Perth & Kinross Council

Scotland's Public Finances Follow-up Audit

AUDIT SCOTLAND

Prepared for Perth & Kinross Council
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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Introduction

Background

1. In August 2011 Audit Scotland published a report on "*Scotland's public finances: Addressing the challenges*". The report provided an overview of the scale of budget cuts expected to be faced by the Scottish public sector in the period 2010/11 to 2014/15, and how public bodies were beginning to respond to the challenges of reducing expenditure.

2. The national report identified that:
   - The Scottish Departmental Expenditure Limit revenue budget will fall by £2.1 billion (eight per cent) to £23.8 billion between 2010/11 and 2014/15 while the capital budget will fall by £1.2 billion (36 per cent) to £2.1 billion. The biggest budget reductions will take place in 2011/12.
   - Public bodies will face increasing demand and cost pressures in the future. Increasing demand will be generated as a result of an ageing population and the heightened expectations of the public, while cost pressures arise in areas such as maintenance backlogs and the cost of revenue-financed capital projects.
   - Public bodies need to focus on achieving long-term financial sustainability. This requires a clear understanding of the organisation's costs, a clear methodology for setting budgets based on priorities and the outcomes to be achieved, and strong leadership and governance.
   - Pay restraint and reducing workforce levels are the most common approach being taken by public bodies to reduce costs over the next few years. Good workforce planning will be necessary to ensure that the right people and skills are available to deliver effective public services in the future.
   - Public bodies are considering how they can work better together as a way to reduce costs, but progress to date has been limited and it is likely to be a number of years before cost savings are realised.

3. The national report provided a checklist setting out a number of key issues and risks which managers, elected members and other leaders of public bodies need to identify, monitor and manage:
   - Reforming public services - including the risk of short-termism, unclear aims and objectives and lack of commitment or constructive challenge.
   - Workforce reductions - including the risk of loss of essential skills as a result of key staff leaving and increased workloads for those who remain.
   - Financial sustainability - including the risk of unclear priority budget-setting, lack of risk and evidence-based cost-reduction strategies and unforeseen cost pressures.

- Leadership and governance - including the risk of lack of direction and ownership as a result of weak leadership, and inadequate scrutiny and challenge as a consequence of poor governance arrangements.

4. Workforce planning is a key focus for Perth and Kinross Council over the medium term. Audit Scotland is currently undertaking a performance audit on workforce planning and therefore to avoid duplication and overlap this follow-up work will not include the consideration of workforce planning issues.

Audit scope and objectives

5. The aim of this review is to assess how public bodies are responding to the challenges of public sector budget constraints and their efforts to achieve financial sustainability.

6. Based on the original report, we focused our work around two key questions:
   - Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction?
   - Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

7. A checklist of questions has been developed and used by auditors to find out how well councils are dealing with these issues. The questions cover the two key questions above and were used in our discussions with management. The responses and supporting evidence form the basis of the key findings below.

Key findings

Economic climate

8. The Council aims to support the local economy and maintain current service provision. It is likely to face real term and possibly cash reduction in resources and along with all other public bodies in Scotland, the Council is having to make significant budget savings.

9. The medium term financial plan considered by the Council in December 2012 undertook an analysis of current longer term predictions and these are outlined below:

- "The Office of Budget Responsibility's 2012 Long Term Report acknowledged that "*future governments are likely to have to undertake some additional fiscal tightening beyond the current consolidation plan for the next five years in order to address the fiscal costs for an ageing population*".
- The Head of the UK Civil Service also recently acknowledged that "*we are 25 per cent through the fiscal adjustment. Spending cuts could last seven, eight, ten years*".
- The Improvement Service has also recently suggested that:
  - There will be at least 3% to 4% real reductions in funding to Scottish Local Authorities for next two years
  - A prudent assumption is for £1 billion cash reductions to Scottish Block in the 2014 Spending Review which would translate into approximately a £340 million reduction in funding for Scottish local authorities
  - There is an expectation from the Scottish Government that health, social care and education will be protected from reductions
  - No real growth is predicted until 2018/19"

10. The above picture highlights that financial challenges will continue with the Council's current predictions being that 2015/16 and 2016/17 may be two of the most challenging years in terms of managing the Council's finances.

Council's position

Does the Council have sustainable financial plans which reflect a strategic approach to costs reduction?

11. A medium term financial plan is updated and approved by the Council on an annual basis. In December 2012 the Council considered its medium term financial plan and extended the current five year capital budget to seven years. This reflected the most up to date commentary on the economic climate and the latest information from the Scottish Government on the provisional settlement figures for the next two years. Given the uncertainty going forward the Council consider a longer term revenue plan to be an unrealistic aspiration.

12. The Council also has a five year strategic financial plan for the housing revenue account incorporating a housing capital investment programme. This plan also details the rent strategy and reserve strategy for the housing revenue account and is approved by the Housing & Health Committee annually.

13. The capital budgets flex between years due to the nature of the spend. However, as highlighted in our 2011/12 annual report the capital programme continues to see significant underspends in capital expenditure. Revisions are approved by the Strategic Policy & Resources Committee. The underspends have continued in 2012/13 with the initial gross expenditure budget approved in February 2012 for:

- the composite programme of £50.9 million being revised during the year to £31.3 million (38% underspend)
- the housing capital investment programme in February 2012 of £14.5 million being revised during the year to £11.4 million (21% underspend).

14. Actions is being undertaken by the Council to take forward the delivery of the capital programme including establishing a Strategic Investment Group chaired by the Chief Executive (comprising the Executive Officer Team and senior elected Members) and appointing a Capital Programme Manager.

15. The revenue budget for 2013/14, and the provisional budget for 2014/15, was agreed by the Council in February 2013. This was considered in the context of uncertainties in relation to Scottish Government funding beyond 2014/15 and the potential impact of health and social care integration, inflation, pay strategy, and legislative changes (e.g. welfare reform; Children and Young Peoples Bill). Whilst the Council is in a relatively strong financial position to deal with the challenges, it is recognised that significant savings will be required in future years.

16. The revenue budget details the expenditure pressures being faced by services and the potential compensating savings. An impact and risk analysis is undertaken in relation to each of the savings. This process allows an open and transparent assessment of the impact that the budget will have on Council services and service users. This analysis considers the following criteria:

- Workforce – including information on numbers of employees affected, vacancies, staff turnover and fixed term contracts.
- Customers – including information on the effect on all customers/stakeholders (both external and internal).
- Outcome & Performance. – identifying any significant impact on the Single Outcome Agreement and/or Service Business Management and Improvement Plans.
- Equalities/Diversity – ensuring that any statutory equalities issues are considered.

17. The Transformation Programme is integral to the budget process and consultation is a key element of the budget review process, where appropriate. Currently consultation is undertaken with staff through the unions on the savings options identified. Officers have indicated that consultations with stakeholders take place, where appropriate, in advance of the

budget decisions taken by the Council in February although it is acknowledged that this is not comprehensive. Decisions are also communicated with the public and stakeholders on specific areas following budget decisions, for example Greenspace.

18. The Reserves Strategy forms a crucial part of the Council's forward planning with reserves held for three purposes:

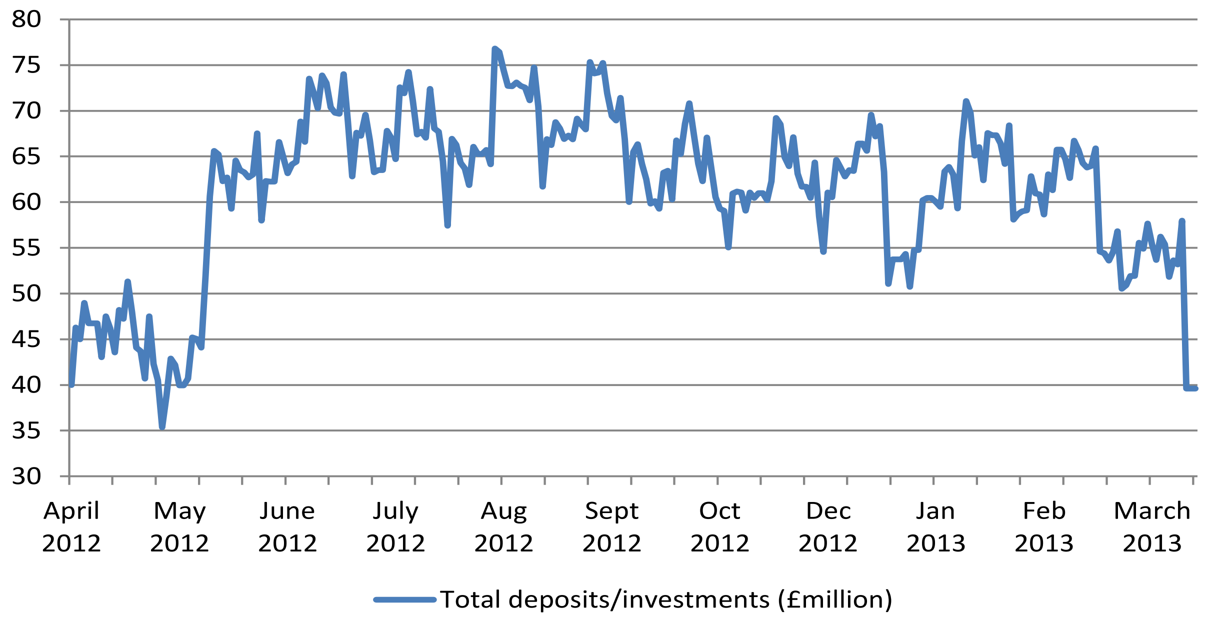
- working balances to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing
- contingency to cushion the impact of unexpected events or emergencies
- funds to meet known or predicted liabilities (earmarked reserves).

19. As highlighted in our annual report to members the Council's funds and reserves at 31 March 2012 totalled £53.394 million, an increase of £8.714 million on the previous year. Of this balance £39.431 million was earmarked for specific purposes leaving an unallocated general fund balance of £13.963 million. This is approximately 4.1% of the Council's net revenue budget for 2012/13 and is within the range of 2 to 5% of net expenditure the Council had previously deemed it required to hold to cover unexpected or unplanned events.

20. The Council's Reserves Strategy approved in February 2013 continues with the target level of uncommitted reserves to be in the range of 2% to 5% of the Council's net revenue expenditure in the medium term but highlights owing to current uncertainties that it "*may not be imprudent to maintain uncommitted reserves above 5% in the short term*". Any element above the 5% is to be earmarked for future costs in relation to workforce planning measures. The housing revenue strategic financial plan has a target level of 2% to 4% of gross housing revenue expenditure (maintaining reserves at £0.8 million for the next five years within the plan)

21. The Council is predicting an increase in reserve balance to £60.6 million (2011/12 - £53.394 million) with uncommitted reserves of approximately £12.2 million. The reserve balances are partially reflected in the money held by the Council during 2012/13 with the balance fluctuating depending on treasury management activity. During 2012/13 the balances were between £35.3 million and £76.8 million on deposit/invested as illustrated in Exhibit 1. These cash balances are planned to be utilised to enable the Council to reduce its borrowing requirement from 2013/14 onwards.

Exhibit 1: Deposits/investments held



22. Underpinning the savings outlined in the budget is the on-going transformation programme, "*Securing the* Future – *Towards 2015 and Beyond*", which was approved by Council in June 2010. The three key strands of the programme were:

- efficiencies in service delivery
- service re-design
- a targeted reduction programme considering the actual services to be delivered.

23. The programme identifies several key areas for delivering future savings including: workforce planning; procurement; asset management; shared services; efficiency reviews and process improvement. The programme itself details a large number of projects at a corporate and service level. The Council is effectively managing the process with a significant number of projects completed, a number of projects on-going and some delayed or put on hold.

24. The efficiencies identified and delivered form part of the Annual Efficiency Statement. The latest statement for 2011/12, which was considered by Council in September 2012, highlighted that the Council had delivered efficiencies of £12.9 million (£8.8 million in relation to workforce planning measures).

25. The Council has a strong track record in delivering efficiency savings with £33.4 million being identified in the previous five financial years. By re-investing the efficiencies achieved the Council has managed to maintain service delivery. The Council recognises that this level of efficiencies will not be available in future years given the reduction in staff numbers, however it is in a relatively strong financial position going forward through the efficiencies achieved to date.

26. A progress update on "*Securing the Future – Towards 2015 and Beyond*" was reported to Council in February 2013. This report also identified the service reviews planned as part of

the transformation programme. Projects within the programme are regularly monitored by the Executive Officer Team (EOT) and are managed through the Council's VERTO system which outlines savings targets, milestones and responsibilities.

27. Benchmarking costs and performance with other private and public organisations can be a valuable tool for identifying efficiencies and improvements. In December 2011 SOLACE commissioned the Improvement Service to develop a benchmarking framework on behalf of Scottish Local Authorities. The overall purpose of the framework is to support councils in focusing transformational change resources to areas of greatest impact in terms of efficiency (unit costs), productivity and outcomes. The Council considered the SOLACE indicators in April 2013. The SOLACE indicators in isolation are unlikely to support significant improvement without targeted 'process' benchmarking.

28. Benchmarking is seen as an important tool within the transformation projects and provides one strand to the reviews undertaken. There is limited evidence to show the outcome of any benchmarking exercise to date.

29. The EOT in April 2012 considered a report considering improving benchmarking within the Council particularly the further development of 'process' benchmarking i.e. comparing the systems/approaches used by comparators to identify improvements that can be achieved locally. The EOT recognised the requirement to increase targeted benchmarking activity within the Council. Each service identified two specific service areas in 2012 for focused benchmarking.

30. A report to the Strategic Resource and Policy Committee identified 9 areas where local 'process' benchmarking was to be investigated. These projects are at an early stage with progress not yet reported. Some projects have still to commence while others were dropped due to meaningful comparisons being unavailable or overtaken by national work. Whilst officers have indicated that 'process' benchmarking is being undertaken, it is acknowledged that this is currently work in progress.

31. The services' Business Management and Improvement Plans identify benchmarking comparisons being undertaken within the service. The housing revenue strategic financial plan also highlights comparisons of rental charges with other local authorities and registered social landlords.

32. Benchmarking activity was considered by Members in the Services Annual Performance Reports 2012/13 in June 2013. These predominately highlight areas where comparisons are made with other authorities with limited evidence to show that any 'process' benchmarking exercise has resulted in service improvements. With the exception of the registered social landlords information noted above there is no evidence that the Council carry out any benchmarking exercises with non local government organisations.

33. Overall we found that the Council have sustainable financial plans which reflect a strategic approach to costs reduction.

Do members and senior officials demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

34. Members are fully involved in agreeing financial plans and setting the framework for efficiencies. Members agree the medium term financial plan and reserves strategy which provides a basis on which the revenue budget is set. The revenue budget is established from an informed position of the impact decisions have on services and customers.

35. The medium term financial plan and the annual revenue budget outline financial risks with the reserves strategy being integral to supporting the Council's approach to the management of these risks.

36. The Strategic Policy & Resources Committee and the Scrutiny Committee consider annually the progress on actions on the Corporate Risk Register to mitigate risks. The risk register includes two specific financial planning areas:

- the continuing financial climate and increasing demands for services with the impact on the ability to deliver outcome targets and maintain service performance into the future
- slippage in the capital investment programme

37. The revenue budget is monitored quarterly by the Strategic Policy & Resources Committee to scrutinise the Council's performance and ensure remedial action is being taken where necessary. The Council also consider progress with the transformation programme, approving new areas of review, which feed into the revenue budget setting process.

38. The transformation projects feature in the individual service's Business Management Improvement Plans (BMIPs) with six monthly progress reports considered by members. As highlighted above the Council also consider the annual efficiency statement outlining the efficiencies achieved during the year.

39. The Council, at its budget setting meeting, agreed the capital investment programme. In 2013/14 this was extended to cover a seven year period and the additional years were approved in February 2013. The housing capital investment programme for the five years to 2017/18 was approved by the Housing & Health Committee in February 2013. The Strategic Policy & Resources Committee monitors the capital investment programme on a quarterly basis and has delegated authority to approve revisions.

40. The EOT is the focal point for the establishment of the budget proposals and regularly monitors the budget, progress against the transformation programme and the efficiencies achieved. The EOT considered the service submissions for 2015/16 in November 2012 however these are still being developed given the uncertainties highlighted previously.

41. The Corporate Resources Group, which reports to the Corporate Management Group (CMG) then the EOT, provides a base for establishing the capital programme. In selecting projects for inclusion in the capital budget, the Council undergoes a process of ranking each proposed project against specific criteria. These criteria have been designed to ensure that the projects meet the Council’s objectives and priorities, links with service's BMIPs and ensure best value and efficiency in the use of the Council’s assets and in the delivery of Council services. Only

those projects that best meet these criteria, within the available resources, are included in the proposed budget.

42. It is clear that members and officers demonstrate ownership of financial plans that these are subject to sufficient scrutiny before approval.

Conclusions

Summary

43. The Council continues to show a good understanding of the financial challenges it faces, and has been proactive in preparing financial plans to manage budget reductions. The Council has a clear understanding of its costs and the impact efficiency savings have on service delivery. The reserves strategy and medium term financial plan allow the Council to mitigate the risks associated with the current financial climate and service pressures. The Council may want to consider further improvements to its approach to the financial planning framework by:

- developing a long term revenue financial plan looking at the impact of reducing budgets on service delivery
- ensuring the capital investment programme delivers the planned improvements to the Council's infrastructure timeously. This will ensure that the infrastructure continues to deliver efficient and effective services and contribute to a prosperous, sustainable and inclusive economy for its area
- further development of 'process' benchmarking with other organisations with a view to identifying efficiencies and improvements
- incorporating the views of users of the service in the planning framework where appropriate.

Management action

44. The Council should consider the areas for improvement outlined above. The issues identified in preparing this report are only those which have come to our attention during the course of the review and are not necessarily, therefore, all the issues that may exist. It remains the responsibility of management to determine the extent of any improvement actions appropriate to the Council. We would stress, however, that commitment to an improvement agenda is an essential part of the efficient management of any organisation.

Acknowledgements

45. The contents of this report have been agreed with relevant officers in terms of factual accuracy. The assistance and co-operation received from officers during the course of our audit work is gratefully acknowledged.