Grant Thornton

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Rising to the challenge
The evolution of local government

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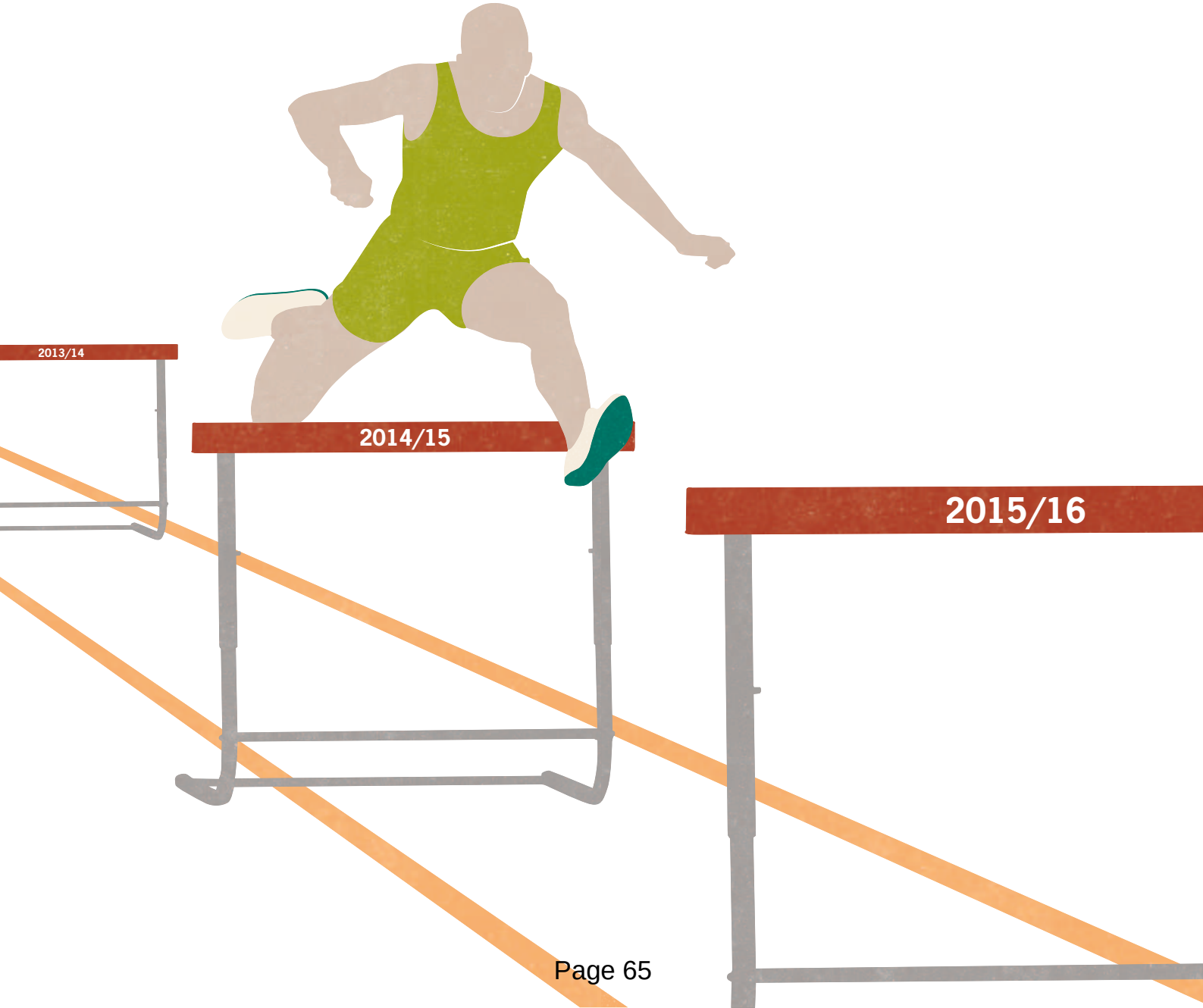
Summary findings from our fourth year of financial health checks at English local authorities

December 2014



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Introduction

In the wake of the financial crisis and the government spending review, this report looks at how local authorities have risen to the huge financial challenges they face. It also looks at the steps they have taken to secure financial resilience and how they can meet the challenges of the future. This is the fourth in our series of annual reports on financial resilience in local government in England.

The era of austerity

In 2008, the UK economy entered a period of sustained financial downturn as a result of the global financial crisis. That led to a large and permanent reduction in the finances available to fund public services.

In October 2010, the chancellor announced a wide-ranging spending review of public services (SR10). This aimed to bring the public finances into balance by financial year 2014/15. The savings required to deliver this objective reflect the largest reduction in public sector funding since the great depression of the 1920s. For local government, this meant a real-terms funding reduction of 28%, excluding schools.

The government then announced that this would not be sufficient to balance the country's finances by 2015. In 2013, a new spending review (SR13), covering the period to 2015/16, required a further 10% saving in local government. The era of austerity is likely to continue through 2017 and beyond.

The funding reductions over this period are compounded by rising demand and, in some cases, rising unit costs for some services – notably adult and children's social care. There has been some localisation of funding decisions but there are other areas where local government has less control eg in local taxation and in the increased activity of regulators such as Ofsted and the Care Quality Commission (CQC), which can have significant cost implications.

This all means that the onus has been on local authorities to innovate and improve efficiency wherever they can.

The response of local government

Since our first report, 'Surviving the storm: how resilient are local authorities?' published in December 2011, we have followed the progress of local authorities in their efforts to manage this time of austerity. We concluded that authorities had responded well to the initial challenge of SR10, but the real challenges lay in the future.

Our next report, 'Towards a tipping point' (2012), identified a series of potential financial 'tipping points' that many local authorities felt were on the horizon. We described a number of tipping point scenarios.

In '2016 tipping point?: Challenging the current' (2013), we reported that local government was continuing to deliver despite the challenges. However, there were some signs of stress, particularly in delivering financial targets, although there was some variation in the stresses affecting authorities of different kinds and in different regions. We were also able to narrow down the risk of reaching the tipping point and identified that it would only affect a minority of authorities with 2016 emerging as the crucial year for them.

This report takes that analysis forward, using information gathered from our work at local authorities during financial year 2013/14.

Evolution in financial management

The last four years have presented an unprecedented challenge to local authorities, but it is a challenge to which many have risen. This report looks at how financial management arrangements have evolved over the period; what still needs to be done; what good arrangements look like; and what the future holds.

Our approach

Our core research is based on a detailed assessment of information from our statutory Value for Money (VfM) audits at 133 local authorities, for the financial year ending 2013/14. This used a combination of document review, supplemented by interviews and a supporting survey, which received 108 responses. We also draw on our research from the previous three years as a comparison and to provide an all-round view of the financial management arrangements in place and their effectiveness.

The thematic areas analysed were:

- **Key indicators of financial performance**
  What are the financial outcomes? This provides insight into the overall effectiveness of the financial management arrangements reviewed under the other three themes. This includes benchmarking against the Audit Commission 'nearest neighbours'.
- **Strategic financial planning**
  Does the authority have a robust financial plan? This theme focuses on financial planning arrangements and the medium-term financial plan (MTFP). This includes the plan's scope; the key financial assumptions made; its relationship with wider strategic and service planning; and its flexibility in changing circumstances.
- **Financial governance**
  Does the authority demonstrate effective financial governance? This focuses on the overall governance of financial planning; monitoring and delivery by the senior management team; and effectiveness of the overview and scrutiny of financial matters by council members.
- **Financial control**
  Has the authority established strong financial controls? This theme looks at the arrangements in place to ensure the delivery of financial plans. This includes savings; the capability of the finance team; and the effectiveness of assurance and risk management arrangements.

Within each of these themes, we identified a number of sub-categories (outlined in Table 1) and gave each a red/amber/green (RAG) risk-rating using the criteria provided in Table 2. The latter was based on a judgement on the part of the reviewer against our VfM framework to provide consistency across authorities.

Generally, a red rating reflects a significant and immediate risk to an organisation's financial resilience. Amber ratings reflect arrangements that are not at optimal effectiveness, but do not pose an immediate significant risk if attended to. Green ratings reflect adequate arrangements, but not necessarily good practice. We have included a checklist of good practice in Appendix A.

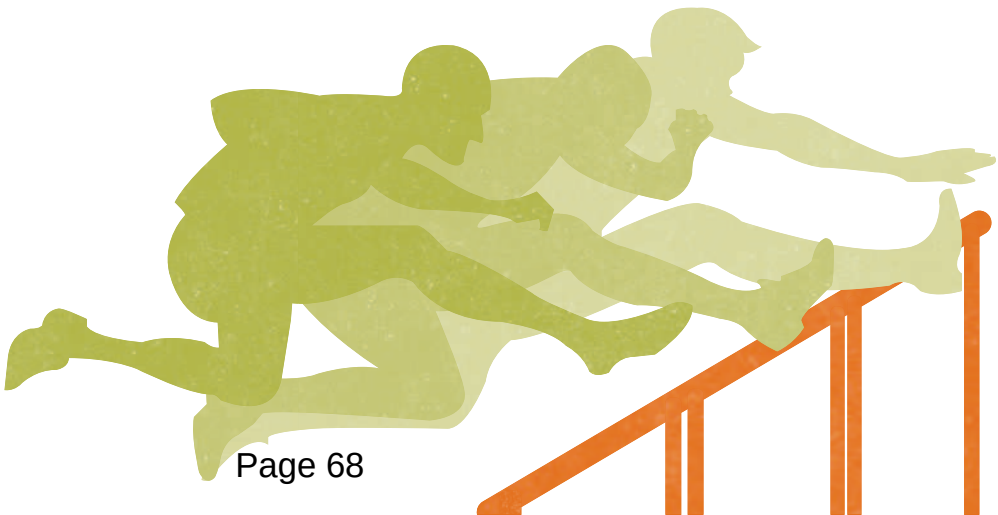

Table 1 Themes and categories for analysis

Theme	Sub-category
Key indicators of financial performance	Schools balances*
	Reserve balances
	Performance against budget
	Workforce
	Borrowing
	Liquidity
Strategic financial planning	Focus of MTFP
	Adequacy of planning assumptions
	Scope of MTFP and links to annual planning
	Review processes
	Responsiveness of the plan
Financial governance	Understanding the financial environment
	Executive and member engagement
	Overview of key cost categories
	Performance management of budgets
	Accuracy of reporting
Financial controls	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

Green	**Arrangements meet or exceed adequate standards** Adequate arrangements identified and key characteristics of good practice appear to be in place
Amber	**Potential risks and/or weaknesses** 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
Red	**High risk** The authority's arrangements are generally inadequate or may have a high risk of not succeeding

Rising to the challenge

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In 2010, the government spending review triggered uncertainty over whether local government was facing a financial tipping point that threatened the survival of local services as we knew them. Four years later, local authorities are still delivering local services to a high standard within a balanced budget. Many are forecasting financial resilience confidently in their medium-term financial strategy. This is a major achievement and reflects an evolution in financial management that would have been difficult to envisage given the original reaction of the sector to the spending review in 2010.

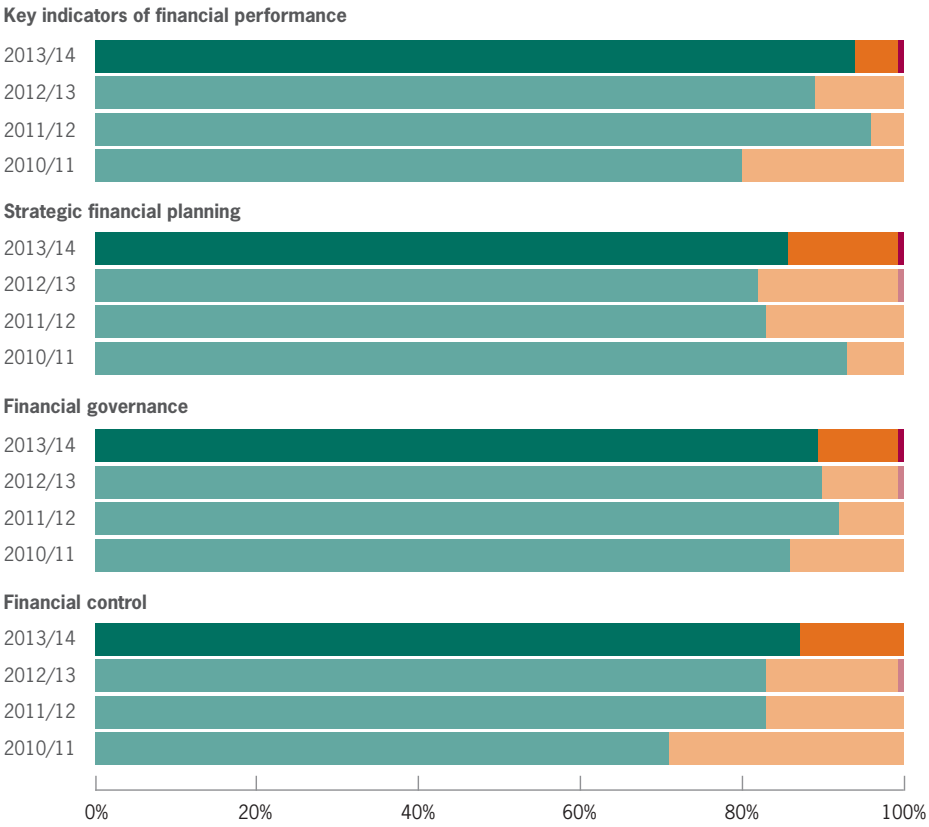
The narrative around austerity and local government funding reductions has been relentlessly negative over the past four years. This was driven largely by valid concerns for the future of local services as we know them. There were also concerns about whether it was possible to effect change on the scale required and whether local government institutions could survive in their current form.

This change would need to be structural, in terms of the way service delivery is organised, but also cultural, in terms of the way the whole organisation is aligned to the future strategy of the authority. The latter is arguably the harder to achieve, and therefore the most critical.

It was always likely that the scale of central government funding reductions would lead to cuts in some service provision. This has started to happen although not to the extent that might have been expected by this point.

Serious concerns remain about whether local government services in the age of austerity can continue to meet the needs of the public, in the face of demographic and economic pressures. Concerns also remain about the funding structure for local authorities, and whether it allocates funding fairly in relation to local geographic, demographic and economic conditions.

Figure 1 Summary ratings over time – all local authorities



The recent interim report of the Independent Commission on Local Government Finance ('Public money, local choice'), concludes that funding arrangements are 'broken'.

It recommends that in the future funding should be entirely locally derived – specifically through retention of business rates and a revision of council tax valuations. The impact on future funding arrangements remains to be seen. However, the scope of this report is to question whether local authorities can effect large-scale change and manage with significantly reduced funding. We are getting the first hints that the answer is yes they can, but not without impacting significantly on the services they deliver.

Evolution in the age of austerity

Through our series of reports on the financial resilience of local authorities over the last four years, we have tracked the effectiveness of financial management arrangements. Most authorities have weaknesses or risks in their arrangements of one kind or another and a minority have multiple weaknesses. But there are very few councils with red-rated, critical issues arising.

The NAO's report, 'Financial sustainability of local authorities 2014', provides a note of caution. It states that 56% of metropolitan and unitary councils local auditors are concerned that their clients will not meet medium-term savings targets. Our analysis aligns with this: 60% of councils of this type within our sample had at least one amber or red-rated risk that could affect the delivery of the medium term financial plan if not addressed. However, our experience over the last four years gives us some confidence that these risks can be overcome in many cases.

What stands out is how local authorities have maintained and in some cases improved their financial performance, in the face of ever increasing challenges.

This is even more impressive when you consider that the level of sophistication and effectiveness required to achieve it has increased year on year. By March 2015, the first period of austerity envisaged in SR10 will have been navigated successfully by almost all local authorities.

Through a combination of necessity, innovation and strong leadership, many organisations have risen to the challenge. Through our work, we have seen financial management arrangements strengthen greatly over this period, with financial control showing particular improvement.

With the possibility of greater devolution of powers and financial freedoms on the horizon, strong arrangements will become ever more important. Local authority members and the public are having to come to terms with the fact that in future their organisations will look and feel very different to the way they did before 2010. But we are only part way through the age of austerity and significant challenges remain which will continue to drive the evolutionary process.

The tipping point?

In our earlier reports, we said that a financial tipping point could be approaching for some local authorities and that significant work had to be done to avoid this risk. The tipping point could have a number of characteristics, but would broadly reflect a point where financial balance was no longer possible, recovery was no longer within the power of the organisation and the continued delivery of services was no longer feasible (Appendix B).

This would be a situation similar to that suffered by the local authority in Detroit (USA) and a growing number of NHS organisations (in the context of significant deficits rather than bankruptcy). This year's research has enabled us to refine this view, because the uncertainties have started to clear. The likely destination for individual authorities is now crystallising in the next generation of medium-term financial plans that take us up to 2016 and beyond.

What now seems clear is that many local authorities should be in a position to secure financial resilience on a sustainable basis, assuming that funding arrangements remain on their current trajectory. However, a minority of authorities are still facing the prospect of a tipping point and 2016 still resonates for them. For single-tier authorities and counties, the 'graph of doom' scenarios around demand-driven services, in particular social care, remain a key part of the challenge. Broadly these predict that, without transformation, local authorities may only be able to fund social care by 2020 if they drastically reduce or even stop other services.

But even here new ways of delivering services are emerging – such as care at home, prevention and early intervention – that can alleviate some of these risks. We are also seeing some progress around health and social care integration, which is explored further in our report on the implementation of the Better Care Fund. By 2016, it will be clear whether the current MTFPs are on track to deliver. Those who have struggled to establish effective arrangements to date are those most likely to face a tipping point in 2016.

What does the future hold?

Predicting the future is fraught with difficulty, particularly as the outcome of the 2015 general election is unpredictable and could have far-reaching consequences for local government financing. But chief executives are showing increased confidence about the future of their organisations.

The localisation agenda is gaining momentum. Greater control over financial decisions in local authority areas, coupled with better co-ordination between public sector agencies, opens up some exciting possibilities for improving services and delivering them more efficiently.

We have already seen significant change in the culture of local authorities. Finance is no longer solely the preserve of the finance department. Responsibility, accountability and financial skills have permeated throughout the whole management structure. A strong culture of continual improvement, efficiency and financial control, aligned with the authority's medium term strategy, will become a necessity over the next few years. There is significant work to be done here, particularly in regard to engaging front-line specialists in financial management. This should be an important area of focus for local authorities.

Our report on the future of local government, '2020 Vision' (2014), builds on this and other themes and is a useful companion to this report. '2020 Vision' explores a number of potential scenarios that local authorities might face, including 'adaptive innovation', 'running to stand still' and 'withering on the vine'.

Analysis by authority type

When we divide the findings by authority type, we see that the level of risk and weakness is not distributed equally. This does not imply that some types are not as well run as others. Rather it reflects that different types face different levels of pressure, due to their size, breadth of responsibility or geographic, demographic or economic profile.

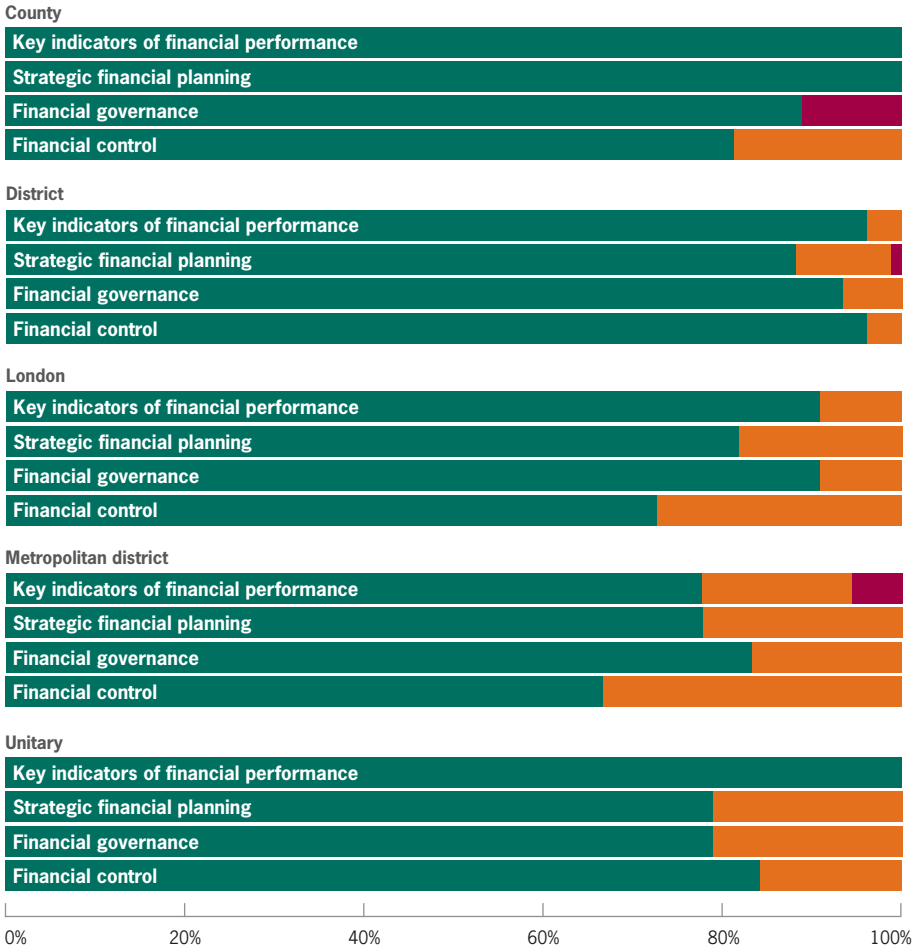
The analysis shows that single-tier authorities of all types are under more pressure than counties or districts. This probably reflects some differences in the funding structures between single- and two-tier arrangements. All single-tier authorities show strategic financial planning as an area of concern, which reflects the scale of savings required over the next few years.

Metropolitan district councils and London boroughs, both with urban demographics, show some similarities in the pattern of amber ratings for key financial indicators and financial controls, which are often closely linked. The metropolitan borough councils, concentrated in the north of England, show a higher number of issues in both areas, which is likely to be linked to the less favourable economic conditions compared to London – affecting both revenue potential and cost pressures.

Unitary councils – often with a greater rural population and concentrated in the midlands and south west of England – show a different pattern with reasonably strong key financial indicators. These are perhaps linked to fewer problems with financial controls. However, they have more problems with financial governance, certainly in comparison to the London boroughs. This could be related to the relative access to members with strong financial backgrounds enjoyed by some London boroughs.

The population of county councils in the sample is comparatively small, so it is harder to draw firm conclusions. However, the counties appear relatively strong compared to single-tier councils, despite similar responsibilities for adult social care and other demand-led services. Financial control seems to be the main area of concern. Although this has not yet impacted on key financial indicators, there is a risk of this in the future in some cases.

Figure 2 Summary ratings by local authority 2013/14



District councils fare better. They do not have the pressures of demand-driven services such as social care or large-scale urban or rural deprivation that other councils face. With some exceptions, district councils are under comparatively less pressure from current funding arrangements. However, in proportion to revenue, some districts have had to deliver significant savings and have done this largely successfully.

There have also been some good examples of innovation, with districts leading the way with shared services and joint management arrangements. Many districts, particularly in the south east, are planning for a near future where they are financially independent, with services being funded entirely by local taxation and other revenue streams. The challenge for some districts is to drive efficiency and find new ways of working without having the 'burning platform' of necessity experienced by other types of authority. The motivation should be to minimise council tax rises and to fund capital programmes within the current financial envelope.

Analysis by region

By classifying councils by region some broad patterns are identified.

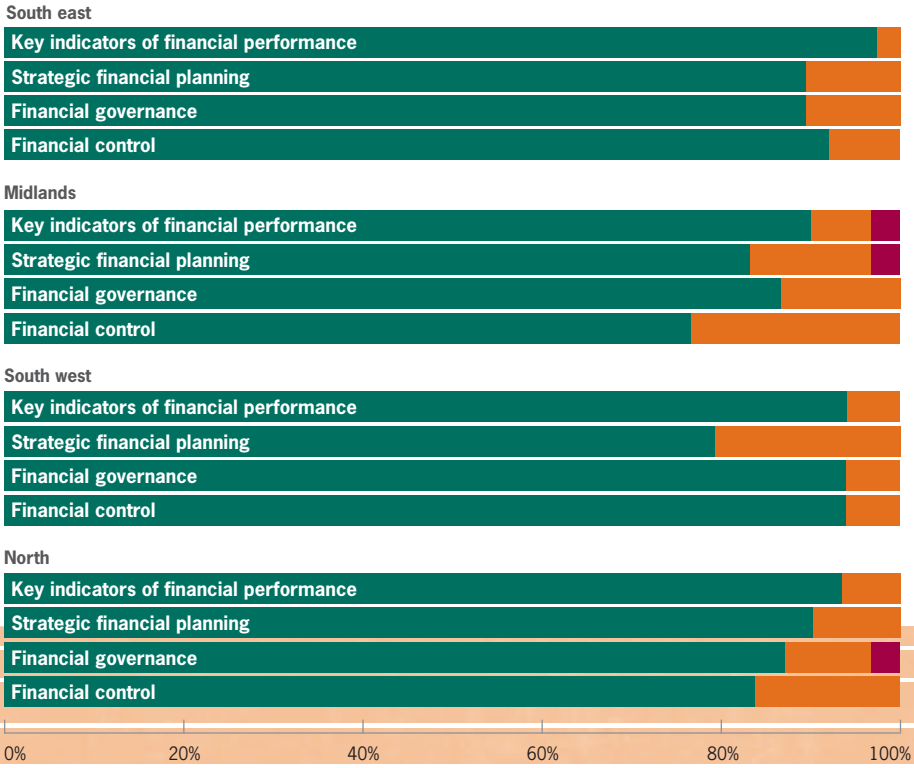
The midlands has the highest level of financial challenge followed by the north of England. In both cases there is a combination of issues which are broadly proportionate across all four themes. The north and midlands have a small number of authorities where the issues are particularly acute (red-rated) that we have not seen in other parts of the country and the highest frequency of issues with financial governance.

The midlands also had the highest level of issues for key indicators of financial performance, with strategic financial planning also being an area of difficulty.

The south east of England is generally faring better than both the north and midlands across all themes, strengthened by the presence of affluent areas in some London boroughs and districts.

The south west of England, with its more rural profile, fares well in 2014, except in strategic financial planning where there is a higher concentration of issues than elsewhere. This indicates that authorities are meeting their financial targets and are reasonably well governed and controlled. But there are concerns about the scale of savings and transformation required to maintain this in future years.

Figure 3 Summary ratings by region 2013/14



Summary

There is reason to be positive about the way that local government has navigated the first period of austerity. But there remains much to be achieved if it is to become sustainable in the long term. Authorities should consider how their:

- medium- to long-term strategy redefines the role of the authority creatively
- operational environment will adapt, working in partnership with other authorities and local organisations
- strategy looks beyond the traditional two- to three-year resource planning horizon
- organisational culture is aligned to where the authority needs to be in the medium to long term
- senior leadership teams – both officers and members – have the necessary skills and capacity to ensure delivery against the medium-term challenges
- corporate governance arrangements ensure effective oversight and scrutiny of the organisation as it adapts to the challenges it faces.

The importance of these actions will be magnified if local government devolves further, particularly in relation to fiscal devolution. The new-found confidence of local government in responding to medium-term challenges will be tested sorely by the second half of the austerity period and the complexity created by fiscal devolution, continued evolution of alternative delivery models and closer integration with other public bodies.

It is unlikely that in balancing the books local government will be able to preserve all of the services it currently delivers. Renegotiating service provision with the public (to enable it to remain within a reducing financial envelope) will be a key task for local government in the next few years.

Key indicators of financial performance

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In the fourth year of our work on key indicators of financial performance, we see a significant improvement across the board compared to the previous year. While some authorities continue to struggle, more are returning to the longer-term trajectory of improvement in delivering sound financial outcomes.

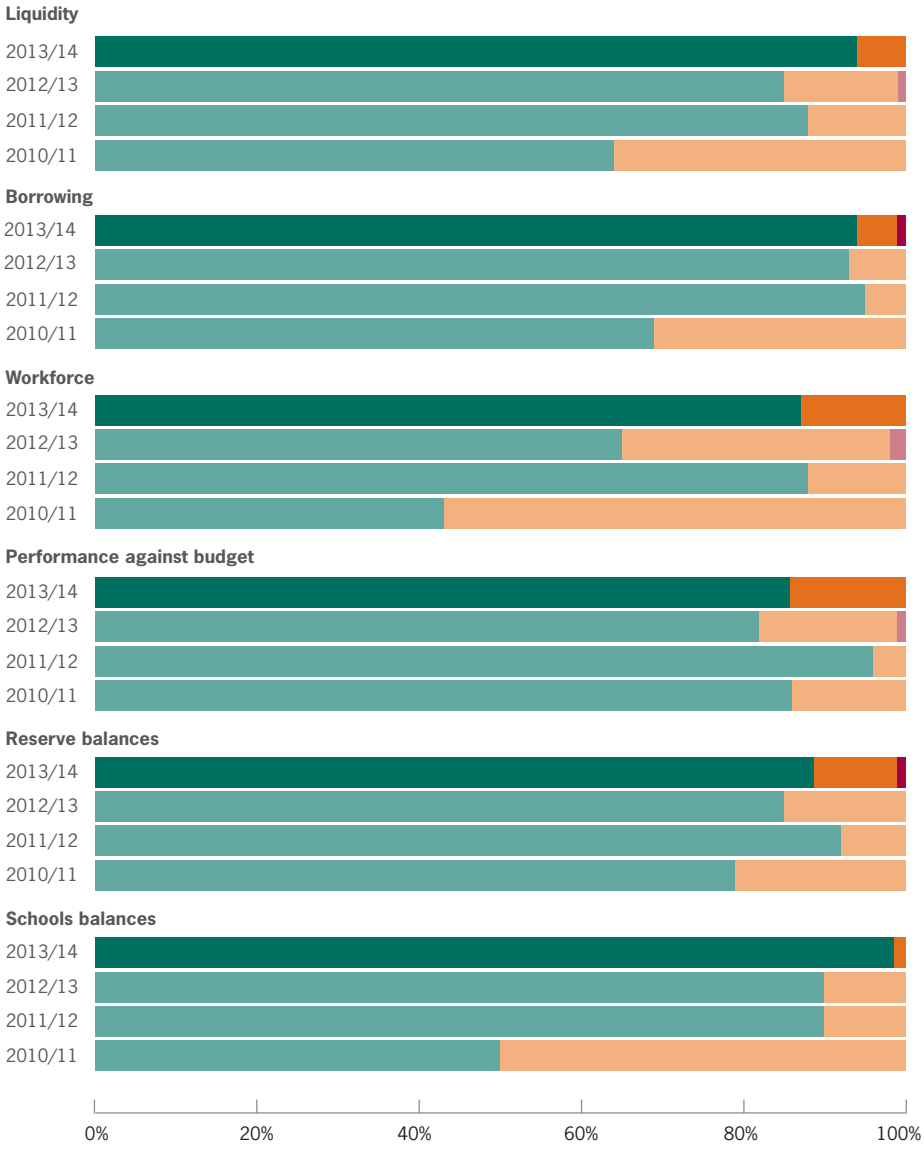
While common in other parts of the public sector and the commercial world, the use of financial ratios and performance indicators remains a comparatively rare feature of local authority financial reporting. This is gradually changing though. This type of analysis is useful as it helps to test whether arrangements that appear to be robust are actually resulting in good financial outcomes.

The key performance indicators (KPIs) we use cover a number of aspects of financial performance. Where possible, we draw on the Audit Commission's benchmarking of financial ratios to provide context.

The majority of authorities continue to deliver good financial outcomes and a robust financial position – a significant achievement given the challenges they face. Our analysis of sub-category ratings over time shows a long-term trend of improvement in all areas. But 2012/13 saw an upsurge in amber potential risks and weaknesses, with a few authorities incurring red ratings. This position has broadly recovered in 2013/14 although not to the levels seen in 2011/12.

In 2012/13, savings challenges started to bite. This may have impacted on a number of indicators. It seems likely that 2013/14 is a reflection of the action taken by authorities to restore control over the delivery of financial plans.

Figure 4 Key indicators of financial performance



Liquidity

We assess the 'current ratio' of assets (cash or assets that are readily convertible to cash) to liabilities (short-term liabilities that require prompt payment). We then look at benchmarking information to see if the authority has a low ratio in comparison to its peers and whether there is enough cash to cover short-term liabilities, with a margin of safety.

This is a rough measure which is common in the private sector. The risk of running out of cash is less acute for local authorities, due to the security of grant income receipts and the low-value, high-volume nature of local taxation, coupled with reliably high collection rates. Increasing numbers of authorities are taking advantage of the security of their income to maximise returns from short-term investments.

The low number of amber ratings in 2013/14 (6%) reflects the increasing recognition that a low current ratio does not necessarily present a problem, as long as treasury management is effective.

Borrowing

We look at benchmarking information for groups of similar authorities. This includes the ratio of long-term borrowing to long-term assets held (assets are used as a proxy for the size of the authority) and the ratio of long term borrowing against tax revenue (revenues are used to assess the ability to repay from locally-generated income, as opposed to grant funding that could be withdrawn). In line with previous years, there is only a small minority of authorities where borrowing is sufficiently large to present a risk to financial resilience (about 6%).

Workforce

We consider a range of workforce indicators, such as staff turnover, agency staff costs and the rate of appraisal. However, the primary indicator we use is the number of full-time equivalent staff working days lost to sickness during the year.

High sickness absence has implications for productivity, as well as associated costs, for example, agency staff. It can also provide an indication of working culture and staff engagement, which often have indirect financial implications. Although there are some fluctuations, the long-term picture is one of gradual improvement, with most authorities now monitoring sickness absence and taking action to reduce it.

The public sector benchmark is an average of eight days per full time equivalent lost to sickness per year, but a small number of authorities have significantly lower rates that are comparable to the private sector. Authorities with a high proportion of traditional 'blue collar' jobs in-house seem to have more problems with sickness absence. Conversely, high levels of agency staff in areas such as social care can artificially lower the sickness rate. The longer-term trend of improvement may reflect the degree of outsourcing that has taken place in the last four years alongside stronger workforce management.

The average number of sick days lost in the sample was eight, broadly in line with the public sector average. However, a minority of authorities had achieved significantly lower rates by revising their workforce management arrangements.

Performance against budget

This is a crucial indicator as it helps validate both the strength of planning arrangements and the effectiveness of financial control. A good track record of delivering to budget is a strong indicator of whether future financial plans, including large-scale savings, can be delivered.

In 2012/13, there was an upsurge in budget targets missed. Although there has been improvement, a significant minority of authorities (14%) have still struggled to deliver in 2014. The most common trigger for an amber rating is a significant revenue budget overspend. This often relates to demand-led services such as adult or children's social care. This will be a key battleground over the next few years and persistent under-budgeting in these areas is a danger sign for future financial resilience. Any authority with weaknesses in this area that is not well advanced in service transformation is likely to face financial difficulty in the immediate future.

Just under half of the issues raised relate to underspent capital budgets, which is often down to unrealistic planning assumptions or weaknesses in

the management of capital programmes. Unavoidable delays are often part and parcel of major capital schemes – which often span several years – and this would not normally trigger an amber risk unless there were doubts about capital scheme management.

This raises questions about the value of monitoring annualised capital budgets, other than in terms of cashflow, and whether authorities should be looking at alternative ways of reporting progress on capital schemes, focusing more on the risk of slippage to planned completion dates.

Reserves

We use peer group benchmarking information for the ratio of total useable reserves (general fund, earmarked reserves and useable capital receipts) compared to the gross cost of services. Comparison of the authority to the average for other similar authorities provides a useful starting point for discussion about whether reserves are sufficient. We also consider whether reserve levels are reducing year-on-year and whether this is part of a measured plan or whether the authority has, for example, used reserves to cover an unplanned revenue budget overspend.

In 2013/14, the number of ambers relating to reserve levels has reduced, in line with the longer-term trend, although a minority of authorities (11%) did have notably low levels of reserves. In these cases, the ability to absorb unexpected financial shocks, to maintain services during transformation, or to invest in schemes and services, can be limited severely. It can also force authorities to borrow to fund capital programmes or to forgo capital investment.

Low or reducing reserve levels is a strong indicator that the authority might struggle to maintain financial resilience in the coming years. But despite the challenges, most authorities have maintained or increased their reserve levels to insure against financial difficulty.

Schools reserves

This indicator only affects county and single tiers with responsibility for oversight of schools. This area has dropped significantly as a risk to authorities over the four-year period. This is partly in recognition of the limited control they can exercise over schools and the limited risk that financial difficulties at a small number of schools could have a material effect on the authority's finances.

In addition, increasing numbers of schools have transferred out of local authority control over the four-year period. Where school reserves are low, it is often because of their cumulative failure to deliver to budget or to set aside reserves within financial plans. In these cases, the local authority has a responsibility to help the schools to recover a more sustainable financial position.

Case study

At Wigan Council, early delivery of the 2013/14 savings plans has allowed funds to be released for the creation of a number of new reserves which will offset some of the risks around the delivery of the Council's transformation programme. The opportunity has also been taken to re-prioritise and re-package a number of existing reserves to assist in the delivery of the transformation agenda. Wigan consider the key to its success in delivering savings to be close monitoring and regular progress reporting, and building required efficiencies to be built into base budgets, and reviews of specific service area budgets, to maintain provision of high-quality, responsive and cost-effective service.

28% of authorities, many of them single tier, considered themselves at risk of a financial tipping point, at some point between 2016 and 2018 if financial plans were not delivered.

Strategic financial planning

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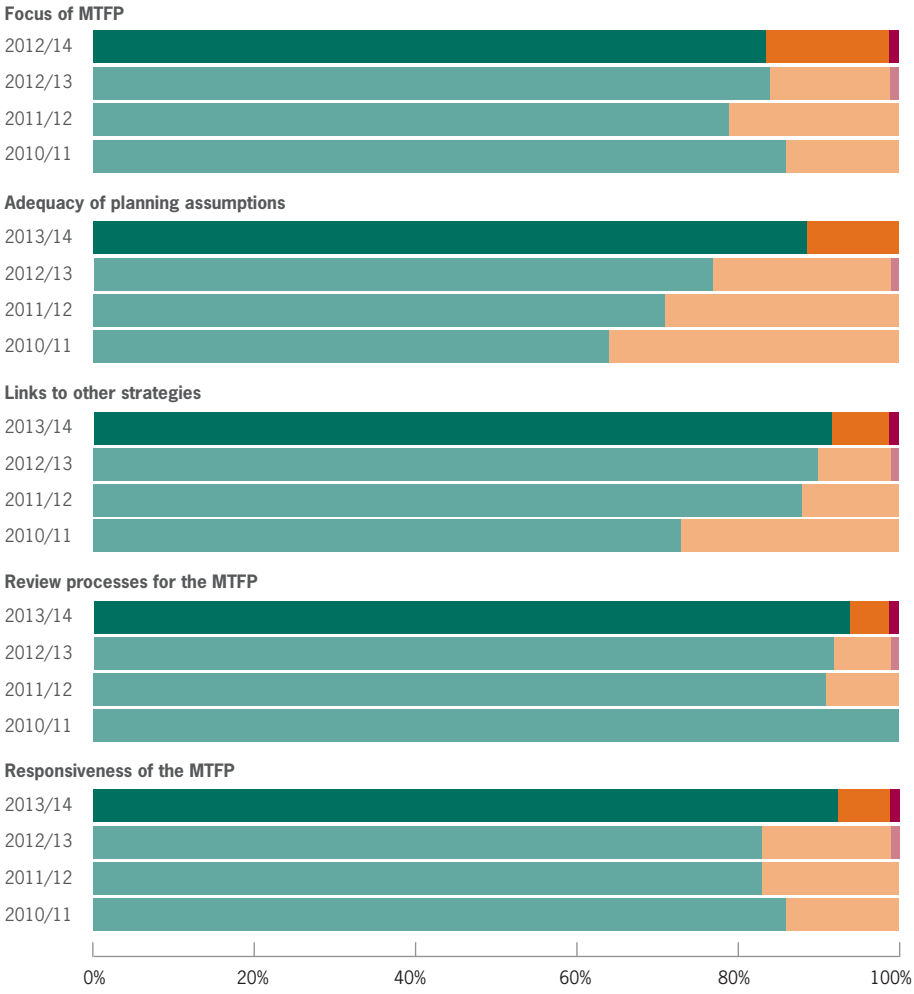
Local authorities have continued to improve and strengthen their strategic financial planning arrangements in line with the long-term trend. Many authorities have delivered their first post-2010 MTFP and have developed new plans for the period to 2016 and beyond. These new plans reflect the additional skills, insight and experience that they have acquired over the last four years.

Robust strategic financial planning is crucial to the future financial resilience of local authorities. Our analysis shows improvement across all sub-categories within the planning theme. This is a strong indication of significant evolution in the sophistication and effectiveness of planning processes. It is partly driven by necessity, but also by the realisation that future financial risks and pressures need to be understood fully, modelled and planned for, to an extent not previously considered.

Authorities have made particular advances in the adequacy of planning assumptions and the responsiveness of the MTFP. The level of ambers for the 'focus of the MTFP' sub-category has improved only marginally and remains a concern for a significant minority of authorities.

Figure 5 Strategic financial planning



Focus of the MTFP

This area looks at the overall scope of the MTFP, the range of forward planning and the extent to which the planned outcomes are achievable and aligned to the longer-term financial health of the authority. Although arrangements at most authorities remain adequate in proportion to their overall financial position, a significant minority (15%) carry potentially significant risks and weaknesses in 2013/14 – a consideration of different scenarios in the underlying financial modelling, or a failure to maintain a fully-developed financial planning horizon of at least three to five years.

The most common trigger was the scale of savings that needed to be achieved over the life of the plan, particularly where it was unclear how

Case study

At St Helens Metropolitan Borough Council (MBC), fully integrated financial and service planning together with joint financial and performance reporting help to ensure that it can concentrate resources on achieving priority outcomes. Departmental directors and the assistant chief executive for finance hold monthly meetings to discuss budgets, progress against key performance measures, issues relating to service delivery and actions required to address any identified concerns. The result is that clear, consolidated reports, covering both budget and service performance monitoring, are presented to cabinet on a monthly basis.

St Helens MBC also believes that gathering the views of local people and key stakeholders should be an integral part of the budget-setting process. Through its budget consultation and budget simulator initiatives, the council allows interested parties to advise on the most valued areas of its spend. The council makes the budget consultation available annually, and publishes a summary report on its website. At the same time, work continues in the form of zero-based reviews of portfolio budgets, and reviews of specific service area budgets, to maintain provision of high-quality, responsive and cost-effective service.

this would be achieved. In almost all cases, some or all of the in-year savings requirement for 2015/16 and beyond had yet to be matched to defined savings schemes. In some cases, the short timescale for delivering these savings was the main concern. In addition, some authorities continue to rely on further efficiencies and top-slicing of budgets rather than transformational schemes.

In this small number of cases, the ambers could quickly turn red in the next two years if significant progress is not made. By 2015/16, it will be apparent whether the current MTFPs, particularly those with significant savings, can be delivered. This supports our contention in previous years that for at least a small number of authorities, 2016 will mark the financial tipping point.

Conversely, we have seen that increasing numbers of district councils, particularly in the south east, are planning for a future where they are broadly self-funding, with MTFPs that reduce the reliance on central government grant to a bare minimum.

Adequacy of planning assumptions

This area has seen significant improvement in 2013/14, compared to the prior year. This probably reflects the number of new MTFPs that have come on line during the year, for 2014/15 and beyond, and the fact that the depth of analysis in many cases is significantly stronger than in the first wave of plans in 2010/11.

For example, we are seeing increasingly sophisticated use of demographic information to predict growth in demand for services, for example in adult social care, as well as the potential for growth in council tax and business rate income. Assumptions around income growth – whether from fees and charges, property or other investments, or from commercial income sources – also feature much more strongly.

A minority of authorities (10%) still have risks around the financial assumptions. There is some crossover here with the focus of the MTFP sub-category, in that the scale of savings required also features as a prominent amber trigger. Under this sub-category, the lack of a strong track record of delivering savings casts doubt on the assumption that the large-scale savings needed could be delivered. In some cases, there was a doubtful assumption that previously weak arrangements for delivering savings could be improved quickly enough to achieve plans in the following year. Other triggers related to a range of authority-specific issues.

Links to other strategies

There has been a consistent and gradual improvement over the four years of review in this area. Authorities have increasingly demonstrated effective and mutually supportive links between

33% of authorities had a planning horizon on their MTFP of only two years. 26% had a horizon of three years and only 36% had a horizon of four years or more.

Case study

A number of councils have demonstrated innovative thinking in achieving efficiencies in their services and delivering better services for less. Elmbridge Borough Council's work in collaborating with neighbouring authorities in the joint delivery of family support services was notable in its success in delivering improved outcomes for families and also resulting in reducing cost to public services overall.

strategic plans, the MTFP and service plans; and links to supporting strategies such as treasury management, capital programmes, housing, workforce and other areas. The few ambers that were raised tended to relate to individual supporting strategies that needed reviewing.

Review process

This area has consistently been the strongest sub-category in the theme. Almost all authorities review their MTFP annually, including presentation to members. In many cases this has prompted amendment of the MTFP, often in regard to the quantum or phasing of savings needed – for example, following government announcements.

In a few cases, the MTFP had not been refreshed, with significant changes being made in annual budgets, resulting in a lack of coherence between the two. In other cases, the MTFP had been allowed to run down to within a year of completion, potentially reducing the forward-planning window. However, in most of these cases this was mitigated by evidence of a longer-range view provided by the underlying financial modelling and revised savings and transformation plans.

Responsiveness of the plan

This is another sub-category that has seen significant improvement since 2013/14 and reflects the new generation of MTFPs. The main focus is on the ability of the plan to absorb financial risks – specifically the extent to which adverse scenarios have been anticipated and mitigated against – and on the flexibility to deal with as yet unforeseen scenarios.

The strength in this area is partly related to the fact that most authorities have set aside significant reserves to provide this flexibility. Many authorities have also built further contingencies into their annual budget. A number of authorities have benefitted from their policy of delivering savings in advance of need and then stripping the savings from the start of the new financial year.

This means that savings plans delivered early provide additional unbudgeted savings that can be held in reserve or used to tackle other budget pressures. Others have benefitted from budgeting investment income based on worst-case scenario returns, in the expectation that income will exceed that planned. As long as the use of additional income to fund overspends is reported transparently – corporately and by services – this is a reasonable and helpful strategy.

Case study

Councils across the country have developed initiatives to make savings in back office expenditure, without depleting resources. The London Borough of Bexley has reduced the number of physical offices used by council staff and reported savings in annual running costs of £1m at the start of 2014/15, rising to £1.5m in future years, as a direct result of this process. In addition, the surplus capital receipts generated from the disposal of former office sites will also reduce the need for borrowing to fund the council's capital programme. At Stockport Metropolitan Borough Council, the roles of staff have changed to create greater efficiency, with roles becoming more generic to allow for greater flexibility in the back office. Tewkesbury Borough Council has redeveloped their property and rationalised the space utilised by their own employees, allowing them to let out space to other entities, such as the county council's adult and children social care services, the police, the DWP, the fire service and the Citizens Advice Bureau, creating a 'public sector hub' to give local people a centralised location to access a range of services. The annual rent benefit to the council is currently £160k with £235k expected in 2015/16.

The average annual savings requirement for 2013/14 was 1.5% of the gross cost of services. This was broadly consistent across all types of council. The highest level of annual savings was 4.6%.

Financial governance

7

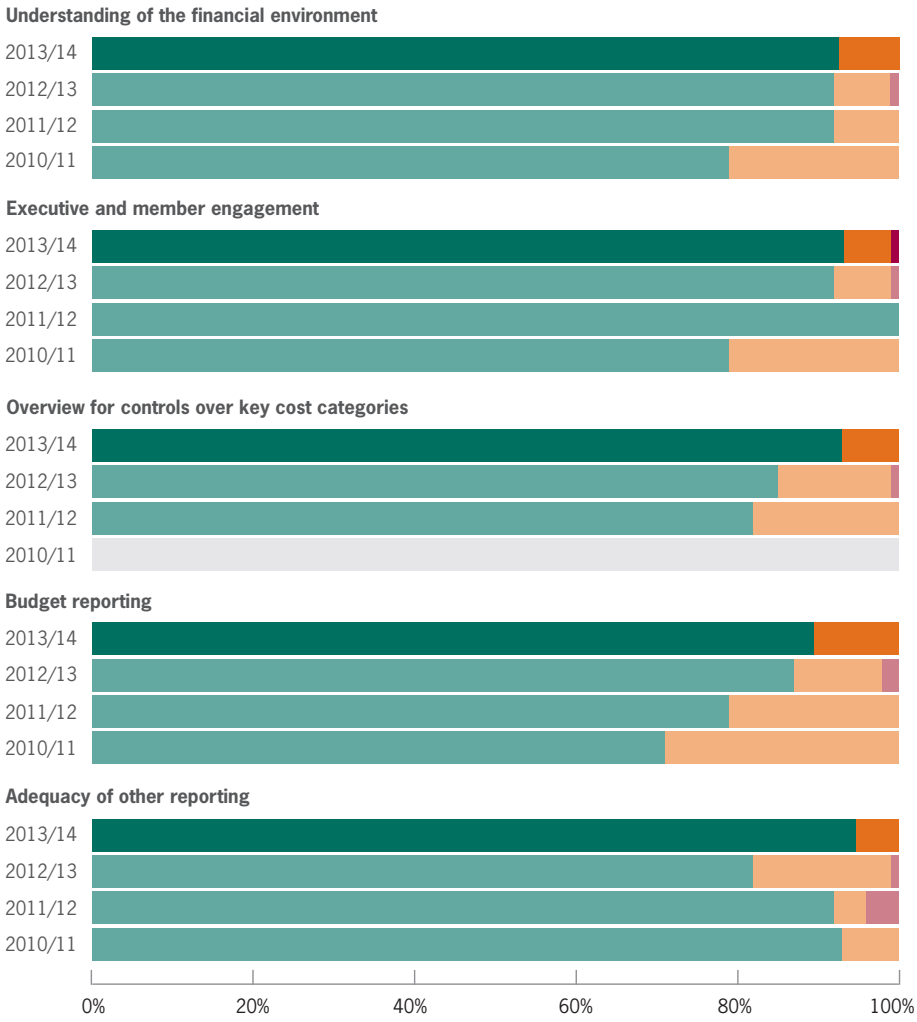
Financial governance remains a relatively strong area for local authorities. In addition to providing oversight and scrutiny, the executive team and members set the tone and the culture of the organisation. This is emerging as a key factor in ensuring financial resilience.

Our work in this theme indicates that overall financial governance continues to strengthen, particularly in the quality and access to information presented to members. This facilitates effective oversight of financial delivery.

The relationship between members and the management of the authority is a complex one, where political and administrative priorities need to be balanced carefully. Members are not necessarily experienced in financial matters, but the onus is on them to engage in the process alongside management's responsibility to support them with advice and information. These factors have to be taken into account when we are assessing what adequate arrangements look like. There will always be some tension between the competing priorities and concerns of members and management.

Although there is an overall reduction in the number of ambers in the detailed sub-categories, there is a slight increase in the number of authorities where governance was rated amber overall. While weaknesses in governance are relatively rare, where they do occur they tend to result in serious financial and/or reputational issues and can affect a broad range of operational areas. While there may be relative strength in core governance procedures, weak governance over key partnerships and within an authority's group structure can still present a significant risk if not reviewed and tested adequately.

Figure 6 Financial governance



17% of authorities do not view cultural change as a priority in regard to delivering financial plans and savings. 28% do regard it as important but have yet to take action. 28% have attempted to change the culture with limited success. Only 32% have managed to improve the financial culture of the organisation successfully.

Understanding the financial environment

This indicator looks at the extent to which members and management have a good grasp of the financial conditions and risks that the authority faces currently and in the next few years. It also reflects on the organisation's culture for finance and the strategic tone that the leadership has set. As might be expected, the level of understanding is high, with over 92% of authorities rated as green.

Over the past few years, members have had to make increasingly difficult decisions about the delivery of services. A better understanding of the underlying issues helps to build mutual confidence with the management team and to extend the organisation's risk appetite. This is particularly apparent in the increasing levels of innovation, for example, with joint working between authorities and other partners, and setting up alternative delivery models for services.

There are still a small number of cases where members have been resistant or slow to appreciate the need for a more radical outlook in regard to the sustainability of services. Some still look to the back office or to piecemeal efficiencies to provide the savings they require, and do not see a strong culture of financial efficiency as a priority, whatever the financial position. In these cases, the onus is on officers to take a stronger role in helping develop their appreciation of the financial environment and the longer-term outlook.

Member training on financial matters and their role in governance remains a weak point at many authorities. This is particularly acute in a year that has seen many new members arriving following election.

Executive and member engagement

This looks at the extent to which members and the management team engage with the financial planning and delivery and act to address problems as they arise. It also looks at the extent to which members participate in and drive the process of financial governance.

Again, this shows a slight improvement from 2012/13, and remains a relatively strong area with 93% of authorities rated green. Where ambers and one red did occur, this was related to: insufficient scrutiny of financially significant decisions; lack of effective action taken on reported financial delivery issues; and insufficient challenge or awareness of financial plans and amendments to budget.

Case study

London Borough of Sutton has demonstrated how integrated reporting can improve members' understanding of the whole picture of delivery. Their Strategy & Resources Committee reviews the financial performance report with integrated KPIs including customer service and workforce information on a quarterly basis. Members therefore review service performance in the context of the financial envelope and the progress of the major change programmes, including savings delivery against targets. The balanced scorecard includes customer feedback and workforce KPIs in a summarised accessible format.

By developing a detailed MTFS with a planning horizon to March 2019, in line with their new Council Corporate Plan, London Borough of Sutton has also been able to identify savings requirements on a long-range basis and put mitigating planning arrangements in place to ensure that they are met. When the MTFS was revised in July 2014, it was determined that the projected funding gap over the period of the plan would be £38m, due to cost pressures and significant forecast reductions to the revenue support grant. By formulating this projection in advance, Sutton now have scope to develop and deliver efficiency plans phased over a significant period of time, easing the burden on staff and the impact on service users.

7

Case study

Herefordshire County Council has taken a bold move in response to changes in provider markets, bringing previously outsourced services back in-house and restructuring existing outsourced contracts. When Herefordshire identified that the outsourcing of its social workers to a local NHS Trust to deliver some aspects of its service was not delivering appropriate outcomes, the contract was terminated, a radically redesigned in-house social work service implemented and the direct provision elements re-commissioned, delivering significant cost savings. Herefordshire have also renegotiated their leisure services contract, using capital investment to improve facilities, increase participation, reduce subsidy cost and improve public health outcomes.

Members receive detailed financial information at committee every two to three months at 73% of authorities. They receive monthly information at 16% of authorities. Only 11% receive updates less than quarterly.

Overview of key cost categories

This looks at the extent to which the governance arrangements provide members and the management team with a good grasp of the full range of financial and operational issues affecting the authority. This is another relatively strong area and has seen significant improvement in 2013/14. One key area of improvement has been in the way that audit committees follow up internal audit recommendations properly. The managers responsible are increasingly being held to account – often being called into meetings to explain non-compliance.

This has also led to the agreement of appropriate recommendations being given more importance. We have seen an upsurge in the establishment of member-led financial scrutiny committees or other finance-focused groups, within the authority governance structures. This additional focus can often have a significant impact on the delivery of financial plans and savings, particularly in larger authorities.

Budget reporting

This covers the scope, depth and accessibility of budgetary performance information provided to members. The last four years have seen a consistent year-on-year improvement in this area. By 2013/14, 89% of authorities were rated green. However, it remains the most problematic area in the governance theme.

Our focus on recommending improvements to our clients in the area of reporting to members has helped to fuel this improvement. But most authorities have themselves recognised the importance of strong high-level reporting as a key pillar of strong financial governance – in many cases prompting internal review and consultation with members.

More authorities are now achieving a good balance in the breadth and depth of the information provided. Methods for drawing attention to key matters such as traffic lighting for risk are becoming more prevalent.

Amber ratings in this category are related to a number of common themes. The frequency of reporting to members at committee was a concern at some authorities. In some cases this was less than quarterly. This can be a particular problem where the authority

has significant financial challenges. In these cases, reliance on member newsletters to keep them informed between meetings and to prompt challenge may not be adequate. Indeed, quarterly review by committee may not be sufficient.

The accuracy of forecasting budget outturn was variable, sometimes resulting in significant variances and amendment between reports. The quantity of information provided, especially where the key points are not adequately drawn out, remains a barrier to member engagement in some cases. Large variances on capital budgets was again a common amber trigger – the emphasis in this theme is on the level of challenge by members on reported variances.

Other reporting

This looks at the scope, depth and accessibility of non-budget-related financial monitoring information. In particular, it considers the way that savings plan performance is monitored and reported to members. In 2011/12 and 2012/13, when many authorities were delivering large-scale savings in year, we saw an upsurge in amber ratings. This was often where members received very little information on savings plan progress, other than as a general feature of delivering the budget.

This was another area of focus for making recommendations to our clients. 2013/14 has seen a significant improvement in this area. However, a number of authorities still do not report savings plan progress separately. Where savings are delivered a year in advance of need, to be stripped from the next year's budget, some authorities consider that budget reporting is sufficient to check that the saving has worked. But this can deny members the chance to see if the next year's savings are on track before it becomes apparent in budget planning discussions. Another advantage of monitoring savings is that members can be clear on the distinction between recurrent savings delivered to plan and short-term fixes – for example, from income windfalls – that will have to be dealt with in future years.

This understanding is vital in being able to challenge the performance of officers, particularly where large-scale savings are required over a number of years. Another factor in the improvement seems to be the increasing use of an integrated balanced scorecard approach to performance management. This enables financial pressures to be viewed in the context of service performance, workforce and other operational aspects. Authorities are increasingly moving away from the old idea of reviewing financial performance in isolation.

Case study

Christchurch Borough Council and East Dorset District Council are working in partnership to facilitate a better level of service provision. A joint management team was formed in 2010, which initiated a three-year programme of shared service reviews – bringing teams together, reviewing work processes and restructuring as required. This is now almost complete and has delivered significant efficiency savings. Both councils also share their revenues and benefits service provision with North Dorset District Council and Borough of Poole through the Stour Valley and Poole Partnership, and their waste provision is part of the Dorset Waste Partnership which it formed with five other authorities.

Progress against savings plans is routinely reported separately to members at 47% of authorities. But 18% report savings to the management team only and 35% do not report savings plan progress as part of their routine financial monitoring process.

Case study

Surrey County Council has introduced regular all member seminars as part of the MTFP planning process, to keep members informed and engaged in financial monitoring. The seminars are jointly led by the Director of Finance and the Chief Executive, and allow for detailed discussion of the main financial risks facing the Council in the medium term. As a result, the interested parties within the Council have a sound understanding of these risks – which at present mainly relate to the erosion of major sources of funding, delivery of the major change programmes and associated efficiencies, delivery of the waste infrastructure and changes to health commissioning.

Surrey is also progressing a cultural shift so that all budget-holding managers have clear ownership of their financial responsibilities and understand how the wider financial environment impacts upon their service. All relevant managers are being trained to use the finance system in order to develop self-service reporting. The overarching aim of the project is proactive financial management and excellent financial decision making. As with any initiative requiring behavioural change, the Council is aware that the project will take time to embed and may be subject to challenge from some staff. The Council is mitigating this by regularly reviewing progress made and identifying actions for improvement. This has been partially achieved to date by implementing a phased roll-out of the dashboard to the directorates. Going forward the Council is considering widening the use of the financial dashboard to include capital monitoring and budget setting.

Surrey County Council is aiming to make further improvements to financial understanding through its new network leadership groups. These groups involve senior managers and experts for each area of Council activity, who meet at least monthly to discuss corporate issues such as budget and performance monitoring, productivity and service improvement. Data is reviewed and 'deep-dives' are made into selected areas, with recommendations being made where appropriate.

Where significant savings schemes fail and mitigating action is taken, this is discussed with members as standard in 44% of authorities, and by exception only in a further 45% of cases. In 11% of authorities this is not normally raised with members.

Financial control

7

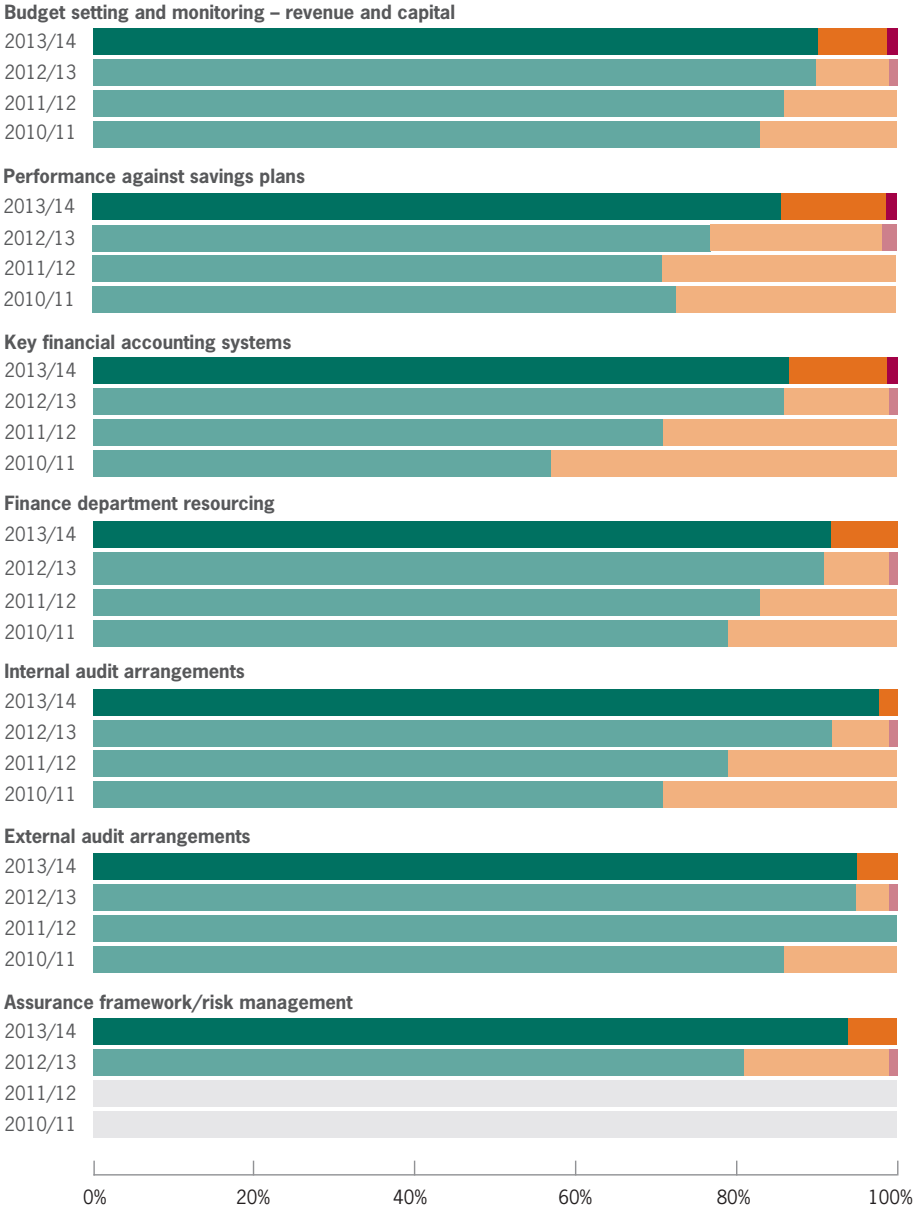
Along with strategic financial planning, financial control remains one of the themes with the highest level of amber ratings. However, most authorities continue to be rated green overall for the theme and there has been a trend of gradual improvement, particularly in 2013/14.

Financial control is a diverse theme covering a number of aspects of financial management and control. These include the budget process, financial systems, the finance team and assurance processes. The management of savings plans continues to be the most prominent area for amber ratings, affecting a significant minority of authorities – 14% in 2013/14. Financial control is partly about having strong financial processes, properly applied by staff with the required skills and experience, and overseen by strong management. It is also about culture – the commitment and belief of the workforce in what the authority is trying to achieve through its financial plans and their motivation to deliver this. This is dependent on the tone set by the management team and members, and how that permeates through the organisation.

Budget setting and monitoring

This sub-category covers the management process of setting and monitoring the budget. Generally this continues to be a comparatively strong area, with 90% of authorities now demonstrating adequate or green arrangements. Budget setting processes were generally well embedded and effective. There was strong engagement from services and increased focus on developing the budget on a zero

Figure 7 Financial control



Savings plans are risk assessed for the likelihood of delivery at only 51% of authorities.

base and on a bottom-up basis. The traditional top-down emphasis for budget setting is becoming much less common – another example of how local authorities have evolved to find the most effective methods. Increasingly, managers within services are taking responsibility for delivering the budget, advised by the finance team.

This has helped improve delivery. Most authorities were monitoring the budget on a monthly basis and reporting this to the management team. There remains a significant minority of authorities with weaknesses. Some of the more common issues are to do with the inaccurate profiling of both revenue and capital budgets. That undermines the ability to monitor variances effectively and manage cash-flow. There were also a small number of authorities using reserves to cover shortfalls in the annual budget which is a danger sign for future financial resilience.

Performance against savings plans

This area looks specifically at the way savings plans are managed and delivered. Although most authorities have adequate arrangements, a significant minority have weaknesses in the process (14%). Of all the areas we cover, this one will arguably be the most crucial in the next few years. Those authorities that are struggling to deliver savings will be increasingly at risk as developing and achieving savings becomes increasingly difficult.

The most common trigger for an amber rating was that in-year savings schemes had not been defined fully for 2015/16 and beyond, with some still developing plans for 2014/15. The fact that savings schemes have not been developed for years two and three of the planning horizon is not necessarily a major risk in itself. However in many cases, efficiency savings and the top-slicing of budgets on an annual basis has delivered as much as it can and these authorities need to look to longer-term transformational schemes.

Experience shows that service and back office transformation takes time to develop, sometimes years. Those that do not yet have these plans in motion will be at risk. Close management of savings plans has become a pre-requisite of successful financial management. A corporate programme or project management approach to delivering large-scale plans is a feature of those authorities that have had success in delivering large-scale savings to date. Sophisticated risk-based reporting on progress and the development of contingency plans are also increasingly important features.

Financial accounting systems

This sub-category focuses on the extent to which the authority has implemented effective IT systems to support financial management and to meet the increased demands placed on them. The long-term picture is one of steady improvement. In 2010/11, 40% of authorities had weaknesses in their systems. In 2013/14, 92% have robust systems in place. The development of the financial system to give budget holders access to live financial information has been hugely beneficial to some. Some authorities have also enabled spending forecasts to be updated in real time. Where this system has been applied, it has assisted the devolution and accountability for financial performance in the services greatly. Amber ratings in 2013/14 tend to relate to problems with older systems acting as a barrier to effective processes or problems with the implementation of new systems. The latter highlights the importance of strong procurement and project governance arrangements.

Finance department resourcing

This looks at the capability, capacity and resilience of the finance team. A strong finance team is crucial to the continued financial resilience of an authority. In 2010/11 and 2012/13 we saw many authorities reducing their finance teams to save cost and an increased devolution of financial authority to non-finance specialists within the services. This created a lot of uncertainty about whether the new arrangements would work and be able to rise to the increasing financial challenge.

95% of authorities have confidence that their finance team is adequately skilled and resourced.

In 2012/13, these concerns reduced as the arrangements proved to be effective. In 2013/14 over 92% of authorities were deemed to have adequate or better finance teams. We have increasing assurance that the new arrangements have been successful in most cases, and have even benefitted the organisation by creating wider financial accountability outside of the finance department.

Some authorities were only just reorganising their finance teams in 2013/14, triggering amber risks due to disruption and uncertainty. The remaining ambers tended to relate to authority-specific matters. An over reliance on key individuals, with limited options for cover or succession, remains a vulnerability at many authorities.

Internal audit arrangements

This indicator covers the capability and impact of the internal audit team as a key source of assurance over financial controls. The vast majority of authorities (97%) have effective internal audit services, showing marked improvement in the years since 2010/11, when it was a significant risk area. The historic problems were not just about the capability of internal audit functions, but also about the impact they had in their organisations and the support they received from audit committees and management in driving improvement.

External audit arrangements

This indicator looks at the findings of the external audit team, primarily in regard to financial reporting and overall governance. It remains an area with few issues arising for local authorities. Over 94% of authorities audited by Grant Thornton provided sound annual accounts on time, supported by adequate accountings systems.

The 6% of amber ratings is consistent with the small number of accounts and VfM qualifications that were issued, and the rarity of authorities that were not able to provide an effective annual financial accounts process. The Department for Communities and Local Government (DCLG) plans to bring forward the date for accounts sign off, which will increase pressure on the capacity of finance teams.

Case study

Bath and North East Somerset Council has moved towards zero-based budgeting to challenge the allocation of resources and focus on resourcing priority services. It reports progress with the budget to senior management and cabinet on a monthly basis. This enables the council to act quickly in response to developing spending pressures.

It also scrutinises performance of key savings plans closely. Detailed savings plans, broken down into specific activities and years, are built into medium-term service resource plans. These feed into the overall budget report and MTFS. Scrutiny panels, cabinet and the full council then scrutinise plans. A detailed monitor of progress is made against savings achieved by directorate.

49% of authorities have a finance team that can offer basic business advice to services. 42% think they are equipped to deliver advanced business advice, including options for alternative service delivery models. Only 10% of authorities still have finance teams that are equipped to deliver only routine budget monitoring.

Assurance framework

This area looks at risk assurance arrangements. The realisation of corporate risks can often impact on financial resilience. Effective arrangements to understand and manage corporate risks enables the organisation to build appropriate contingencies into their financial plans to absorb financial shocks. These shocks could arise from almost any aspect of operations – for example, equal pay claims, an adverse Ofsted report or extensive flooding.

We looked at this area for the first time in 2012/13 and found a number of authorities where risk assurance arrangements had not been developed adequately or had been allowed to lapse, inhibiting their ability to plan for key risks. In 2013/14, we have seen a significant improvement, in some cases as a result of our recommendations. Risk assurance is prone to being treated as a bureaucratic necessity or as a second priority. However, an effective risk assurance process is important as a financial planning tool and authorities should make sure a proportionate and effective process is maintained.

Starting planning early provides more time to develop and challenge deliverable savings plans. Only 49% of authorities begin their planning early, from April to July. 51% begin later, from September onwards. District councils are more likely to begin later than other types.

34% of authorities use a dedicated corporate programme management team to help them deliver savings. 33% are confident this can be managed by the finance team. 32% of authorities are confident they can deliver savings without corporate monitoring of savings plans outside of the budget monitoring process.

Case study

The London Borough of Haringey has reorganised their senior management structure. This has improved clarity of roles and responsibilities which include full accountability for budget setting, monitoring and achievement. A new strategic layer of assistant directors has been introduced whose accountabilities include managing and monitoring budgets in their areas and holding budget-holders to account for performance. In addition, a new corporate management group (top 100 managers) and a corporate leadership group (assistant directors) have been formed who work collaboratively to find solutions to strategic issues and who have been responsible for developing the council's three-year savings and investment plans. It is important during times where budgets are tight to ensure that the whole council works together to achieve the required outcomes – the new structures and governance help to break down silos.

The NHS experience

7

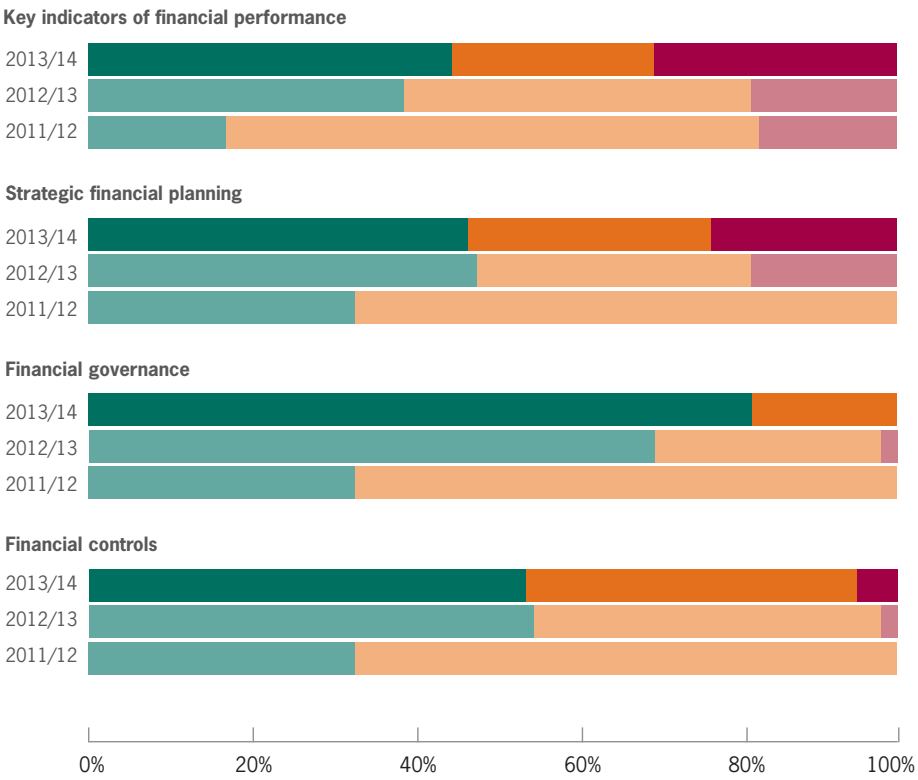
While local government has, arguably, borne the largest proportion of government funding cuts in the era of austerity, other parts of the public sector have had their own significant challenges to overcome. In this section we explore the extent to which local government can benefit and learn from the experience of the NHS.

The relative impact of austerity on different parts of the public sector is not just about the quantum of cost and the share of reductions in central government funding. The impact is affected by political priorities and the extent to which these reflect public opinion. For example, health and education have been prioritised over welfare in the current round.

Funding arrangements also play a key role – particularly the extent to which this is demand-driven – and different local economic and demographic conditions lessen or amplify the challenge.

We have used the same methodology for assessing arrangements to secure financial resilience for both NHS and local government clients. This allows us to draw some useful comparisons and learning opportunities from the NHS experience.

Figure 8 Annual comparison of thematic areas



NHS funding

In 2006, the majority of NHS funding switched from block contracts based on adjusted historic cost, to an activity-based tariff model. This was based on a standard price paid for each type of treatment delivered. The tariff was based on actual cost, but incorporated a downward adjustment that amounted to an annual cost efficiency target.

Although in theory trusts get paid for the activity they undertake, NHS commissioner budgets remained subject to tightly controlled spending limits. Until very recently, this meant that if a trust delivered more activity than planned, it may not be paid full tariff for it and therefore it may not cover costs. Patient care activity is demand-led. With an aging population demanding more care, trusts have been under pressure to make significant annual savings since 2006. However, these arrangements also led to a culture of reliance on receiving additional, unplanned tranches of money at year end from commissioners to cover at least some of this discrepancy in reimbursement. In 2013/14 this additional money ceased to be available in the same quantities, as a result of the new NHS commissioning regime. This tipped a number of trusts into financial problems.

Similarities and differences

From a localist perspective the lack of progress in achieving financial sustainability could be linked to overly bureaucratic and centrally-driven processes which hinder effective partnership working with local government. The NHS also has significant challenges in the efficient use of infrastructure and assets and in effective performance and workforce management which hinder financial sustainability. It may also reflect a failure to deliver large-scale transformational change on the scale that some parts of local government have already achieved. The NHS has had productivity improvements built into its funding and pricing for nearly a decade well before SR10 hit local government. This is clearly impacting on its ability to achieve further savings now.

It provides a useful example of what can happen to UK public services if cost savings do not keep pace with funding reductions. NHS funding arrangements resemble the grant funding element in local government. But the NHS does not have the advantage of the relatively secure revenue streams, with some scope for growth, offered by local taxation and fees and charges, being in effect wholly grant funded. There is some scope for income generation, for example from car parking and private patients, but this is limited. In addition, all NHS services are demand-driven, whereas only some local government services are – such as adult and children's social care.

Therefore the NHS scenario is closer to that of a single-tier, heavily grant-dependent local authority in many respects.

One final key difference is what happens when an NHS trust runs into financial difficulty. In these cases, the Trust Development Authority (TDA) or Monitor, the foundation trust regulator, step in and support or impose a financial turnaround process. This usually incorporates short-term support funding and external support on developing a turnaround plan, including savings and service transformation. It can also incorporate a reshuffle of the management team. Post Corporate Assessment there have been no comparable examples of this in local government, notwithstanding the recent government intervention at Tower Hamlets which was not finance driven. It will be interesting to see what emerges if and when the first local authorities reach the tipping point.

The NHS in 2013/14

The financial position of the NHS provides a stark warning to local government about the consequences of inadequate financial management. There has been a 4% increase in real terms funding during this parliament compared to a 35% reduction in local government funding. However, NHS restructuring had to meet £20 billion of health service savings under SR10 (25% of the total), and this has proved very difficult to deliver.

Although the NHS has not, on the surface, suffered a reduction in funding, spiralling demand for services and a lack of real term inflationary increases has landed the service as a whole into an unsustainable financial position in 2013/14. A large minority of NHS

trusts are having serious difficulty in delivering a balanced budget in the medium term. As a result, the NHS shows a predominance of red and amber ratings, contrasting considerably with the predominantly green outcomes we have seen for local government.

This does not necessarily mean that local government has better financial arrangements, rather that the scale of the challenge has made it harder to achieve adequate arrangements in the NHS.

Comparison of themes

There is a pattern of improvement over time common to the NHS and local government, at least for key indicators and financial governance, with strategic financial planning and financial control in the NHS worsening only marginally.

The issues that trigger amber and red ratings are similar in both sectors – for example, a lack of clarity on how savings targets will be met over the life of the MTFP or failure to deliver budget or savings plans. The key difference has been the significant increase in red-rated risks seen in the NHS by 2013/14 in three of the four themes. This seems to indicate a process of polarisation, with the majority of trusts re-establishing control of their financial position gradually, but leaving a significant minority that are struggling.

It is tempting to speculate that a similar situation is evolving for local authorities, with one important difference. It seems that the minority of local authorities suffering acute financial difficulties will be a much smaller proportion of the whole than in the NHS.

Lessons from the NHS experience

The comparison with the NHS remains a useful yardstick, when considering the future of local government financial resilience. There are a number of lessons to be drawn from the NHS experience:

- Organisations that do not establish robust arrangements for delivering recurrent savings on schedule can quickly lose the ability to overcome the revenue deficit they accumulate.
- Efficiency savings from current processes have limited potential to deliver savings beyond the first few years. Organisational and service transformation is the only proven way to drive down unit costs and achieve large-scale savings in the medium to long term.
- It is often years before the financial benefits of large-scale transformation are felt. It often involves additional cost or investment in the initial stages. Long-range planning is therefore important.
- Effective engagement with service staff and budget holders is essential to unlock the level of leadership, drive, innovation and accountability that is required to deliver large-scale, sustainable savings year-on-year.
- Large-scale transformation involves significant cultural change, which takes time to plan and deliver. There are perhaps some useful lessons in the way that doctors and nurses have become an integrated part of financial planning and management at successful trusts. That would apply equally to social workers and other non-finance trained specialists in local government services.
- Strong governance is key to making sure that the issues above are addressed. A lack of clear action and progress made between meetings of those charged with governance can be very damaging.

A Appendix: good practice checklist

7

Key indicators of financial performance	✓	X	Comments
There is regular monitoring of key indicators of financial performance			
The council 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 set by the section 151 officer			
Levels of long-term borrowing are manageable and within prudential borrowing limits			
Targets have been set for future periods in respect of key indicators, such as reserve balances and prudential indicators			
There is a track record of spending to budget and proactively managing forecast overspends in-year			
There is 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 council			
There is regular review of the MTFP and the assumptions made within it. The council responds to changing circumstances and manages its financial risks			
The council has performed sensitivity analysis on its financial model using a range of economic assumptions including the impact of SR10			
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 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 CFO is a key member of the leadership team			
Officers and managers across the council understand the financial implications of current and alternative policies, programmes and activities			
The leadership ensure 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 foster an open environment of challenge to financial assumptions and performance			
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			

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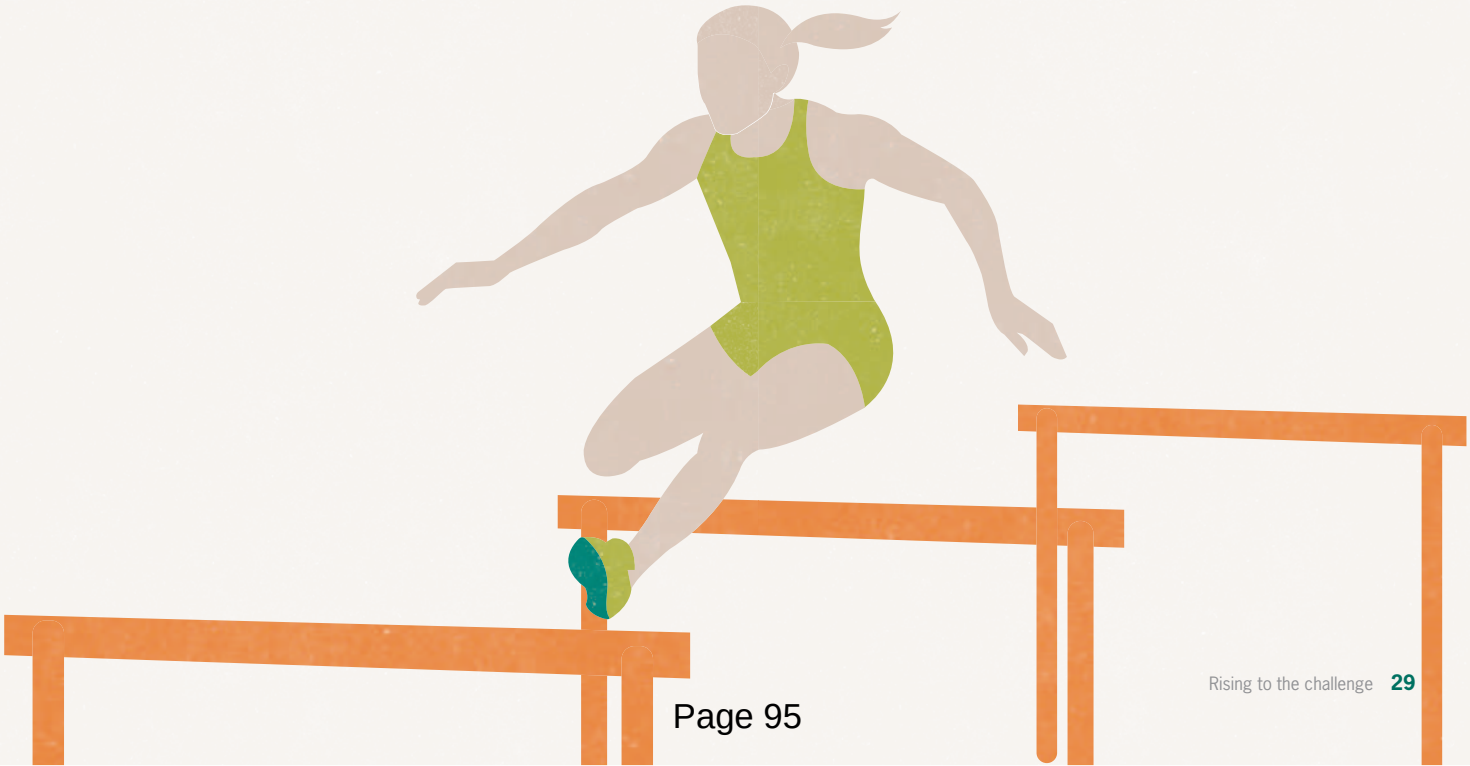
Financial control	✓	X	Comments
Budget setting and budget monitoring			
Budgets are robust and prepared in a timely fashion and the council has a good track record of operating within its budget			
Budgets are monitored at an officer, member and cabinet level and officers are held accountable for budgetary 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			
Staff resources			
The capacity and capability of the finance department and service departments are fit for purpose for effective financial planning and financial management			
Financial systems			
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			
Internal control			
Strength of internal control arrangements – there is an effective internal audit, which has the proper profile within the organisation. Agreed internal audit recommendations are implemented routinely and in a timely manner			
There is an assurance framework in place, which is used effectively by the council. This is how business risks are managed and controlled			
The annual governance statement gives a true reflection of the organisation			



B Appendix: tipping point scenarios

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Tipping point scenario	Description
Decision paralysis	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
Statutory	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
Financial	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 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
Industrial	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
External	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
Incremental	Multiple, smaller failures in individual service areas lead to an eventual critical mass of tipping points
Militancy	A local authority ignores or defies one or more statutory obligations
Civil disturbance	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
Doomsday	A further banking/financial crisis leads to even greater levels of austerity, over a significantly longer timeframe

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 24 locations nationwide. We understand regional differences and can respond to needs of local authorities. But our clients can also have confidence that our team of local government specialists is part of a firm led by more than 185 partners and employing over 4,200 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 in the UK. 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. We 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 draws on a deep knowledge of local government combined with an understanding of wider public sector issues. This comes 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 in 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.

Contact us

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If you would like to find out more, discuss any of the points raised in this report or discuss financial resilience at your organisation, please get in touch.

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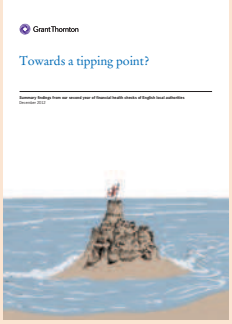

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