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Archwilydd Cyffredinol Cymru  
Auditor General for Wales

# The financial resilience of councils in Wales



WALES AUDIT OFFICE  
SWYDDFA ARCHWILIO CYMRU



Grant Thornton

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# Contents

	Summary	4
	Recommendations	10
1	Most councils demonstrate clarity of vision and set coherent corporate objectives but need to ensure their medium term financial plans and operational plans are sufficiently aligned to deliver their objectives	12
2	Financial management and controls are sound in most councils, although many need to improve budget setting and monitoring and ensure there is sufficient capacity and capability in the finance team to meet the challenges ahead	28
3	Whilst financial governance arrangements are comparatively robust, the quality of performance and cost information being used and the level of scrutiny and challenge in Welsh councils varies significantly, which can undermine the effectiveness of decision making	34
4	Councils are under significant stress and financial management arrangements that were once good enough will not remain fit for purpose in the face of increasing financial pressures	39
5	The experience of English councils shows that it is possible to tackle significant reductions in funding but to be successful requires a step change in strategic and operational financial planning	45
	Appendices	
	Appendix 1 – Methodology	50
	Appendix 2 – Selected case studies from England	51
	Appendix 3 – The differences in the way local government is funded in Wales and England	56

## Summary Report

Councils in Wales are under significant financial stress and have been active in meeting the challenge. However, the next few years will see increasing financial pressures and councils will need to further improve strategic financial planning in order to effect transformation and protect their financial resilience





# Summary

- 1 Councils in Wales are experiencing significant reductions in the level of funding they receive from the Welsh Government. So far, most councils have managed these cuts successfully but the scale of annual reductions is set to increase in the period leading up to 2015-16 and beyond. Overall, councils in Wales had a £155 million (3.8 per cent) real-terms reduction in their revenue funding from the Welsh Government in 2011-12. Funding levels are continuing to decline where revenue funding from the Welsh Government was approximately £283 million (seven per cent) lower in 2013-14 than 2010-11. In October 2013, the Welsh Government announced reductions in core funding of £175 million for 2014-15 and a further £65 million in 2015-16. By the end of 2016 the Welsh Local Government Association expects the local government shortfall will be in the region of £460 million.
- 2 In England, councils have already faced dramatic cuts in their government funding over the five year period of the Comprehensive Spending Review from 2011-12 to 2015-16. The Local Government Association in England calculates that this will represent a reduction of 40 per cent of core funding for local government in real terms by 2015-16, requiring total savings of £20 billion over this period. Whilst the level of reductions to grant income appear low compared to those seen in England, it should be noted that there is a greater predominance of councils that are highly grant dependent in Wales so the cuts have been deeper than they at first appear.
- 3 Welsh Councils are still allocated specific grants, whereas this ring-fencing has been largely eliminated in England. Councils and the Welsh Local Government Association are of the view that this grant funding should be un-hypothecated and included as part of the revenue settlement. At the timing of the annual funding settlement, the details of the allocations for a number of specific grants can still be subject to finalisation, creating further uncertainty for councils in their financial planning and budget setting.
- 4 To manage the impact of these budget decreases will require significant changes in the way that local council finances are managed and governed, as approaches to financial management that were once good enough, are now unlikely to be fit for purpose to continue to deliver strong financial outcomes in the future.
- 5 The Welsh Local Government Association has continued to raise concern over the stability of funding allocations and the annual incremental budget setting by Welsh Government. Annual budget setting, together with late changes to budget settlements and in-year reductions to grant funding, impacts upon councils' ability to effectively plan and agree their own budgets.

- 6 We reviewed the robustness of management and planning arrangements to support financial resilience at each council, focusing on how councils plan and then deliver their budget commitments. These reviews involved external audit teams undertaking fieldwork of each council's financial planning arrangements.
- 7 As we undertake further work on the financial resilience of councils we intend to develop a 'traffic light' reporting system covering financial and workforce performance and identify where further improvements are required. This approach to assessing financial resilience is similar to that taken by Grant Thornton in England<sup>1</sup> and will enable useful comparisons to be made. We intend to develop this approach to report more fully on financial resilience and will discuss the methodology we intend to use with councils and other stakeholders in coming months.
- 8 The third and final element of this study draws comparisons with the experience of English councils, based on similar analysis conducted in 2013-14 by Grant Thornton. By making these comparisons, the report identifies some key lessons to support Welsh councils in becoming financially resilient in the future. Councils in England have faced significant financial challenges earlier than councils in Wales. There is therefore an opportunity for Welsh councils to learn from and draw upon the experience of councils in England.
- 9 This work was undertaken by staff of the Wales Audit Office and Grant Thornton on behalf of the Auditor General. The focus of the review is the 2014-15 financial planning period and the delivery of 2013-14 financial plans. We have also analysed the financial performance track-record of councils in 2011-12 and 2012-13. There were three main elements to our work.
- 10 Based on the findings of this audit, the Auditor General has concluded that **Councils in Wales are under significant financial stress and have been active in meeting the challenge. However, the next few years will see increasing financial pressures and councils will need to improve strategic financial planning in order to effect transformation and protect their financial resilience.**

<sup>1</sup> *Rising to the challenge - The evolution of local government*, Grant Thornton, November 2014.

**Most councils demonstrate clarity of vision and set coherent corporate objectives but need to ensure their medium term financial plans and operational plans are sufficiently aligned to deliver their objectives**

- 11 Robust strategic planning is crucial to the future financial resilience of councils. Effective planning requires a focus on a suitably long-range financial horizon, an understanding of financial risks and the development of contingencies within medium term financial plans. Our analysis found areas for improvement in most of the key areas we reviewed, and without improvements, planning arrangements will become increasingly unable to deal with and address the growing financial pressures on councils.
- 12 Arrangements will need to evolve to reflect changing patterns of delivery and proficiency in financial management will need to improve significantly to ensure financial resilience in future years. If financial arrangements do not evolve and improve, councils will increasingly 'have to run to stand still' each year and their financial positions may see a corresponding decline.
- 13 Across Wales, a greater number of councils failed to accurately forecast the budget shortfalls they would need to bridge by the end of the 2013-14 financial year than for 2012-13. However, the difference between the anticipated levels of savings required at the time of setting the budget and those actually required during the year were relatively small in most cases, limiting their exposure to financial risk.
- 14 The majority of councils were able to identify specific savings measures to address budget shortfalls. However, an increasing number of councils had not fully identified savings proposals to manage their funding gaps and were still developing their detailed savings plans at the time their budgets were approved.
- 15 Whilst most councils identified the funding gap to be met by savings plans for 2014-15 and beyond, a significant number have not identified plans to fully meet the shortfall. There are also a few councils where poor performance on delivering savings plans would have a significant impact on financial resilience if not mitigated by some other means. The assumptions and arrangements that underpin savings plans, when judged against SMART<sup>2</sup> principles, are not sufficiently robust and significant development is needed in all areas. Further work on assumptions will be a key area of focus for councils in Wales over the next few years. In England, this area of financial planning has required the most improvement but, encouragingly, has also seen the highest level of evolution and innovation.
- 16 A general pattern of increases in reserve balances suggests that councils in Wales are managing to deliver surpluses in spite of the financial challenges they face. These surpluses offer the opportunity to build up a financial buffer and to invest in service transformation as well as supporting delivery of local priorities. However, there are concerns that without a clear strategy for utilisation of reserves as part of the medium term financial plan, some councils may be criticised for hoarding funds without a clear and agreed purpose.

<sup>2</sup> SMART stands for specific, measurable, achievable, relevant and time bound.

- 17 Our analysis shows that the majority of councils in Wales are deemed to hold adequate levels of reserves. There were a very small number of councils identified where the ratio of reserves to Gross Revenue Expenditure (GRE) is declining, indicating that reserves are being drawn down to support revenue expenditure, a significant indicator of financial stress. For those councils holding low levels of useable reserves, there is a risk that they will not be able to maintain a balanced budget if savings plans fall short or if there is significant slippage on the budget due to cost pressures.

**Financial management and controls are sound in most councils, although many need to improve budget setting and monitoring and ensure there is sufficient capacity and capability in the finance team to meet the challenges ahead**

- 18 Overall arrangements for financial management and control were sound at the majority of councils and should provide a good foundation that councils can build on to address future pressures. However, we found that performance is mixed and noted significant risks in all key areas we reviewed. Few councils are fully exploiting the potential to generate income. Importantly, the effectiveness of budget setting and control and the capacity and capability of finance managers are both issues of concern in many councils.

**Whilst financial governance arrangements are comparatively robust, the quality of performance and cost information being used and the level of scrutiny and challenge in Welsh councils varies significantly, which can undermine the effectiveness of decision making**

- 19 Councils current performance on financial governance is better than in other areas of financial management we reviewed. However, areas of weakness included oversight and accountability for ensuring savings plans are delivered. Major failings in governance are rare, but where they do occur, they can have far-reaching financial and other negative consequences. The report from the Commission on Public Service Governance and Delivery (January 2014) highlights some of the changes that will be required to support good and effective governance in order to meet the challenges of future local government reforms and deliver the expected reductions in funding.



**Councils are under significant stress and financial management arrangements that were once good enough will not remain fit for purpose in the face of increasing financial pressures**

- 20 The financial management arrangements at Welsh councils are under significant stress, and are not consistently delivering strong financial outcomes. Experience of funding reductions suggests that management arrangements that were once good enough will not remain fit for purpose without significant evolution.

**The experience of English councils shows that it is possible to deal effectively with significant reductions in funding through redesigned service delivery models supported by sophisticated financial planning**

- 21 Whilst some councils in England are potentially facing a financial tipping point, it is encouraging that the majority continue to deliver a sustainable financial position. To maintain a stable financial position has required a fundamental re-think about what services should be delivered; who should receive them, and the models by which they should be delivered to reduce cost and improve efficiency. This service re-design has, in turn, required the development of highly sophisticated financial management arrangements that, four years ago, were not imagined. Given the response of councils to the step change in England, it is imperative that Welsh Councils focus on developing their future model of delivery and revise their service delivery structures to reflect this model. Failure to do so will increase the risk of councils being unable to deliver their statutory responsibilities and remain financially viable.

# Recommendations

## Recommendation

Councils need to make informed assumptions about the future trajectory of central funding in the absence of definitive guidance and identify the desired role of the council within a chosen delivery model for the future.

[Section 1]

**R1 Councils should ensure that their corporate plan:**

- **is the core driver for the service plans and other supporting strategies including workforce, information technology and capital expenditure;**
- **maintains at least a three to five year forward view and is aligned with the medium term financial plan and other supporting strategies; and**
- **should clearly articulate the desired role of the council in five years - the model for delivering priority services and the infrastructure and resources needed to deliver future priorities within available finances.**

Adverse financial scenarios should be anticipated and mitigated against in the medium term financial plan, with built-in flexibility to deal with risks using reserves and other contingencies.

[Section 1]

**R2 Councils should ensure that their medium term financial plan identify the major financial risks and key assumptions and senior officers and councillors should subject them to effective scrutiny and challenge before adopting the plan.**

Annual savings requirements must be realistic and achievable and avoid 'back-loading' towards the latter years of the medium term financial plan. Savings in the latter years of the medium term financial plan should focus on service transformation projects that need to be developed well in advance of any projected financial benefit.

[Section 1]

**R3 Councils need to ensure that funding deficits are accurately projected and fully reconciled to detailed savings plans for each year over the life of the medium term financial plan.**

Failure to deliver planned savings will have a severe cumulative effect on a council's ability to continue to be financially resilient in the future.

[Section 1]

**R4 Councils should regularly review the adequacy of the financial assurance arrangements that underpin the delivery of annual savings plans, including the level of scrutiny and challenge provided by councillors.**

## Recommendation

A reserves strategy should form part of the medium term financial plan and should clearly demonstrate the rationale for reserves in light of financial risks. The plan should include a policy on the use of revenue surpluses.

[Section 1]

**R5 Councils should ensure that they have a comprehensive reserves strategy that outlines the specific purpose of accumulated useable reserves as part of their Medium term Financial Plan.**

A better understanding of income for subsidised activities can help inform investment and service delivery decisions. Profit share arrangements with commercial organisations and the commercialisation of some council services should also form part of strategic planning discussions.

[Section 2]

**R6 Councils should develop corporate wide policies on income generation.**

It will be increasingly important that Council financial management systems, including budget setting and monitoring, are regularly tested. This is to ensure they continue to be effective and provide councils with assurance that their internal systems are fit for purpose.

[Section 2]

**R7 Councils should**

- **strengthen budget setting and monitoring arrangements to ensure financial resilience; and**
- **review the coverage and effectiveness of their internal and external assurance financial systems and controls to ensure they are fit for purpose and provide early warning of weaknesses in key systems.**

Any proposed reductions in finance team capacity should be carefully considered in light of the need for enhanced finance skills to manage the challenges councils face. These skills include commercial awareness and cash-flow management, as well as the ability to engage with councillors, service managers and the public. Recruitment, cover and succession planning arrangements need to be strengthened.

[Section 2]

**R8 Councils must review their finance teams and ensure that they have sufficient capacity and the right skills to meet future demands.**

The effectiveness of financial overview and scrutiny will be increasingly tested as the financial pressures intensify. Councillors will have to become more skilled at addressing financial risks and understanding the financial implications of their decisions. Council officers will play an important role in helping to equip and support councillors to deliver these demanding expectations.

[Section 3]

**R9 Council officers need to equip councillors with the knowledge and skills they need to deliver effective governance and challenge by extending training opportunities and producing high quality management information.**



## Part 1

Most councils demonstrate clarity of vision and set coherent corporate objectives but need to ensure their medium term financial plans and operational plans are sufficiently aligned to deliver their objectives





- 1.1 In this section of the report, we focus on the effectiveness of councils strategic financial planning arrangements. For the purposes of our review, we have used the following as the key characteristics of effective strategic financial planning.

#### **Characteristics of Effective Strategic Financial Planning**

- Focus on achievement of corporate priorities is evident through the financial planning process.
- The medium term financial plan focuses resources on priorities.
- Service and financial planning processes are integrated.
- The medium term financial plan 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 medium term financial plan 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 funding guidance from central government.
- The medium term financial plan 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 medium term financial plan.
- Zero-based budgeting is used to improve strategic prioritisation during the financial planning cycle.
- Effective treasury management arrangements are in place.



## Most councils translated their corporate vision into a coherent set of improvement objectives but did not ensure the corporate planning framework adequately supported their delivery

- 1.2 In addition to setting out the priorities for residents and the local area, a council's corporate strategy should also articulate its medium-to-long term vision. This vision should cover what services will be delivered, the model for delivering these services, how the Council will work with partners and what infrastructure and resources will be needed to support delivery of priorities. This clarity of vision can help to avoid piecemeal strategic development, which can lead to inefficiencies.
- 1.3 Many Welsh councils have clearly revisited their vision and aims in light of the impact of austerity and reductions in funding. A number of common themes were noted across all councils in developing their vision and strategic aims, including:
  - a a stronger focus on community engagement;
  - b a focus on sustainable services;
  - c a focus on alternative delivery models such as collaboration and shared service delivery; and
  - d a need to restructure the organisation, and improve culture and behaviours across the council.
- 1.4 It was clear that councils see the period of austerity as an opportunity for strategic and operational change. This appetite for change should help drive improvement in financial management arrangements. Our review found that most councils had good strategic planning arrangements for developing robust improvement objectives within their improvement plans. However, some common themes were identified across a number of councils, where these arrangements can be strengthened. In particular, improvement objectives were not always SMART; clear on what they are meant to achieve; or prioritised in the context of the Council's corporate priorities and reducing resources.
- 1.5 It is important that corporate aims are translated into SMART objectives. Without clear objectives it is difficult to measure how well councils are performing and whether risks are being addressed. Failure to develop SMART objectives also reduces the effectiveness of operational service plans and limits elected members' ability to hold those responsible for delivery to account. Where it is difficult to establish SMART objectives for a particular aim this can often be a good test of how robust the corporate aim actually is.

- 1.6 The corporate planning framework supports the development of the corporate plan and all supporting plans including the medium term financial plan. Therefore, the framework needs to be robust in order to ensure that the corporate plan is fit for purpose. A significant minority of councils had weaknesses in their planning arrangements, because the corporate plan objectives and the corporate planning framework were not effectively inter-linked and the planning framework did not clearly set out how objectives were to be achieved.
- 1.7 We reviewed how effectively councils link their corporate improvement objectives to service delivery and financial plans. Approximately a third of councils showed a need for further improvement. A number of common themes were identified, including:
- a a lack of clarity of how corporate and service objectives aligned to the medium term financial plan;
  - b links between corporate and service objectives were under-developed and it was unclear how the objectives were aligned to support each other; and
  - c improvement objectives were not adequately linked to financial savings plans.
- 1.8 The extent to which corporate improvement objectives are fully reflected in service and financial plans needs to be improved at many councils in Wales. The corporate planning framework should demonstrate a clear 'golden thread' setting out how achievement of corporate objectives is underpinned by service plans, the medium term financial plan and other supporting strategies. Without such a coherent and robust framework, there is a risk that supporting plans are developed in silos, do not support the overall strategic aims and could even inhibit their achievement. The corporate planning framework should be used to make sure the links between strategic and operational planning are explicit, even where the documents are drafted in different parts of the organisation.
- 1.9 The experience in England has shown how difficult it can be to translate the corporate vision and aims into coherent operational objectives that can be delivered. This challenge should not be underestimated. The link between the corporate plan and other supporting strategies has been an area of gradual improvement over the four years of review work undertaken by Grant Thornton in England. Councils have increasingly demonstrated effective and mutually supportive links between strategic plans, the medium term financial plan and service plans; and links to supporting strategies such as treasury management, capital programmes, housing, workforce and other areas. A key issue was the need to ensure that individual supporting strategies were regularly reviewed and kept up to date ensuring that supporting plans are updated in line with revisions to the corporate objectives and the medium term financial plan.

## While a number of Welsh councils have effective financial planning frameworks, they need to ensure that they remain fit for purpose and are fully aligned to medium term strategic priorities

- 1.10 Robust strategic planning is crucial to the future financial resilience of councils. Our analysis identified significant issues in most of the key areas we reviewed. Unless planning arrangements are strengthened, councils will increasingly be unable to deal with future financial pressures. In England, Grant Thornton has seen financial arrangements evolve significantly in response to these pressures. However, we have also noted that the minimum standard required to ensure financial resilience has also risen each year. This means that a failure to evolve leads to a decline in the effectiveness of their financial arrangements and a corresponding decline in the financial position.
- 1.11 Our work identified that approximately half of Welsh Councils had effective financial planning frameworks that were clearly linked to savings plans and set out across a reasonable timeframe. It is important to emphasise that even those whose current planning frameworks are considered effective, will need to evolve to respond to future financial challenges. We identified a number of areas in which strategic financial planning arrangements need to be improved. In particular, councils should ensure that the planning framework makes explicit links between its corporate plan objectives and financial planning requirements; and financial plans set out clear, forward-looking solutions to the medium term challenges the Council expects to face.
- 1.12 The experience of councils in England has highlighted the importance of establishing a robust financial planning framework that actively supports the delivery of a council's corporate objectives. Without this clarity, financial plans will often fail to support the achievement of these corporate priorities. Grant Thornton's work in England has also highlighted the importance of establishing a medium-to-long term financial planning horizon, with increasing numbers of councils in England creating a three to five year financial planning horizon in their financial models, with some looking up to 10 years ahead. One of the perceived barriers to this in England has been a reluctance to plan in the face of uncertainty about future funding settlements or even the future policy of the government.
- 1.13 Whilst there is a balance to be struck in regard to the financial resources that have to be committed, in general, those English councils that have made good assumptions about future cuts have been well placed to deliver service transformation projects where the financial benefit will often only be realised in later years. English councils that do not have a sufficiently long planning horizon have found themselves under pressure to deliver the financial benefits of transformation in enough time to cover projected deficits.

## Whilst all councils had a medium term financial plan in place, the quality and robustness of the plans was mixed

- 1.14 The medium term financial plan is a key component of an effective corporate planning framework. Our review also considered whether the Council's annual budget flows from and influences the longer-term financial strategy. Councils performed better in this area, with almost two thirds of councils adequately linking annual budgets and the medium term financial plan. Those councils that are developing medium term financial plans for the first time tended to showed greater risk as they are still developing clear links with annual budgets. Where divergence between the annual budget and the medium term financial plan occurs, it is often because of weaknesses in medium term financial plan assumptions or a failure to review and update the medium term financial plan to better reflect the Council's circumstances and operating environment.
- 1.15 Whilst all councils had a medium term financial plan in place, the quality and strength of the plans varied. Common weaknesses included assumptions within the medium term financial plan that were overly optimistic and not adequately challenged by council committees, and medium term financial plans not being fully integrated with corporate plans, the performance reporting framework and improvement objectives. The medium term financial plan should act as the link between the corporate strategy and the budget setting process. This linking should ensure that any decisions on budget amendments, reductions and investments are aligned to corporate improvement objectives. Where this does not occur, it is a strong indication of weaknesses in the corporate planning framework and the robustness of the medium term financial plan. Only a third of Welsh councils were considered to have adequate arrangements in place that fully aligned budget setting with the delivery of the corporate vision, aims and improvement objectives.

### Area of good practice noted - Conwy County Borough Council

To support their prioritisation of services Conwy County Borough Council, undertook a service prioritisation exercise involving councillors in 2010. This exercise allowed the Council to check the proportion of its budget allocated to delivery of each of the Council's priorities. This exercise has been built on in subsequent years to ensure additional resources are only deployed based on robust business cases, and are directed to the priority service areas, which are in turn linked to the efficiency/saving areas the Council has identified each year.

## The use of financial Key Performance Indicators within Medium Term Financial Plans to monitor and manage performance is under developed and poor

- 1.16 The use of KPIs within the medium term financial plan can be useful to measure progress and financial resilience, particularly for important issues such as liquidity, return on investments and borrowing levels. Our analysis shows that the development and use of appropriate KPIs within medium term financial plans is one of the areas where councils need to improve, and the majority have struggled.
- 1.17 Our review found that some councils had not developed any KPIs and have not reached a stage of maturity where performance information is being used to underpin decision-making. These weaknesses stop members from scrutinising performance, and even where councils have KPIs in place for service delivery and financial performance, these are not explicitly set out as such within the medium term financial plan. The use of KPIs within medium term financial plans is variable in England as well as Wales and tends to work best when the KPIs are set with reference to external benchmarking information.
- 1.18 As we undertake further work on the financial resilience of councils we intend to develop with councils key financial and workforce performance measures akin to that taken by Grant Thornton in England. We intend to develop this approach to report more fully on financial resilience and will discuss the methodology we intend to use with councils and other stakeholders in coming months.

## Medium Term Financial Plans are subject to regular review, but some weaknesses remain in the use of scenarios and assumptions

- 1.19 All councils had their medium term financial plan reviewed at least once during the financial year by a Scrutiny Committee and/or by Cabinet. However, we identified a number of weaknesses with these arrangements across many councils, including:
- a the medium term financial plan was not tested under different financial scenarios to assess the impact of variances in the assumptions making it difficult to determine the robustness of the plan; and
  - b recommendations made by Cabinet and/or Scrutiny Committee following their review of the medium term financial plan were still being addressed at the time of our review which created a heightened level of risk particularly around the achievement of savings.
- 1.20 Over the last four years, one of the key areas of improvement made by English councils has been the medium term financial plan's capacity to absorb financial risks. Adverse financial scenarios have increasingly been anticipated, and mitigated against, and the flexibility of the medium term financial plan to deal with as yet unforeseen scenarios has improved. The best medium term financial plans now include a discussion of financial risks and the impact of differing financial scenarios and sensitivities in the narrative commentary, often in the context of justifying the assumptions used in agreeing the medium term financial plan.



- 1.21 The advantage of this approach has been a greater awareness of the need for mitigation strategies. Many councils have set aside significant reserves to provide this flexibility and often have built further contingencies into their annual budget. A number of English councils 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 monies that can be held in reserve or used to tackle other budget pressures. Others have benefitted from budgeting investment returns, and other income, based on worst-case scenario returns and in the expectation that income will exceed the levels that were assumed or planned. As long as the use of additional income to fund overspends is reported transparently (both corporately and by services) this can add resilience to Council plans.

**While most councils have a good track record of forecasting budget shortfalls and recognise the importance of a fully defined savings plan, an increasing number underestimated the level of savings required by 31 March 2014**

- 1.22 Across Wales, a greater number of councils struggled to accurately forecast the budget shortfalls they would need to bridge by the end of the 2013-14 financial year. However, the difference between the anticipated levels of savings required at the time of setting the budget and those actually required during the year were relatively small in most cases, limiting these councils exposure to financial risk.
- 1.23 An increasing number of councils were able to ensure that budgeted shortfalls were covered by planned savings delivered during the financial year. Where shortfalls were not covered by planned savings, councils funded any additional shortfalls through further ad-hoc savings. Overall, these unplanned additional shortfalls were not of a significant value in any instances.
- 1.24 The majority of councils continue to accurately predict budget shortfalls in their financial planning. There was an improvement in identifying budget shortfalls between 2011-12 and 2012-13, although in 2013-14 the number of councils accurately predicting shortfalls fell slightly. This decline is primarily due to increased pressure on councils to deliver the previous year's approved savings whilst also identifying further additional savings in future years. There may be pressure to predict higher levels of savings, which are becoming increasingly difficult to realise as the easiest savings options have already been utilised.
- 1.25 In England, Grant Thornton's work found that most councils have been relatively successful in predicting budget shortfalls. There has been a general trend to use worse case financial scenarios as the basis for the medium term financial plan assumptions, which has contributed to the frequency of unplanned surpluses and therefore the increase in reserve levels in England. While this 'prudent' approach is preferable to over optimistic financial scenarios, councils do have an obligation to council tax payers to forecast financial outcomes as accurately as possible to limit potential council tax increases.

- 1.26 We also looked at whether Welsh councils had any budget deficits that could not be addressed and still needed detailed savings plans to be developed to show how these would be addressed at the time the budget was approved. Across the period 2011-12 to 2013-14 the majority of Welsh councils demonstrated good performance in this area, and the source of savings was generally identified at the time the budget was set. However, in 2013-14 a growing number of councils were still developing detailed savings plans at the time the budget was approved.
- 1.27 In 2013-14, councils with gaps in their savings plans tended to be restricted to those that had not accurately predicted the budget shortfall they would face at the year end. This was not necessarily the case in prior years. For example, in 2012-13 a number of councils successfully identified a budget shortfall but were not able to define savings plans to the full value of that shortfall. This suggests that by 2013-14 more councils were recognising the need to start the financial year with a fully populated savings plan.
- 1.28 In England in 2013-14, Grant Thornton found that the majority of councils had fully developed savings plans, covering the full value of the predicted budget shortfall for that year. Increasing numbers of councils, have also developed savings plans that cover all or part of the predicted funding gap for future years of the medium term financial plan. Council predicting future funding gaps is a significant improvement over the last four years, where it was common for some councils to start the financial year without a full understanding of how the budget shortfall would be met. Many English councils continue to struggle with developing detailed savings schemes beyond the current year, particularly beyond year two. Where this is achieved, it tends to be related to longer-term transformational projects where the financial benefit is phased in over several years.

**Most councils have forecast the savings gap for 2014-15 and beyond but in many cases savings plan assumptions and arrangements are not robust and need significant development**

- 1.29 Whilst most councils identified the projected funding gap to be met by their savings plans for 2014-15 and beyond, a significant number did not identify sufficient savings to fill this gap. We also identified a small number of councils where poor performance in delivering previous years savings plans were having a significant impact on their financial resilience and needed to fill the financial gap by other means, for example from their reserves.

- 1.30 The robustness of savings plans assumptions and planning actions is weak, when judged against SMART principles, and all councils need to develop their arrangements significantly if they are to improve their financial performance. We found that whilst almost two thirds of councils had adequate arrangements for identifying potential funding shortfalls, over a third were considered to have weaknesses in the accuracy and deliverability of their savings plans. In particular, we found that some councils were still reacting to the government announcement regarding a decrease in Revenue Support Grant (RSG) levels for 2014-15 and were late in identifying shortfalls beyond the next financial year. Their plans for addressing the savings gap for 2015-16 and beyond were unclear and they continued to struggle to achieve their savings targets. There are serious concerns about the capability and capacity of these councils to deliver future savings.
- 1.31 A quarter of councils were thought to carry a risk of not being able to mitigate saving shortfalls without falling below the useable reserves threshold agreed by the council, which could lead to a significant impact on operations. Generally, this was because councils did not have sufficient reserves to meet future saving shortfalls as the reserves have been used in the past to address funding gaps. In addition, council tax increases had already been included in future saving plans to increase council income and so any further council tax increases were deemed to be unacceptable to bridge any saving shortfalls. In addition, savings plans had weaknesses and the plans did not “bring forward” sufficient early savings to offset budget deficits.
- 1.32 In England, Grant Thornton found that the most notable financial planning risk in 2013-14 was the sheer scale of savings that needed to be achieved over the life of the medium term financial plan, particularly where it is unclear how these will be achieved. In most cases, some or all of the in-year savings required in 2015-16 and beyond are yet to be defined. In other cases, the short timescale for delivering savings is a major concern. In addition, some councils continue to rely too much on top-slicing of budgets rather than transformational schemes and for a small number of councils, 2015-16 will mark a financial tipping point unless radical improvements are made in how savings are planned and delivered.
- 1.33 For councils in Wales, the key lesson from England’s experience is the importance of developing robust savings plans and service transformation schemes in as much detail as possible that will be delivered in full in a realistic time period. As a small number of English councils are now finding, if projected deficits are not accurately identified and addressed, there is a real risk that the cumulative deficit carried forward may lead to financial failure.

### **In general, the financial assumptions in council saving plans have been subject to some challenge and scrutiny from councillors, but weaknesses in the information used to monitor performance undermines accountability arrangements**

- 1.34 The financial assumptions adopted by councils as part of their current saving plans have generally been subject to challenge and scrutiny by senior managers and councillors. However, we identified a number of key themes where improvements are needed. For example, plans often have:
- a an optimistic outlook on the national pay award, with councils taking their best estimate of a national pay increase;
  - b a lack of detail behind assumptions;
  - c limited benchmarking of assumptions against other councils, in particular fees and charges;
  - d a lack of consistency in the way officers applied assumptions across directorates; and
  - e savings plans focused on cost rather than cost effectiveness and value for money.
- 1.35 These weaknesses make it difficult for members to scrutinise and challenge performance and hold the executive and senior officers to account. The issue of poor scrutiny is particularly salient because Grant Thornton found that in England, some councils have overestimated the contribution of savings (and income generation) in delivering a balanced budget. This has been a significant area of improvement and by 2013-14 most English councils were making more robust estimates in this regard, although a significant minority still have weaknesses in their arrangements for delivering savings.

### **Councils in Wales demonstrate mixed performance in developing savings plans that follow SMART principles**

- 1.36 Whilst just over half of councils in Wales had adopted SMART savings plans, our review identified that many councils had not set realistic and specific measures to deliver savings within the timeframes set. This raises concerns about the ability of some councils to deliver large transformational projects.
- 1.37 One of the major weaknesses in councils' savings plans is their achievability. Our review found that only a third of councils have saving plans that we consider to be achievable in terms of value and less than a quarter have plans where we consider the majority of savings are likely to be delivered on time.

- 1.38 The majority of councils continue to struggle to deliver all of their identified savings plans in full. We identified a number of common weaknesses in this area relating to:
- a Limited information on individual savings plans and how they will be achieved in the set time scales.
  - b Proposals lacking contingencies for slippage, including impact analysis on the savings gap and how councils will fund any short term slippages.
  - c Poor sensitivity analysis, in particular with regard to worst case scenarios should the savings not be met in 2014-15 and what options for corrective action are available to the Council.
  - d Significant service demand pressures (most commonly adult services) which are identified within a number of council saving plans but often lack detail and fail to make clear how these pressures will be mitigated by end of the financial year.
  - e Deficiencies in oversight and challenge on savings. For example, individual savings plans not being separately reported and analysed in finance management reports, which makes it difficult to scrutinise performance when planned schemes do not deliver expected savings.
- 1.39 We consider these weaknesses in savings plans to be the most crucial challenge facing councils in the next few years in both England and Wales.
- 1.40 In comparison, Grant Thornton found that many councils in England have now established comparatively robust arrangements to support delivery of their savings plans. The most common trigger for heightened risk at English councils is the failure to develop specified savings schemes beyond a one-year horizon. In England, this is particularly acute, as the relatively easy savings have been delivered and councils need to look to longer-term transformational schemes to address the significant budget pressures they face. Grant Thornton reported that service and back office transformation takes time to develop, often several years. Those that do not yet have these plans in motion will be at risk.
- 1.41 Close management of savings plans has become a pre-requisite of successful financial management. A corporate wide programme or project management approach to delivering large-scale plans is a feature of those councils 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.



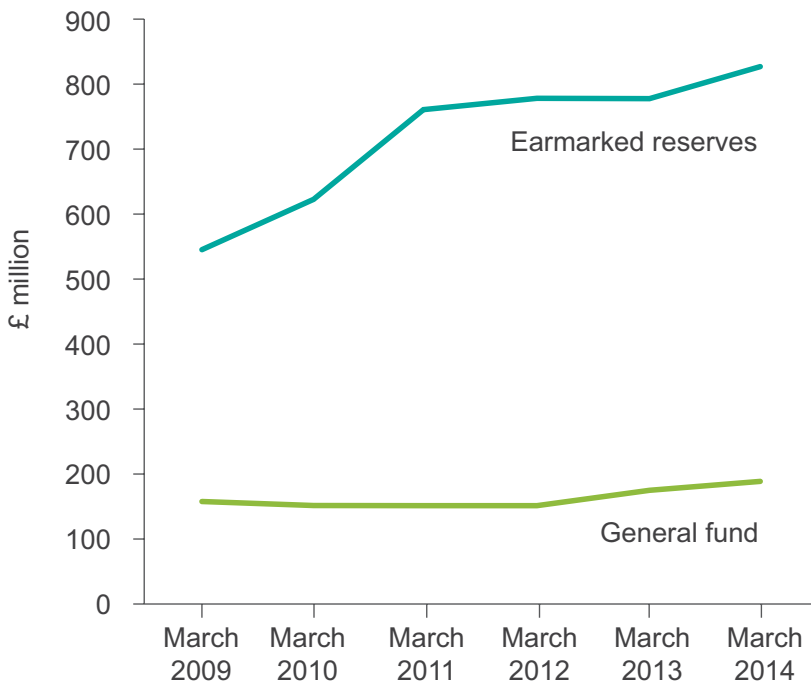
- 1.42 Some of the key developments seen at English councils over the past four years that enable effective savings delivery include:
- a A rise in formalised transformation or change programmes that look at the full range of council operations and establish work-streams to develop detailed schemes under a number of theme headings.
  - b Detailed service reviews to evaluate opportunities to deliver services more efficiently, including consideration of alternative delivery models.
  - c Use of a Project Management Officer to manage major schemes – typically including a separate governance structure, clear accountability, project management experts and cross service involvement.
  - d Use of standardised business cases and other supporting materials.
  - e Cultural change that promotes financial awareness at all staff management levels across council services, often accompanied by strengthening financial accountability and management skills in individual services.
  - f Strong councillor led governance arrangements to oversee delivery of savings, which reports delivery of savings plan separately from budget reporting and identifies what the shortfall is and sets out how the savings gap will be closed.
  - g Delivering enhanced levels of savings to maximise the potential surplus which can be invested or used to build up reserves. (Contrasting with the current practice prevalent amongst Welsh councils of phasing savings during the year in order to deliver the planned outturn, which leaves little scope for slippage).

**Despite the significant financial pressures all councils face, reserves continue to increase and councils need to ensure they have clear strategies on the creation and use of reserves when setting their medium term financial plans**

- 1.43 On the surface, a continuing trend of increases in councils' average reserve balances suggests that it is one of the strongest performing criteria of financial resilience in Wales. However, whilst it has been presumed for the purposes of this analysis that high levels of reserves are considered to reflect strong financial resilience, this is a more complicated and complex picture. Building up reserves with no clear purpose is not an effective use of resources.
- 1.44 Councils are required to hold various types of reserves, some of which are useable to support spending and others which are unusable, merely being held for technical accounting purposes. Those that are useable and cash backed are either held in relation to specific commitments or cost pressures (earmarked reserves) or as security against unforeseen expenditure or events (council fund or general reserves).

1.45 As can be seen from **Figure 1**, over recent years the overall level of reserves held by Welsh councils increased. In 2013-14, general reserves increased by £15.2 million and earmarked reserves increased by £49.0 million. This increase is somewhat surprising as councils indicated two years ago that they expected reserves to fall significantly in 2013-14. However, this may be due to a combination of issues including the timing of budget reductions, delivery of financial savings or deliberate plans to build up reserves to manage future risks.

**Figure 1 – General fund and earmarked reserves: Welsh unitary authorities at the end of each financial year**



Source: Wales Audit Office review of published accounts

- 1.46 Earmarked reserves make up the largest element of total reserves and include balances and amounts set aside for, amongst other items, equal pay or single status costs, insurance, PFI payments, funding for capital schemes or repairs and renewals. The amount of general and earmarked reserves as a percentage of GRE varies significantly between audited bodies.
- 1.47 Councils must determine the extent of the reserves they hold based on their assessment of need, risks and future commitments. They also need to ensure that they are used in a sustainable way that supports on-going service change and transformation rather than simply supporting annual revenue expenditure on an on going basis. The appropriate level of reserves for any council will depend upon a number of factors and each council should set a reserves target based on clear and agreed criteria.
- 1.48 The extent to which budget underspends are driving the increased levels of reserves needs to be further explored. Many councils are continuing to report year-on-year underspends against their revenue budget. Whilst logically underspends are preferable to overspends, consistent high levels of variances against revenue budgets indicate that a greater accuracy in the budget setting and monitoring process is needed. Underspends should not be relied upon in the medium term to bolster reserves or to mask other areas of overspend within the budget.
- 1.49 If a council is holding low levels of useable reserves, it may be unable to maintain a balanced budget if savings plans fall short or if there is significant slippage on the budget. A reducing reserve level is also a strong indicator that a Council might struggle to maintain financial resilience in the coming years. Despite the challenges, most councils have maintained or increased their reserve levels - often by delivering budget surpluses - to insure against financial difficulty. The general trend of increasing reserves is common to both Wales and England.
- 1.50 Grant Thornton reported that in England in 2013-14, the level of risk relating to inadequate reserve levels has reduced, in line with the longer-term trend, although a small number of councils did have notably low levels of reserves. In these cases, the ability to absorb unexpected financial problems, to maintain services during transformation, or to invest in schemes and services, is severely limited. Low levels of reserves can also force councils to borrow to fund capital programmes or to forgo capital investment opportunities.
- 1.51 In both Wales and England, there has been a significant commentary on the growth in council reserve levels, especially the perceived contradiction of generating surpluses and transferring these to reserves at a time of significant cuts in council budgets. The conclusion often drawn is that council tax payers are footing the bill for the accumulation of cash that is not being used for maintain and/or improve services.

- 1.52 However, in both countries the underlying issues are complex. Many surpluses are specifically planned for in order to build up earmarked reserves for specific future purposes – such as house building or support for regeneration work. Councils are also prudently setting aside reserves to enable them to cope with risk – such as the failure of a savings programme to deliver benefits on schedule.
- 1.53 It has to be recognised that once reserves are used they are gone for good. Pressure to use reserves to fund revenue expenditure, for example to avoid council tax rises, reflects a very short term view as this is not sustainable and eventually the money will have to be found elsewhere. Reserves are better used to help fund capital projects and service transformation, while providing security against financial risks. As long as a council is using reserves in a planned and strategic manner, it can refute charges of ‘hoarding’.
- 1.54 In England Grant Thornton found that there has been increased use of more sophisticated treasury management policies, which ensure that reserves are made to work for the Council while retaining the liquidity needed to mitigate financial risks. There is a strong argument that the accumulation of reserves in times of economic hardship can actually reflect good management and mitigation of financial risks.

## Part 2

Financial management and controls are sound in most councils although many need to improve budget setting and monitoring and ensure there is sufficient capacity and capability in the finance team to meet the challenges ahead





- 2.1 In this section of the report, we focus on the councils financial management and control arrangements. For the purposes of our review, we have used the following as the key characteristics of good financial management and control, reviewing current standards of performance against these.

### Characteristics of good financial control

#### Financial control

- 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
- 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
- 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

2.2 The framework for financial management and control at most councils is generally adequate for current needs, but we noted risk areas in all areas of performance we reviewed. The level of risk across some aspects of financial management and control illustrates the need to strengthen arrangements in these areas. The specific aspects that we looked at are discussed in the following sections.

### **No council has a corporate policy on income generation, which is an area that will become more important as councils increasingly look for alternative sources of revenue**

2.3 Although the majority of councils had adequate and up to date policies and financial management arrangements for income generation, we considered that a significant minority face some risk because their arrangements need to be updated. Whilst most Welsh councils have recognised the need for an explicit policy on income generation and charging, the vast majority delegated decision making on fees and charges to directorate and individual service teams. The lack of an explicit policy document on income generation does not necessarily pose a significant financial control risk – such policy documents are not a common feature of English councils approaches to charging and income generation. However, as has been the case in England the development of corporate wide policies on income generation is likely to increase among councils in Wales as they seek to address the predicted funding deficits.

2.4 In England, councils are increasingly developing their strategic approaches to income generation, including an identification of the maximum level of charging and its potential negative impact on services and citizens. The work of Grant Thornton in England found that in areas such as car parking and green waste collections, increased charging has resulted in increased revenue streams. In other areas of operation, it has resulted in a better understanding of income for subsidised activities, particularly for non-statutory services such as leisure, and this has often led to increased investment in sports centres, theatres, golf courses and other facilities. Increasingly, profit share arrangements with private sector organisations have formed part of the strategic planning discussion. Finally, the commercialisation of some council services is also an area that some councils in England have been exploiting – for example, waste disposal and recycling services sold to the commercial sector.

## Systems for budget setting and monitoring were adequate or carried only minor risks at most councils in Wales, although there was scope for improvement

- 2.5 We found that the majority of councils have robust budget setting and budget monitoring procedures and processes, including timely reviews, well-developed forecasts and effective financial target setting. This demonstrates that budget setting and monitoring processes are well embedded and effective. Some of the weaknesses we identified included: the need to improve the quality of demand forecasting by individual services during the budget setting process; a tendency for budgets to be based on optimistic assumptions and poor scrutiny and challenge of the performance of directorate and service budgets especially on unexpected over and underspends.
- 2.6 Systems for budget setting and monitoring have been a key area of development for councils in England over the past four years, driven by increasing demands on these systems to ensure continued financial resilience. Key features of effective and robust arrangements that we have seen develop include:
- a establishing a well embedded and effective budget setting processes;
  - b strong engagement from services in financial planning;
  - c increased focus on developing the budget on a zero base and on a bottom-up basis;
  - d traditional top-down emphasis for budget setting becoming much less common;
  - e increasingly, service managers taking responsibility for managing the budget, freeing the corporate finance team to develop as a business advisory function, and;
  - f monitoring the budget on a monthly basis and reporting this to the senior management team, with councillors reviewing at least quarterly.

## The majority of councils in Wales are considered to have effective financial controls

- 2.7 Many councils can take assurance of the robustness of current financial controls, in particular, the work of their internal audit departments. However, where councils fared less well key factors were major system changes causing disruption during the year and the council failing to act on the findings and recommendations made by internal or external auditors and regulators.
- 2.8 Clearly, the establishment and maintenance of effective financial controls is a prerequisite to ensure financial resilience, and prevent material errors and fraud that could undermine the financial position. Failure to address identified weaknesses of this kind could result in a major failure of financial governance.
- 2.9 Grant Thornton reported that in England, one of the notable areas of improvement has been in the way that internal audit and other external reviewers have been used to support the financial control framework and provide early warning of weaknesses before they develop into major problems. The historic problems were not just about the capability and effectiveness of internal audit functions, but also about the impact they had in their organisations and the support they received from audit committees and senior management in driving improvement.

## The effectiveness of finance managers, in terms of capacity and capability, was a cause for concern at more than half of councils in Wales

- 2.10 Just under half of councils in Wales were considered to have a full complement of finance managers. In other councils, there is some risk that finance team capacity and/or capability is not adequate to meet the enhanced financial risks all councils face. Common themes underpinning the heightened risk we identified include: councils having to rely on interim arrangements and short term agency staff to fill key finance positions within the finance teams; a loss of knowledge and experience of the Council when temporary staff leave; and difficulties embedding effective controls because staff turnover is high.
- 2.11 The experience of councils in England has shown that reductions in finance team capacity were a feature of many savings plans in the early years of austerity. Counter-intuitively, this also coincided with a need for higher finance skills to manage the financial challenge, compounding the level of risk. At the start of the austerity programme many councils in England reduced their finance teams in order to make savings in back office support costs. The loss of finance capacity would be compensated (in theory) by the increased devolution of financial responsibilities to managers within the Council service departments. Although these managers were not finance professionals, they were re-trained or recruited to fulfil this role by their organisations. Initially, this created a lot of uncertainty about whether these new arrangements would work effectively and would be able to adequately respond to the increasing financial challenge.

- 2.12 By 2012-13, Grant Thornton noted that these concerns had started to recede as the arrangements proved to be effective in many cases. In 2013-14, over 92 per cent of councils were assessed as having adequate or strong finance capability and capacity. This gave assurance that the new arrangements have been successful in most cases, and have even benefitted organisations by creating wider financial accountability outside of the finance department. In regard to other risks related to finance team capacity, an over reliance on key individuals, with limited options for cover or succession, remains a vulnerability at many English councils.
- 2.13 For councils in Wales that are considering options to reduce finance team capacity, it is important that they fully understand their future changing financial management needs and implement a managed process to replace lost central finance team capacity through greater devolution of financial responsibilities to individual services. A poorly managed reduction in finance team capacity can have serious implications for financial resilience in the future. The upside is that, if executed well, a planned and managed reduction in staff has proven to be highly successful in reducing costs and increasing the effectiveness of financial management. Cover and succession planning for financial managers in councils in Wales needs to develop at an early stage as the demand for highly skilled and experienced finance managers will continue at a high level in the current climate.



## Part 3

Whilst financial governance arrangements are comparatively robust, the quality of performance and cost information being used and the level of scrutiny and challenge in Welsh councils varies significantly, which can undermine the effectiveness of decision making





- 3.1 In this section of the report, we focus on councils financial governance and accountability arrangements. For the purposes of our review, we have used the following as the key characteristics of good financial governance and have reviewed current practice and performance against these.

#### Characteristics of good financial governance arrangements

##### Financial governance

- 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 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.
- 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 implemented promptly.
- Committees and cabinet regularly review performance and it is subject to appropriate levels of scrutiny.
- There are effective recovery plans in place.

- 3.2 Councils performed better on financial governance than in other areas considered in our review, although some weaknesses remain, particularly in regard to ensuring the delivery of savings plans. Although the general frequency of financial governance risks was relatively low compared to other areas, our findings still highlight a need to strengthen arrangements in the face of increasing levels of risk due to financial pressures. A report from the Commission on Public Service Governance and Delivery<sup>3</sup> (January 2014) highlights some of the changes that will be required in governance in order to meet the challenges of significant reductions in local government funding.
- 3.3 Experiences in England indicate that major failings in governance are rare, but where they do occur, they can have far-reaching financial and other consequences – as recent examples such as the cases of Mid Staffordshire NHS Foundation Trust and Rotherham Metropolitan Borough Council have shown. It is the nature of major governance issues that they can arise from weaknesses in arrangements that may previously have seemed relatively minor, highlighting the need for vigilance and effective action when weaknesses are identified.
- 3.4 It also follows, from the experiences in England, that improvements in governance arrangements can sometimes lag behind improvements that take place in other areas of financial management, as it is harder to measure the effectiveness of governance until something goes wrong. However, councils in Wales should make sure they identify and apply emerging best practice, to mitigate this risk.
- 3.5 Our review found that approximately half of Welsh councils faced some risk in one or more of these areas. The key areas where there is scope for improvement relate to the following:
- a failure to ensure separate analysis of the delivery and progress of saving plans routinely monitored by councillors as part of the Council's overall financial monitoring arrangements;
  - b limited or no performance indicators in place or presented at the relevant committee;
  - c a lack of accountability for budget underspends/overspends and delivery of savings from the directors and service heads;
  - d limited monthly reporting to senior officers such as the section 151 officer or Chief Executive, on the performance of savings plans and related teams;
  - e a lack of transparency in the way the savings plans are shown to have been delivered, for example, the extent to which failed schemes have been substituted by other recurrent and non-recurrent savings or unplanned income; and
  - f ineffective challenge by councillors and senior officers of financial and savings plan performance.

<sup>3</sup> Report of the Commission on Public Service Governance and Delivery, Welsh Government, January 2014.

- 3.6 Councils should regularly report individual savings to identify over and under achievement and to ensure appropriate and timely action is taken to deliver agreed savings plans. If councils do not monitor specific areas of savings their ability to evaluate and scrutinise saving plans is compromised. As councils have to set more difficult and challenging savings targets, it is increasingly important that effective scrutiny and monitoring takes place on individual saving plans.
- 3.7 Grant Thornton found that in England in recent years, councillors have increasingly had to make difficult decisions about the delivery of services as has also been the case in Wales. In the process, councillors have developed a better understanding of the underlying financial conditions, helping to build mutual confidence with the management team and to extend the organisations' risk appetite. This is particularly apparent in the increasing levels of innovation, for example, with joint working between councils and other partners, and developing alternative delivery models for services.
- 3.8 There are still cases at individual councils in England and Wales where councillors have been resistant or slow to appreciate the need for a more radical outlook in regard to the sustainability of services. These councils are often focussing too much on reducing back office or on piecemeal efficiency measures to provide the savings they require. Many do not see a strong culture of financial efficiency as a priority, irrespective of the council's financial position.
- 3.9 In these cases, the onus is on officers to take a stronger role in helping councillors to understand the financial environment and the longer-term outlook. Councils in Wales will benefit greatly from developing training and development programmes for councillors delivered in a timely way to support them in their roles.
- 3.10 However, our analysis reveals that in some cases councillors and senior management may not be challenging enough during the budget setting process leading to higher than anticipated variances at year end. The need to improve scrutiny and challenge has been an area of significant development in England, and needs to be addressed urgently in Wales if councils are to meet the financial challenges they face.
- 3.11 Likewise, Grant Thornton's work shows that training and development for councillors in financial matters and on their role in governance remains a weak point at many English councils. This weakness is particularly acute in a year that has seen many new councillors created following local government elections. The frequency of reporting to councillors was a concern at some councils in England. In some cases, this was less than quarterly. This lack of regular reporting can be especially problematic where the Council faces significant financial pressures and consequently requires more regular reporting and review than has been standard in the past.

- 3.12 In England, the accuracy of forecasting budget outturn remains an area where further improvements are required. Too often, there are significant variances between monthly or quarterly reports, and frequent amendments to forecast outturn stemming from weaknesses in the systems for managing and reconciling budget and savings plans performance. Financial information provided to councillors, where the underlying performance issues are not adequately drawn out, remains a significant barrier to effective councillor engagement and robust scrutiny of delivery.
- 3.13 Our review found that many councils in Wales do not have a strong track-record of delivering savings plans. The governance risks we identified are primarily associated with the lack of formal monitoring of the delivery of individual savings targets against planned performance by councillors, and the resulting lack of challenge and/or holding of responsible senior officers to account.
- 3.14 In England, in 2011-12 and 2012-13, when many councils were starting to deliver large-scale savings, we saw an increase in governance risks related to savings plan delivery. This was because in preceding years, savings were usually small scale and delivery could be adequately monitored through the budget. The impact of a failure to deliver savings did not therefore pose a strategic risk to council operations and the light touch scrutiny arrangements were adequate for the council's needs. However, as the scale of savings increased together with the associated strategic risks, governance arrangements were slow to be adapted. Hence, resulting in councillors received poor quality or incomplete information on progress in delivering agreed savings plans - which were now becoming of critical importance to future financial resilience.
- 3.15 We found that a number of Welsh councils are still not reporting savings plan progress separately and this approach undermines the ability of councillors to scrutinise and challenge delivery of in-year savings and whether they are on track. It also makes it difficult to clearly identify the distinction between recurrent savings delivered to plan, and short-term fixes – for example, from income windfalls – that will not be available 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.
- 3.16 One important recent development in England is the increasing use of an integrated balanced scorecard. The use of scorecards enables financial pressures to be viewed in the context of service performance, workforce and other operational aspects. English councils are increasingly moving away from the traditional approach of reviewing financial performance in isolation and this is an option for councils in Wales.

#### **Area of good practice noted - Powys County Council**

Powys County Council has taken proactive steps to strengthen their financial governance process by taking part in a peer review and identifying key areas of improvement. The Council has taken a collaborative approach, working with the Centre for Public Scrutiny (CfPS), Grant Thornton UK LLP and CIPFA Wales to enhance their financial governance processes.

## Part 4

Councils are under significant stress and financial management arrangements that were once good enough will not remain fit for purpose in the face of increasing financial pressures



- 4.1 In this section of the report, we focus on councils use of performance measures and management of performance. For the purposes of our review, we have used the following as the key characteristics of good financial performance management and have reviewed current practice and performance against these.

#### **Characteristics of good financial performance management**

##### Key indicators of financial performance

- 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



- 4.2 As we undertake further work on the financial resilience of councils we intend to develop a ‘traffic light’ reporting system covering financial and workforce performance and identify where further improvements are required. The traffic light approach is similar to that taken by Grant Thornton in England and enables useful comparisons to be made. We intend to develop this approach to report more fully on financial resilience and will discuss the methodology we intend to use with councils and other stakeholders. Our analysis of financial KPIs indicates that financial arrangements at many councils are under significant stress. Furthermore, the experience of funding reductions in England reported by Grant Thornton has seen arrangements that were once good enough no longer fit for purpose and requiring significant and rapid evolution to enable councils to deliver the savings they need to make.
- 4.3 The information used in our analysis is taken from each council’s statutory accounts. The analysis is based on an aggregate of KPIs relating to budget delivery, liquidity, borrowing, and reserve levels. Our analysis of councils’ performance on these measures shows that 15 of 22 councils have an improving risk position. Whilst there are no councils that are classed as being high risk with a declining position, there are four councils, which are facing increasing risk because performance against these measures is declining. Below we summarise the performance of Welsh councils against the three key financial performance indicators – budget delivery, liquidity and borrowing.

**There is a high degree of risk for councils in delivering a balanced budget but the direction of travel indicates that budget performance is improving as improvements to financial planning and control take hold**

- 4.4 This performance indicator looks at the Council’s history of under or overspends against revenue budgets, performance on the outturn of net revenue expenditure, which 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 savings, can be delivered.
- 4.5 Our analysis is determined by councils’ budget performance and whether there have been significant revenue budget overspends and consistent and/or substantial budget deficits. These often relate to demand led services such as adult and children’s social care. These services will remain a key risk area over the coming years as grant funding continues to reduce but demand remains steady, even increasing in some areas. Councils that continue to deliver revenue budget overspends in demand led services such as these are likely to face financial difficulties in the future. We consider councils to be performing well when they have delivered consistent underspends against their revenue budget or where they have minimised net budget deficit (or achieved a surplus) and delivered a favourable net out-turn position.

4.6 Grant Thornton reported that the experience in England shows that a good track-record of delivering to budget is a strong indicator of whether future financial plans, including large-scale savings, can be delivered. A significant minority of English councils (14 per cent) struggled to deliver their budget in 2013-14. The most common risk was a significant revenue budget overspend. This overspending often related to demand-led services such as adult or children's social care. Persistent under-budgeting in these services is a danger sign for future financial resilience. An authority with weaknesses in this area which has not made sufficient progress in transforming its services is likely to face significant financial difficulties in the immediate future. Our analysis for Welsh councils found that over a third (36 per cent) of councils have historically experienced some difficulties in delivering a balanced budget but the direction of travel indicates that budget performance is improving across all councils.

**It is evident that there is a high degree of variation in the liquidity ratios of Welsh councils at a time when cash-flow management is becoming increasingly important for councils**

4.7 The 'current ratio' of assets (assets that are readily convertible to cash) to liabilities (short-term liabilities that require prompt payment) gives an indication of liquidity within councils. The risk of running out of cash has traditionally been less acute for councils, compared to the NHS or private sector, because of the security of grant income receipts and the low-value, high volume nature of local taxation. However, the profile of council funding is changing from the traditional model with reduced reliance on grant funding and an increased reliance on income generation, increased financial risk from borrowing and cash investments. Because of these changes, the risk of running out of cash increases and robust cash flow management becomes increasingly more important to make sure that costs can be covered and employee salaries paid on time.

4.8 From our analysis, it is evident that there is a high degree of variation in the liquidity ratios of Welsh councils. Our review classed 55 per cent of councils as at low or low-to-medium risk and 45 per cent of councils as having an increasing level of risk. Overall, the direction of travel shows that in 2013-14, 14 of the 22 Welsh councils have reduced levels of liquidity in comparison to 2012-13, and only eight councils have seen improving liquidity. The reasons for this reduced level of liquidity include increased use of short-term borrowing to meet the council's working capital requirements and declining levels of short-term bank deposits, with low interest levels likely to be the cause for this.

### **Borrowing levels are not currently an area of major concern for the majority of councils in Wales and the general level of financial risk is low**

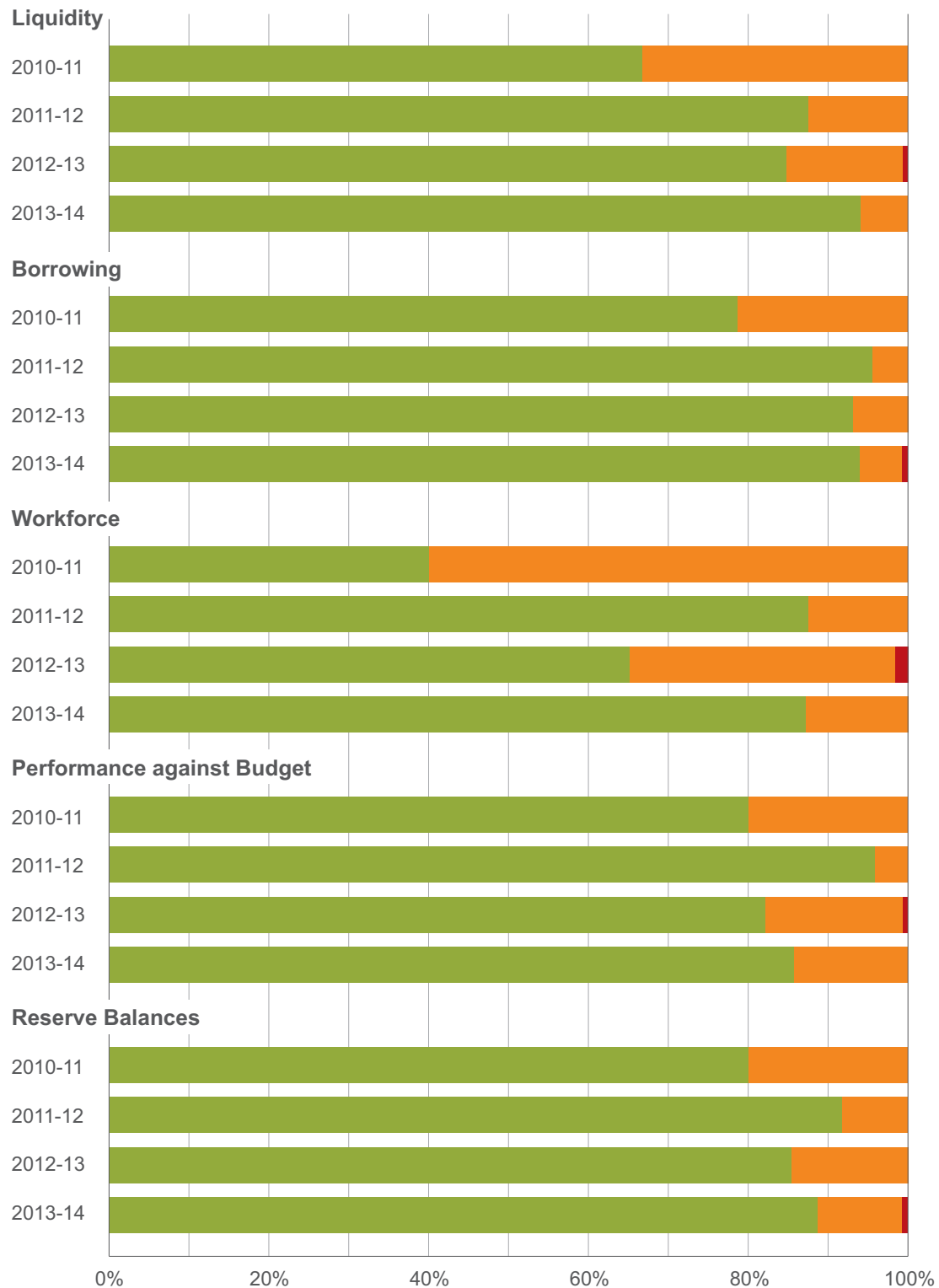
- 4.9 A low gearing ratio indicates that a council is financially stable and can generally borrow more freely as it will be better placed to pay the interest than those with higher ratios. Gearing is therefore a useful measure of corporate financial health as it allows a comparison between council funds and borrowed 'debt'.
- 4.10 We have calculated the gearing position for each council and identified them as either having an improving gearing position, where the levels of borrowing and debt have remained stable or fallen, or a deteriorating gearing position, where the level of borrowing and debt is increasing. Based on this analysis, 10 councils have an improving gearing position and 12 councils a declining gearing position. The range of gearing percentages identified in councils in Wales varied from 14 per cent as the lowest to 32 per cent as the highest.
- 4.11 Grant Thornton's work in England found only a handful of councils where borrowing presented a risk to financial resilience, particularly with regard to a council's ability to service debt. The general level of risk was further mitigated by the fact that the majority of borrowing was from low risk lenders such as the Public Works Loan Board (PWLB). Very few councils were significantly out of step with their respective peer groups which was the primary means used to assess the level of risk for English Councils. As with liquidity, the increase in sophistication in Treasury management policies and the use of professional advisors is often reducing the risk for local authorities.

### **The equivalent English Key Performance Indicator ratings, tracked over time show the positive impact that improving financial planning, governance and control arrangements can have on financial outcomes, despite significant financial challenges**

- 4.12 **Figure 2** summarises the findings of Grant Thornton's review work of financial resilience of councils in England since 2010-11 and demonstrates a trend of improvement that reflects the positive evolution in financial management arrangements over the past four years. This development is consistent with the improving trajectory we have seen with the strength of financial planning, governance and control arrangements. We plan to use a similar risk rating analysis to that used by Grant Thornton in future reports on the financial resilience of councils in Wales.

Figure 2 – Summary of Grant Thornton’s analysis of English councils financial management performance 2010-11 to 2013-14

English councils are continuing to manage the financial risks they face



Source: *Rising to the challenge - The evolution of local government*, Grant Thornton, November 2014



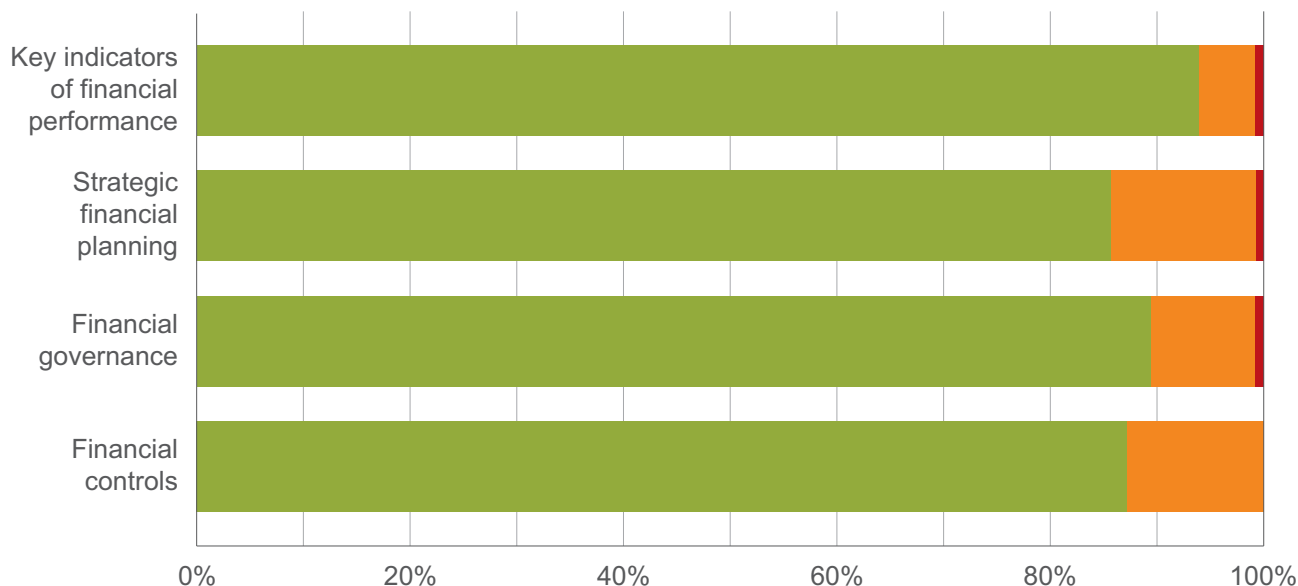
## Part 5

The experience of English councils shows that it is possible to tackle significant reductions in funding but to be successful requires a step change in strategic and operational financial planning



- 5.1 Grant Thornton’s work in England found a trend of improvement in councils that reflects the positive evolution in financial management arrangements over the past four years. This development is consistent with the improving trajectory we have seen with financial planning, governance and control arrangements.
- 5.2 While some English councils are facing a financial tipping point, the positive lesson for Welsh councils is that the majority continue to deliver a sustainable financial position and are likely to do so as long as they can continue to develop and deliver effective responses to changing conditions. However, in most cases in England this has required a fundamental re-think about what services can be delivered, to whom and what levels of service are affordable. This in turn has required the development of highly sophisticated financial management arrangements that were not imagined four years ago.
- 5.3 **Figure 3** shows that most councils in England are managing the financial challenges they face and the current level of financial risk is relatively low.

**Figure 3 – Summary of Grant Thornton Financial Risk Indicators for English Councils 2013-14**  
 Most councils in England are managing the financial challenges they face and the current level of financial risk is relatively low



Source: *Rising to the challenge - The evolution of local government*, Grant Thornton, November 2014



5.4 Grant Thornton found that:

- a Strategic financial planning standards in England are also improving. This is a strong indication of significant evolution in planning processes, partly driven by necessity. Many councils still need to increase the range of their forward planning, ensure that planned outcomes are achievable and change focus from efficiency savings towards service transformation and income generation.
- b Standards of financial governance in England continue to strengthen, particularly in the quality and access to information presented to councillors. While major weaknesses in governance are relatively rare, they tend to have serious and wide ranging financial consequences. Governance of key partnerships and group structures presents a risk for some councils.
- c Financial control remains one of the themes with the highest concentration of issues in England, often concerning the delivery of savings plans. However, most councils continue to perform adequately and there has again been a trend of gradual improvement in financial control systems in the last few years.

5.5 Grant Thornton's review in England concluded that despite the challenges councils face in each of these three areas, the current level of financial risk is relatively low at the majority of councils.

## The headline messages from the 2013-14 review of councils in England draw some useful parallels with the experience of councils in Wales

- 5.6 Most councils in England continue to rise to the challenge posed by government funding reductions, supported by an evolution in financial management arrangements over the past four years. Those who have struggled to establish effective financial arrangements to date are those most likely to face a tipping point. The challenges are set to increase as spending reductions continue over the next few years, and councils must continue to adapt. Those that do not transform their services face a financial tipping point in 2016-17.
- 5.7 Grant Thornton's research also found an increasing confidence that the majority of councils in England are finding ways to overcome the financial challenges they face, particularly transforming the way local services are delivered. Grant Thornton's review of councils in England concludes that inevitably, this continues to present councillors with some difficult decisions and has ultimately led to reduced service provision in some areas.
- 5.8 Proportionally, single tier and county councils face a greater challenge than districts, partly due to the former's responsibility for demand led services such as social care, which continue to present a particularly acute financial risk. However, many district councils have delivered significant savings and are often leading the development of new models of delivery including shared services and joint management arrangements.

- 5.9 The number of English councils with critical financial issues remains low, in comparison to the NHS in England, for example. What stands out is how councils have gradually improved their financial management arrangements, maintaining or even improving their financial performance, in the face of ever-increasing challenges. The same cannot be said of NHS bodies in England.
- 5.10 Most English councils have weaknesses or risks in their arrangements of one kind or another that could affect their ability to deliver financial plans in the medium term. However, our findings suggest that over the past four years risks can be mitigated and service performance maintained. Indeed, many councils are confidently predicting continued financial resilience 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 in 2010.
- 5.11 However, councils remain concerned about the funding structure for local government, and whether it allocates funding fairly in relation to local geographic, demographic and economic conditions. Reductions to grant funding disproportionately affect those councils where council tax provides a lower proportion of total income. Those councils who collect less income from council tax are often those with high levels of deprivation.
- 5.12 For single tier councils and counties, the 'graph of doom' scenarios around demand-driven services (such as adult social care) remain a key challenge. However, new ways of delivering services are now emerging to alleviate some of these risks. We have seen significant change in the culture of councils – financial responsibility has started to permeate throughout the whole management structure. A strong culture of continual improvement, efficiency and financial control, aligned with the council'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 fully within the services. This should be an important area of focus for councils.

## Appendices

Appendix 1 - Methodology

Appendix 2 - Selected case studies  
from England

Appendix 3 - The differences in the way  
local government is funded  
in Wales and England



# Appendix 1 – Methodology

## Review of literature, data and statistics

We have reviewed a wide range of documents and media, including:

- Welsh Government and Department of Communities and Local Government policy and guidance documents;
- reports and briefings from the Welsh Local Government Association and Local Government Association in England; and
- relevant research and guidance from CIPFA.

## Local authority fieldwork

We visited all 22 local authorities in Wales, between June 2014 and November 2014. During the visits, we interviewed a range local authority staff, elected members, and produced local reports for each council summarising our key findings on each authority's financial resilience.

# Appendix 2 – Selected case studies from England

These good practice case studies are taken from Grant Thornton's financial assessment work in England and have been included in this report as good practice examples for councils in Wales to consider.

## Sheffield City Council: outcome-based financial planning

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.

## London Borough of Barnet: commissioning focused delivery model

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.



### **Solihull Metropolitan Borough Council: aligning our resources to our priorities**

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 per cent of all savings have been delivered, with progress well under way for the two subsequent years.

### **Gloucestershire County Council: monitoring system linked to support services**

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.

### **Wigan Metropolitan Borough Council: use of reserves to support transformation**

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.

## Surrey County Council: five year budgets

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 (i.e. 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 closure' 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.

Surrey County Council has also introduced regular all member seminars as part of the medium term financial 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 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.

### **St Helens Metropolitan Borough Council: fully integrated financial and service planning**

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.

### **Bexley, Stockport and Tewkesbury: back office cost reduction**

Councils across England 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 £1 million at the start of 2014/15, rising to £1.5 million 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.

### **London Borough of Sutton: integrated reporting**

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 £38 million, due to cost pressures and significant forecast reductions to the RSG. 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.

### **Bath and North East Somerset Council: zero-based budgeting**

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.

### **London Borough of Haringey: top 100 approach**

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.

# Appendix 3 – The differences in the way local government is funded in Wales and England

Most local government-related policies and responsibilities, from education to planning, or social services to housing, are devolved to the Welsh Government. The Welsh Government sets the national priorities, strategic context and overall level of funding for services. It is then the responsibility of the 22 councils in Wales to deliver these services on a local level within the national context. Approximately a third of the Welsh Government's budget is spent through local authorities reflecting the importance of local services.

In England, council funding is primarily administered by the Department for Communities and Local Government (DCLG). In Wales Schools funding goes through the RSG whilst in England the education funding comes from the Department for Education and is administered by the Educational Funding Agency.

In Wales and England, council income is derived from a range of sources, the key ones being RSG from Welsh Government; Council Tax; Non-Domestic (business) rates; and other income/grants.

Local government budget protection in Wales differs considerably from the situation in England, where local government experienced significantly deeper cuts – a reduction in revenue support from central government of around 9.8 per cent between 2010-11 and 2013-14. An important factor behind the difference is the degree of protection afforded to the NHS. In England, the UK government has sought to protect spending on health in real terms. In Wales, by contrast, revenue spending on health has been cut by about 5.5 per cent in real terms.

The Welsh Government originally produced an indicative settlement for 2014-15, which showed a small real-term reduction of one per cent compared to 2013-14. However, its subsequent budget includes more funding for the NHS and other priorities within its Programme for Government than set out in indicative budget plans and a larger-than-anticipated reduction for local authorities. Local government in Wales faced a nominal revenue reduction of 3.2 per cent for 2014-15 (five per cent in real terms); indicative budget proposals for 2015-16 show a further revenue reduction of over three per cent in real terms. Councils faced the challenging task of incorporating these unanticipated reductions into their medium-term financial plans; ongoing uncertainties about the level of funding available to deliver services means that councils cannot be sure about the level of savings they will need to make.

In addition, in Wales, the RSG is not ring fenced or hypothecated and councils are responsible for deciding how they spend their allocation on the services for which they are responsible. Councils in Wales are also still allocated specific grants, where this ring-fencing has been largely eliminated in England. Welsh councils and the WLGA are of the view that there should be a de-hypothecation of grants and these monies included as part of the revenue settlement. At the timing of settlement, the details of the allocations for a number of specific grants can still be subject to finalisation, creating further uncertainty for councils in its financial planning and budget setting.

The structure of local government in Wales is relatively consistent as all councils are set up on a single tier (unitary) structure – with a single body responsible for all local council services. In England, there are significant structural differences with the two tier system or County and District Councils, alongside single tier (unitary) councils of various types. This makes it very difficult to measure the relative cost efficiency of these differing configurations.

A key area of current debate in England is around the fact that cuts to government grants disproportionately affect less affluent areas, where council tax and business rates takings are a lower proportion of total income. This issue has a similar impact in Wales.



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