

# 2016 tipping point? Challenging the current

Summary findings from our third year of financial health checks of English local authorities  
December 2013



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# Introduction

Local authorities have so far met the challenges they face as pressures mount on their services and finances. But these challenges are set to increase and authorities will have to work harder to ensure they stay financially resilient.

Local authorities are managing the financial challenges they face and delivering against their financial plans. However, the funding reductions are some of the largest in the public sector and set to get deeper. Meanwhile, demographic and economic pressures on authorities' services are increasing.

This report summarises the issues and good practice that emerged from our third national financial health reviews; and looks at how local authorities are coping. It shows that improvements noted in our last survey have in some cases reversed this year. All authorities will need to work hard across a range of important areas to ensure that they avoid this position.

## Our third year of financial health checks

We published our report 'Towards a tipping point?' in December 2012. The report examined the resilience of local government to the financial, economic, demographic, policy and other challenges that the sector faces. It also looked at how effectively the sector delivered the first year of the front-loaded 2010 spending review, and how it was planning for the medium-term.

Our analysis was based on a national programme of financial health check reviews that we conducted during 2011 and 2012. We have repeated these reviews during 2013 and this report updates our findings and highlights the trends that are emerging in the sector.

## The wider picture

The Chancellor of the Exchequer announced the 2010 spending review (SR10) to parliament on 20 October 2010. This formed a central part of the coalition government's response to reducing the national deficit, with the intention to bring public finances into balance during 2014/15.

The savings introduced in the four-year SR10 period – from 2011/12 to 2014/15 – represent the largest reduction in public spending since the 1920s. Revenue funding to local government is to reduce in real terms by 28% by 2014/15, excluding schools, fire and police, with local government facing some of the largest cuts in the public sector. In addition, local government funding reductions were partially front-loaded, with 8% cash reductions in 2011/12. These reductions followed a period of sustained growth in local government spending, as it increased by 45% between 1997 and 2007.

The Chancellor has subsequently announced that public finances will not be brought back into balance during the lifetime of the current parliament. The next spending round period (2015/16) was announced on 26 June 2013 (SR13). Local government will face a further 10% funding reduction. **Financial austerity is expected to continue until at least 2017.**

The funding reductions come at a time when demographic changes and recession-based economic pressures are increasing demand for some services. For example, demand for social care, and debt, housing and benefits advice is rising. Meanwhile, demand for some paid-for services, such as planning and car parking, is reducing. At the same time, local authorities continue to manage the implications of the government's policy agendas – such as those relating to localism and open public services – that should see a significant shift in the way public services are provided. This includes partnership working with other public bodies, such as the NHS.

### Promoting good practice

To meet these significant challenges, local authorities must improve their efficiency and productivity, reduce their costs, and have sustainable medium-term financial plans (MTFPs) to ensure their financial health remains robust.

This report summarises the important issues, themes and good practice that have emerged from our third national programme of financial health reviews. It provides an up-to-date picture of how local authorities are coping with the service and financial challenges that they face.

This report draws on benchmarking data provided by the Audit Commission and other stakeholders. It uses the Audit Commission's broad thematic approach for assessing the value for money arrangements in place in local authorities.

### Our approach: analysing key areas

The focus of our financial health check reviews of individual authorities was on the 2013/14 financial planning period and the delivery of 2012/13 budgets. The research included a desktop review of key documents, interviews with key stakeholders to validate our findings and – new for 2013 – the findings from a survey completed for 120 of the reviewed authorities.

Analysis for our previous two reports was based on reviews of 24, or 7%, of all English local authorities. This year it is based on 138, or 40% of all, English local authorities. This larger sample size increases the validity of our findings and has allowed us to segment our results by local authority type and by region.

We analysed the following thematic areas:

- **Key indicators of financial performance**

Benchmarked analysis on key indicators of the financial health of authorities, such as reserve balances, long-term borrowing, liquidity, and staff sickness absence levels

- **Strategic financial planning**

Are local authorities setting their budget in the context of a longer-term financial strategy and an MTFP that includes the SR10 and SR13 periods?

Is the MTFP realistic? Are assumptions around inflation, income levels, demographics and future demand for services modeled and based on reasonable predictions?

- **Financial governance**

High quality financial governance and leadership is critical in meeting the financial management challenges that authorities face, and for securing a sustainable financial position. Good basic systems, processes and controls are important. But do local authorities have the right overall financial culture in place?

- **Financial controls**

Are local authorities managing within their budgets? Do they have a robust way of challenging budget monitoring and reporting arrangements to ensure they are fit for purpose? Can they respond to the ever greater need to demonstrate value for money and achieve efficiencies?

Within each of these themes, we considered a number of categories (outlined in Table 1) and gave each a risk rating using the criteria provided in Table 2.

Table 1 Themes and categories for analysis

Theme	Category
<b>Key indicators of financial performance</b>	Schools balances*
	Reserve balances
	Performance against budget
	Workforce
	Borrowing
	Liquidity
<b>Strategic financial planning</b>	Focus of MTFP
	Adequacy of planning assumptions
	Scope of MTFP and links to annual planning
	Review processes
	Responsiveness of the plan
<b>Financial governance</b>	Understanding the financial environment
	Executive and member engagement
	Overview of key cost categories
	Performance management of budgets
	Accuracy of reporting
<b>Financial controls</b>	Performance management of budgets
	Performance of savings plans
	Key financial systems
	Finance department resources
	Internal audit arrangements
	External audit arrangements
	Assurance framework/risk management approach

\*For single tier and county councils only

Table 2 Risk rating criteria

<b>Green</b>	<b>Arrangements meet or exceed adequate standards</b> Adequate arrangements identified and key characteristics of good practice appear to be in place
<b>Amber</b>	<b>Potential risks and/or weaknesses</b> Adequate arrangements and characteristics are in place in some respects, but not all. Evidence that the authority is taking forward areas where arrangements need to be strengthened
<b>Red</b>	<b>High risk</b> The authority's arrangements are generally inadequate or may have a high risk of not succeeding

\* These ratings do not imply excellent, good, weak or poor performance. They are based on whether arrangements appear to be adequate or inadequate.

We have also drawn on our analysis from 2011 and 2012 to identify trends in how the sector is responding to the financial challenges it faces.

# 2016 tipping point?

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The local government sector has continued to deliver and remains financially strong, but funding reductions will start to bite harder and deeper after 2015. County and district councils are faring well, but metropolitan authorities less well.

Our first report in 2011 identified a high level of confidence in the sector that savings targets would be achieved during 2011/12, the first year of SR10. Our 2012 report noted the sector had delivered during 2011/12, but local government's resilience over the medium-term remained far less certain.

Our 2012 report identified a number of important factors leading

to uncertainty in local government financial planning. It proposed that a 'tipping point' may be on the horizon for some authorities. We noted that authorities do not share the same level or types of risk, so not all may experience a tipping point.

Since the publication of this report, we have undertaken extensive dialogue across the sector on the concept of

tipping point scenarios and found a high degree of resonance and agreement. The scenarios in Table 3 were all seen as possible, some even probable, and include some new scenarios developed during this dialogue. These scenarios therefore represent a broad sector view and are not in all cases shared by individual local authorities, or by Grant Thornton.

Table 3 Tipping point scenarios

Tipping point scenario	Description
<b>Decision paralysis</b>	Local authorities fail to make the challenging but necessary decisions required to manage financial and other challenges. This has been identified as a potentially over-arching tipping point
<b>Statutory</b>	A local authority can no longer meet its statutory responsibilities to deliver a broad range of services with the funding available, leading to legal challenges and protests from impacted stakeholders
<b>Financial</b>	The Section 151 officer is unable to set a balanced budget, leading to an unbalanced budget report to members in line with Section 114 of the Local Government Finance Act 1988 (England and Wales); or where the increased uncertainty leads to budget overspends that reduce reserves to unacceptably low levels; or where an authority demonstrates characteristics of an insolvent organisation, such as a failure to pay creditors. Bankruptcy is a potential outcome of this scenario, as has happened for some US local authorities, most recently Detroit
<b>Industrial</b>	In response to pay restraints, changes to terms and conditions and job losses, employees and trade unions enact prolonged strike action, leading to major service disruption and long-term industrial relations disputes
<b>External</b>	A major supplier fails, due to general economic conditions, leading to significant service disruption and reputational damage to the authority. A further banking/financial crisis would increase the risk of this scenario
<b>Incremental</b>	Multiple, smaller failures in individual service areas lead to an eventual critical mass of tipping points
<b>Militancy</b>	A local authority ignores or defies one or more statutory obligations
<b>Civil disturbance</b>	Where service cuts run so deep that the dissatisfaction of users leads to widespread civil disturbance, as was experienced in relation to the Community Charge/Poll Tax. This could impact on business continuity and extreme and prolonged civil disturbance could impact significantly on the overall resilience of an authority
<b>Doomsday</b>	A further banking/financial crisis leads to even greater levels of austerity, over a significantly longer timeframe

### The summary position by local authority type

While the overall high proportion of green ratings indicates strong financial health during 2012/13, Figure 1 demonstrates that some local authority types are more financially resilient than others.

County councils are performing strongly, which perhaps is no surprise given these are typically the largest authorities. They have the resource, capacity and resilience to manage pressures the best. The variation in government funding reductions across different types of authority is also a key factor. The Audit Commission's

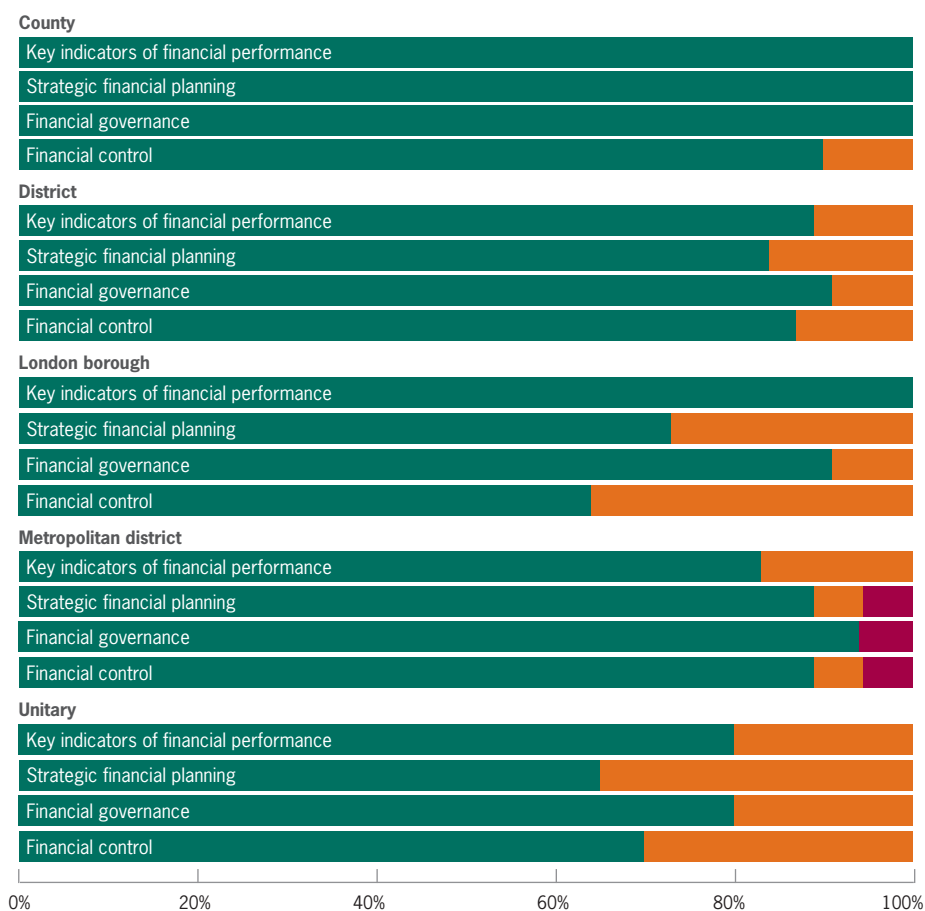
'Tough times 2013' report noted that real-term funding reductions since 2010/11 average 19.6% across all local authority types, but county council budgets show the smallest reduction at 16.4%.

District councils are also performing well, but unitary councils have the lowest green ratings for three of the four areas. This was validated by our survey with 40% of unitary councils fearing a tipping point in the short-term, compared to an average of 20% for other local authority types.

Perhaps the most striking feature of this segmented analysis is that metropolitan districts are the only authority type to receive red ratings for overall thematic areas. This supports the fact that the most high profile council leaders to publicise financial difficulties are typically from metropolitan districts. 'Tough times 2013' also notes that metropolitan districts have faced the highest funding reductions from 2010/11 to 2013/14, at 22.5%.

However, the issues at metropolitan districts are limited to a small number of authorities and overall they are performing well.

Figure 1 Summary ratings by local authority type 2012/13





### The summary position by region

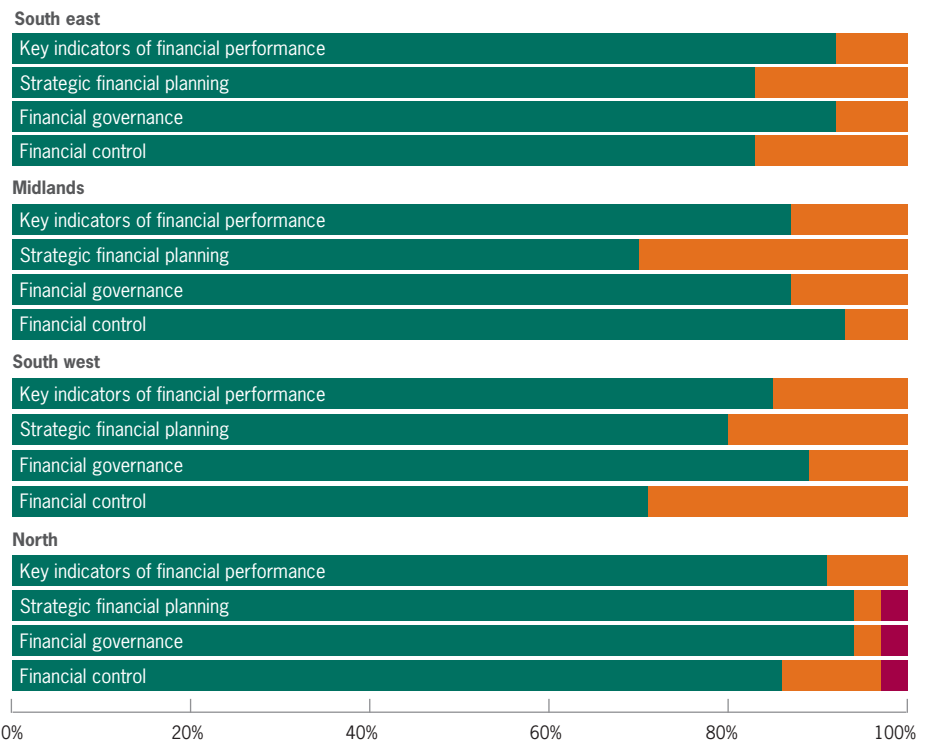
There are regional variations in the financial health of local government (Figure 2).

The north has the highest level of green ratings for strategic financial planning (94%) and financial governance (94%). It also has the second highest green ratings for key indicators of financial performance (91%) and financial control (86%). This makes it the best performing region overall. However, the north is the only region with red ratings. This reflects the ratings received by metropolitan districts, which are predominantly located in this region.

The south west has the lowest level of green ratings in two areas (85% for key indicators of financial performance and 71% for financial control) and has the second lowest level of green ratings for the other two areas (80% for strategic financial planning and 89% for financial governance). This makes it the worst performing region overall.

The picture for the Midlands is mixed. It has the lowest level of green ratings for two areas (70% in strategic financial planning and 87% in financial governance) but the highest level of green ratings (93%) for financial control. The south east has the highest level of green ratings (92%) for key indicators of financial performance and

Figure 2 Summary ratings by region 2012/13



the second highest level of green ratings for two other areas (83% for strategic financial planning and 92% for financial governance) making it the second strongest region overall.

The lowest green rating for regions was 70% (the Midlands, for strategic financial planning) and the lowest green rating for local authority types was 64% (London boroughs, for financial control).

### Overall summary position

While there are variations across regions and local authority types, the overall picture for 2012/13 is that the majority of councils were rated green.



### 2016 tipping point?

The sector has shown great resilience and focus and carried on with the delivery of local services. During his announcement of the 2015/16 spending round in June 2013, the Chancellor gave specific credit to local government for the scale of savings it has delivered to date. The Chancellor did not highlight other parts of the public sector in the same way, implying that local government leaders are more capable of meeting the national austerity challenge than other parts of the public sector. The level of additional funding reductions in SR13 also demonstrates that the government is continuing to rely on local government's ability to deliver savings to support the national budget position.

By the end of 2015/16, local government will have seen spending reduce by 35% compared with 8% in education and a 4% increase in health. We support the view that local government leaders have shown a continued capacity to adapt and innovate to deliver significant change and realise efficiencies and savings. Our findings also indicate that, while there will be significant future challenges in the medium-term, the sector is likely to ride out the storm until the end of 2014/15 – 80% of authorities in our survey do not anticipate a tipping point during this period.

But the position will vary and this national picture masks regional variations. The majority of councils

(97%) in the south east – with the exception of a single London borough – did not feel they were approaching a financial tipping point. The results for councils in the south west and Midlands were 69% for both regions, while for those in the north the figure was 83%. Instead, [the majority of councils felt a tipping point would be faced in 2015/16 or 2016/17](#) (46% and 33% respectively) with the remainder considering it would be in 2017/18 or later.

Most local government leaders are realistic enough to accept that a change of government following the 2015 election would not see a radical change to the funding levels forecast by the coalition government. In this context, [some commentators harbour serious doubts about the sustainability of the current model of local government beyond 2014/15](#).

To respond to this challenge, we consider that:

- authorities will need to have a relentless focus on generating additional sources of revenue income as government grant continues to fall. The sector believes it is unrealistic this focus should be on fees and charges to the public. Rather their focus, where market conditions allow, should be on areas such as: investments in the commercial property portfolio; increased commercialisation of services and local authority trading; regeneration and inward investment to boost local economic activity;

and generating higher income from business rates. Effective realisation and reinvestment of capital receipts is also a crucial part of the local authority agenda

- the trend towards increased use of alternative delivery models with public, private and third sector partners will also need to accelerate. This should include shared services and strategic partnering arrangements. A move towards full-blown strategic commissioning models will mean a fundamental change for councils. Our 2014 report 'Responding to the challenge: alternative delivery models in local government' examines this trend in more detail
- local authorities will need to keep a sustained focus on health integration and embedding best practice across the country
- some form of re-organisation, statutory or otherwise, will be a necessity for many authorities
- authorities need to continue and, in some cases, sharpen their focus on housing development. They must work closely with local enterprise partnerships (LEPs) to support effective and sustained projects funded by monies earmarked for the New Homes Bonus. This should go hand in hand with the broader framework for supporting wider economic development across districts, sub regions and wider economic areas.

Our survey identifies an increasing trend towards councils seeking to commercialise their services to provide additional revenue streams. But this varies by council type and by region. While it is still a minority of all councils (19%) that are considering this approach, it is more common in county and unitary councils (25% and 33% respectively). The south west has the lowest level (13%) of councils considering this approach, and the south east has the highest level at 23%.

We will continue our dialogue with the sector to monitor the outcomes of key questions, such as:

- will adult social care demands overwhelm those councils responsible for delivering these services?
- can the most socially deprived parts of the country cope with increasing welfare costs?
- will the economy revive outside London and the south east?
- how will councils manage the risks associated with business rates?
- will London and the south east be able to overcome the housing crisis and a rise in homelessness?
- can districts survive with fewer and fewer staff?

Our summary findings from our 2013 reviews, and the trends between our 2011, 2012 and 2013 reviews, are set out in the following chapters. The appendix provides a checklist of good practice evidenced at local authorities. We will be undertaking a fourth year of financial health reviews of local authorities during 2014. This will relate to the 2014/15 financial planning cycle and the delivery of budgets and savings plans during the 2013/14 financial year. We will publish the summary results of our fourth year of reviews during autumn 2014.



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# Key indicators of financial performance

Our third year of benchmarking data shows green ratings declining across most key financial criteria. Red ratings appeared in some areas for the first time. The biggest fall in green ratings for 2012/13 was in level of sickness absence which was also the worst performing area overall.

Our previous reports noted that, while local government accountants have an understanding of the use of financial ratios to interpret financial statements, this skill has traditionally only been applied to procurement exercises. Thus the application of financial ratios to local authority financial statements for the purpose of inter-authority benchmarking remains a recent development.

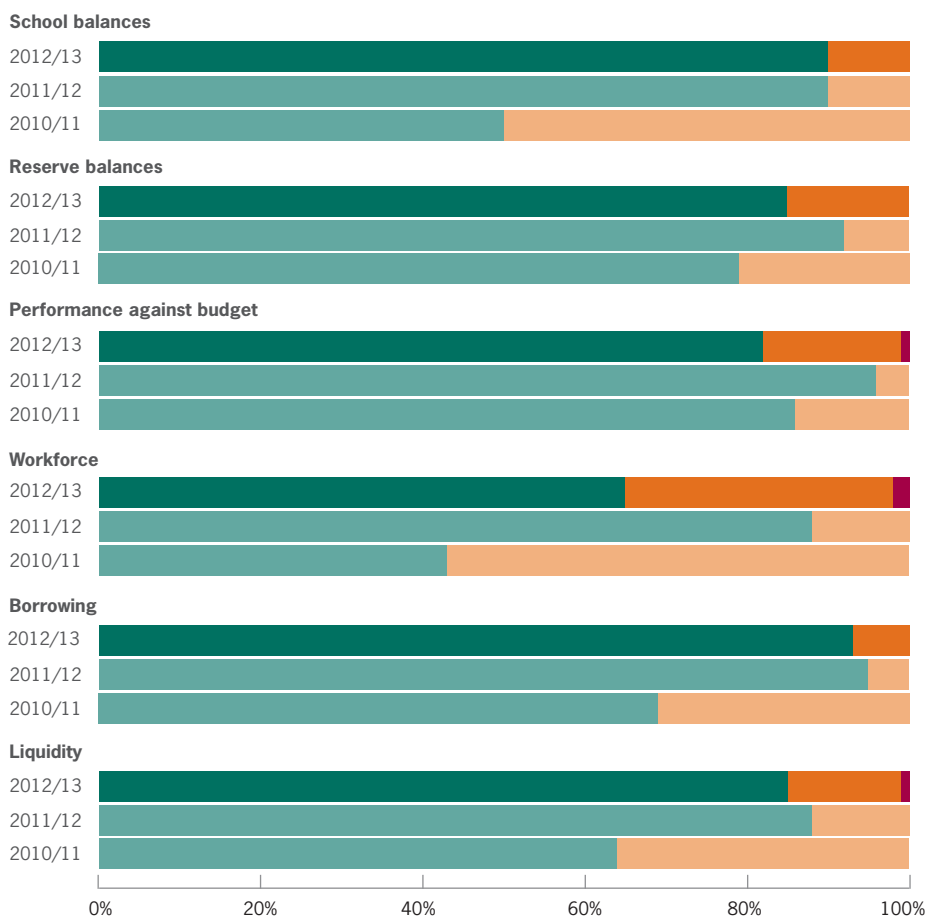
Figure 3 provides a summary of our ratings for selected key indicators of financial performance for the last three years. For each authority, we benchmarked key indicators against their nearest neighbour group. The overall trend was an improving one between 2010/11 and 2011/12 but this trend has been reversed in all but one category in 2012/13.

## Schools balances

For single tier and county council (STCC) authorities with responsibility for education, we analysed the ratio of schools balances as a proportion of dedicated schools grant (DSG). Green ratings increased from 50% in 2010/11 to 90% in 2011/12, then remained at 90% in 2012/13.

An important factor in this trend is that schools continue to adopt a cautious approach to financial management due to concerns over

Figure 3 Key indicators of financial performance



future funding levels. In many cases, this leads to annual underspends. Where this is not the case, authorities will need to seek to influence good financial management strongly, due to their limited controls over school

spending. As schools move to academy status, DSG will reduce, which will impact on this ratio. In addition, authorities face a risk of funding any deficit when a school transfers to academy status.



### Reserve balances

We noted in our first report that authorities had generally acted prudently over a long period, but we were starting to see them use general fund reserves to fund revenue expenditure. In 2010/11, 79% of authorities were rated green, increasing to 92% in 2011/12. The level of green ratings fell to 85% in 2012/13, indicating that pressures associated with delivering SR10 are beginning to impact on some authorities. **Less than half of the councils in our survey (42%) had set aside reserves** to cover shortfalls in savings plan delivery. This indicates that the majority have confidence in the delivery of savings over the lifetime of their MTFP. This approach had regional variations, with the position being much higher (62%) in the south east.

While the sector as a whole increased reserve levels during 2012/13, in cash terms there is a trend of reducing reserve levels in real terms for some in all local authority types, with metropolitan districts being the most likely to reduce reserve levels during 2012/13, according to 'Tough times 2013'. It will be critical for councils to monitor their general and earmarked reserve levels carefully to ensure they maintain financial resilience during SR10 and SR13.

### Performance against budget

The track record of local authorities in our sample in managing revenue and capital budgets has been generally good. 86% were rated green for 2010/11 and 96% rated green in 2011/12. We recognised in our second report that, as 2011/12 was the first year of SR10 funding reductions, and these reductions were front-loaded to 2011/12, this represented a significant achievement for the sector.

The level of green ratings remains high, but 2012/13 saw a reduction to 82% and the first level of red rating (1%) indicating increased delivery challenges for some authorities. **Ratings were affected by significant unplanned underspends on capital programmes, which have an economic, as well as service delivery, impact.**

### Workforce

The focus for this indicator was the level of sickness absence. Costs that accrue from sickness absence relate to the hiring of agency staff to cover staff gaps, or holding a larger workforce complement than is desirable. Absence also damages service levels, either through staff shortage or lack of continuity.

Reducing absenteeism saves money, improves productivity and can have a positive customer benefit. 57% of authorities received amber ratings in 2010/11 and this reduced significantly to 12% in 2011/12. This indicates that authorities were managing absenteeism proactively.

However, absence management will remain a challenge for authorities during SR10, particularly given the context of significant pressures on staff to deliver 'more for less'. **This conclusion is supported by an increase in amber ratings to 33% in 2012/13 and the first red rating (2%) for this category.** Furthermore, workforce received the lowest level of green ratings (65%) in this theme, and was the lowest across all four themes for 2012/13.

*Less than half of the councils in our survey (42%) had set aside reserves to cover shortfalls in savings plan delivery.*

*We noted in our first report that authorities had generally acted prudently over a long period, but we were starting to see them use general fund reserves to fund revenue expenditure.*

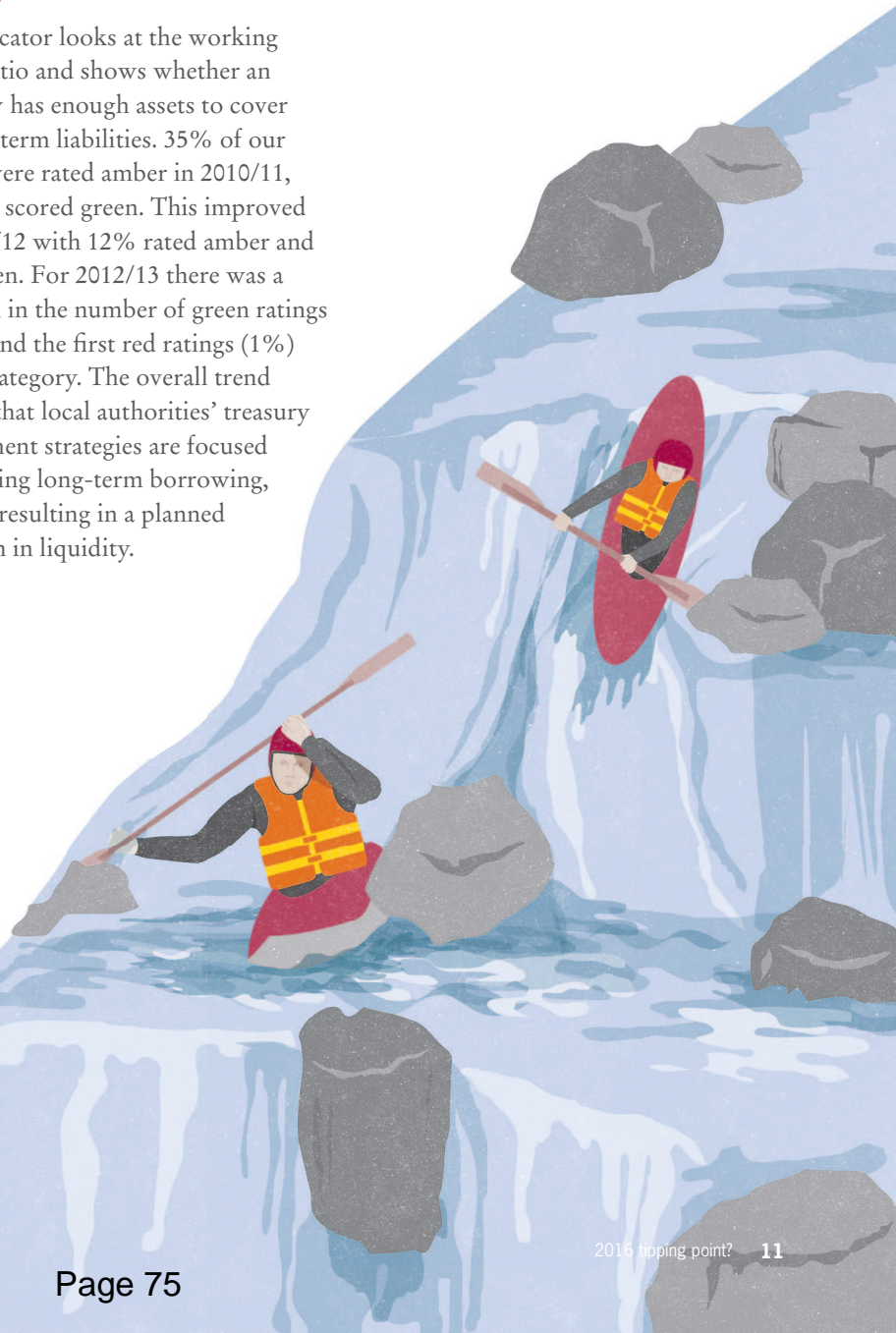
### **Borrowing**

We reviewed long-term borrowing as a proportion of long-term assets and as a share of tax revenue. The majority (69%) of authorities in our sample in 2010/11 had an appropriate ratio of long-term borrowing to long-term assets, and long-term borrowing as a share of tax, indicating that the level of borrowing was geared effectively. The trend across our sample improved for 2011/12 with 95% of authorities rated green and long-term borrowing ratios reducing. The number of green ratings fell slightly to 93% in 2012/13.

An important trend is authorities delivering strategies for reducing high interest-bearing, long-term borrowing and moving to internal and short-term, external borrowing. This is to take advantage of improved lower level borrowing rates. It also reflects greater caution with long-term borrowing following the experience of investment in Icelandic banks.

### **Liquidity**

This indicator looks at the working capital ratio and shows whether an authority has enough assets to cover its short-term liabilities. 35% of our sample were rated amber in 2010/11, and 65% scored green. This improved for 2011/12 with 12% rated amber and 88% green. For 2012/13 there was a slight fall in the number of green ratings to 85% and the first red ratings (1%) for this category. The overall trend remains that local authorities' treasury management strategies are focused on reducing long-term borrowing, which is resulting in a planned reduction in liquidity.



# Strategic financial planning

Many areas of strategic financial planning in local government have improved over the last year but some remain behind their 2010/11 levels in terms of green ratings – meanwhile some red ratings have appeared for the first time. Adequacy of planning assumptions is still the weakest area.

Figure 4 provides a summary of our ratings for selected key indicators of strategic financial planning.

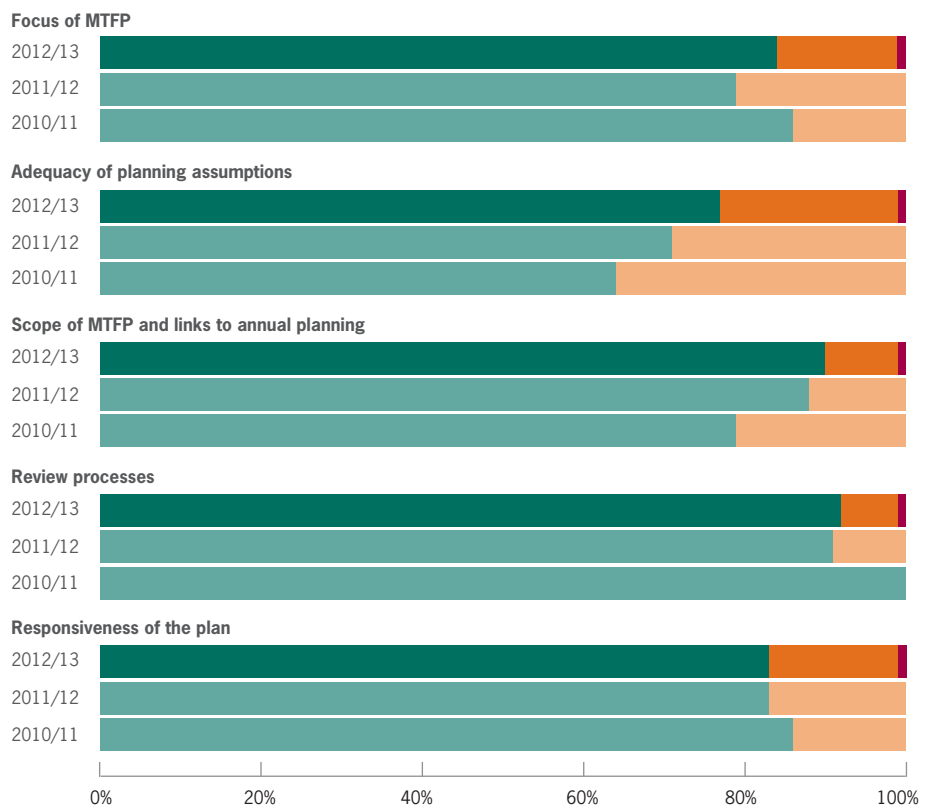
Strategic financial planning had the best overall rating across our sample for 2010/11, but saw a reduction in some ratings in 2011/12. The overall trend has been one of improvement in 2012/13. The main findings are set out below.

## Focus of MTFP

86% of our sample received a green rating for 2010/11. This reduced to 79% for 2011/12, but increased to 83% in 2012/13. However, 2012/13 received the first red rating (1%) for this category. **Authorities with lower ratings typically need to improve scenario planning, develop a robust financial model underpinning the plan, and move away from an annualised approach to financial planning.**

Our survey highlighted that the majority of councils have MTFPs that end between 2015/16 and 2017/18, providing a three- to five-year planning horizon. This is reasonable practice given the alignment to the SR10 and SR13 spending rounds. However, **a minority of councils have a shorter planning horizon, which does not cover the full SR10/SR13 period.** Only a small number of councils have an MTFP planning horizon of

Figure 4 Strategic financial planning



more than five years. This trend was consistent across all regions.

The majority of councils had at least part of their savings plan still under development for 2014/15 and 2015/16 (73% and 80% respectively). **16% of councils still had savings to identify for the current year of 2013/14. This could be a significant risk for these councils.**

This pattern was broadly consistent across all council types.

Of those councils with a gap in their savings plans over the period 2013/14 to 2015/16, the average annual gap represented no more than 4% of their 2011/12 gross revenue expenditure (GRE). However, there were **a small number of councils with savings gaps**





### Good practice case study

#### Sheffield City Council

Sheffield introduced outcome-based financial planning when developing its 2013/14 budgets. This supported the new strategic outcome plan for the city, which has a 12-year horizon (2013 to 2025).

The plan:

- sets the strategic direction for delivering the outcomes over this period
- provides the framework for decisions about where to allocate resources
- defines the performance measures to help track progress towards delivery.

The council introduced a strategic outcomes board to oversee the development and delivery of the plan and associated governance arrangements, with directors accountable to the board for realising the benefits of the plan.

The business model for delivery against the strategic outcome plan is built around:

- outcome-led investment, to achieve the outcomes for the city and to make a difference to Sheffield and its people
- outcome-led commissioning of projects that will contribute directly to achieving a step change to the outcomes for local people and businesses.

This approach has improved long-term decision making, prioritised the use of resources, and identified where new sources of funding or income need to be pursued.

The council is using a robust and transparent lessons learned process when reviewing the first year of outcome-based financial planning, to ensure this new approach becomes fully embedded across the organisation.

not require external support. However, the use of external support and advice varied regionally, with the practice most common for counties (50%) and least common for districts (9%).

For single tier councils, the average annual savings requirement in each year over the period 2013/14 to 2015/16, was between 2% and 4% of 2011/12 GRE. For districts, the average savings requirement was between 1% and 2% for all three years. There were a small number of councils, primarily single tier, with savings plans in excess of 5% of 2011/12 GRE.

Of those councils with a gap in their savings plans over the period 2013/14 to 2015/16, the average annual gap was just over 56% of the average savings plan requirement in 2013/14 and 62% in 2014/15, rising to 80% for 2015/16. This pattern was broadly consistent across all council types. Where councils had identified income generation as an important contributor towards closing the funding gap, or as part of savings plans, the average annual contribution was between 8% and 13% of the total savings requirement for the period 2013/14 to 2015/16.

in excess of 5% of 2011/12 GRE in at least one year. This pattern was broadly consistent across all council types. These saving gaps are less than is common in the NHS, where over 5% of GRE is increasingly seen.

#### Adequacy of planning assumptions

This was the weakest category in relation to financial planning for 2010/11 and 2011/12, with 36% and 29% of the sample, respectively, rated amber. It was again the weakest category for 2012/13 but amber ratings had reduced to 22%. This indicates that, while there

is significant uncertainty regarding finances over the medium-term, planning assumptions are improving for the majority of authorities. The position for a minority of authorities is worsening, reflected by the first red rating (1%) for this category.

Many local authorities still need to ensure they have the skills and capacity to develop and maintain an effective financial model that underpins their MTFP. 85% of councils in our survey believe they have appropriate skills in-house to develop savings plans, or plan to develop capacity internally and do



### Good practice case study

#### Stevenage Borough Council

Stevenage Borough Council has adopted a priority based budgeting (PBB) approach based on a methodology developed by Aberdeen City Council, to meet its need for a three year forecasted funding gap of £3 million. Central to the PBB process is a full citizen engagement programme with local people to establish their service priorities and a determination of their preferences between tax increases, service cuts and raising fees and charges. This informed the development of a range of savings proposals over the three year timeframe. After internal officer challenge, these were put to members in the form of a Leaders Services Priority Group whose membership included majority and opposition councillors, front and backbench members. Over a period of eight weeks, members ranked all savings proposals into a priority order that reflected future challenges and the results of the engagement programme. This has succeeded in producing a detailed savings programme which addresses the council's funding gap, via a permanent shift away from short-term 'salami-slicing' to a well-managed longer-term process.

### Scope of MTFP and links to annual planning

78% of our sample was rated green for this category for 2010/11 and this had increased to 88% for 2011/12. This increased again to 90% in 2012/13, but also received its first red rating (1%).

88% of councils surveyed started reviewing savings options during the first quarter of the year prior to which the savings relate, and this was broadly consistent across all regions. This is good practice because authorities must extend planning cycles to ensure they have adequate time to identify and approve savings before the start of the year to which they relate.

Good practice authorities also demonstrate effective integration of the service and financial planning processes. A small minority of authorities are introducing innovative outcome based financial planning approaches.

### Review processes

100% of our sample was rated green for this category for 2010/11. This decreased to 91% for 2011/12, and has improved slightly to 92% for 2012/13. This indicates that the majority of authorities have effective processes for the regular review of the MTFP and the associated assumptions, including appropriate scrutiny from elected members and the audit committee.

While amber ratings have reduced from 9% to 7%, this category has received its first red ratings (1%).

**Authorities received lower ratings because of weaknesses in the presentation of the financial plan to members and other stakeholders.**

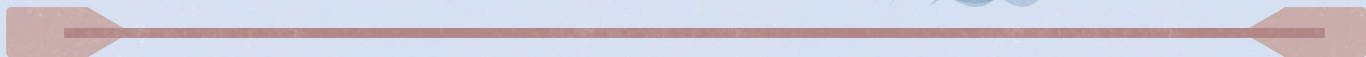
This included: inadequate supporting information, such as the impact of future demographic changes and other corporate risks; and a lack of benchmarking and other analytical techniques to support and explain the rationale for key financial decisions.

### Responsiveness of the plan

86% of our sample was rated green for this category for 2010/11. This reduced to 83% for 2011/12, and has remained at 83% for 2012/13. The category received its first red rating (1%) for 2012/13. **Reasons for poor ratings include lack of an effective process to ensure regular reviews and updates of the plan and associated medium-term financial strategy (MTFS), and lack of evidence to support how financial and service risks are being mitigated.**







## Good practice case studies



### Eden District Council

Recognising that it faced a significant revenue deficit, the council developed a strategy to increase income, reduce costs and support community service provision.

Key elements were:

- **income** – the council worked with a national supermarket to develop some of its underused land for a major retail development which has generated a major rental income
- **costs** – by re-tendering its long-term contracts for municipal and leisure services substantial savings were made whilst adding some new services
- **community service provision** – some services have been transferred to community groups. A significant grant fund was established to support local communities to develop new and improved services.



### Warwick District Council

The MTFS is prepared over a five year period and currently runs to 2018/19. Long range financial forecasting has been very accurate, largely as a result of the projections being regularly updated so as to be responsive to the most up to date information, notably with regard to government funding announcements. This allows long-term planning and decision making to facilitate achieving financial balance. The latest forecast is that recurrent savings of £1.975 million will need to be achieved by 2018/19. This will necessitate the General Fund Budget, currently £16 million, reducing to £14 million by 2018/19.



### Sevenoaks District Council

The council implemented a rolling ten year budget which includes the use of short-term surpluses to build up an earmarked reserve, to be drawn down over the remainder of the period to ensure a balanced budget across each of the ten years. This has allowed the council to take a longer-term view on service transformation. The rolling ten year budget is accompanied by a four year savings plan and is underpinned by robust assumptions and efficient, high quality services that reduce the risk of unforeseen challenge or failure.

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### Manchester City Council

The council has set out a strategic framework and budget setting principles to inform decision making and to take a sustainable approach to achieving budget savings. There is a focus on providing leadership for reform – promoting economic growth, reducing worklessness and dependency and promoting private sector investment. By safely reducing demand for high cost services, the council plans to maintain resources to fund universal services to support the city's economy to grow and enable and places to prosper.



### London Borough of Croydon

Croydon Council is challenging existing practices and methodologies to develop strategic and long-term financial plans that consider alternative solutions. The council is fundamentally reviewing all service provision and undertaking a completely different approach to building up the budget for 2015/16 and 2016/17 where significant shortfalls in the medium-term forecasts have been identified. The council brought forward the timeframe for the agreement of the 2014/15 budget to allow greater focus on this longer-term strategy. The council is already engaging with budget holders and members in order to agree some of the key decisions early.





# Financial governance

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Our sample indicates a growing maturity amongst councils in understanding the financial environment and areas such as managing forecast overspends. But challenges remain, especially in areas of reporting such as transparency of saving plans.

Figure 5 summarises our ratings for selected key indicators of financial governance.

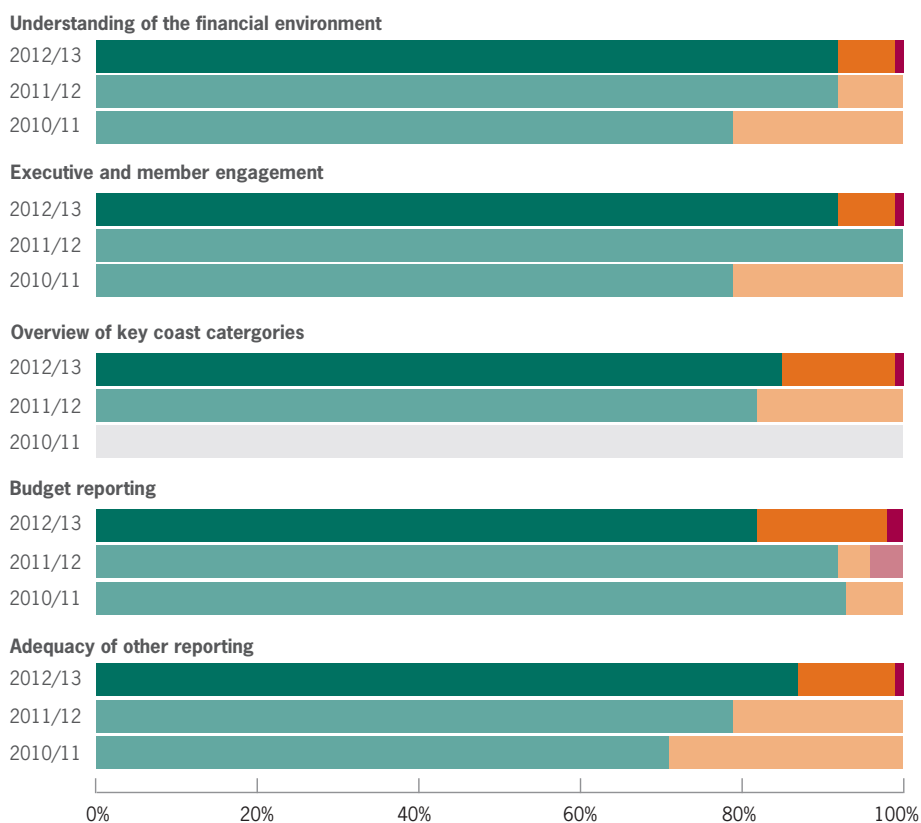
## Understanding of the financial environment

79% of our sample was rated green for 2010/11. This increased to 92% for 2011/12, and fell slightly to 90% for 2012/13. 2012/13 also received its first red rating (1%).

Senior leadership continue to recognise the importance of communicating the impact of SR10 and SR13 to all staff and elected members. Many also recognise the need for greater consultation with their local communities on spending and saving priorities.

With the focus on protecting front-line services, back office functions such as finance have seen significant reductions in staff numbers. As noted in our previous reports, an important trend across many authorities in response to these reductions is placing greater financial management responsibilities on service managers and budget holders; and enhancing job descriptions and competencies to reflect this change. In parallel to this, the finance function is providing higher level and more targeted support to services.

Figure 5 Financial governance



Our third year of reviews indicates that the implementation of these changes by both finance and service staff has been mixed, and they are not yet embedded in many councils. Failure to embed these changes represents a risk to future effective financial management.

### Executive and member engagement

Our 2010/11 review rated 79% of our sample as green. This increased to 100% for 2011/12, but fell to 92% for 2012/13, which also saw the first red rating (1%).

The role of member engagement in, and scrutiny of, financial planning and financial management is critical. The funding environment is placing ever greater demands on elected members, who must have appropriate and frequent financial information as well as the right skills to fulfil this critical role. **While the overall ratings indicate effective engagement, this is not the case in a minority of councils.**

### Overview of key cost categories

This category was introduced in our second year of reviews, having previously formed part of 'Executive and member engagement'. It rated 82% of our sample green in 2011/12, increasing to 85% in 2012/13, when it also received its first red rating (1%).

Features of those receiving amber or red ratings included an unclear scheme of delegation, lack of consistency in the application of unit cost data, and a lack of tracking information in monitoring internal audit recommendations to audit committee.

### Budget reporting

71% of our sample were rated green for 2010/11. This increased to 79% for 2011/12. In 2012/13, it rose again to 82%, but also received its first red rating (2%). This was the lowest score for a category in financial governance for all three years, but the trend is improving and reflects a reasonable position overall.

Local authorities continue to face challenges managing volatile, demand-led, budgets. Our sample indicates a growing maturity amongst councils in managing forecast overspends corporately, rather than within departmental silos, which is good practice. However, the challenges of setting appropriate budgets and then spending within them, or generating forecast levels of income, continues to be one of the main risks and challenges.

**Weak financial year-end forecasts, resulting in unexpected revenue underspends or overspends during the final quarter, and significant unplanned underspends on the capital programme, were key reasons for authorities receiving amber or red ratings.**



### Good practice case study

#### London Borough of Barnet

The council is at the forefront of the move by local government bodies to a more commissioning-focused model of governance and service provision. From April 2013, the council moved to its new commissioning council structure. This includes an assurance group responsible for providing independent oversight to the strategic commissioning board and to members, so that the council's decision making is effective and appropriate risk management arrangements are in place and being used effectively by the council's lead commissioners and its delivery units. While the effectiveness of the new arrangements will require testing over time, initial indications from officers show they are working well and are helping to focus the council's senior team on how resources can best be used in a joined-up way across all services rather than a silo based approach.

### Adequacy of other reporting

We continue to find that most authorities provide comprehensive levels of timely financial reporting to senior management and members. Within the top performing councils, there is a growing trend towards considering financial monitoring reports alongside performance and workforce data, which is good practice. However, the overall trend is falling, with 93% of our sample rated green for 2010/11, reducing to 92% for 2011/12, and falling again to 87% in 2012/13.

This category included the only red rating (5%) in our 2011/12 programme of reviews, and this red rating fell to 1% for 2012/13. Factors leading to red ratings have not changed. They include a lack of consistent timing in the reporting of financial and other performance information, and changes to how information is presented during a financial year. **Other factors were: limited frequency of reporting; lack of reporting on savings; failure to use graphics; a propensity to use lengthy narrative; and cabinet reports including only forecast year-end outturn position, not the actual position against a profiled budget.**

Most authorities continue to use risk-based exception reports, allowing them to make decisions on corrective action and to allocate responsibilities



### Good practice case study

#### Solihull Metropolitan Borough Council

Decision making is based on clear business cases for investment and LEAN reviews provide detailed analysis for cost reduction initiatives. The main reporting vehicle is Aligning our Resources to our Priorities (ARTOP). ARTOP meets monthly, is chaired by the director of resources, and its role is to monitor progress against the delivery of all of the savings in the current three year medium-term financial strategy (MTFS) 2013/14 to 2015/16. ARTOP is a sub group of the corporate leadership team (CLT) and reports the outcomes of each of its meetings to CLT as part of a monthly financial report. Savings are identified three years in advance, and for the current financial year 85% of all savings have been delivered, with progress well under way for the two subsequent years.

for these actions. In most cases, year-end forecasts are effective in providing no surprises. However, a minority of authorities do not apply commitment accounting fully, which poses a risk to the provision of accurate outturn forecasts. Given the importance of reporting savings programmes, our survey highlighted the following.

### Frequency of reporting savings plans

It is critical, given the scale of savings required by all councils, that the executive receives progress updates frequently. Our survey identified that the position varies by local authority type. The majority of single tier councils report on the progress of savings plans to cabinet, or equivalent, either monthly or quarterly (35% and 44% respectively). County and district councils tend to favour quarterly reporting (63% and 67% respectively). **A significant minority of councils of all types (23%) report savings plan progress to cabinet less frequently.**

The most common frequency of reporting savings plan progress to non-cabinet members or equivalent is quarterly (49%). However, most of the remainder (38%) report less frequently than this and only a small number (13%) report to non-cabinet members on a monthly basis in some form.

The majority of councils of all types (63%) report savings plan progress to the corporate management team or equivalent on a monthly basis. A minority report quarterly (19%) and the remainder at other intervals (weekly or fortnightly).

### Reporting savings plans separately

It is important that savings programmes are reported transparently, and that savings are not reported within base budget financial monitoring information. Overall, the sector has room for improvement. While more than two thirds of single tier and county councils reported progress against savings plans separately during the year, a significant minority do not take this approach. For district councils, the split is more even with just under half taking this approach to monitor savings delivery.

The south east bucks the national trend with all counties reporting progress against savings plans separately during the year, which is good practice. However, less than half of single tier councils and less than a third of district councils in this region have not taken this approach to monitor savings delivery.

*It is important that savings programmes are reported transparently, and that savings are not reported within base budget financial monitoring information. Overall, the sector has room for improvement.*

### Reporting countervailing savings

Countervailing savings, used in response to slippage or non-delivery, were reported to members in a transparent way at the majority of single tier and county councils (58% and 63% respectively) and just under half of the district councils. This leaves a significant minority of councils where changes to the savings plans were not reported in a transparent way. The south east was the worst performing region, with countervailing savings reported to members transparently in a minority of single tier and county councils (27% and 0% respectively); and in just under two thirds of the district councils. This leaves, for the south east region, a significant proportion of councils (52%) where changes to the savings plans were not reported transparently.

This lack of transparency could mean that, if a reduced budget which incorporates agreed savings does not overspend at year end, it could be considered a success, when the reality may be that other factors have led to the break-even position or underspend. For example, management decisions to hold vacancies that did not form part of the original savings plan may be hidden from management information and the consequent impact on service delivery may not be identified.

This approach is not unique to local government – it is common across the public sector. But given the level of savings being delivered, and still to be delivered, it is critical key stakeholders know whether the savings agreed have been delivered as planned.





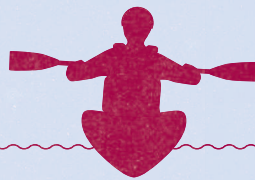
## Good practice case studies

8



### Shropshire Council

The council is building on the work already undertaken on strategic commissioning to factor in area based and local commissioning, either directly itself or by co-commissioning with its partners. Local commissioning will be led by local members alongside partners in the public, private and voluntary sector to help redesign services based on demand in a locality with a focus on prevention. This will help shape community outcomes and priorities which will inform commissioning activity. The commissioning and governance of place will also be managed and led locally, creating a local approach to commissioning of services.



### Copeland Borough Council

Copeland Borough Council consulted on a two year savings programme for 2013-2015. The approach was aimed at delivering a policy led budget where feedback from the consultation informed the council's strategy for the next three years. This was vital as the council felt it had exhausted the sharing and efficiency agenda and financially could not continue to fund all the discretionary services previously provided. This was a fundamental change to the role of the council with views sought on alternatives, priorities and mitigations, all aimed at ensuring the council had a strong evidence base for safe decision making.



### Kent County Council

Kent County Council recognised that a strategic focus was required to deliver the significant financial challenge they faced. A project management approach was developed via project initiation documents (PIDs) for all savings over £200,000. The responsible directorate/manager prepares a PID identifying how savings will be delivered, the quantum of savings and project milestones. The budget programme board (BPB) was established to oversee the process. This is a mixed group of members and officers chaired by the cabinet member for finance. Meetings focus on holding budget holders to account for their PIDs which are assessed 'at risk'. This process has been a significant contributory factor to the delivery of the majority of savings plans in the past two years.

*While more than two thirds of single tier and county councils reported progress against savings plans separately during the year, a significant minority do not take this approach.*

# Financial controls

This year green ratings increased across nearly all the key indicators in this area. However, 2012/13 also saw red ratings appear for the first time in all of those indicators. One of the biggest areas of improvement in green ratings has been ‘Key financial systems’.

Figure 6 provides a summary of our ratings for selected key indicators of financial controls.

## Budget setting and monitoring

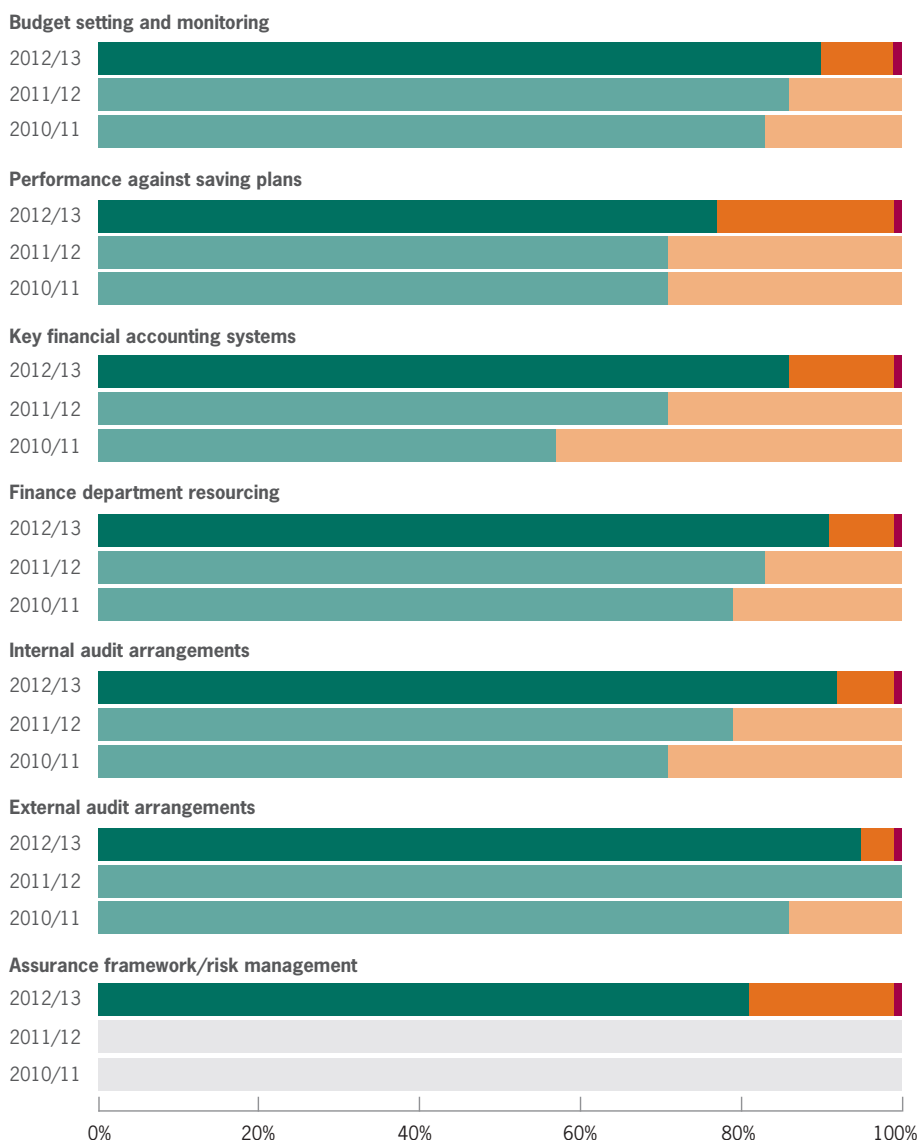
The financial controls in place to ensure effective performance management of budgets were generally good for 2010/11, with 83% of our sample rated green. This improved slightly for 2011/12 with 86% rated green, and improved again in 2012/13 (90%). However, 2012/13 also saw the first red rating for this category (1%).

Those authorities who scored amber or red typically still need to improve the accuracy of financial reporting. They can do this, for example, by: having accurate budget profiles; an improved understanding of cost drivers; and better use of benchmarking, trend analysis and unit costs. They also need a more effective approach to presenting financial information.

## Performance against savings plan

Local authorities have traditionally had a good track record of delivering efficiencies and savings. Most authorities were able to manage the 2010/11 in-year funding reductions effectively with 71% of our sample rated green. For 2011/12, that position remained at 71%. Given the context of front-loaded, year one SR10 savings,

Figure 6 Financial controls



this is a considerable achievement. Councils continued to deliver and the level of green ratings increased to 77% for 2012/13. However, a small number of councils are now facing significant risks, with the first red ratings for this category (2%) appearing in 2012/13. For the first time, this category received the lowest green ratings in the financial controls theme.

### Approach to monitoring savings

It is good practice to adopt a risk-based approach to monitoring savings, such as the use of red-amber-green (RAG) ratings. The majority of single tier and county councils (60% and 88% respectively) used RAG ratings to help understand the risk associated with delivering individual savings. However, a significant minority of single tier councils (40%) and the majority of district councils did not use this kind of analysis.

There are also regional variations. In the south west, less than half of single tier and county councils (45% and 100% respectively) used a RAG rating approach while the majority of single tier councils (55%) and the majority of districts (78%) did not use this kind of analysis. **In the Midlands, the majority of single tier and county councils (57% and 100% respectively) did use RAG ratings. However, a significant minority of single tier councils (43%) and the majority of districts did not use this kind of analysis.** This indicates ineffective processes or a potentially weak financial position.



### Good practice case study

#### Surrey County Council

The council has not completed stand-alone annual budgets for a number of years, but produces five year budgets from which annual budgets are set. This means future years' budgets are more detailed, reliable, and allow changes between years to be more readily identified (ie capital projects spanning a number of years). This results in greater transparency, efficiency and more achievable in-year budgets. It allows senior managers to plan longer-term with a greater degree of certainty.

As part of the budget setting process the council considers a number of scenarios and applies the most suitable. It completes a number of draft budgets throughout financial planning cycle, and engages with the business and voluntary sector, communities, trades unions, all members, and residents at each stage. Elected members and senior managers are supported in their strategic financial management by revenue and capital budget monitoring reported in month, a quarterly 'hard close' of the accounts (including all the primary statements) and an early close and publication of the statement of accounts. This provides the base information and confidence in the council's financial systems and financial management arrangements to be able to make long-term decisions.

### Approach to managing savings

The majority of single tier and county councils (70% and 75% respectively) took a project management approach to savings projects and programmes, which is good practice. However, a significant minority of single tier and county councils, and just over half of district councils, did not use this kind of process. The region where this approach was most prevalent was the Midlands, with the majority of single tier and county councils (86% and 50% respectively) using project management techniques to manage savings. However, a significant minority of single tier and county councils, and the majority of districts did not use this kind of process.

The majority of single tier councils (60%) and half of the counties had to identify alternative savings during 2012/13 as a result of slippage or non-delivery of savings plans. The majority of district councils (84%) did not have to resort to these measures. We have already noted that, for some councils, there is a lack of transparency in how these savings are reported to members.

### Key financial systems

57% of our sample was rated green for 2010/11. This increased to 71% in 2011/12 and 86% in 2012/13. This was the lowest level of green ratings for financial controls in both 2010/11 and 2011/12, but not for 2012/13. However, the first red ratings (1%) were also received in 2012/13.



Councils typically have well-established systems and procedures for producing reliable financial monitoring and forecasting information. They use these alongside related performance information to support decisions. We noted in our previous reports that many authorities are considering enhancing the functionality of their key financial systems to ensure the burden of producing work around financial information does not fall to non-financial managers, given the reduction in finance staff. While they continue to make progress, such changes take time to specify, procure and implement. In the context of reducing finance resource and increasing financial management responsibilities within services, authorities in this position will have to monitor the risks associated with such work around solutions carefully.

### Finance department resourcing

78% of our sample was rated green for 2010/11, which increased to 83% for 2011/12. Green ratings increased again to 91% for 2012/13 but this year also received the first red ratings (1%). This improving trend indicates that most authorities have been able to manage the impact of funding reductions to this part of the back office. **The potential inability of finance teams to withstand planned and unplanned absences in providing support to services remains a key risk for councils. This is especially the case given the widespread reductions in staff numbers and delivery of major savings at a time when services are taking on enhanced financial management responsibilities.**

### Internal audit arrangements

The majority of authorities in our sample (71%) were rated green for 2010/11 and this increased to 79% for 2011/12. This increased again to 92% for 2012/13, but this year also saw the first red ratings (1%).

Most councils continue to: apply a risk-based approach to audit planning and involve services in the planning process; have a robust process for preparing and reporting the annual governance statement, and an engaged audit committee. Amber or red-rated authorities had weaknesses such as audit plans that were too focused on reviewing traditional back office processes (such as low level financial controls) at the expense of more risk-focused work (such as assurance on delivery of key projects and programmes, including savings). **Other areas of weakness included significant reduction to internal audit resource – impacting on effective delivery of the annual audit plan – and a lack of effective follow up on internal audit recommendations.**

### External audit arrangements

We rated 86% of our sample green for 2010/11 and this increased to 100% for 2011/12. The level of green ratings fell to 96% in 2012/13 and this year saw the first red ratings (2%). **The reason for amber and red ratings varied, but included: the council receiving a qualified value for money conclusion; ineffective responsiveness of accountants to queries raised by external auditors; and weaknesses with benchmarking and understanding unit cost information.**



### Good practice case study

#### Gloucestershire County Council

The council uses Verto, a project management package, to record and monitor the delivery of individual savings plans that make up the total 'Meeting the Challenge' savings programme for the council. This system facilitates accountability, ownership and supports delivery through input from a wide cross section of the council. Specifically, each savings programme goes through a number of gateways that ensure plans are robust and deliverable. To facilitate deliverability, each savings plan uses Verto to identify and secure the support services it needs to succeed. The support services include finance, needs analysis, HR, risk and asset management colleagues ensuring corporate ownership.

### Assurance framework/risk management approach

This is a new category for 2012/13, for which 81% of authorities received a green rating, and 2% a red rating. While the majority of councils have adopted effective approaches to risk management, a minority have not. Reasons for non-green ratings included: infrequent reporting of risks to members; out of date risk management documentation; failure of the corporate management team to quality assure risk registers effectively; lack of alignment of risk registers to corporate priorities; poor risk ownership; and a lack of effective risk escalation procedures.

# Summary and conclusions

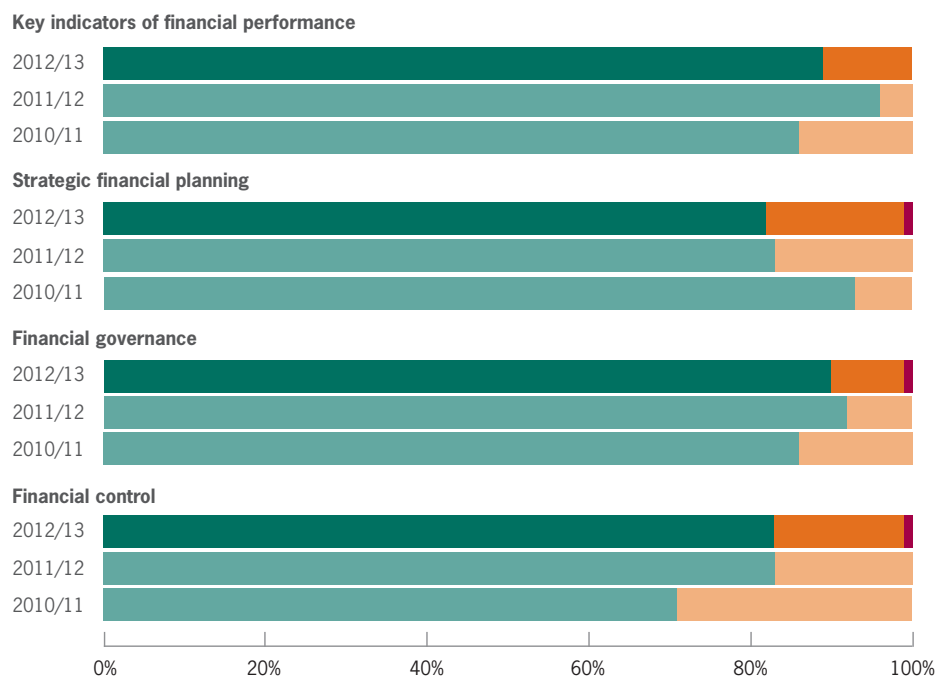
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Overall, local authorities are delivering against their financial plans. However, the challenges are increasing; some improvements in the last survey have reversed this year; and a small number of authorities now have insufficient arrangements to ensure financial resilience. Authorities will need to work hard in all these key areas to stay in robust financial health.

Figure 7 provides a summary of the overall ratings for each of the four themes. The overall trend for many of the categories we rated was an improving position between 2010/11 and 2011/12. This was demonstrated by three of the four overall themes, apart from strategic financial planning, showing improved ratings. This trend has reversed in our third year of reviews, with three of the four thematic areas receiving lower overall levels of green ratings than for 2011/12, albeit, in most cases, small reductions.

17 of the 22 categories received red ratings in 2012/13, when there were no red ratings at all during 2010/11 and only one category – adequacy of reporting in the financial governance – received a red rating during 2011/12. As a consequence, three of the four overall themes received red ratings in 2012/13. While these represent a small proportion of authorities in our sample (1% to 2%), it indicates that a minority of authorities do not have adequate arrangements in place to ensure they will remain financially resilient. A summary for each theme follows.

Figure 7 Summary ratings over time – all councils



*The overall trend for many of the categories we rated was an improving position between 2010/11 and 2011/12. This was demonstrated by three of the four overall themes, apart from strategic financial planning, showing improved ratings. This trend has reversed in our third year of reviews, with three of the four thematic areas receiving lower overall levels of green ratings than for 2011/12.*

Local authorities demonstrated strong **strategic financial planning**, during our 2010/11 review, with 93% in our sample receiving a green rating. This declined to 83% for 2011/12, the only thematic area that saw a fall in the overall green rating. This trend continued with a small reduction to 82% for 2012/13, and the theme received its first red rating (1%). For the first time, this theme received the lowest overall green rating.

Local authorities continue to face increased difficulty planning for the medium-term in what remains a greatly challenging and uncertain period. **It remains critical that authorities improve their scenario planning and their use of sensitivity analysis on key assumptions in their financial models.** As we noted in our 2012 report, we believe councils can learn directly from the financial modelling analysis required by foundation trust applicants in the NHS.

Our 2010/11 reviews indicated that the weakest thematic area was **financial control**, with 71% of authorities receiving a green rating. Our 2011/12 reviews highlighted an improvement, with 83% of our sample receiving a green rating. The rating stabilised at 83% for 2012/13, but received its first red rating (1%).

An important risk that local authorities need to continue managing in this area is embedding the changes resulting from reductions in finance staff and the associated increase in financial responsibilities of service managers and budget holders. A significant minority of authorities also need to improve the way they manage savings programmes, either by introducing project management rigour, or in the way that they report and monitor delivery risks.

Authorities demonstrated good **financial governance** during our 2010/11 reviews, with 86% receiving green ratings. This increased to 92% for 2011/12 but fell slightly to 90% in 2012/13. This theme received its first red rating (1%) during 2012/13.

Local authorities will need to ensure that financial governance arrangements remain robust. **An important area of improvement for many in the sector is ensuring the appropriate frequency of reporting savings programmes to members, including greater transparency on the use of countervailing savings. This is so stakeholders can better understand the impact on service delivery and policy decisions, where such alternative savings are being applied to pre-agreed targets.**

86% of authorities were rated green for **key indicators of financial performance** for 2010/11 and this increased to 96% for 2011/12. Green ratings fell to 89% for 2012/13, but this was the only theme not to receive any red ratings during 2012/13.

For all but one category in this thematic area, the trend has been an increasing level of green ratings and reducing levels of amber ratings between 2011/12 and 2012/13. The overall position indicates that local authorities are treating the financial challenges they face seriously, and delivering against their financial plans. **However, three categories received red ratings for the first time – liquidity, performance against budgets and workforce – highlighting significant financial pressures for a minority of authorities.**

Workforce received the lowest rating in this theme, and was the lowest rating (65% green) across all four themes. Reducing absenteeism saves money, improves productivity and can have a positive customer benefit. The pressures on staff to deliver “more for less” will be a key challenge for the sector over the medium-term.



### Comparison to the health sector

We undertook similar reviews of all our NHS trust clients for 2010/11, 2011/12 and 2012/13, and of a sample of our foundation trust (FT) clients for 2012/13. In the two prior years, we undertook reviews of all our primary care trust (PCT) clients and for 2012/13 we consulted with our clinical commissioning group (CCG) clients about their initial experiences.

The methodology used for our reviews of health bodies was the same as that used for local authorities, and the summary results for our sample of health bodies are set out in Figure 8.

Despite the government maintaining NHS funding levels, health bodies again received lower ratings than local authorities for 2012/13, with significantly lower levels of green ratings across themes, though there has been improvement in all themes since 2011/12. This appears to be one beneficial effect of NHS trusts going through the FT application process, which requires high levels of rigour over processes for planning, governance and control.

Figure 8 Summary ratings – Health sector

#### Key indicators of financial performance



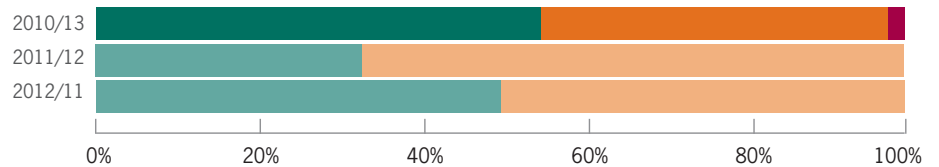
#### Strategic financial planning



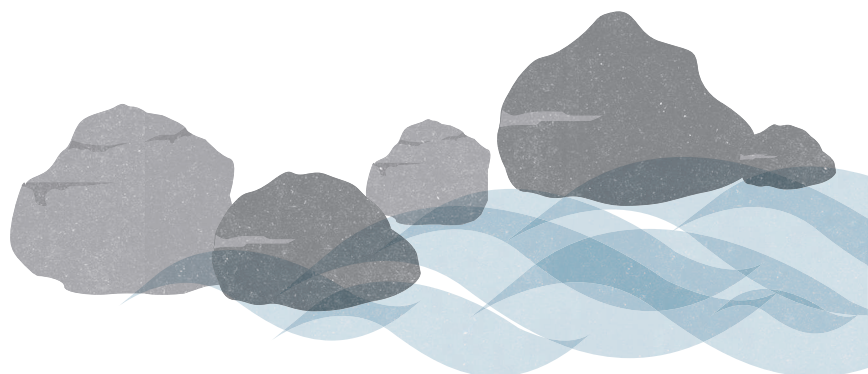
#### Financial governance



#### Financial controls



*Despite the government maintaining NHS funding levels, health bodies again received lower ratings than local authorities for 2012/13, with significantly lower levels of green ratings across themes, though there has been improvement in all themes since 2011/12.*



These reviews revealed that:

- cost improvement programmes (CIPs) are not delivering effectively. 44% of trusts and 31% of FTs did not achieve their planned savings in 2012/13; half of trusts and a quarter of FTs relied on non-recurrent savings; and half of trusts and FTs had future savings programmes where we had concerns about achievability. The level of savings required is also the main factor putting CCGs at financial risk.
- non-recurrent support obscures the picture on resilience: 32% of NHS trusts and 23% of FTs either relied on non-recurrent external revenue support to break even in 2012/13, or were expecting to receive such support during 2013/14. This is also reflected in a National Audit Office report '2012/13 update on indicators of financial sustainability in the NHS' which suggests that, without this sort of support, nearly a quarter of NHS trusts would have been in deficit in 2012/13.
- workforce issues are increasing. We observed high levels of turnover at board level at a quarter of clients, rising levels of temporary staff at two thirds of clients, and higher than targeted levels of sickness absence at 90% of NHS trusts. The trend being upward at most clients.

Partners working together in health economies need to aspire to delivering the best quality of patient care within available resources. This will not always be achieved through existing pathways, in existing settings. Local leaders will need to challenge the notion of "What is best for my organisation?" and replace it with "What is best for the patient?". Healthcare providers and commissioners will need to work together with local authorities in the field of health and social care if all the parties are to benefit from the recently-announced Integration Transformation Fund.

Our findings indicate that local authorities are performing significantly better than NHS bodies. To avoid a deterioration in their ratings, local authorities should consider whether any lessons can be learned from the NHS, to help manage their own financial sustainability, and mitigate the chances of a declining position.

Our full analysis of the financial health of the NHS is available in our report 'Alternative therapy – strengthening NHS financial resilience' which was published in November 2013.



*Our findings indicate that local authorities are performing significantly better than NHS bodies. To avoid a deterioration in their ratings, local authorities should consider whether any lessons can be learned from the NHS, to help manage their own financial sustainability, and mitigate the chances of a declining position.*



# About us

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Dynamic organisations know they need to apply both reason and instinct to decision making. At Grant Thornton, this is how we advise our clients every day. We combine award-winning technical expertise with the intuition, insight and confidence gained from our extensive sector experience and a deep understanding of our clients.

Grant Thornton UK LLP is a leading business and financial adviser with client-facing offices in 25 locations nationwide. While we understand regional differences and can respond to needs of local authorities, our clients can also have confidence that our team of local government specialists is part of a firm led by more than 200 partners and employing over 4,400 professionals, providing personalised audit, tax and specialist advisory services to over 40,000 clients.

Grant Thornton has a well-established market in the public sector, and has been working with local authorities for over 30 years. We are the largest employer of CIPFA members and students and our national team of experienced local government specialists, including those who have held senior positions within the sector, provide the growing range of assurance, tax and advisory services that our clients require.

We are the leading firm in the local government audit market, and are the largest supplier of audit and related services to the Audit Commission, and count 40% of local authorities in England as external audit clients.

We also audit local authorities in Wales and Scotland via framework contracts with Audit Scotland and the Wales Audit Office. We have over 180 local government and related body audit clients in the UK and over 75 local authority advisory clients. This includes London boroughs, county councils, district councils, city councils, unitary councils and metropolitan authorities, as well as fire and police authorities.

This depth of experience ensures that our solutions are grounded in reality and draw on best practice. Through proactive, client-focused relationships, our teams deliver solutions in a distinctive and personal way, not pre-packaged products and services.

Our approach combines a deep knowledge of local government, supported by an understanding of wider public sector issues, drawn from working with associated delivery bodies, relevant central government departments and with private-sector organisations working in the sector

We take an active role in influencing and interpreting policy developments affecting local government and responding to government consultation documents and their agencies. We regularly produce sector-related thought leadership reports, typically based on national studies, and client briefings on key issues. We also run seminars and events to share our thinking on local government and, more importantly, understand the challenges and issues facing our clients.



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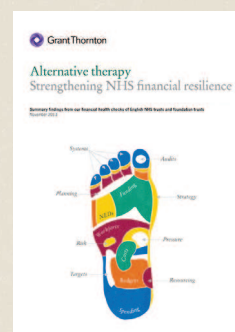
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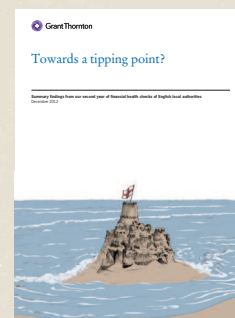
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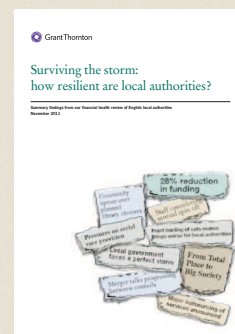
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# Appendix

## Good practice checklist

Key indicators of financial performance	✓	X	Comments
Regular monitoring of key indicators of financial performance			
The authority operates within a locally determined appropriate level of reserves and balances			
The general fund balance is maintained at or above the locally agreed minimum level			
Working capital is at, or above, a ratio of current set by the Section 151 officer			
Manageable levels of long-term borrowing within prudential borrowing limits			
Targets have been set for future periods in respect of key indicators, such as reserve balances and prudential indicators			
The authority has a track record of spending to budget and proactively managing forecast overspends in-year			
A robust organisational approach and focus on absence management to improve productivity, reduce costs and enhance customer service			
Strategic financial planning	✓	X	Comments
Focus on achievement of corporate priorities is evident through the financial planning process. The MTFP focuses resources on priorities			
Service and financial planning processes are integrated			
The MTFP includes outcome measures, scenario planning, benchmarking, resource planning and details on partnership working			
Annual financial plans follow the longer-term financial strategy of the authority			
There is regular review of the MTFP and the assumptions made within it. The authority responds to changing circumstances and manages its financial risks			
The authority has performed sensitivity analysis on its financial model using a range of economic assumptions including the impact of SR10 and SR13			
The MTFP is linked to and is consistent with other key strategies, including workforce			
KPIs can be derived for future periods from the information included within the MTFP			
Zero based budgeting on priority based budgeting is used to improve strategic prioritisation during the financial planning cycle			
Effective treasury management arrangements are in place			
Financial governance	✓	X	Comments
There is a clear understanding of the financial environment the council is operating within			
Regular and transparent reporting to members. Reports include detail of action planning and variance analysis			
Actions have been taken to address key risk areas			
The chief finance officer is a key member of the leadership team			
Officers and managers across the authority understand the financial implications of current and alternative policies, programmes and activities			
The leadership ensures appropriate financial skills are in place across all levels of the organisation – for example, a good understanding of unit costs and cost drivers			
The leadership fosters an open environment of open challenge to financial assumptions and performance			
There is an effective scheme of delegation, ensuring clarity of financial responsibilities and accountabilities			
There is engagement with stakeholders, including budget consultations			
There are comprehensive policies and procedures in place for members, officers and budget holders which clearly outline responsibilities			
Internal and external audit recommendations are not overdue for implementation			
Committees and cabinet regularly review performance and it is subject to appropriate levels of scrutiny			
There are effective recovery plans in place (if required)			

Financial control	✓	X	Comments
Budgets are robust and prepared in a timely fashion and the authority has a good track record of operating within its budget			
Budgets are monitored at an officer, member and cabinet level and officers are held accountable for budgetary performance			
Financial forecasting is well-developed and forecasts are subject to regular review, including trend analysis, benchmarking of unit costs, risk and sensitivity analysis			
Budget profiles are accurate and regularly monitored			
There is particular focus on monitoring income related budgets			
Savings programme reporting includes effective management information on countervailing savings and the use of RAG ratings			
The capacity and capability of the finance department and service departments are fit for purpose for effective financial planning and financial management			
Key financial systems have received satisfactory reports from internal and external audit			
Financial systems are adequate for future needs, for example commitment accounting functionality is available			
There is an effective internal audit which has the proper profile within the organisation and agreed internal audit recommendations are routinely implemented in a timely manner			
There is an assurance framework in place which is used effectively by the authority and is how business risks are managed and controlled			
The annual governance statement gives a true reflection of the organisation			





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