

‘SUMMING UP’

A Review of Financial Management in Local Government 2005-2008

Summary

Audit Commission
Local Government National Report April 2009

Summary

1. Councils are accountable for around one-quarter of all public spending. In 2006/07 total expenditure was £144 billion, with councils' assets valued at £250 billion. Sound and strategic financial management is essential to ensure resources are available to support priorities and improve services.
2. The Audit Commission's use of resources assessment evaluates how well councils manage and use their resources. The imminent change in the assessment framework in 2009 means that now is a good time to review progress made by councils to date in managing their finances.
3. There has been a steady improvement in overall use of resources scores between 2005 and 2008. In 2005, 44 per cent of councils performed consistently or well above minimum requirements (scoring level 3 or 4). By 2008, this had increased to 77 per cent. However, 47 per cent of councils remained at or have returned to the same performance level in 2008 compared to 2005.
4. The rate of improvement did, however, vary between the use of resources themes. The most improved theme was internal control where only 28 per cent of councils were performing well or strongly in 2005, compared to 72 per cent in 2008. Financial management and financial standing also demonstrated significant improvement. Value for money and financial reporting showed slower improvement.
5. Financial reporting was the least well performing theme in 2008 and was also the only theme subject to deterioration in performance between 2005 and 2008. Between 2007 and 2008 for example, performance deteriorated at 24 per cent of councils. Particular issues have been identified with the quality and timeliness of final accounts preparation.
6. The external environment in which councils operate is getting tougher. The current challenging financial environment and the introduction of International Financial Reporting Standards (IFRS) will place even more of a premium on sound and strategic financial management and robust financial reporting processes. All council financial management arrangements will be tested by pressures linked to the recession and expected reductions in public expenditure over the medium term, so councils will need to deliver further improvements in performance to meet these challenges.

Introduction

7. Councils are accountable for around one-quarter of all public spending. In 2006/07 the total expenditure of councils in England was £144 billion, with councils' assets valued at £250 billion. Expenditure in real terms increased every year between 1997 and 2008.
8. Sound and strategic financial management is essential to ensure resources are available to support priorities and improve services. This view was reflected in the Audit Commission's Comprehensive Performance Assessment (CPA) framework where the overall score for use of resources formed a significant element in determining the CPA category.

9. The Audit Commission's, World Class Financial Management discussion paper, published in 2005, describes financial management as:

- an essential element of good corporate governance;
- forming part of the firm foundations of an organisation, underpinning service quality and improvement; and
- the basis of accountability to stakeholders for the stewardship and use of resources.

10. Local government is facing significant challenges arising from the current economic downturn as well as a rapidly changing and increasingly complex operational environment. Added to this there will be additional pressure on councils as IFRS are introduced. Given this and the special accountabilities attached to the stewardship and use of public money, all councils need to rise to the challenge of improving financial management.

11. The quality of financial governance and leadership in developing a strong financial management culture and developing financial skills will be critical if these challenges are to be met successfully.

12. Evidence from auditors indicates that strong leadership from senior management, including the finance director, is a characteristic of improving councils. This is as much about changing the culture of the organisation as it is about developing skills or processes. At those councils that achieved and maintained strong performance, managers across departments understand the importance of good financial management and their responsibility to contribute towards it.

13. A culture of good financial management is not just important for officers. Auditor reports also picked out effective executive and wider member involvement as a particular strength of the better performers.

14. Two further key characteristics of the better performers were:

- being open to and actively seeking external advice and notable practice to improve their learning; and
- understanding the need to invest in and involve staff through appropriate training and performance management.

15. Finance directors across the public sector highlighted the importance of performance management and staff training in underpinning improvement. This is consistent with auditor reporting on the skills and capacity of staff dealing with accounts preparation and wider financial management.

16. This report provides an overview of councils' progress in developing their financial management arrangements between 2005 and 2008, and discusses the importance of sound financial management in helping to meet the challenges facing local government in the short to medium term.

17. In drafting this report we have drawn on the results of:

- the Audit Commission's use of resources assessments from 2005 to 2008;
- other information reported by auditors;
- Audit Commission research reports and policy papers;
- surveys of chief executives and chief financial officers carried out in 2008; and
- a review of annual accounts of all single-tier and county councils.

Conclusions and way forward

18. The external environment in which councils operate is getting tougher. The most recent comprehensive spending review requires councils to make cashable efficiency savings between 2008 and 2011 in order to ensure that their resources match expected income. The subsequent rapid deterioration in the economy will reduce this expected income while increasing likely demand for services. Most commentators also suggest that there will be less national money available for local services by the time of the next comprehensive spending review, so resources are likely to get tighter every year for the foreseeable future.

19. The recession is likely to affect policies on the level and use of council reserves. Possible future reductions in financial settlements, falling interest rates and reductions in income may result in deterioration in the financial position. In such circumstances, councils may decide to reduce reserves by using some of them to balance future budgets. It is, therefore, important that councils review their reserves policies to ensure that they remain relevant and appropriate to current financial circumstances.

20. The Audit Commission report, *Crunch Time: The Impact of the Economic Downturn on Local Government Finances*, published in 2008, showed that the recession has already affected council income for 2008/09, and greater future reductions are expected. It is also an issue for those councils with significant current income from charges for car parking and development. This will impact in particular on district councils, who overall receive more income from fees and charges than from council tax.

21. With less income available, the importance of efficient and effective systems for income and debt collection and management increases. For example, previous research on rent arrears has shown that a critical factor is to identify problems early and prevent small arrears from escalating. Almost three-quarters of councils are already anticipating increases in council tax and rent arrears as the recession and rising unemployment affects household incomes.

22. All council financial management arrangements will be tested by pressures linked to the recession. Good medium-term financial strategies will be more important than ever, as they provide a framework for evaluating the financial impacts of different policy choices. In particular, income projections will need to be reviewed, and plans revised accordingly. Turbulence in the financial markets will make sound treasury management policies increasingly important. Overall reductions in interest rates will reduce income from investment. Greater uncertainty in income streams and service demands will make income and debt management more important.

23. Underpinning all of this will need to be the effective tracking of income and expenditure, associated in-year financial reporting to decision makers and external accountability to the public through published annual accounts and reports.

24. Financial management in most councils has improved over the past four years but performance in financial reporting has been variable with some councils showing a deterioration. The current challenging financial environment will place even more of a premium on sound and strategic financial management and robust financial reporting and councils will need to deliver further improvements in performance.