

# Summing up

A review of financial management in local government 2005 - 2008



**Local government**

**National report**

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 **audit**  
commission

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# Summary

- 1** Councils are accountable for around one-quarter of all public spending (Ref. 1).<sup>1</sup> In 2006/07 total expenditure was £144 billion, with councils' assets valued at £250 billion (Ref. 2). 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.

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<sup>1</sup> Twenty-seven per cent of UK public expenditure (Ref. 1).

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- 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.

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# Introduction

- 7** Councils are accountable for around one-quarter of all public spending (Ref. 1).<sup>I</sup> In 2006/07 the total expenditure of councils in England was £144 billion, with councils' assets valued at £250 billion (Ref. 2). Expenditure in real terms increased every year between 1997 and 2008 (Ref. 3).
- 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.<sup>II</sup> 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.

<sup>I</sup> Twenty-seven per cent of UK public expenditure (Ref. 1).

<sup>II</sup> Analysis of annual audit letters.

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- 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 (Ref. 4). This is consistent with auditor reporting on the skills and capacity of staff dealing with accounts preparation and wider financial management.<sup>I</sup>
- 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;<sup>II</sup>
  - Audit Commission research reports and policy papers;
  - surveys of chief executives and chief financial officers carried out in 2008 (Ref. 4, Ref. 5); and
  - a review of annual accounts of all single-tier and county councils.

<sup>I</sup> Expressed in annual audit letters and regular returns to the Audit Commission.

<sup>II</sup> Including annual auditor returns, strengths and areas for improvement analysis and annual audit letters.

# 1 | Use of resources assessment

## Background to use of resources

- 18** The Audit Commission's use of resources assessment, introduced for the purposes of CPA, evaluated how well councils managed and used their resources. The 2008 assessment was the fourth and last for single-tier and county councils under the Audit Commission's CPA – *The Harder Test* framework and also for district councils.<sup>1</sup>
- 19** The use of resources assessment required auditors to reach scored judgements, on a scale of 1 to 4, for five themes:
- financial reporting;
  - financial management;
  - financial standing;
  - internal control; and
  - value for money.
- 20** The five themes were underpinned by 11 high level statements known as key lines of enquiry (KLOE). In turn, these KLOE were supported by detailed criteria for judgement.
- 21** The scores arrived at by auditors for each of the themes were used by the Audit Commission to calculate an overall use of resources score. The overall score was calculated according to a set of rules shown in Table 1.

**Table 1**  
Use of resources scoring scale and associated rules

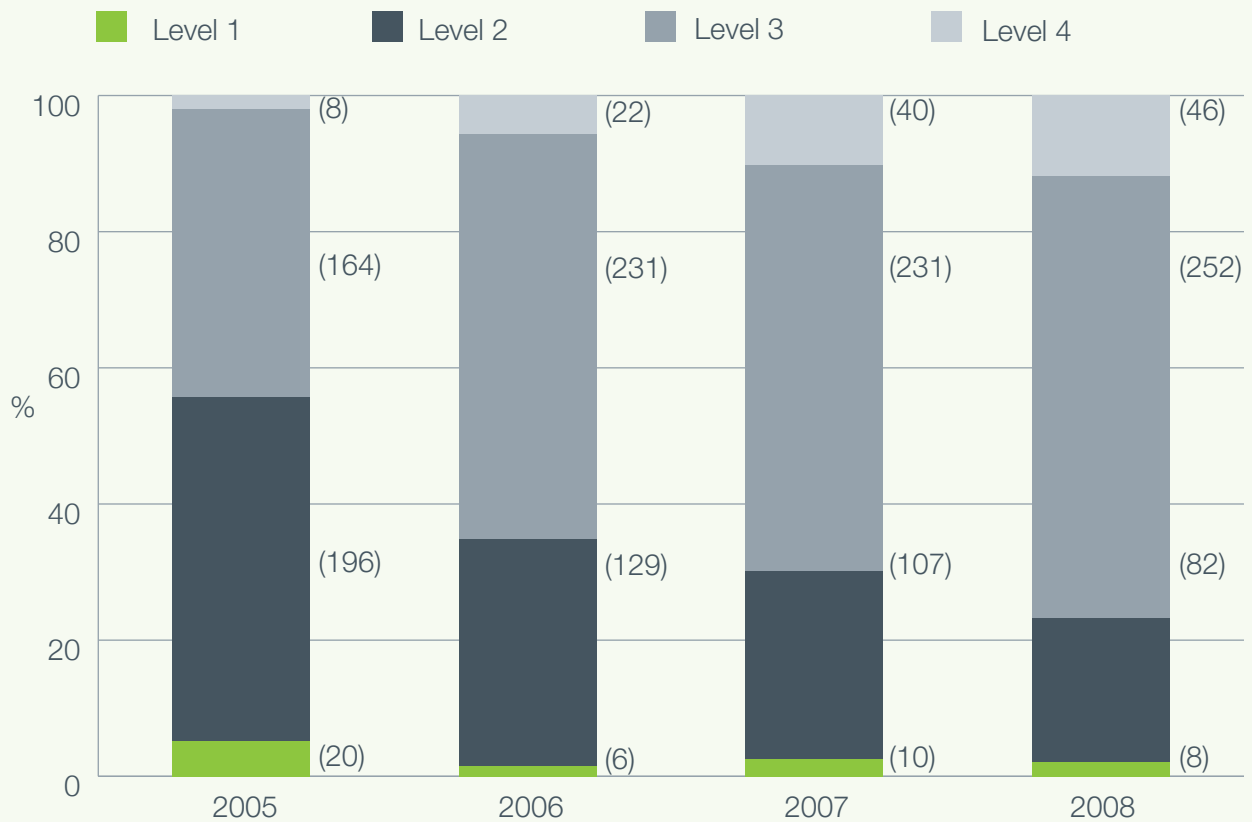
Score	Description	Relevant rules for overall score
4	Well above minimum requirements; performing strongly.	Two or more themes with a score of 4. None less than a score of 3.
3	Consistently above minimum requirements; performing well.	Three or more themes with a score of 3 or more. None less than a score of 2.
2	Only at minimum requirements; adequate performance.	Three or more themes with a score of 2 or more.
1	Below minimum requirements; inadequate performance.	Any other combination.

<sup>1</sup> Further information on the CPA framework for single-tier and county councils and district councils can be found on the Audit Commission's website: <http://www.audit-commission.gov.uk/>

**22** In spring 2008, Ipsos MORI asked a large sample of chief executives and directors of finance in local government and the NHS for their views on a number of Audit Commission activities. Ninety-one per cent considered that the Audit Commission was effective at raising standards of financial reporting and financial management. This is supported

by the Audit Commission's report on the impact of CPA (Ref. 6) which includes evidence showing that the assessment has supported improvement and driven up standards.

**Figure 1**  
**Use of resources overall scores for 2005 to 2008 (number of councils)**



Source: Audit Commission

# Use of resources assessment

## Use of resources scores for 2005 to 2008

### Overall scores

**23** There has been a steady improvement in overall scores between 2005 and 2008. In 2005, 172 councils (44 per cent) performed consistently or well above minimum requirements (scoring level 3 or 4). By 2008, this had increased to 298 (77 per cent). In 2005, 20 councils (5 per cent) were performing below minimum requirements compared to eight (2 per cent) in 2008, with eight councils (2 per cent) performing strongly in 2005 compared to 46 (12 per cent) in 2008. The overall scores for 2005 to 2008 are summarised in Figure 1.<sup>1</sup>

**24** Most of the improvement over the four years can be seen by councils moving up one performance level. Of the 189 councils that improved their score, 184 (97 per cent) moved up by one level. Only five councils improved by two levels; three of these moved from below adequate to performing well, and the other two from adequate to strong performance. Only five councils performed strongly throughout the period.

**25** Seventeen councils (4 per cent) had a lower score in 2008 compared with 2005, with one council deteriorating by two performance levels. One hundred and eighty-two councils (47 per cent) remained at or have returned to the same performance level in

2008 compared to 2005, of which 59 councils (15 per cent) are still at or below minimum requirements. This information is illustrated in Figure 2.

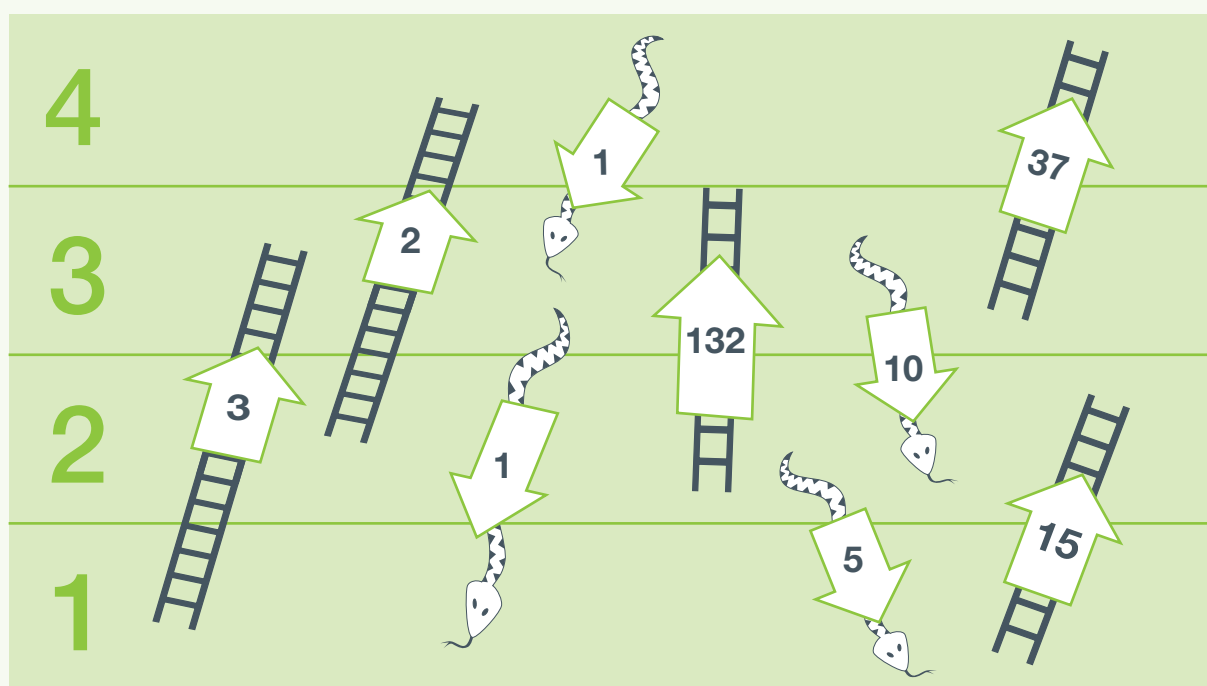
**26** The nature of the rules-based scoring system (Table 1), along with some tightening of the assessment standards year-on-year, meant that councils which remained at or returned to the same performance level in 2008 compared to 2005, may have improved in some aspects of their performance without resulting in an overall score change.

**27** Overall rates of improvement were similar across the different types of councils but there are differences in the performance levels achieved, with single-tier and county councils generally achieving a higher level of performance than district councils. In 2008, 91 per cent of single-tier and county councils were performing well or strongly overall compared to 68 per cent of districts. There were no single-tier and county councils and only eight district councils performing below minimum requirements. The most significant difference is in the number of councils performing strongly, with 22 per cent of single-tier and county councils achieving the highest score in 2008 but only 5 per cent of districts.

<sup>1</sup> Published use of resources assessment scores are available on the Audit Commission's website: <http://www.audit-commission.gov.uk/>

**Figure 2**

**Changes in overall use of resources score between 2005 and 2008**



Source: Audit Commission

**189 councils improved their overall score**

The scores for **five** councils increased by two levels, three from a 1 to a 3 and two from a 2 to a 4

**37** councils moved from a 3 to a 4

**132** councils moved from a 2 to a 3

**15** councils moved from a 1 to a 2

**182 councils remained at, or returned to, the same overall score in 2008 compared to 2005**

**The scores of 17 councils deteriorated**

**1** council moved from a 4 to a 3

**10** councils moved from a 3 to a 2

**5** councils moved from a 2 to a 1

**1** council moved from a 3 to a 1

Source: Audit Commission

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# Use of resources assessment

**28** Capacity issues have been suggested as a reason for more district councils not achieving the higher use of resources performance levels. However, analysis indicates that there is no relationship between size and performance within any group of council types, so capacity issues alone should not prevent district councils from improving their performance and achieving levels 3 and 4.

## Theme scores

**29** The rate of improvement between 2005 and 2008 varied between themes (Figure 3). The most improved theme was internal control where only 109 councils (28 per cent) were performing well or strongly in 2005 compared to 278 councils (72 per cent) in 2008. Financial management and financial standing also demonstrated significant improvement. Value for money and financial reporting showed the least improvement, with financial reporting the least well performing theme in 2008.

**Figure 3**  
**Use of resources theme scores for 2005 and 2008 (number of councils)**



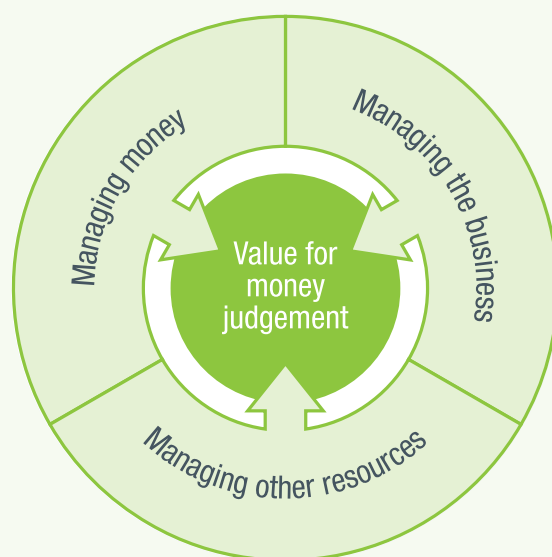
Source: Audit Commission

# Use of resources assessment

## New use of resources framework

- 30** From 2009, the overall assessment regime for councils and other local public services is changing with the introduction of Comprehensive Area Assessment (CAA).<sup>1</sup> The use of resources framework has also changed with effect from 2008/09 to feed into CAA.
- 31** The new use of resources framework will continue to assess the areas of greatest relevance to financial management and financial reporting highlighted in this report. However, the themes and KLOE are new so future scores will not be directly comparable with those for the previous assessment between 2005 and 2008.
- 32** The new use of resources assessment considers how well organisations are managing and using their resources to deliver value for money and better and sustainable outcomes for local people.<sup>1</sup> The assessment comprises three themes that focus on:
- sound and strategic financial management;
  - strategic commissioning and good governance; and
  - the management of natural resources, assets and people.

**Figure 4**  
Use of resources framework



Source: Audit Commission

- 33** The managing finances theme of the new framework is based on the principles of *World Class Financial Management* and comprises three KLOE addressing the following questions:
- Does the organisation plan its finances effectively to deliver its strategic priorities and secure sound financial health?
  - Does the organisation have a sound understanding of its costs and performance and achieve efficiencies in its activities?
  - Is the organisation's financial reporting timely, reliable and does it meet the needs of internal users, stakeholders and local people?

<sup>1</sup> The CAA framework document and the new use of resources framework is available from the Audit Commission's website: <http://www.audit-commission.gov.uk/>

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# 2 | Financial planning and financial health

- 34** 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. The following chapters in the report are linked to the KLOE in the new managing finances theme.
- 35** Financial planning is a key element of financial management and is essential for aligning resources to strategic objectives and priorities.
- 36** *World Class Financial Management* identifies the features of a good financial planning process as:
- focusing over the medium to long term;
  - integrating financial and wider business and service planning; and
  - integrating capital, revenue and treasury management planning.
- 37** The budget and longer-term financial plan is a quantitative expression of an organisation's plan of action and as such should reflect its key priorities and objectives for the year and the longer term. Financial planning is more than just budgeting; it is about the whole financial process including links to other planning cycles, for example service planning, and arrangements for monitoring financial performance.
- 38** For an organisation to manage its financial health effectively, an annual budget is not sufficient. The organisation needs to develop its budget in the context of a longer-term, typically three to five-year, financial plan that is updated at least annually. Good financial planning can ensure short-term fixes are not achieved at the expense of long-term sustainability.
- 39** The following sections analyse the results from the financial planning and financial standing KLOE of the Audit Commission's use of resources assessments for 2005 to 2008.

# Financial planning and financial health

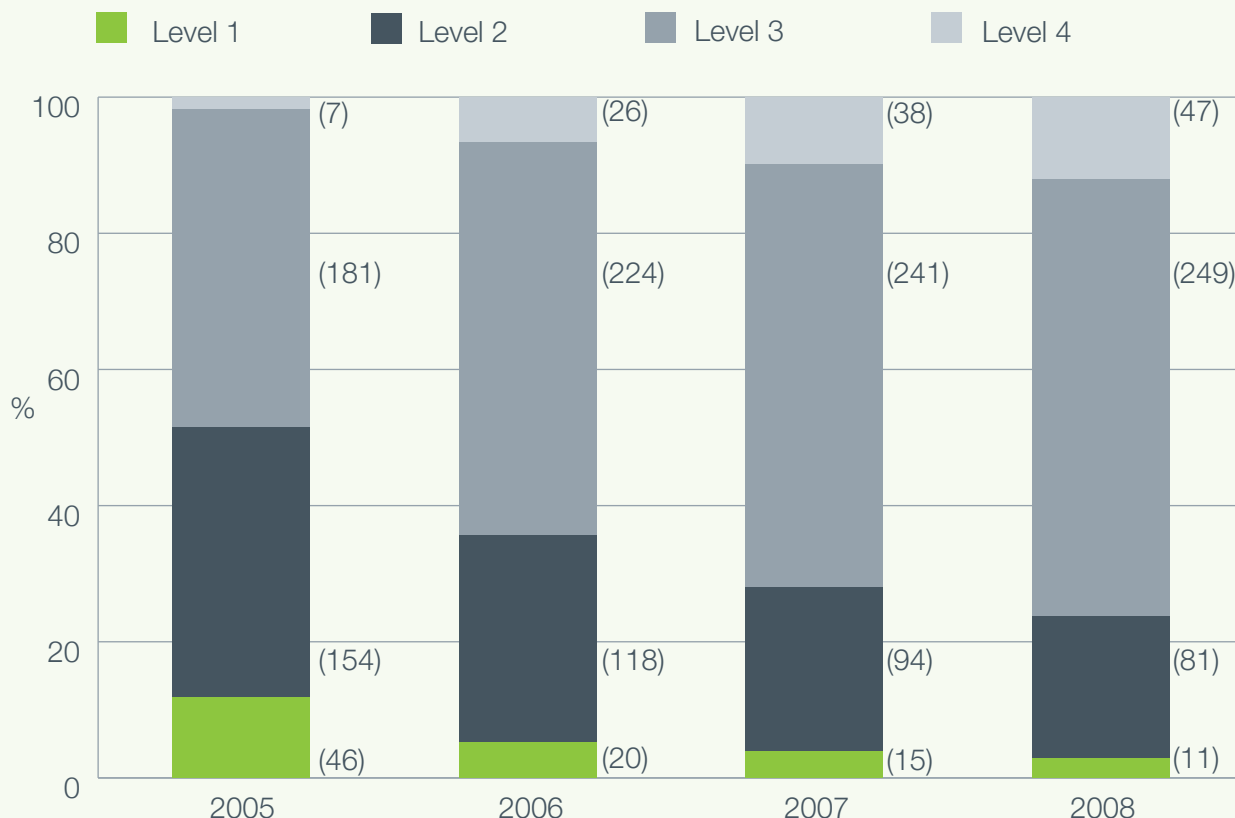
## Financial planning

**40** The financial planning KLOE of the use of resources assessment looked at whether councils' medium-term financial strategies, budgets and capital programmes were soundly based and designed to deliver their strategic priorities.

**41** There has been a steady improvement in scores for this KLOE between 2005 and 2008. In 2005, 188 councils (48 per cent) performed consistently or well above minimum requirements (scoring level 3 or 4). By 2008, this had increased to 296 (76 per cent). In 2005, 46 councils (12 per cent) were performing below minimum requirements compared to 11 (3 per cent) in 2008. The financial planning KLOE scores for 2005 to 2008 are summarised in Figure 5.

**Figure 5**

**Use of resources financial planning KLOE scores for 2005 to 2008 (number of councils)**



Source: Audit Commission

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- 42** There has been widespread improvement in the development of medium-term financial strategies which link to strategic objectives and efficiency programmes. Weaker performing councils often had no adequate medium-term financial strategy in 2005; most developed these financial strategies first and then improved the links with wider business plans and corporate priorities. In 2008, auditors considered such integration a particular strength in 41 per cent of councils and a specific weakness in only 7 per cent. Better performing councils can also point to the effective engagement of the executive in financial management as a key strength.
- 43** Financial planning in partnerships continued to be identified by auditors as an area for improvement in 2008. However, the better performing councils can show how they have consulted with stakeholders and are including joint financial plans agreed with other partners within their own medium-term financial strategy. Engaging with local partners in the financial planning process will become increasingly important for councils in the future and will be assessed in the managing finances theme of the new use of resources assessment.
- 44** An example of a council which has improved considerably its approach to financial planning over recent years is Peterborough City Council (Case study 1). Peterborough City Council has moved to a medium-term financial strategy that is corporately owned, links to the Council's strategic priorities and has been developed with the involvement of councillors. This improvement took place in parallel with improvements in financial reporting which are discussed later in this report.

# Financial planning and financial health

## Case study 1

### Peterborough City Council

Peterborough City Council developed a corporate approach to medium-term financial planning and integrated this with wider business planning.

Prior to 2007, Peterborough City Council set cash limits for each department. There was no corporate ownership of budget pressures, with reserves held by each department. This reduced corporate control of actual expenditure against the budget.

In 2007, a more corporate process was adopted for setting the budget and medium-term financial strategy, integrating business and financial planning.

Each service completed a baseline assessment incorporating financial and performance data, as well as contextual information regarding the service. Assessments were subject to challenge by a peer group of officers to determine whether the service provided value for money.

The baselines were then used as the first section in an integrated business and financial planning document. This also considers the future objectives of the service, together with performance information and targets. The resourcing implications of achieving the objectives and targets are then determined in comparison with existing budgets. Additional resource requirements are considered and ranked using a prioritisation process.

A list of bids for resources considered essential are presented for approval by Cabinet at a special meeting. Presentation of the bids by each director allows decision makers to take a corporate view of priorities and allocate resources accordingly. Priorities, such as growth associated with the Council's objectives, are considered alongside legislative and demand-led financial pressures.

The Council's medium-term financial strategy is underpinned by an ambitious savings programme, the delivery of which is facilitated by a business transformation team. The savings programme is discussed and agreed with directors and heads of service to ensure understanding and buy-in. Subsequent budgetary control reports to Cabinet report savings achieved compared to targets.

The Council is now developing a local area agreement (LAA) financial framework. A series of internal meetings ensures departmental plans align with and contribute to the sustainable communities strategy and LAA. The focus is on ensuring existing resources are aligned to strategic objectives rather than bids for additional capacity. Further challenge meetings are held to consider how departments will deliver the outcomes in their plans.

The new planning process has allowed senior officers and members to gain a clearer corporate view of financial pressures and priorities across the Council, with enhanced corporate ownership of both the budget and strategic objectives.

**45** Further financial management case studies can be found on the Audit Commission's website.

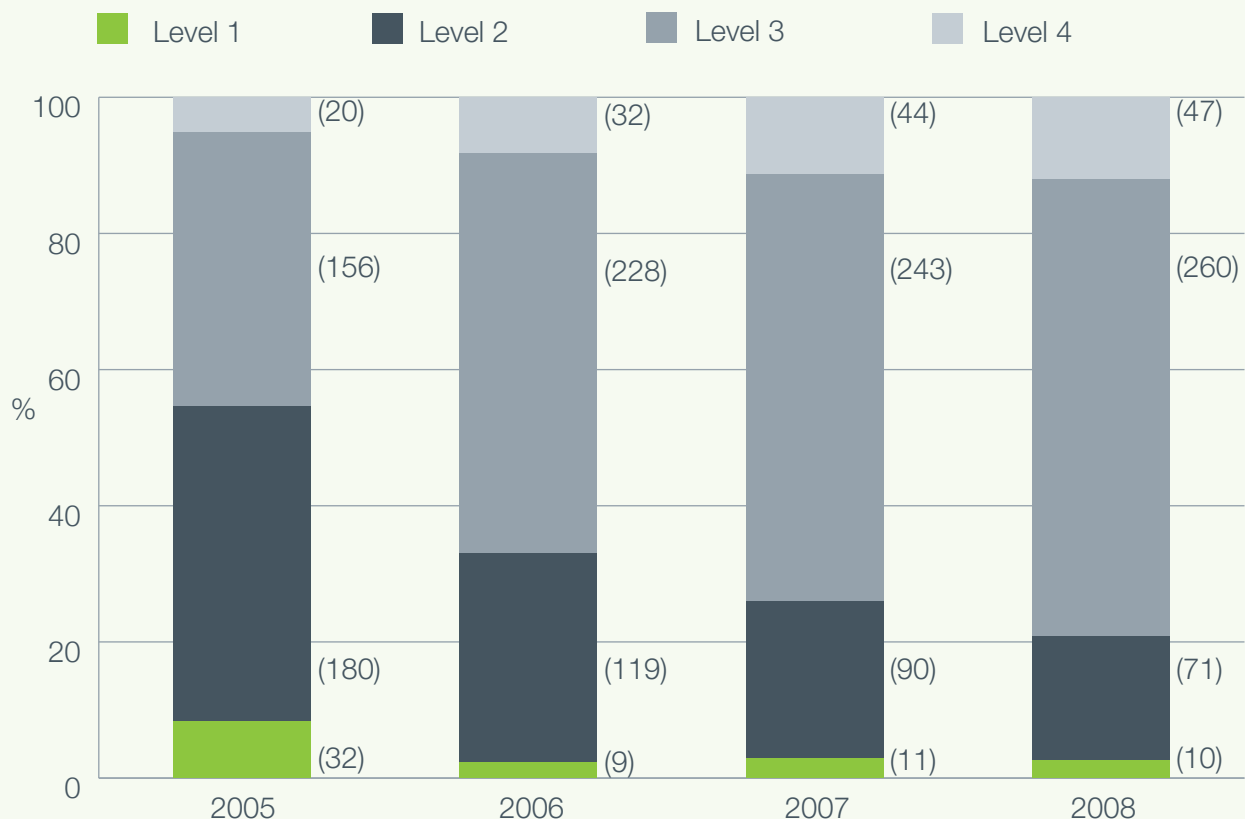
## Financial health

**46** Financial health was assessed under the financial standing theme of the use of resources assessment. This theme looked at whether councils managed spending within available resources.

**47** There has been an improvement in performance between 2005 and 2008. In 2005, 176 councils (45 per cent) performed consistently or well above minimum requirements (scoring level 3 or 4). By 2008, this had increased to 307 (79 per cent). In 2005, 32 councils (8 per cent) were performing below minimum requirements compared to only ten (3 per cent) in 2008. Financial standing scores for 2005 to 2008 are illustrated in Figure 6.

**Figure 6**

**Use of resources financial standing theme scores for 2005 to 2008 (number of councils)**



Source: Audit Commission

# Financial planning and financial health

**48** Auditors identified significant variations in the level of reserves that councils hold, and suggested that some needed to improve the management of reserves and balances. They also had some concerns over income and debt management in a minority of councils. Only one council has remained below minimum standards since 2005, although two have been considered inadequate since 2006 and four since 2007.

**49** Between 2005 and 2007, there was year-on-year improvement across all councils but the rate of improvement slowed in 2008. Following the Icelandic bank default, auditors at some councils reviewed and revised their scores

for financial standing to reflect the weaknesses revealed in their treasury management arrangements. This may have contributed to the slower rate of improvement for 2008. The Audit Commission's report *Risk and Return*, published in March 2009, examines in detail the issues arising from local government investments in Icelandic banks.

**50** Auditors reported that in 2007/08 most councils managed spending within budget. Council spending against budgets is summarised in Table 2. Over 90 per cent of councils were within 5 per cent of their budget, suggesting this is an area of strength.

**Table 2**  
**Council spending compared to budget**

Council type	Number of councils overspending against budget	Number of councils underspending against budget
County	6	27
Metropolitan	5	30
London borough	10	23
Unitary	11	36
District	59	166
Total	91	282

Source: Auditors' returns to the Commission<sup>1</sup>

<sup>1</sup> Fifteen councils neither overspent nor underspent.

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**51** An example of reporting financial health using a traffic light system and key financial indicators is the Metropolitan Borough of Trafford discussed in Case study 2. The introduction of web based financial health indicators means that all members and the public now have an easy-to-read and accessible document. The document shows, at a glance, the financial status of the Council, progress against targets with details of areas requiring attention and where further information can be found.

# Financial planning and financial health

## Case study 2

### Trafford Metropolitan Borough Council

Trafford Metropolitan Borough Council has developed an approach to reporting for better financial health.

A financial management improvement programme was introduced in Trafford and over the past four years performance has steadily improved.

One aspect of the improvement programme was to develop financial reporting and monitoring. The aim was to produce a simple way of informing all members and other interested stakeholders of the financial standing of the Council without burdening them with large operational reports. Members, especially those involved in scrutiny, may need to drill down into further information for specific areas, so signposting was also an important feature of improving financial reporting.

In 2007, the Chair of Scrutiny and the Executive Member for Finance along with officers formed a task group to look into ways of improving financial information, and in particular budget monitoring. The output from this group was a short two-page template, entitled Financial Health Indicators. This presents information in a user-friendly traffic light reporting style. It shows members and the public how well the Council is doing financially at regular intervals.

Key financial indicators were already a feature of operational performance management. To decide which targets to select, Trafford researched all councils which scored level 3 or 4 in use of resources to identify good practice that could be tailored to local circumstances.

The document is designed to encourage and promote usage. It has three sections: management of resources, treasury management and exchequer performance. Progress against individual key targets within each of the sections is presented in table form with traffic light indicators and high level supporting narrative to explain variances.

The financial health indicators are published on the Council website on a quarterly basis as this is felt to be the most appropriate frequency and effective means of providing access. Members are also given a hard copy to ensure they are fully aware and kept up to date.

The initiative has been welcomed, particularly by scrutiny and back-bench councillors. Many members who used to get such information under the old committee system are grateful to have access to financial information as received in the past, as this has made them feel more included in the operational affairs of the Council. It has also significantly increased the Council's openness, governance and accountability. There is a clearer focus on management's responsibility for achieving targets, which reinforces existing monitoring of performance by senior management and the Executive.

The financial health indicator report is issued by the Chief Finance Officer to all members and unlike many public documents is not subject to Executive or Corporate Management Team approval. This reinforces openness and public accountability.

The indicators promote wider interest in financial management in the Council and help to improve financial understanding and literacy. The document is a model for a simple but effective method of communication that has become a standard for others in the Council to emulate.

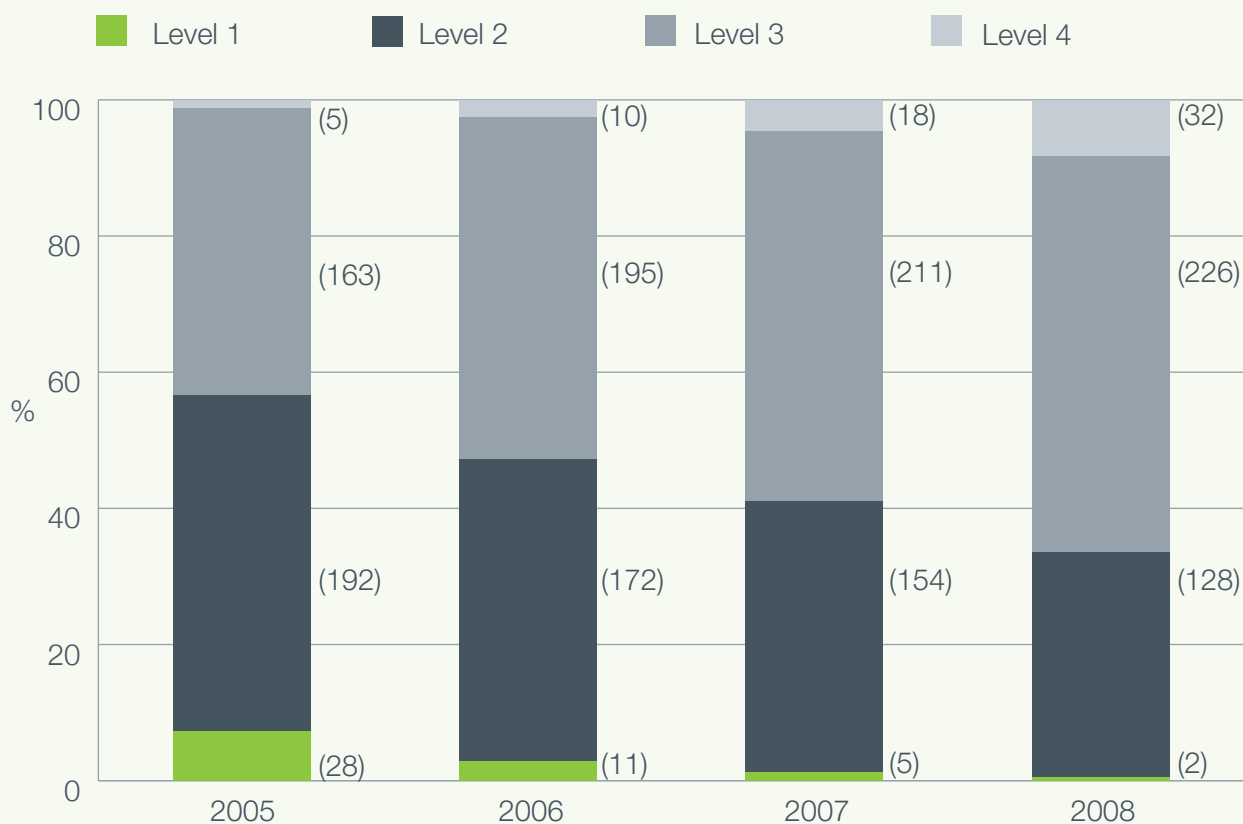
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# 3 | Understanding costs and achieving efficiencies

- 52** *World Class Financial Management* concluded that while costing is fundamental to good financial management, it is an underdeveloped practice in the public sector, including local government. The current focus on securing greater efficiencies and value for money, often to sustain existing service levels, means that councils will increasingly need to pay greater attention to costing in order to provide better information to inform difficult decisions in allocating scarce resources.
- 53** Councils have the further challenge of achieving annual 3 per cent cash releasing gains over the period to 2010/11 (as set out in the 2007 *Comprehensive Spending Review*) in a recessionary environment. Councils will need to demonstrate strong leadership to bring about planned efficiencies. All of this makes it essential that councils understand both what costs they incur in delivering their services and activities, and the drivers that influence these costs.
- 54** Councils' approach to costing was assessed under the value for money theme in the use of resources assessment, which considered whether councils achieved, managed and improved value for money. Auditors reviewed whether councils:
- understand, benchmark and monitor costs;
  - link costs and investment with outcomes;
  - make efficiency savings; and
  - ensure that procurement and other spending decisions take account of long-term costs and benefits, including environmental and social costs.
- 55** Councils have improved performance in the value for money theme at a steady rate over the past four years, as shown in Figure 7, although the rate of improvement is not as marked as that for financial management or financial standing. In 2008, only two councils were considered to be performing below minimum requirements compared to 28 councils (7 per cent) in 2005. Councils performing well or strongly increased from 43 per cent in 2005 to 66 per cent in 2008.

# Understanding costs and achieving efficiencies

**Figure 7**  
Use of resources value for money theme scores for 2005 to 2008 (number of councils)



Source: Audit Commission

**56** Auditors have highlighted the achievement of efficiency gains as a strength area at a significant number of single-tier and county councils and district councils, and delivering savings through procurement was also a particular strength area at single-tier and county councils.

**57** Understanding unit costs and the use of comparative benchmarking information on costs has been identified as a strength area at approximately 60 per

cent of single-tier and county councils but at less than 20 per cent of district councils.

**58** An example of a council that improved its value for money arrangements is the London Borough of Sutton (Case study 3). The Council used benchmarking to drive its efficiency programme.

### Case study 3

#### London Borough of Sutton

London Borough of Sutton has established a value for money strategy and has used benchmarking to drive the Council's efficiency programme.

A key objective of the strategy was to balance flexibility with a systematic and objective assessment. The process also needed to secure buy-in from service managers and allow appropriate member involvement.

A benchmarking system provides a guide to comparative performance across all service areas, taking account of particular known local pressures. Potential areas of efficiency savings are identified using an assessment tool known as the 'VfM quotient'. This uses data from the Audit Commission and the Chartered Institute of Public Finance (CIPFA) to provide automatically an assessment of each service's value for money. Automated production of these reports frees officer time for more intensive research into performance and results.

Service areas are then charged with selecting one or two significant areas of potential efficiency savings to be subjected to particular focus through efficiency challenge workshops. This ensures that service managers are involved at an early stage. The workshops involve councillors, relevant service managers, other Council staff and external consultants. Ideas that the workshops identify are then consolidated into an efficiency programme that informs the financial and corporate planning process.

Each project in the efficiency programme is subject to the Council's formal project management process. Efficiency projects are categorised into four areas:

- customer services – transferring processes from back office to front-facing customer services staff;
- invest-to-save projects;
- procurement projects; and
- transitional services – combining similar functions across the Council or with other partner organisations.

These areas are supported with specialist staff and funds. Members play an active role by taking personal responsibility for providing ideas and oversight of selected projects. Regular reports are produced to ensure progress can be monitored by senior officers and members.

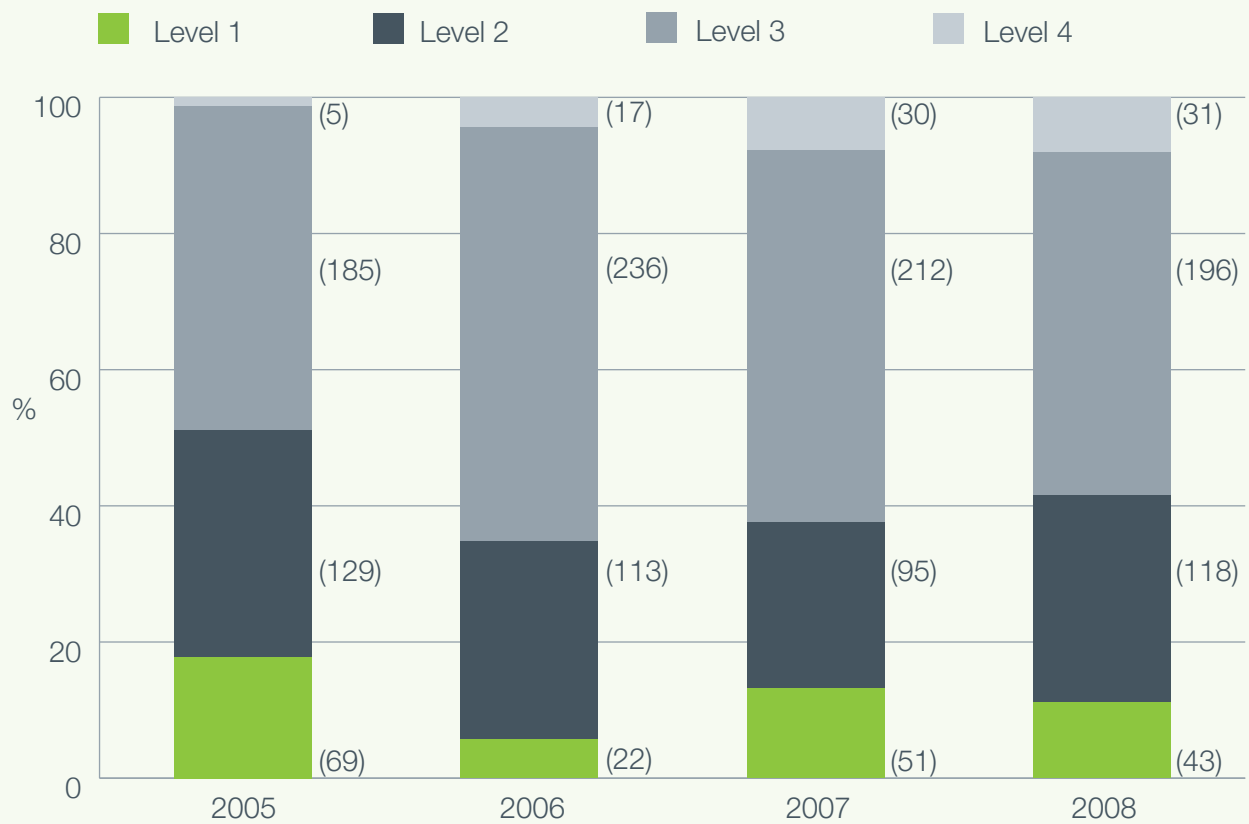
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# 4 | Financial reporting

- 59** Financial reporting is the principal means by which a council meets its accountability to stakeholders for its stewardship of public money and use of resources.
- 60** To be effective, financial reporting must be tailored to the needs of the user, must be timely, and be open, clear and concise.
- 61** Public bodies are required to prepare their annual accounts in accordance with statutory requirements and timetables, and relevant accounting and reporting standards. They need to put in place robust processes for preparation of their financial statements on a timely basis and should support them with good quality working papers.
- 62** Auditors' assessments of financial reporting consider timeliness, accuracy and compliance with financial reporting standards as interpreted for local government by the *Code of Practice on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice* (LG SORP).
- 63** There has been variable performance for the financial reporting theme between 2005 and 2008. In 2005, 190 councils (49 per cent) performed consistently or well above minimum requirements (scoring level 3 or 4). By 2008, this had only increased to 227 councils (59 per cent). However, there was deterioration in performance between 2006 and 2007 when the proportion of councils not meeting minimum requirements increased by 57 per cent, from 22 councils to 51 councils.
- 64** In 2005, 69 councils (18 per cent) were performing below minimum requirements compared to 43 councils (11 per cent) in 2008. Financial reporting theme scores for 2005 to 2008 are illustrated in Figure 8.
- 65** A significant level of changes in accounting requirements in recent years, at the same time as bringing forward reporting deadlines, has increased the pressures on accounts preparers. However, it is disappointing to note that this is the only theme within the use of resources assessment where scores have deteriorated or stalled across all authority types.

**Figure 8**

**Use of resources financial reporting theme scores for 2005 to 2008 (number of councils)**



Source: Audit Commission

# Financial reporting

**Table 3**

**Movement between levels of performance for use of resources KLOE 1.1: 2005 to 2008**

The quality of accounts has deteriorated in many councils, particularly over the past two years

Use of resources assessment year	Number of councils deteriorating	Number where there was no change in the year	Number improving their score
2005/06	40 (10%)	228 (59%)	120 (31%)
2006/07	77 (20%)	246 (63%)	65 (17%)
2007/08	100 (26%)	196 (51%)	92 (24%)

Source: Audit Commission

## Preparation of final accounts

- 66** Use of resources KLOE 1.1 in the financial reporting theme considered whether councils produce annual accounts in accordance with relevant standards and timetables, supported by comprehensive working papers.
- 67** There was deterioration in performance in KLOE 1.1 scores between 2005 and 2008. This is summarised in Table 3.
- 68** In *World Class Financial Management*, the Audit Commission noted that in the public sector, the production of annual accounts is still seen as a one-off, year-end exercise. The above results suggest that this is still the case in many councils.
- 69** Performance in each of the following key areas is considered in the sections below:
- tailoring financial reporting to the needs of the user or stakeholder;

- narrative reporting;
- timeliness of financial reporting; and
- quality of the accounts.

## Tailoring financial reporting

- 70** There is a growing concern among accounts preparers and regulators that the current length and complexity of council accounts does not promote accountability and makes them difficult to understand.
- 71** This complexity has resulted in final accounts for single-tier and county councils that, at an average of 90 pages, are half as long again as the annual financial statements of a sample of the top 350 UK listed limited companies (60 pages) (Ref. 7) (Table 4).

**Table 4**  
**How council statutory accounts break down**

	Single-tier and county council	
	Number	Percentage
Average length in pages	90	
Of which:		
explanatory forward	7	8
accounting policies	9	10
responsibilities, governance statement	10	11
core accounts	6	6
notes	36	40
supplementary accounts	8	9
notes	6	7
glossary	5	6
(auditor)	3	3

Source: Audit Commission

**72** The content of council accounts is largely governed by the requirements of the LG SORP. The main contributor to the length of the accounts is the disclosure notes that provide further analyses of the figures disclosed in the primary financial statements. The requirement for supplementary statements and supporting notes for specific activities, for example a separate housing revenue account, group accounts and pension

fund accounts, will also have an impact on the length of the financial statements. However, length can be influenced by councils, for example through decisions to list or aggregate smaller reserves, or the use of clearer and larger text and layout of pages.

**73** CIPFA has recognised the concerns about the length and complexity of the accounts. In its 2008 consultation, *Back to Basics* (Ref. 8), it identified a number of changes that could be made to council statutory accounts to simplify and shorten them. The Audit Commission welcomes and supports these proposals. In our view, the current detailed guidance supporting the LG SORP contains disclosure requirements that do not relate to financial reporting requirements, but reflect requirements of government departments for additional information. Removing disclosures from the financial statements that are not a requirement of financial reporting standards and amending current detailed guidance to adopt a more principles-based approach, would allow councils to use discretion in the level of disclosure in accordance with financial reporting standards and potentially reduce the overall length of the financial statements.

# Financial reporting

**74** These proposed changes are, in the Audit Commission's view, timely. The move to IFRS from 2010/11 will place additional pressure on the length and complexity of the accounts as the international standards increase the level of disclosure required compared to current UK standards. In the private sector their introduction led to a significant increase in notes to annual accounts.

## Narrative reporting

**75** With the existing complexity of the financial statements, there is a need for an accompanying narrative commentary on financial performance to make them accessible to important stakeholders such as members and the wider public. A key role of members is to scrutinise and approve the annual financial statements. Their ability to do this is hindered if they do not fully understand them.

**76** The Audit Commission has previously expressed the view that the best way to do this is by publishing an annual report which includes all relevant financial information, explains this and links it to local priorities. We remain concerned that local government remains the only economically significant sector in the UK in which there is no statutory requirement to produce such a report.

**77** The number of councils producing an annual report has increased. In 2007, it was 44 per cent compared to 64 per cent in 2008.<sup>1</sup> Some councils produce

the equivalent under other formats or names. But as there is no statutory requirement there are no agreed principles for disclosure, so coverage, quality and content remains variable.

**78** We were, therefore, pleased to support CIPFA's 2008 consultation on the introduction of annual reporting for local government (Ref. 9). The introduction of a principles-based framework for mandatory annual reporting will encourage better narrative reporting of financial performance, supporting the financial statements, on a more consistent basis.

**79** In the absence of a mandatory annual report, published accounts currently include an explanatory foreword. However, councils often use this to explain changes between their original budget and the eventual outturn, and to highlight technical accounting changes, rather than to provide a commentary on the financial statements themselves. Only a minority use it to highlight and explain key financial issues and changes.

## Timeliness

**80** The timetable for the approval and publication of audited local government accounts has moved forward by three months in the three years since 2003/04. This tighter timetable has contributed to errors in the preparation of financial statements in some councils. However, many councils successfully achieved the new timetable without any significant deterioration in quality. This reflects the

<sup>1</sup> Annual auditor returns, Audit Commission.

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fact that too many councils still regard the financial statements as a year-end exercise and, therefore, have to prepare their accounts to a much shorter timetable.

- 81** Timeliness is still an issue for auditors in almost one-fifth of councils, with audit opinions delayed in one in ten councils in 2007/08 – double the number in the previous year. By mid March 2009, 26 single-tier and county councils still did not have a set of audited accounts for 2007/08. This level of delay undermines public accountability and good financial management. It means that members are agreeing budgets for 2009/10 without being certain that their baseline financial information is robust.
- 82** With the move towards the publication of whole of government accounts, incorporating the whole of the public sector, including local government, there is increasing pressure to bring forward further the deadline for local government accounts. Such a move would require consideration of some of the approaches to earlier closure of accounts that are being adopted in other parts of the public sector, such as a ‘hard close’ at month nine or ten. However, before that can be achieved, councils will need to improve their performance against the current timetable.

### Quality

- 83** Auditors continue to report that accounts presented for audit often contain significant and material errors

requiring adjustments. In 2008, poor quality accounts were highlighted as a particular weakness in 29 per cent of councils. Between 2007 and 2008, the percentage of auditors reporting non-compliance with the LG SORP increased from 30 per cent to 42 per cent. Material audit adjustments were required to the accounts at 50 per cent of councils in 2008, the same level as in 2007.

- 84** In part, this level of amendment reflects the level of accounting changes required by the LG SORP. However, in 2008, 16 per cent of auditors reported concerns about basic skill levels or staff capacity among those responsible for accounts preparation.<sup>1</sup> Annual audit letters confirm that errors and delays could be linked to a lack of staff skills or training. In the poorer performing councils there were also examples of poor basic planning and management including:
- key staff on leave throughout the period previously agreed for external audit;
  - the use of temporary accountants for final account preparation, who were then not present to answer auditor questions;
  - agency staff employed but not supported; and
  - supporting papers not available when pre-arranged audit visits were made.

<sup>1</sup> Annual auditor returns, Audit Commission.

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# Financial reporting

- 85** This lack of basic accounting skills and planning is a particular concern with the introduction of IFRS from 2010/11. That transition will require:
- a review of how the council's accounting policies will change in response to IFRS;
  - consideration of those transactions and balances that will change under IFRS; and
  - good project management and monitoring arrangements to ensure the above issues are addressed.
- 86** In 2008, auditors reported that most councils recognised that there would be issues arising from IFRS, but 60 per cent had not actually begun to address these.<sup>1</sup> Without more focus there is a danger of this change leading to a further deterioration in the quality of financial reporting and a failure to report effectively under IFRS as at 31 March 2011.
- 87** Some councils have demonstrated that it is possible to make rapid improvements in financial reporting. A review of comments made by auditors suggests that appropriate systems, attention to staff skills and communication with external auditors are key.
- 88** An example of improvement is described in Case study 4 for Peterborough City Council, where performance was below minimum requirements for KLOE 1.1 in 2005. A new chief financial officer and management team arrived in 2006 and have turned performance around. By 2007, the Council was assessed as performing strongly. The Council learned from other councils, revised its processes, improved links with the auditor and increased council-wide awareness of the importance of closedown.

<sup>1</sup> Annual auditor returns, Audit Commission.

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## Case study 4

### Peterborough City Council

Peterborough City Council has improved its approach to the production and audit of annual accounts.

Historically the production and audit of the annual accounts had not gone smoothly. A review of the finance department identified skills and knowledge gaps. A new structure for the department was put in place which was better able to support the business and removed the causes of poor practice. This required a fundamental shift in the way the department operated:

- A service plan was developed to change behaviour, to ensure improvement could be delivered. Current practice was assessed and previous audit reports analysed.
- Workshops helped to develop a more efficient and effective closedown process for the future.

The new ways of working also involved a more effective role for members through the Audit Committee. A better relationship with the auditor included agreed protocols for dealing with queries, use of electronic working papers and more effective day-to-day liaison. The revised process took account of advice on proven good practices gained from other councils assessed as level 4 for use of resources.

These changes meant a statement of accounts was presented for audit, with only a small number of non-trivial errors, supported by excellent working papers and queries being answered promptly. There were more effective and efficient communications between corporate accounting and service finance teams. The finance department now works as one team to achieve the desired goals. There is increased awareness across the Council of the responsibilities and importance of closedown.

There is now greater confidence in the management of the Council's finances and the role of the finance department has become central to the decision making processes of the Council.

# Financial reporting

## Wider resource reporting

**89** An increasing emphasis on sustainability means councils now need to also look at wider resource reporting covering sustainability and environmental footprints. This is a new approach for many councils and in 2008 auditors felt that this was a common area in need of improvement. However, there are some good examples available as identified in Case study 5.

## Reviewing financial performance: the use of financial ratios to ask questions

**90** In the private sector, financial ratios, drawn from published accounts, are recognised as an important tool for measuring the financial performance of organisations. The driver behind such comparisons is the need to make sound investment decisions, and assess the performance of the company and its management.

### Case study 5

#### Sunderland City Council and Chichester District Council

Sunderland City Council and Chichester District Council have developed good approaches to reporting the councils' environmental footprint.

The Sunderland City Council annual report, together with the Council's carbon plan, includes detailed information on carbon footprint, environmental and sustainability issues.<sup>I</sup> The annual report presents financial and environmental data in a user-friendly way and links financial data, performance information and user/local people's views. Information is presented in a 'school report' style using pie and bar charts, tables and 'did you know' boxes to assist the reader.

Chichester District Council has good arrangements to promote external accountability and report financial and other council information, with a well developed website. For 2007/08, the annual report has been further enhanced and now includes well presented information on the Council's environmental footprint.<sup>II</sup> This looks at waste, energy, water, biodiversity, transport, sustainable procurement, construction and green initiatives in the community.

<sup>I</sup> The Sunderland City Council 2007/08 annual report is available on the Sunderland City Council website: <http://www.sunderland.gov.uk/>

<sup>II</sup> The Chichester District Council 2007/08 annual report is available on the Chichester District Council website: <http://www.chichester.gov.uk/>

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- 91** The commonly used commercial financial ratios are of only limited relevance to local government. In many cases, the focus of these ratios is the level of profit the organisation has made. Without the objective of generating profit, as is the case in local government, many of these ratios no longer provide a meaningful or measurable outcome.
- 92** However, ratios can be a useful starting point for understanding historic financial positions and future options. Comparing ratios between apparently similar councils, or reviewing trends over time, can raise policy questions and may help members, taxpayers and other stakeholders to better scrutinise and potentially challenge councils' financial performance and position.
- 93** There is currently no comparative database of council accounts. The Audit Commission has therefore undertaken a review of the accounts published by single-tier and county councils on their websites. An analysis of ratios comparing aspects of those accounts is set out in Appendix 1. The Audit Commission plans to make available a web based comparator tool enabling councils to review their ratios and how these compare to others. The Audit Commission would welcome feedback on the usefulness of this exercise.
- 94** The ratios we have selected are:
- working capital – current assets as a percentage of current liabilities;
  - useable reserves, capital and revenue, as a percentage of general revenue expenditure;
  - long-term borrowing as a percentage of (partial) tax revenue;
  - long-term assets as a percentage of long-term borrowing; and
  - total school reserves as a percentage of dedicated schools grant.
- 95** In considering these ratios it needs to be borne in mind that while they often reflect local operational and risk management decisions, they are not in themselves a description of good or poor performance.
- 96** The ratios focus on comparisons between councils as the data has been extracted from only one year's accounts. However, with many of these ratios, the greater benefit will come by comparing an individual council's performance over time to identify significant trends and movements.

# Financial reporting

**97** The ratio analysis highlights the following issues:

- **Working capital** – Councils should monitor the relationship between their current assets and current liabilities. Where current liabilities exceed current assets, councils should satisfy themselves that they have arrangements in place to meet their liabilities. Councils with high levels of current assets may need to consider whether their debt collection and financial management arrangements are adequate.
- **Useable reserves as a percentage of general revenue expenditure** – Councils need to consider whether the level of their reserves is adequate to meet potential future expenditure variations. Those with high levels of reserves should consider why their levels are so high. The continued retention of earmarked reserves should be reviewed to ensure those reserves are still required.
- **Long-term borrowing compared to tax revenue** – Councils with high levels of long-term borrowing need to ensure that their medium-term financial strategies adequately reflect the repayment profile for that borrowing to ensure that any future impact on service delivery is minimised.
- **Long-term borrowing compared to long-term assets** – Councils need to understand the historical reasons for high levels of long-term borrowing. The relationship between borrowing and assets should be considered year-on-year, to assess the potential implications of changes in the ratio for the medium-term financial strategy.
- **School balances as a percentage of dedicated schools grant** – Councils should consider whether there are specific reasons why individual schools are retaining particularly high or low levels of reserves and whether year-on-year changes in the level of reserves indicate issues in individual schools or groups of schools. Councils should consider whether issues are being raised with relevant head teachers and chairs of governors and whether clawback arrangements, introduced in summer 2008 (Ref. 10), should be invoked where balances are deemed to be excessive.

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# 5 | Conclusions and way forward

- 98** 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.
- 99** 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.
- 100** 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 (Ref. 11). 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 (Ref. 12).
- 101** 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 (Ref. 13)<sup>1</sup> has shown that a critical factor is to identify problems early and prevent small arrears from escalating. Almost three-quarters of councils (Ref. 11) are already anticipating increases in council tax and rent arrears as the recession and rising unemployment affects household incomes.
- 102** 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.

<sup>1</sup> Audit Commission reports on rent arrears in housing associations and councils.

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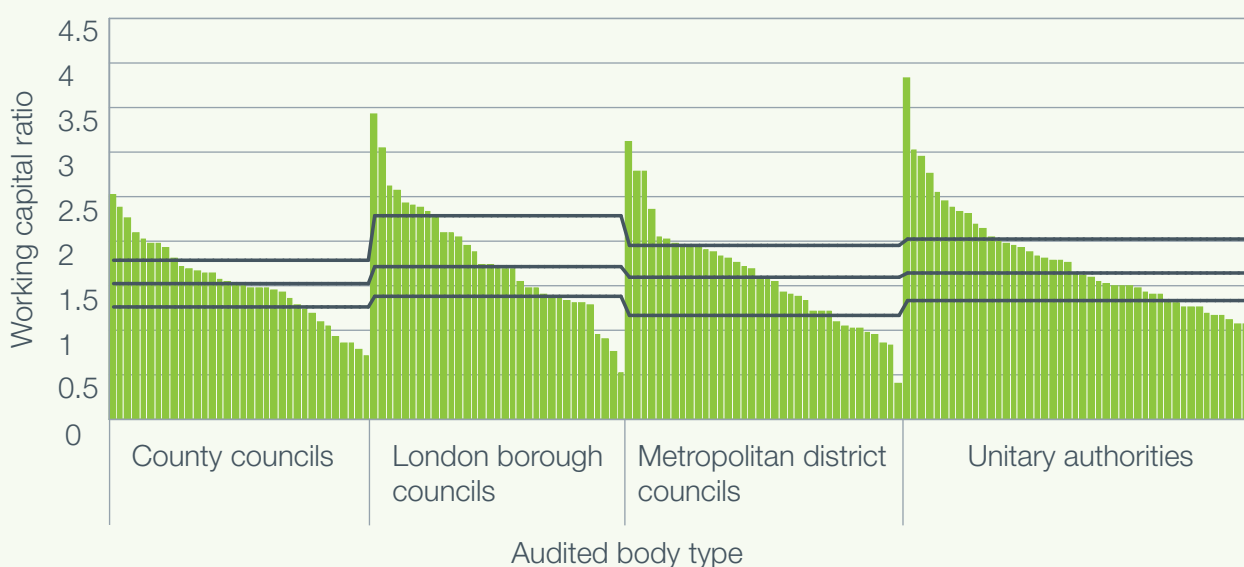
# Conclusions and way forward

- 103** 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.
- 104** 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.

# Appendix 1: Financial ratios

**Figure 9**

**Working capital ratio: Current assets: current liabilities**



Source: Audit Commission

## Financial ratios: comparative performance and individual ratios

- 1** The working capital ratio is widely recognised as the most important ratio used in the commercial sector, and is equally relevant when considering the financial performance of councils. It measures the relationship between current assets and current liabilities and recognises a council's ability to pay its current liabilities in the short term.
- 2** A ratio of less than 1 indicates that a council has more current liabilities than current assets and could, potentially, have difficulties paying current liabilities in the short term if required to do so.

However, a ratio significantly above 1 – that is, current assets significantly higher than current liabilities – does not, in itself, indicate good financial performance. A high level of current debtors, for example, may indicate a poor performance in recovering debt, which could have longer-term implications for the financial performance of the council. The ratio at the balance sheet date will also be affected by activity on or near that date. A payment run made near to the balance sheet date may reduce liabilities while a billing run will increase the level of current assets.

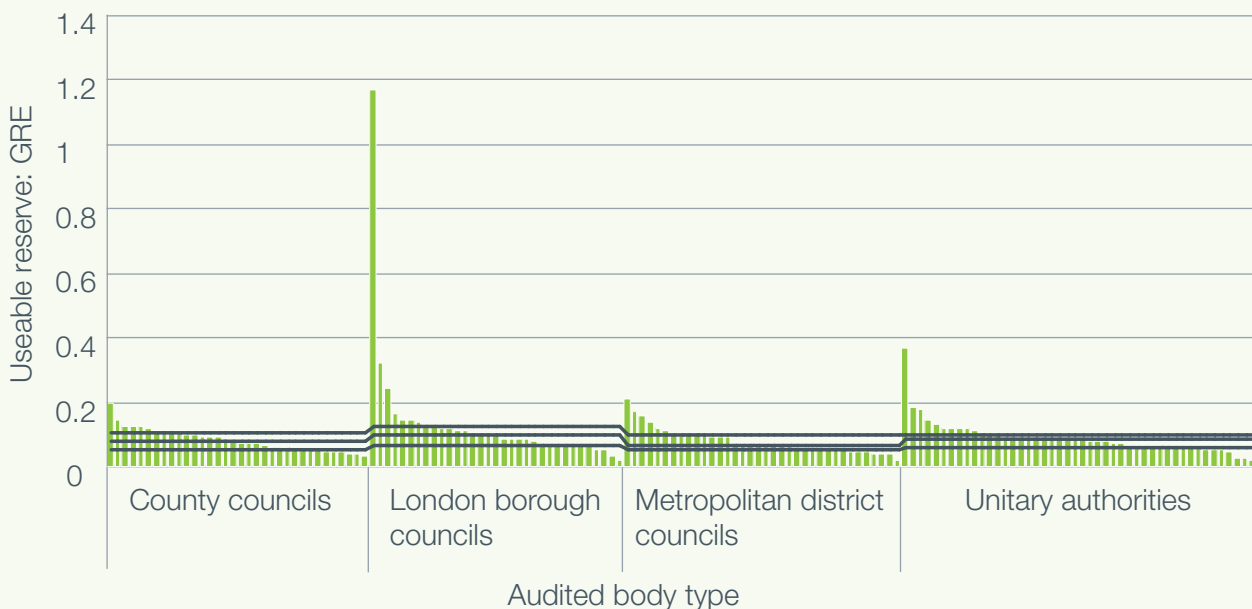
# Appendix 1: Financial ratios

3 Therefore, in considering this ratio, it is important to understand what the key factors are. If the council has a high level of liabilities, does it have arrangements in place to meet these? Conversely, if current assets are high, does this reflect a conscious decision by the council to hold assets at that level, or is this an indication of poor debt collection and financial management arrangements?

4 Figure 9 shows that only 15 of the 149 councils surveyed had a ratio at 31 March 2008 of less than 1. These councils should satisfy themselves that they have arrangements in place to pay their current liabilities. Conversely, the 38 councils falling in the upper quartile for their type of authority should be considering whether the ratio indicates any potential problems with their debt collection and financial management arrangements.

**Figure 10**

**Useable reserves (capital and revenue) as a percentage of general revenue expenditure**



Source: Audit Commission

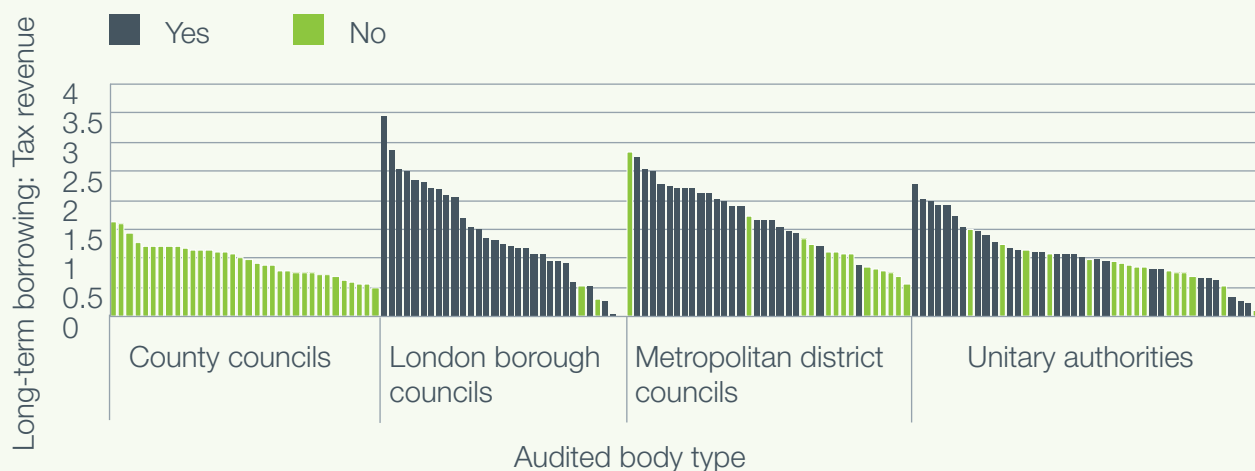
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- 5** Useable capital and revenue reserves as a percentage of general revenue expenditure has no direct comparison in the commercial sector. It shows the percentage of annual spend that could be covered by reserves. The calculation of this ratio can be difficult as the level of detail disclosed in the accounts can vary widely, making it difficult to identify useable reserves.
- 6** Councils will hold reserves for two main purposes:
- as general cover for fluctuations in the level of unforeseen expenditure between years (general reserves); or
  - to meet specific future expenditure requirements (earmarked reserves).
- 7** There are also a number of reserves that councils are required to hold by statute, for example the pension reserve and revaluation reserve. These have been excluded from this analysis as they are not available to meet general expenditure.
- 8** The level of reserves held by a council will reflect its objectives and policy decisions, and councils should have a clear statement of their reserves policy. Therefore, comparisons between councils will not identify good or bad performance, but may highlight issues that individual councils need to consider. A very low level of reserves may put a council's financial health at risk as it would not be well placed to meet sudden significant levels of unforeseen expenditure. However, very high levels of reserves may themselves indicate poor financial management. The holding
- of high levels of reserves, without a clear policy decision on why those reserves are being held, diverts financial resources away from the delivery of services.
- 9** Therefore, when considering this ratio, councils need to ask the following questions:
- Is the level of general reserves set at an appropriate level to meet potential future expenditure variations, taking account of the council's evaluation of its financial risks?
  - Is the holding of individual earmarked reserves still valid? Changes in operational policy or future plans may remove the purpose for which earmarked reserves were being held. If so, consideration should be given to releasing those reserves back to revenue.

# Appendix 1: Financial ratios

- 10 The standard commercial gearing ratio compares long-term debt to shareholders' equity. This ratio has little relevance to local government because there is no direct equivalent of shareholders equity. While the balance on the general fund can be regarded as taxpayers' equity, the purpose for holding that balance is very different.
- 11 However, consideration of the impact of long-term borrowing is relevant for local government. The requirement to service and repay debt may have consequences on in-year financial performance. Therefore, this ratio compares long-term debt with tax revenue to consider the proportion of a council's tax related income that would be needed to pay off current long-term debt.
- 12 For the purposes of this ratio, tax revenue has been defined as council tax, national non domestic rates and other non-specific government grants. Specific grants and income from fees and charges have been excluded because they cannot be readily identified from the financial statements.
- 13 The level of long-term borrowing a council has will largely reflect past capital expenditure and funding decisions. Therefore, comparisons to other councils will not highlight right or wrong levels of borrowing. However, councils with high levels of long-term borrowing compared to their tax revenue will need to consider the impact on their medium-term financial strategies and what this will mean for overall council finances.

**Figure 11**

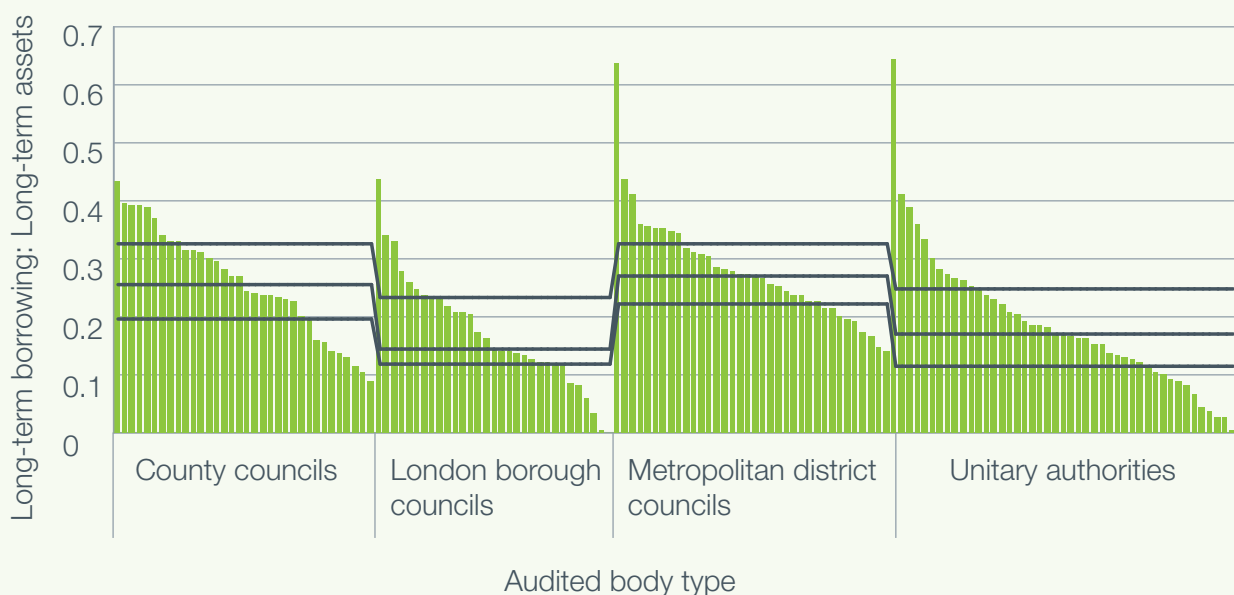
**Long-term borrowing compared to tax revenue, showing which councils do or do not have a housing revenue account**



Source: Audit Commission

- 14** Figure 11 indicates that, in the main, the highest proportion of debt exists at those councils which have retained housing stock. This would be expected as borrowing will be the main source of funding for housing capital expenditure, probably the largest element of capital spend at housing authorities.
- 15** The ratio for 32 councils falls in the upper quartile for their authority type. These councils in particular should consider whether their medium-term financial strategies adequately reflect the repayment profile for their long-term borrowing to ensure any future impact on service delivery is minimised.
- 16** In the private sector, companies will use ratios to consider the degree to which they are ‘sweating their assets’ – that is, are they getting the maximum value out of those assets? The key consideration for the private sector will be whether the assets have been used to maximise their income-earning potential.
- 17** The imperative in local government is different. The majority of the assets held by a council will be for the delivery of services rather than for the generation of income, so the key consideration is whether assets can be used for longer without deterioration in the quality of service delivery. If assets require replacement or repair, this will often be funded from borrowing. Consequently,

**Figure 12**  
**Long-term borrowing compared to long-term assets**



Source: Audit Commission

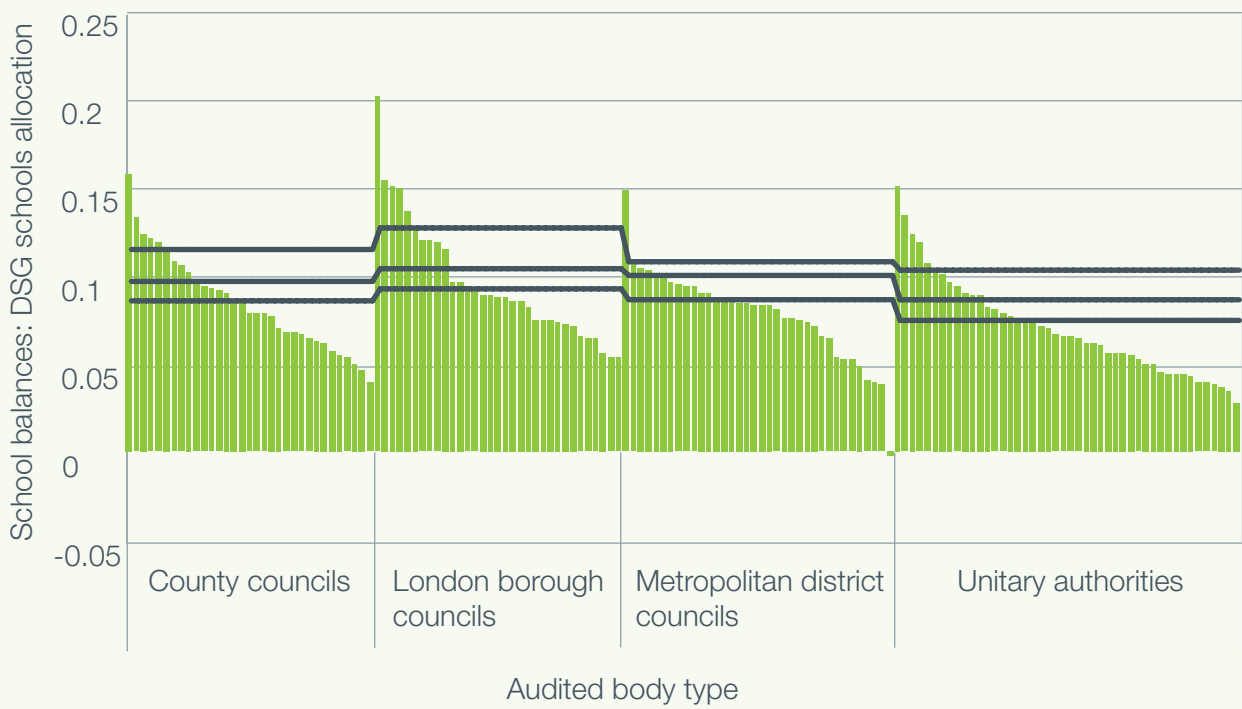
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# Appendix 1: Financial ratios

the above ratio examines the relationship between long-term assets and long-term borrowing. A low ratio indicates a low level of borrowing compared to the level of long-term assets.

- 18** As with the other ratios considered in this report, there are no right or wrong answers, and the ratios often reflect past funding decisions. However, 39 councils fall in the upper quartile for their authority types, indicating high levels of borrowing compared to their long-term assets. Those councils need to consider this ratio, both in terms of comparison to other similar councils and by comparing the ratio between years, to understand:
- the historic reasons for their long-term borrowing;
  - the reason for any annual change in the relationship between assets and liabilities; and
  - whether changes in trends have implications for the medium-term financial strategy.
- 19** Dedicated schools grant (DSG) is ring-fenced and can only be applied to meet expenditure properly included in the Schools Budget. Education authorities are then required to apply a scheme of delegation to DSG to allocate specific budgets to individual schools. Under and overspends are then retained by the schools, which are required to manage their financial position.
- 20** This ratio compares the level of balances retained by schools to their DSG allocation. The level of balances retained will be influenced by decisions made by school governors to hold money back to fund future expenditure plans. However, unnecessarily high levels of school reserves indicate that schools are not applying DSG to meet in-year educational needs.
- 21** Figure 13 indicates that in 66 councils, the level of school reserves is above the national average for their authority type, with 35 councils being in the upper quartile. This may raise questions about why this level of reserves is being held, rather than being spent on the delivery of education services in year.
- 22** Councils should consider whether:
- there are specific reasons why individual schools are retaining particularly high or low levels of reserves;
  - year-on-year changes in the level of reserves indicate issues in individual schools or groups of schools;
  - issues are being raised with relevant head teachers and chairs of governors; and
  - clawback arrangements, introduced in summer 2008 (Ref. 10), should be invoked where balances are deemed to be excessive.

**Figure 13**  
**School balances as a percentage of dedicated schools grant**



Source: Audit Commission

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# Appendix 2:

# Suggested further reading

- *World Class Financial Management*, Audit Commission, 2005. An Audit Commission discussion paper developed to stimulate debate across public services and among finance professionals about the standards of financial management to which the public sector should aspire.
- *Risk and Return*, Audit Commission, 2009. This report examines the issues arising from local government investments in Icelandic banks.
- *Back to Front: Efficiency of Back Office Functions in Local Government*, Audit Commission, 2008. This examines whether councils are taking a strategic approach to managing back-office functions, including reviewing current practice, working with partners to improve efficiency, benchmarking and taking efficient make or buy decisions.
- *Healthy Competition*, Audit Commission, 2007. Considers the potential for councils to use competition and contestability to generate cost savings and service improvements. It gives practical examples of councils successfully using competition and contestability, and explores the pre-conditions that councils must have in place to make effective use of these mechanisms.
- *Improving Budgeting: Modernising the Cycle*, CIPFA, 2008. In this guidance CIPFA look at budget setting, in-year monitoring and the reporting of financial outcomes to gauge whether the approaches and styles currently in place serve public service organisations well.

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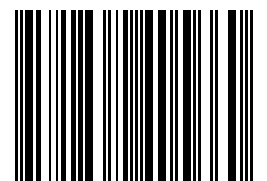
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