

Introduction

The third and final element of the framework for good practice consists of a structured approach to drafting an improvement action plan to improve your organisation's balance sheet management practices and outcomes. The results generated in the first two elements of this framework must be analysed to inform this plan.

The actions that will be appropriate for inclusion in your organisation's improvement action plan depend on the specific issues identified using the assessment tools. These are likely to be different in every organisation. Therefore, the following steps should be considered and tailored to your particular circumstances, to ensure your improvement action plan is appropriate to your organisation's needs.

Approach to improvement planning

1. **Confirm the material and significant balance sheet areas**

   Review the results from the balance sheet analysis matrix (the traffic light tool in Section 4.2) in order to highlight the most significant and material areas of your balance sheet. Discuss your conclusions with managers from different parts of your organisation, including both financial and operational areas, to ensure that different perspectives are considered.

2. **Consider the results of self-assessment**

   Review the results of the self-assessment in Section 4.3 to identify any areas where current performance is below the level required. Revisit the characteristics that support these good practice statements to highlight specific areas where performance is insufficient, and to understand fully why. You should review carefully any statements rated only 1 or 2, to consider if improvement in these areas could deliver significant improvements in efficiency, operational performance, or risk management.

3. Identify areas of focus for improvement

Taking into account the information in steps 1 and 2 above, identify those areas of balance sheet management that should be given priority attention.

Review the summary good practice statements at the start of the self-assessment tool (see Section 4.3) and identify which of the statements impact on the areas you have assessed as significant (eg red or amber) on your balance sheet analysis matrix. Then consider whether the ratings from the self-assessment indicate that improvement action is required.

Example: The illustrative analysis matrix shown previously (see Section 4.2) shows an organisation where fixed assets and stocks dominate the balance sheet, drive large operating costs and are crucial to operational delivery. In this scenario, the following good practice statements are particularly important:

GRC1–6	The balance sheet is clearly important to this organisation, therefore the governance around balance sheet issues must be strong and well defined.
AER1	As a central government department with significant assets, modified historical cost accounting considerations, particularly regarding revaluation and disposal accounting, are likely to be important.
FMD1–5	Planning, budgeting and in-year management practices will be important to maintain financial control and achieve efficiency objectives. Decision making must consider potential impacts on assets/stocks.
OM1 and 2	Strong asset and stock management disciplines are required due to the importance of these areas to operational delivery, and the size of their impact on operating costs.

The identification of ‘low’ ratings in any of these priority areas should warrant particular focus.

4. Develop the improvement action plan

The next step is to develop an improvement action plan. The first stage is to identify the actions which will need to be undertaken in order to transform each specific area where performance is relatively weak (per the good practice statements). The second stage is to prioritise these actions, and identify timescales and responsibilities within the organisation for carrying out each action. Resources should also be earmarked to ensure that each action can be implemented successfully. The improvement action plan should, of course, be revisited periodically to assess progress against the timetable for implementation.

Clearly there will be great diversity in public sector organisations, in terms of both scale of balance sheet values and issues, and the resources (including project management capabilities) available. Although the approach taken to developing an improvement action plan may be similar, the inputs to the plan and the characteristics of the completed plan may vary substantially between organisations. However, whatever the nature of the organisation it is imperative that there is ownership at board level (or equivalent) to ensure that the plan is implemented.

The development and successful implementation of a robust improvement action plan will help realise the benefits of good balance sheet management, ensuring that resources are used effectively and that appropriate governance arrangements are in place around the public sector assets and liabilities under your control.

5. Implementation of the improvement action plan

The improvement action plan should be aligned with other financial management improvement activities to ensure a consistent and coherent approach. When implementing the plan, priority should be given to those areas that will provide greatest benefit, financially and/or operationally.

The assessment framework should be revisited periodically during the implementation phase to ensure that benefits are being realised, and to identify and respond to any new requirements.

The implementation of the improvement action plan should provide opportunities to raise general awareness of the importance of balance sheet management. It should also support the development of routine consideration of balance sheet implications and the embedding of good practice within everyday activities.

CHAPTER 5

The CIPFA FM Model

5.1 THE CIPFA FM MODEL

Readers of this publication may also benefit from use of the CIPFA FM Model. This has been developed as a model for financial management that identifies the contribution financial management makes to a successful public service organisation. Balance sheet management should be an integral part of an overarching approach to strong financial management. As a consequence, the FM Model includes an explicit reference to the need for organisations to have processes to ensure that they have the information about key assets and liabilities necessary for effective balance sheet management.

The model offers a practical tool for improving organisational effectiveness. It presents the components of financial management in a structured framework based around three styles of financial management:

- **Enabling transformation**: the finance team have input into strategic and operational plans taking into account proactive risk management, clear strategic directions and focus-based outcomes.
- **Supporting performance**: finance teams are actively committed to continuous improvement focused on efficient and effective delivery and organisational performance.
- **Delivering accountability**: financial information is accurate, timely and focuses on controls, probity, compliance and accountability.

It looks for each style across four management dimensions:

- **Leadership** – which focuses on strategic direction and performance management, and the impact on financial management of the vision and involvement of the board and senior managers
- **People** – which includes both the competencies and the engagement of staff. This aspect generally faces inward to the organisation
- **Processes** – which examines the organisation's ability to design, manage, control and improve its financial processes to support its policy and strategy
- **Stakeholders** – which deals with the relationships between the organisation and those with an interest in its financial health, whether government, inspectors, taxpayers, suppliers, customers or partners. It also deals with customer relationships inside the organisation, between finance services and their internal users

The model is a matrix setting out statements of good practice, 30 in total.

Behind each statement lies a set of questions that invite users to explore the practical implications of the statements. By using the model, organisations can conduct a self-assessment of their financial management. They can score themselves and build up a profile of financial management effectiveness.

The methodology used in the model is also used in Aligning Local Public Services Framework: A Reference for Good Practice (CIPFA, 2015). This is a reference guide of good practice in working with local partners to deliver public services as economically, efficiently and effectively as possible, based on common strategies and high-quality financial and operational data.

Further Guidance

2015-16 Year End Supplementary Accounting Guidance (Department of Health, 2016)

Aligning Local Public Services: Overview Report (CIPFA, 2015)

Aligning Local Public Services Framework: A Reference for Good Practice (CIPFA, 2015)

Balancing Local Authority Budgets (CIPFA, 2016)

The CIPFA FM Model

Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 (CIPFA/LASAAC, 2017)

Code of Practice on the Highways Network Asset (2016 Edition) (CIPFA, 2016)

Easing the Pressure: The Incentive for Early Accounts Closedown (CIPFA, 2016)

Evaluating the Government Balance Sheet: Financial Assets and Investments (HM Treasury HC 463 Report by the Comptroller and Auditor General, National Audit Office, 2016)

Explanatory Report of the Comptroller and Auditor General to the House of Commons (Department of Health, 2016)

Financial Sustainability of Local Authorities: Capital Expenditure and Resourcing, Department for Communities and Local Government (HC 234, Report by the Comptroller and Auditor General, National Audit Office, 2016)

Fiscal Sustainability Analytical Paper: Public Sector Balance Sheet (Office for Budget Responsibility, 2016)

Glossary for NHS and Local Authority Finance and Governance (HFMA, 2015)

Guide for Finance Committee Members in Academies, Colleges and Universities (2015 Edition) (CIPFA, 2015)

The Guide to Local Government Finance (2016 Edition) (CIPFA, 2016)

Higher Education Finance (Fully Revised Third Edition) (CIPFA, 2011)

Integrated Thinking and Reporting; Focusing on Value Creation in the Public Sector: An Introduction for Leaders (CIPFA, 2016)

Introductory Guide to Corporate Governance in the NHS (HFMA, 2003)

Investing in Council Housing: The Impact on HRA Business Plans (CIPFA, 2016)

Joint Letter on the 2015-16 Outturn and 2016-17 Plan (Monitor and the NHS Trust Development Authority, 2016)

Local Authority Accounting Panel Bulletin 99 – Local Authority Reserves and Balances (CIPFA, 2014)

Local Government Asset Management: Better Practice Guide (Local Government, Victoria, Australia, 2015)

Looking Forward: Medium Term Financial Strategies in the UK Public Sector (CIPFA, 2016)

NHS Trust Accounts: A Guide for Non-executives (HFMA, 2007)

Place-based Asset Management: Managing Public Sector Property to Support Aligned Local Public Services (CIPFA, 2015)

The Prudential Code for Capital Finance in Local Authorities (CIPFA, 2011)

Public Accounts Committee Oral Evidence: Government Balance Sheet (HC 485, 2016)

Supporting Housing Investment: A Case Study Guide (Local Government Association, 2014)

Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA, 2011)

Whole of Government Accounts: Delivering their Full Potential (CIPFA, 2015)

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PUB FM042E