

PERTH AND KINROSS COUNCIL

Strategic Policy and Resources Committee – 1 October 2014

**AUDIT SCOTLAND - SCOTLAND'S PUBLIC FINANCES
A FOLLOW UP AUDIT: PROGRESS IN MEETING THE CHALLENGES**

Report by the Head of Finance

PURPOSE OF REPORT

This report provides a summary of Scotland's public finances – A follow-up audit: Progress in meeting the challenges published by Audit Scotland in June 2014. The Audit Scotland report covers the whole of the public sector, but also provides a local government specific checklist aimed at Councillors which is intended to help promote good practice, scrutiny and challenge in setting 2015/16 budgets and beyond.

1. INTRODUCTION

- 1.1 In June 2014, Audit Scotland published the report 'Scotland's public finances – A follow-up audit: Progress in meeting the challenges'. A full copy of this Audit Scotland report is attached at Appendix 1. This report follows on from the report 'Scotland's public finances: Addressing the challenges'.
- 1.2 The report is aimed at public bodies including councils, NHS Boards and central government bodies such as executive agencies and non-departmental public bodies. The report raises a range of important issues for those involved in scrutinising public finances including councillors and chief executives and other board members. The findings and issues raised apply to all those who have a role in financial scrutiny.

2. KEY MESSAGES

- 2.1 Scotland's public sector continues to face significant financial challenges. The Scottish budget has fallen nine per cent, in real terms, from £31.9 billion in 2009/10 to £28.9 billion in 2014/15 and is expected to reduce further. Audit Scotland consider that public bodies have coped well so far but face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand.
- 2.2 Audit Scotland also consider that in setting budgets, public bodies need to focus more on their priorities, making clearer connections between planned spending and the delivery of outcomes. Rigorous use of options appraisal based on sound information is advocated by Audit Scotland for good budget related decisions and making those decisions clear and understood.
- 2.3 Audit Scotland concludes there is limited evidence of longer term financial planning. Plans generally focus on the short to medium term up to five years. Audit Scotland considers that more work is needed to develop and regularly review long-term financial strategies that reflect priorities, risks and liabilities and the implications for affordability.

- 2.4 Councillors have a crucial role which involves approving budgets and holding people within their organisation to account for how money is spent and the outcomes achieved. Audit Scotland considers that public bodies need to improve the quality of information provided to support them in their role.
- 2.5 Alongside this follow-up report, Audit Scotland has also provided a local government specific checklist designed to help councils to improve. This is aimed at councillors and is intended to help promote good practice, scrutiny and challenge in setting 2015/16 budgets and beyond. The local government checklist is set out at Appendix 2.

3. PERTH AND KINROSS COUNCIL'S POSITION

- 3.1 The Council has in place the following key elements of its financial strategy.

	<u>Report Reference</u>
Medium Term Financial Plan	13/475
Housing Revenue Account Strategic Financial Plan	14/18
Revenue Budget 2014/15 and 2015/16	14/44
Capital Budget 2020/21	14/45
Reserves Strategy	14/46
Annual Treasury Investment Strategy	14/77
Revenue Budget 2013/14 – Monitoring Report No. 4	14/169
Composite Capital Budget and Housing Improvement Programme 2012/17 – Monitoring Report No. 4	14/170
Annual Treasury Strategy & Prudential and Treasury Management Indicators	14/300
Composite Capital Budget 2014/21 and Housing Improvement Programme 2014/19 – Monitoring Report No. 1	14/408
Revenue Budget 2014/15 – Monitoring Report No. 1	14/407

- 3.2 Additionally on the agenda for the next meeting of the Council is the Council's Annual Audited Statement of Accounts for 2013/14.
- 3.3 The elements of the Council's strategy are regularly updated and reviewed and reported to either the Strategic Policy and Resources Committee or the Council.
- 3.4 An updated Medium Term Financial Plan will be considered by the Council on 8 October 2014 which will include projections and recommendations as to how the Council might progress the revenue budget through to 2019/20. These recommendations will take account of the Audit Scotland report.

4. CONCLUSION AND RECOMMENDATIONS

4.1 Audit Scotland recommend that public bodies should:

- Implement an approach to budgeting that focusses more on priorities and links planned spending more closely with the outcomes they want to achieve;
- Develop a longer-term approach to financial planning that takes account of priorities, risks and liabilities and provides assurance on long term affordability; and
- Support effective scrutiny by ensuring that good quality information is available and that councillors have the right skills to carry out their scrutiny roles.

4.2 The Committee is asked to note the contents of the Audit Scotland Report - Scotland's public finances – A follow-up audit: Progress in meeting the challenges.

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Approved

Name	Designation	Date
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If you or someone you know would like a copy of this document in another language or format, (on occasion only, a summary of the document will be provided in translation), this can be arranged by contacting (*Scott Walker – 01738 475515*)



Council Text Phone Number 01738 442573

ANNEX

1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

The undernoted table should be completed for all reports. Where the answer is 'yes', the relevant section(s) should also be completed

Strategic Implications	Yes / None
Community Plan / Single Outcome Agreement	None
Corporate Plan	Yes
Resource Implications	
Financial	Yes
Workforce	Yes
Asset Management (land, property, IST)	Yes
Assessments	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	Yes
Sustainability (community, economic, environmental)	Yes
Legal and Governance	None
Risk	None
Consultation	
Internal	Yes
External	None
Communication	
Communications Plan	None

1. Strategic Implications

1.1. Corporate Plan

1.1.1. The Council's Corporate Plan 2013 – 2018 lays out five outcome focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:

- (i) Giving every child the best start in life;
- (ii) Developing educated, responsible and informed citizens;
- (iii) Promoting a prosperous, inclusive and sustainable economy;
- (iv) Supporting people to lead independent, healthy and active lives; and
- (v) Creating a safe and sustainable place for future generations.

1.1.2 This report relates to all of these objectives.

2. Resource Implications

2.1. Financial

2.1.1. There are no direct financial implications arising from this report other than those reported within the body of the main report.

2.2. Workforce

2.2.1. There are no direct workforce implications arising from this report other than those reported within the body of the main report.

2.3. Asset Management (land, property, IT)

2.3.1. There are no direct asset management implications arising from this report other than those reported within the body of the main report.

3. Assessments

3.1. Equality Impact Assessment

3.1.1. Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.

3.1.2. The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

3.2. Strategic Environmental Assessment

3.2.1 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.

3.2.2 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

3.3. Sustainability

3.3.1 Under the provisions of the Local Government in Scotland Act 2003 the Council has to discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.

3.3.2 The information contained within this report has been considered under the Act. However, no action is required as the Act does not apply to the matters presented in this report.

4. Consultation

4.1 Internal

4.1.1 The Chief Executive and all Executive Directors have been consulted in the preparation of this report.

2. BACKGROUND PAPERS

2.1 No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

3. APPENDICES

Appendix 1 – Scotland's public finances – A follow-up audit: Progress in meeting the challenges

Appendix 2 – Checklist to support councillors' scrutiny of public finances (Local Government)

Scotland's public finances

A follow-up audit: Progress in meeting the challenges



 ACCOUNTS COMMISSION

 AUDITOR GENERAL

Prepared by Audit Scotland
June 2014

The Accounts Commission

The Accounts Commission is the public spending watchdog for local government. We hold councils in Scotland to account and help them improve. We operate impartially and independently of councils and of the Scottish Government, and we meet and report in public.

We expect councils to achieve the highest standards of governance and financial stewardship, and value for money in how they use their resources and provide their services.

Our work includes:

- securing and acting upon the external audit of Scotland's councils and various joint boards and committees
- assessing the performance of councils in relation to Best Value and community planning
- carrying out national performance audits to help councils improve their services
- requiring councils to publish information to help the public assess their performance.

You can find out more about the work of the Accounts Commission on our website: www.audit-scotland.gov.uk/about/ac 

Auditor General for Scotland

The Auditor General's role is to:

- appoint auditors to Scotland's central government and NHS bodies
- examine how public bodies spend public money
- help them to manage their finances to the highest standards
- check whether they achieve value for money.

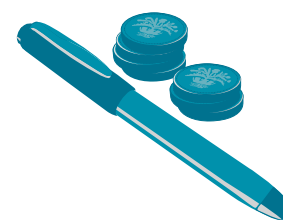
The Auditor General is independent and reports to the Scottish Parliament on the performance of:

- directorates of the Scottish Government
- government agencies, eg the Scottish Prison Service, Historic Scotland
- NHS bodies
- further education colleges
- Scottish Water
- NDPBs and others, eg Scottish Police Authority, Scottish Fire and Rescue Service.

You can find out more about the work of the Auditor General on our website: www.audit-scotland.gov.uk/about/ags 

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

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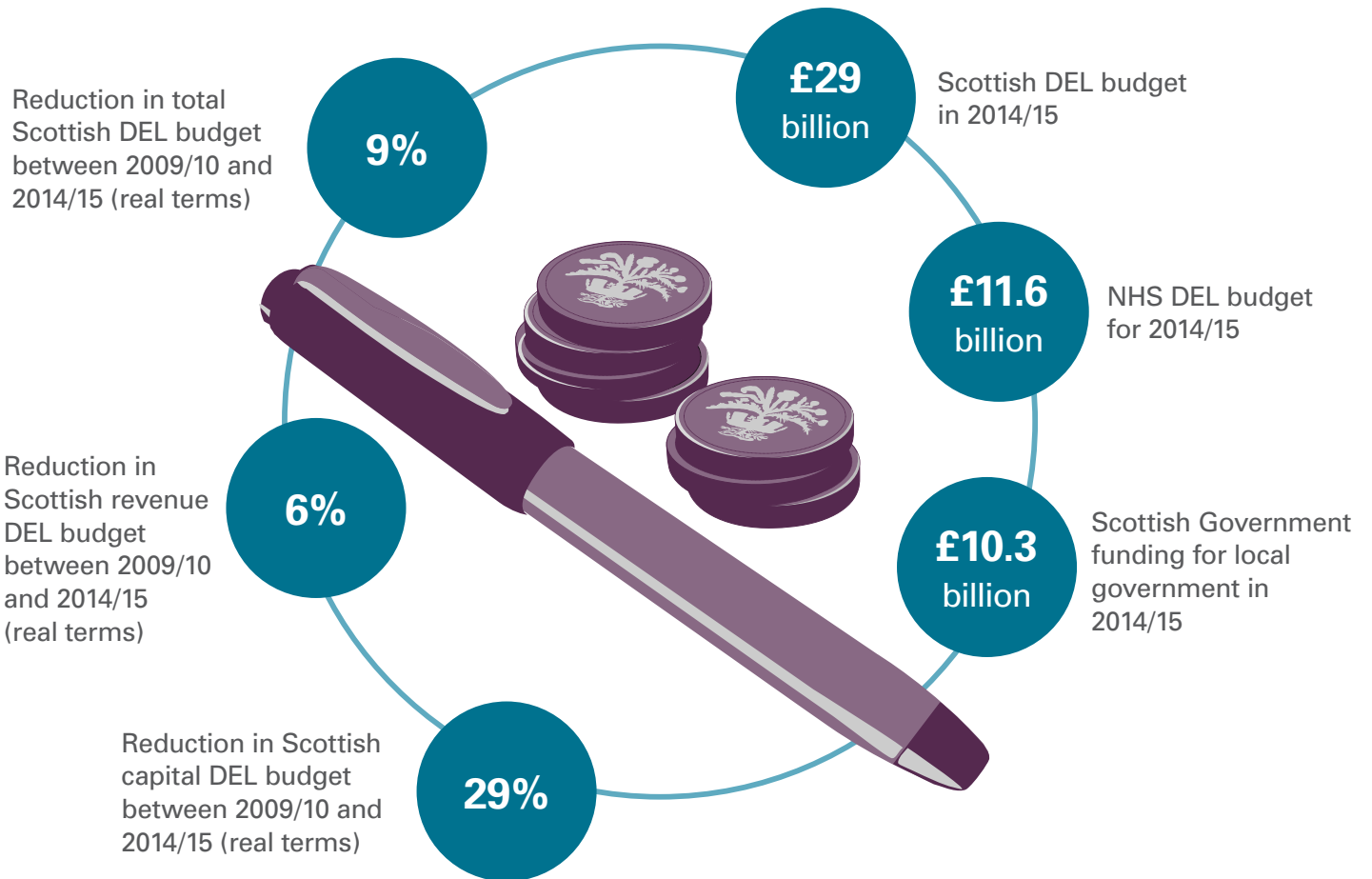


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Summary



Key facts




Introduction


1. Since 2009/10, public sector budgets have fallen each year with the Scottish budget decreasing by nine per cent in real terms to 2014/15.¹ Public bodies have coped well, so far, with budget reductions and have maintained services during this challenging period. Looking ahead, finances remain tight and most public bodies anticipate further reductions. Just a few examples of the significant ongoing issues facing public sector bodies are:

- increasing numbers of older people, who typically need more services in the form of health and social care
- the need to provide and maintain public assets (eg, schools, hospitals, prisons and roads) that are required to deliver services
- paying for public sector pensions.

These pressures have been evident for some time and will continue for the foreseeable future.

2. We highlighted the challenges facing the public sector in our 2011 report [Scotland's public finances: Addressing the challenges \(PDF\)](#) . This provided an overview of the scale of budget reductions expected in the Scottish public sector in the five years to 2014/15, and how public bodies were beginning to respond. The report highlighted that pay restraint and reducing staff numbers were the most common ways of balancing budgets but that these alone were not sustainable in the longer term.

3. Since then, we have published other reports that have looked in more detail at aspects of public sector spending.²

- The NHS financial performance reports concluded that the NHS managed its overall finances well in the short term but needed to increase its focus on longer-term financial planning. With demand for healthcare rising and the introduction of treatment time targets, there were signs of pressure within the system. Vacancy rates for NHS staff were increasing and boards were spending more on agency staff and on private sector providers.
- The annual overview of local government in Scotland reports found that demand on local services such as housing, advice services and school places continued to increase. In response, councils needed to review how services are currently delivered and to consider options for delivering services in the future. In addition, more work was needed to develop longer-term resource plans to show how to get the most from finances, staff and assets such as land and buildings. The most recent [overview report](#), in March 2014, highlighted the need for councils to make better use of options appraisal, based on sound information, to help make clear why decisions are made.
- [Scotland's public sector workforce \(PDF\)](#)  found that in the four years to March 2013, the Scottish public sector workforce reduced by 26,600 whole-time equivalents (WTE) (seven per cent) to 373,400. This included transferring almost 10,000 WTE staff to arm's-length external organisations (ALEOs) and organisations outside the public sector although some of

these staff will still be providing public services. Given the continuing challenges, public bodies were likely to need to make further workforce changes and think differently about how they delivered services. Examples of the latter included prioritising and redesigning services and increasing joint working and collaboration.

- Reports on Scotland's colleges highlighted that the further education sector was facing significant funding reductions. Colleges faced an 11 per cent reduction in revenue grant allocation from the Scottish Government between 2011/12 and 2014/15. They aimed to reduce staff numbers as the main way of making savings. In doing so, they would need to ensure they retained the skills and experience required to maintain the quality of learning they were providing.

4. These reports show that the challenges facing leaders and managers across the public service vary from sector to sector. Yet there is a great deal of common ground: all must produce balanced budgets and hold people in their organisations to account for how the money is used and what is achieved. Regardless of sectors or structures, councillors and non-executive directors have an important role in making sure the budgets they approve are used to best effect. To do this they need good-quality and timely financial information. They need to take a longer-term view on:

- the options available for services and how these will deliver outcomes
- the standards of services that are affordable
- the sustainability of financial plans.

5. The Scottish public sector has undergone significant changes in recent years. The Scottish Government's public service reforms aim to provide more effective and efficient public services that make best use of public finances. The reforms centre on four key components; prevention, performance, people and partnerships. Since 2007, these reforms have resulted in the number of public bodies reducing from 199 to 113. In addition, there have been significant reforms in the police, fire and further education sectors and more recently in the approach to health and social care services.

6. The Scottish Government sets the national policy context for public services in Scotland. In 2007, it established an outcome-focused performance framework to provide a common purpose and direction for all public service activity. The National Performance Framework (NPF) sets out targets and outcomes for public bodies to work towards to deliver the Government's overall objectives. For example, in the health sector all NHS bodies are required to develop local delivery plans in line with outcomes established in the NPF. Similarly, the Scottish Government and Community Planning Partnerships (CPPs) agreed Single Outcome Agreements based on local priorities and the Scottish Government's national outcomes. The agreements set out how each CPP will work towards local outcomes within the context of the Scottish Government's overall objectives.

7. The voluntary sector continues to have an important role in delivering public services. Spending by charities is at its highest level; in 2012/13, charities in Scotland spent £4.7 billion, over half of which was spent on providing social care

and housing services.³ Despite this, the voluntary sector has raised concerns about financial pressures as 60 per cent of organisations expect their costs will increase during 2014 due to rising demand but many do not expect their income to increase.

8. Alongside the current and future pressures, other factors will affect public finances in Scotland. The Scotland Act 2012 introduces tax-raising powers, through the land and buildings transactions tax and landfill tax from 2015 and the new Scottish rate of income tax from 2016. The Act also provides limited borrowing powers. These new measures provide more flexibility but also introduce greater variability if, for example, the amounts raised through taxes are more or less than expected.


9. Irrespective of the outcome of the 2014 Referendum on Scottish independence, pressures on finances will remain. Those leading and managing public services will face increasingly difficult choices about how to spend the money that is available; making best use of that money is paramount.

Who is this report for?

10. The report is aimed at public bodies including councils, NHS boards and central government bodies such as executive agencies and non-departmental public bodies. The report does not cover the Scottish Parliamentary process for approving the Scottish Government's overall budget although the messages should be considered by all organisations that are responsible for spending public money. The report raises a range of important issues for those involved in scrutinising public finances including councillors, non-executive directors, chief executives and other board members. For simplicity, we refer only to 'non-executive directors and councillors', however, the findings and issues raised apply to all those who have a role in financial scrutiny.

11. Alongside this follow-up report, we have published three sector-specific checklists designed to help public sector organisations to improve. These are aimed at councillors and non-executive directors and are intended to help promote good practice, scrutiny and challenge in setting 2015/16 budgets and beyond.

About this audit report

12. The challenges of increasing demand and cost pressures and the need to focus on long-term financial sustainability were among the key issues raised in our 2011 report [Scotland's public finances: Addressing the challenges \(PDF\)](#) . This report provides a high-level update on the financial position and on how public bodies are meeting the challenges of reduced public spending. It considers the importance of long-term financial planning and the key role of councillors and non-executive directors in ensuring bodies are well positioned to deliver quality services for less money.

13. During 2013, the auditors of 67 public bodies examined and reported on how the bodies are meeting the challenges of budget constraints. This report provides a high-level summary of the main themes arising from the local audit work and identifies what more needs to be done. The [Appendix](#) provides a list of the public bodies where local audit work was carried out.

14. The auditors assessed whether public bodies had sustainable financial plans that reflected a strategic approach to their finances. They also considered the role of councillors and non-executive directors in approving budgets and in holding staff to account for delivering budgets.

15. The report is organised in two parts:

- In **Part 1**, we consider the current financial position and outline indicative future spending levels across each sector in 2015/16.
- In **Part 2**, we report on financial scrutiny and the progress public bodies are making in getting the most from budgets and developing approaches that are sustainable.

16. Our findings are based on evidence from a number of sources, including:

- local audit reports from 67 individual public bodies
- a review of published documents on Scotland's public finances
- analysis of financial information on the Scottish budget
- published good practice on governance and budgeting mechanisms.

17. All budget figures in the report are quoted in real terms at 2013/14 price levels using the latest GDP deflators (March 2014) unless otherwise stated.⁴

Key messages



- 1** Scotland's public sector continues to face significant financial challenges. The Scottish budget has fallen nine per cent, in real terms, from £31.9 billion in 2009/10 to £28.9 billion in 2014/15 and is expected to reduce further. Public bodies have coped well so far but face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand.
- 2** In setting budgets, public bodies need to focus more on their priorities, making clearer connections between planned spending and the delivery of outcomes. Rigorous use of options appraisal based on sound information is required for good budget-related decisions and making those decisions clear and understood.
- 3** There is limited evidence of longer-term financial planning. Plans generally focus on the short to medium term up to five years. More work is needed to develop and regularly review long-term financial strategies, that reflect priorities, risks and liabilities and the implications for affordability.
- 4** Non-executive directors and councillors have a crucial role. This involves approving budgets and holding people within their organisations to account for how the money is spent and the outcomes achieved. Public bodies need to improve the quality of information provided to non-executive directors and councillors to support them in their role.

Part 1

The financial position



18. This part of the report sets out the current position of public finances in Scotland. It considers how levels of funding for public bodies have changed in recent years and indicates how much money will be available in the future.

Scottish public spending reduced significantly after 2009/10

19. In 2014/15, the total Scottish budget is £34.6 billion. This provides funding for central government, the NHS and local government. The Scottish Government's annual spending plans are set out in the budget approved by the Scottish Parliament. The Scottish Government has discretion on how the £28.9 billion set aside for day-to-day spending is used. This is known as the Departmental Expenditure Limit (DEL) budget. The remaining £5.7 billion covers demand-led expenditure such as pensions for NHS staff and teachers. This is known as Annually Managed Expenditure (AME). The Scottish Government administers AME but has no discretion over how it is spent.

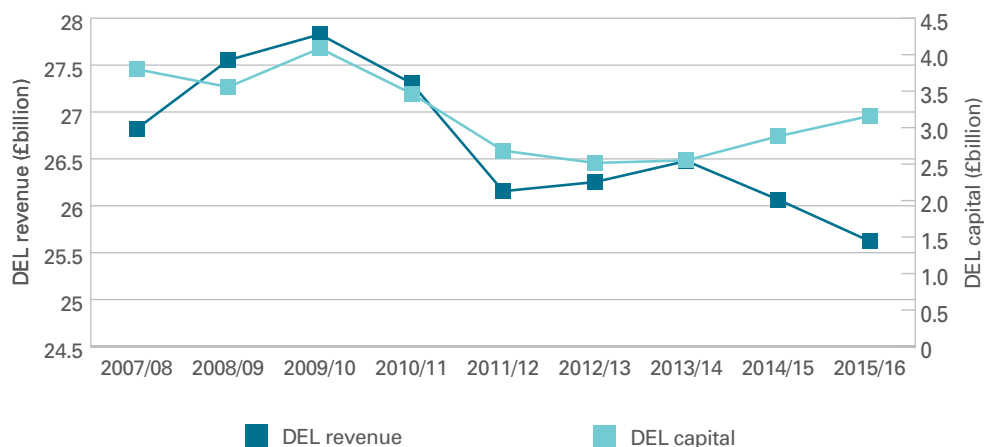
20. Following annual growth in budgets averaging five per cent from 2000/01, the total Scottish DEL budget has fallen nine per cent in real terms since 2009/10. It has fallen from a peak of £31.9 billion in 2009/10 to £28.9 billion in 2014/15. ([Exhibit 1, page 11](#)). The two main components of the DEL budget, revenue and capital, show different trends since 2009/10:

- The revenue DEL budget, for day-to-day expenditure such as staff salaries and supplies, has fallen by £1.8 billion (six per cent) to £26 billion in 2014/15. The revenue DEL budget reduced each year except between 2011/12 and 2013/14 when it increased by one per cent.
- The capital DEL budget, for maintaining and building property such as schools, hospitals and roads, has fallen by £1.2 billion (29 per cent) to £2.9 billion in 2014/15. Although the overall trend shows a decline, the budget has increased by 15 per cent since 2012/13 in line with the Scottish Government's policy to increase capital investment. The Scottish Government also plans to use several revenue-financed methods such as Non-Profit Distribution (NPD) to finance capital projects and increase capital investment activity.⁵ These methods can be used to support investment but their effect is to create longer-term financial commitments and to reduce flexibility in how future revenue budgets can be used. Since 2010, contracts for projects with a value of around £1.7 billion have been agreed using revenue-financed methods with a further £1.7 billion planned for future years.⁶ The Scottish Government has set a limit of five per cent of future total annual DEL budgets to be used on the total annual costs associated with these financing methods.

the total
Scottish DEL
budget has
fallen nine
per cent in
real terms
since 2009/10

Exhibit 1

The Scottish Government DEL budget 2007/08 to 2015/16 (real terms at 2013/14 prices)



Source: Scottish Government

Further budget reductions are planned for 2015/16 and beyond

21. Looking ahead, the Scottish Government has outlined spending levels for 2015/16 in its draft budget.⁷ The overall DEL budget will fall slightly, by £0.1 billion (0.4 per cent) to £28.8 billion. Within this, the revenue budget will reduce by £0.4 billion (two per cent) to £25.6 billion, whereas the capital budget will increase by ten per cent from £2.9 billion to £3.2 billion.⁸

Funding for health and local government sectors will reduce in 2015/16

22. The Scottish Government's health DEL budget will reduce by £73 million (one per cent) in 2015/16. Within this:

- funding for territorial NHS boards will increase by £85 million to £8.2 billion, an average increase of one per cent
- funding for NHS special boards (such as NHS 24 and Scottish Ambulance Service) will reduce by an average of one per cent, with total funding reducing from £1.03 billion in 2014/15 to £1.02 billion in 2015/16
- the amount spent by the Scottish Government directly, will decrease by £58 million (three per cent) to £2.1 billion in 2015/16.

23. The Scottish Government provides over 80 per cent of the funding for local government. The rest comes mainly from council tax. The Scottish Government's DEL budget for local government will decrease by £0.2 billion from £7.7 billion to £7.5 billion, a decrease of three per cent. The Scottish Government's total funding to local government, which includes redistributing money raised from non-domestic rates, will decrease by £88 million (one per cent) to £10.2 billion in 2015/16.⁹

Funding for central government bodies will increase in 2015/16


24. Central government funding includes budget allocations for the core Scottish Government, agencies, non-departmental public bodies and bodies directly funded from the Scottish budget such as the Scottish Parliamentary Corporate Body. The overall DEL budget for this group of public bodies will increase by £147 million (two per cent) to £9.7 billion in 2015/16 including increased funding for housing supply (£92 million) and police and firefighters' pensions (£16 million).

Further funding reductions are forecast beyond 2015/16

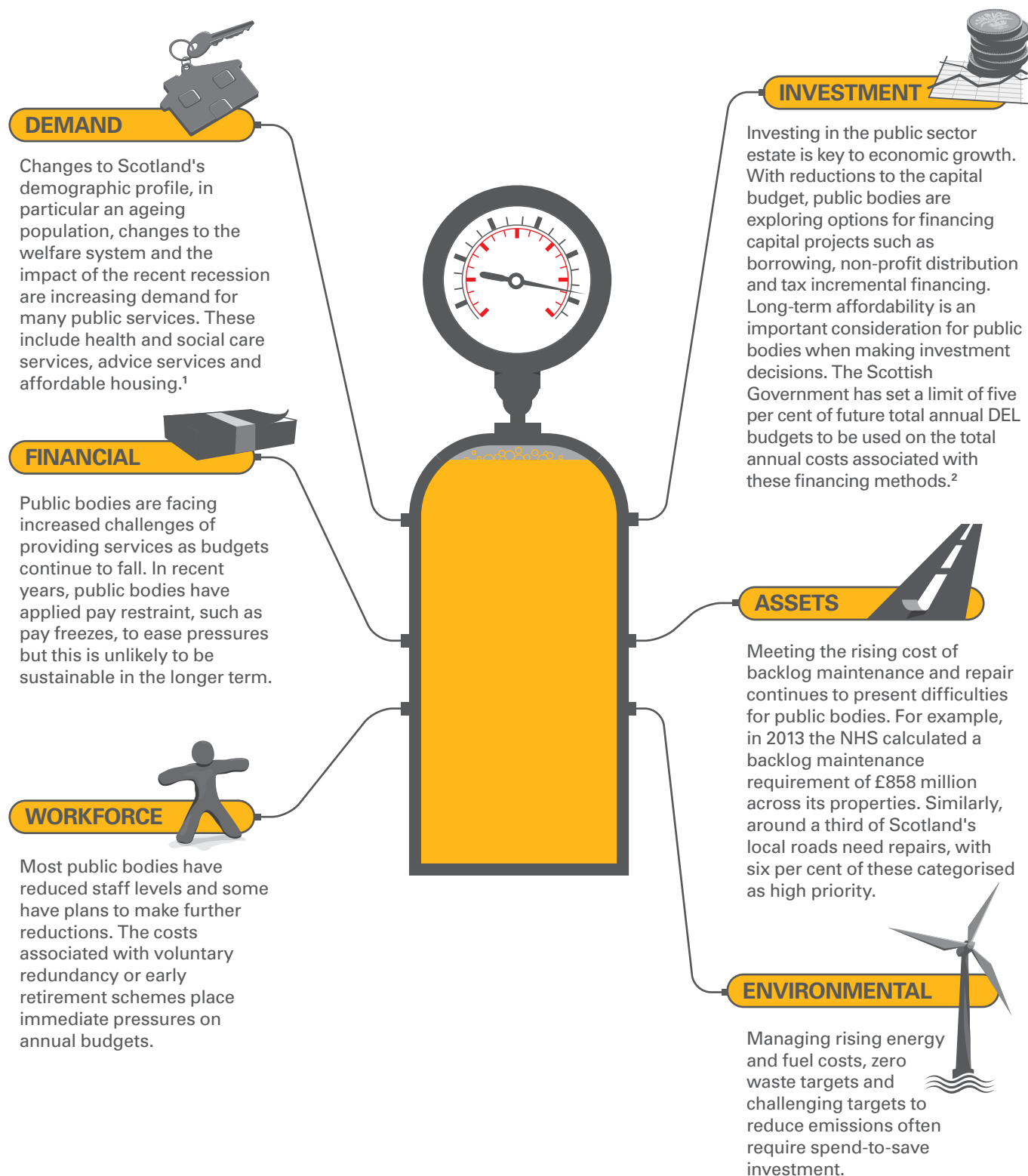
25. There may be further reductions in budgets beyond 2015/16. In March 2014, the UK government published total spending projections up to 2018/19 although allocations to individual departments, including Scotland's allocation, have yet to be decided.¹⁰ At the same time, the Office for Budget Responsibility suggests that the UK DEL budget could reduce by 4.2 per cent in 2016/17, 5.1 per cent in 2017/18 and 2.2 per cent in 2018/19.¹¹ If the Scottish Government's budget reduces in line with UK projections, the overall Scottish DEL budget could reduce by:

- £1.2 billion to £27.6 billion in 2016/17
- £1.4 billion to £26.2 billion in 2017/18
- £0.6 billion to £25.6 billion in 2018/19.

Public bodies have coped well so far, but service demands and pressures are increasing

26. Public bodies have coped well so far with reduced budgets. Reducing staff costs was one of the main methods used to achieve the required savings. In our report [Scotland's public sector workforce \(PDF\)](#)  we estimated that staff costs across councils, the NHS, and central government reduced by a total of £1 billion (eight per cent) to £12.7 billion between 2009/10 and 2011/12. This was achieved mainly by reducing staff numbers by 26,600 to 373,400 (whole-time equivalent) using voluntary early release schemes and transferring almost 10,000 WTE staff to ALEOs and organisations outside the public sector. Where staff transferred, some form of public funding is paid to the provider to deliver public services, a proportion of which will be used to pay staff. Other methods such as pay and recruitment freezes were also used to manage costs.

27. Public bodies continue to face significant challenges from rising demand, increasing energy prices and the need to provide and maintain 'fit-for-purpose' assets such as schools and hospitals ([Exhibit 2, page 13](#)). These pressures remain and present even greater challenges as budgets continue to fall.

Exhibit 2**Ongoing pressures in the public sector**

Notes:

1. Scotland's population of people aged 75 and over is expected to increase by 86 per cent by 2037. *Projected Population of Scotland (2012-based)*, General Register Office for Scotland, January 2014.

2. *Infrastructure Investment Plan 2011*, Scottish Government, December 2011.

Source: Audit Scotland

Part 2

Getting the most from budgets



28. This part of the report provides an update on how public bodies are meeting the financial challenges outlined in [Part 1](#). It focuses on budget setting and how longer-term planning can help achieve financial sustainability. It also underlines the crucial role of non-executive directors and councillors in scrutinising their organisations' finances and the information they need to do this effectively.

Public bodies need to focus more on their priorities when setting budgets

29. Despite reducing budgets, the level of public spending in Scotland continues to be significant. Public bodies need to focus on making the most of the money available as well as identifying ways to reduce costs. Effective budgeting is an important component of good financial management and can help bodies understand where best to direct resources to achieve the greatest benefit. It sets out where and how much money will be allocated and provides the basis for monitoring the position throughout the year. As a result, the development and scrutiny of setting annual budgets is an important activity within public bodies, particularly during periods of financial constraint.

30. Public bodies have different approaches to budgeting. Most use an incremental approach where they allocate money based on the previous year's budget and adjust to reflect inflation, savings targets and other known factors. An incremental approach to budgeting works best when available funding is similar to previous years and change is gradual and planned. But it can limit the ability to prioritise spending or reduce costs when less money is available. Some bodies take a zero-based approach, where they decide budgets based on need through continually reassessing the base budget. Zero-based budgeting is a useful approach in specific circumstances as it helps public bodies provide a greater focus on value for money in their budget decisions.

31. In the current financial environment, public bodies need to implement an approach to budgeting that focuses more on their priorities and links planned spending more closely with the outcomes they want to achieve. The outcome-based performance framework (through the National Performance Framework and Single Outcome Agreements) provides a basis for public bodies to adopt a priority-based approach. The approach focuses on priorities and allocating money to the services or areas that contribute most to delivering these outcomes. This depends on a shared understanding of which services contribute most and least to the organisation's priorities. Services or activities that contribute least to outcomes may be reduced or withdrawn. A priority-based approach helps non-executive directors and councillors take decisions in the clear knowledge of the consequences. Local audit work found that only a few bodies have adopted a priority-based approach to budgeting.

**scrutiny
arrangements
are sound
but more
information
is needed
on progress
towards
delivering
outcomes**

32. Achieving outcomes often involves joint working with partners. Where this is the case, for example in Community Planning Partnerships (CPPs), public bodies need to work together to identify where they can direct money to make the greatest difference. This means ensuring that budget setting takes full account of shared priorities and commitments. In September 2013, the national Community Planning Group agreed that it should focus on getting partners to deploy their resources jointly towards partnership objectives.¹² This includes a requirement for relevant partners in CPPs to:

- share budget, investment and resource planning information
- agree how total resources can most effectively be deployed and aligned between partners to achieve outcomes.

33. Options appraisal and benchmarking are key components of financial management including priority-based budget setting. Rigorous options appraisal based on sound information, including information from service users, helps ensure good budget-related decisions and helps make clear why decisions are made. Using benchmarking information in budget setting can highlight potential opportunities associated with different options such as improved procurement practices or more efficient deployment of staff. There is evidence that some public bodies are considering proposals to reduce or stop services, for example some councils are considering removing subsidies for bus services, closing libraries or reducing support for arts development. As part of that process, public bodies need to identify the risks associated with budget options, including the potential implications for how services perform, the impact on service users and the effect on longer-term outcomes.¹³

There is limited evidence of longer-term financial planning

34. Long-term financial strategies covering a five to ten-year period help set the context for annual budgets. They also help clarify the financial sustainability of an organisation over an extended period and can help identify problems with affordability at an early stage. Although funding allocations from the Scottish Government typically cover one to three-year spending review periods, this should not prevent public bodies assessing their spending needs and options over a longer period.

35. It is important that public bodies develop and maintain long-term financial strategies to direct and control their finances. A strategy should outline spending levels over an extended period (five to ten years) and include projected levels of income, how spending will be funded and, where relevant, why reserves are held and how they will be used ([Exhibit 3, page 16](#)). To enable them to implement the strategy, public bodies should also develop detailed financial plans that outline spending commitments over the short (one year) and medium term (two to five years).

36. Most councils produce longer-term financial plans, but the timescales involved vary up to ten years. Where councils have longer-term plans, they generally contain less detailed financial information in later years but councils use indicative spending levels to estimate potential funding gaps. [Case study 1 \(page 17\)](#) provides an example of City of Edinburgh Council's financial planning to 2017/18. The council plans to address a potential budget shortfall of £95 million although it is too early to comment on whether this will be achieved.

Exhibit 3

Important features of a financial strategy

A financial strategy should cover five to ten years.



COSTS

A clear understanding of the business model and the cost of individual activities within it



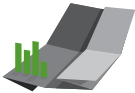
SAVINGS OPTIONS

Evidence-based options for achieving savings



SAVINGS DETAILS

Details of one-off and recurring savings



SCENARIO PLANNING

Scenario planning to outline best, worst and most likely scenarios of the financial position and the assumptions used



ASSETS/LIABILITIES & RESERVES

Details of assets, liabilities and reserves and how these will change over time



CAPITAL INVESTMENT ACTIVITY

Details of investment needs and plans and how these will be paid for



DEMAND

An analysis of levels of service demand and projected income



FUNDING SHORTFALLS

Any income or funding shortfalls and how to deal with these



STRATEGY LINKS

Clear links to the corporate strategy, CPP objectives and other relevant strategies such as workforce and asset management



RISKS & TIMESCALES

The risks and timescales involved in achieving financial sustainability



The strategy should be underpinned by detailed financial plans in the short (one year) and medium (two to five years) term.

Source: Audit Scotland

Case study 1

Financial planning in the City of Edinburgh Council

In 2012/13, the council developed a budget covering years 2013/14 to 2017/18. This was designed to help deal with a potential budget shortfall of £95 million by 2017/18 that their financial plan identified.


Using the plan as a starting point, the council applied a planning framework to identify pressures and the options to achieve savings. It also considered structural and legislative changes, such as the integration of health and social care services and welfare reform. The 2013/14 budget was developed using the principles agreed as part of the framework.

The framework approach focused on identifying proposed savings across three main areas:

- transformation (such as recruiting more foster carers while reducing the use of foster agencies)
- efficiency and council-wide savings (such as improving procurement and increasing the use of e-advertising)
- additional income (reviewing existing charges and fees).

An important element of the process was preparing a service cost model to chart changes in projected service costs over the medium to long term. The outputs of this model were integrated as closely as possible to the financial plan.

Source: The City of Edinburgh Council

37. In the NHS, the timeframe for financial planning is generally three or five years.¹⁴ The report [NHS financial performance 2012/13 \(PDF\)](#)  highlighted that NHS boards' Local Delivery Plans provide financial projections covering expected funding, expenditure levels and savings required, but that detailed financial planning is restricted to the first year. Central government bodies generally do not produce long-term financial strategies. Financial information is reported within the corporate plan but, in many cases, the information is limited or does not extend beyond a three-year period.

38. With limited information on available funding beyond 2015/16, public bodies should undertake scenario planning as part of their long-term financial strategies. This involves making assumptions about different levels of future income, expenditure and activity and outlining options based on each scenario. This helps to identify potential solutions to difficulties arising from variations in levels of future funding. It also provides an opportunity to outline ways to maintain service levels. Without planning like this, there is a risk that public bodies continue taking a short-term approach to cost reduction at the expense of better alternatives over the longer term. Local audit work showed that few public bodies had undertaken scenario planning as part of their long-term financial planning.

Better information is needed to scrutinise spending plans

Scrutiny arrangements are sound but more information is needed on progress towards delivering outcomes

39. Scrutiny plays an essential role in ensuring public bodies' budgets, financial plans and strategies are credible and transparent: that is, based on clearly understood information. It also ensures they work towards achieving their overall aims and objectives. Effective scrutiny should be independent, balanced and hold people to account for their spending plans and use of public money for which they are responsible. It requires relevant, reliable and timely information.

40. Different scrutiny arrangements are in place across public bodies in Scotland. Overall, across local government, the NHS and central government, arrangements to enable scrutiny are generally sound.

- Within councils, relevant committees consider financial plans and budgets regularly (at least four times a year). Many councils have established committees or working groups to scrutinise and develop budget proposals before they are considered at council level.
- In the NHS, board members, including non-executive directors, are involved in preparing Local Delivery Plans, allowing them to challenge and scrutinise financial plans. Financial monitoring is generally reported at each board meeting, along with minutes from financial scrutiny committees. In 2012/13, NHS Fife established a Programme Management Office to challenge savings plans. Other health boards are considering a similar approach ([Case study 2, page 19](#)).
- In central government bodies, non-executive directors and individual committees generally scrutinise finances. Most have financial and performance monitoring reports at every board meeting. Local audit work found that, in general, the budget-setting process involves significant input from senior officials and board members.

41. Irrespective of the structures in place, councillors and non-executive directors have an important role in making sure public bodies plan to achieve the necessary outcomes from spending decisions. This requires the identification and definition of desired outcomes and the ability to monitor progress towards their achievement. Together, public sector leaders should be clear how each spending decision contributes to each outcome; how it will result in improvements; and what changes can be made to ensure it is successful. Scrutiny should include regular monitoring of progress towards outcomes and include feedback on where further improvements can be made.

Case study 2

Scrutiny of savings plans: NHS Fife

NHS Fife set up a Programme Management Office (PMO) in 2012/13 to help identify and deliver savings. The PMO supports the coordination and prioritisation of resources across different projects, helping to manage the links between projects, and identifying any impact on other services or patient care, as well as overseeing the delivery of efficiency savings.

Directorate service managers and their teams identify savings. These are overseen and challenged by directorate and divisional heads, with relevant input from finance staff. The risks associated with delivering individual savings schemes are identified as high, medium or low. This indicates the likelihood of not achieving individual savings so that NHS Fife can assess and manage the impact on the overall savings programme. The PMO uses a tracking database to monitor the progress of projects, with regular reports being provided to management. Using this approach NHS Fife achieved £17.5 million savings in 2012/13.

During 2012/13, the emphasis was on cash-releasing savings schemes. In 2013/14 the PMO considered cash-releasing and non-cash releasing savings and identified £16.3 million cash and non-cash savings.

The PMO approach provides a clear evidence base for identifying savings plans. Some other health boards have expressed an interest in developing a similar approach.

Source: NHS Fife

There is scope to improve financial information provided for scrutiny

42. All levels of the governance structure, from working groups to committees and boards, need reliable, accurate and timely information to scrutinise effectively. Public bodies need to improve the level and consistency of information provided for scrutiny. For example, auditors reported cases where:

- actions, responsibilities, measurable outcomes or timescales were unclear
- reporting of financial information was limited in frequency and content
- scrutiny of plans and savings took place in private with no reporting of decisions.

43. Budget scrutiny largely focuses on how budgets compare with the previous year. The actual spending outturn and savings achieved in the previous year receive limited attention. In addition, more work is needed to identify and consider different options available including new ways of delivering services that make better use of the money that is available.

44. The opportunity to provide good scrutiny and challenge of financial plans and savings will be reduced if information is not provided, incorrect, out of date or incomplete ([Exhibit 4](#)). Senior managers and staff in public bodies are responsible for making sure enough information is available for public sector leaders to scrutinise effectively and approve spending decisions. They also need to ensure an appropriate balance is made between information used for internal purposes and information made publicly available as part of the scrutiny process. Likewise, it is the responsibility of non-executive directors and councillors to make sure they have the information they need.

45. The public sector workforce reduced by 26,600 WTE (seven per cent) to 373,400 between 2009 and 2013.¹⁵ In view of these significant staff reductions, public sector leaders should also consider the leadership, capacity and resilience of finance departments and their ability to supply information to scrutinise budgets. The chief financial officer has a crucial role in providing advice on all aspects of finance and is central to effective governance. For example, in local government, in assessing the capacity of finance departments, councillors should satisfy themselves that the officer has appropriate access and influence to perform the role.¹⁶

Exhibit 4

Important characteristics of financial information



RELIABLE

Information should be accurate, representative and verifiable. Where assumptions or estimates are used these should be clearly stated



TIMELY

Information should be up to date and provided on a regular basis



COMPLETE

Information should be comprehensive and cover the areas relevant to the needs of key decision-makers



TRANSPARENT

Information should be clear, understandable and easy to obtain



CONSISTENT

Information should be reported on the same basis across different periods to allow for comparisons to be made

Source: Audit Scotland

Most public bodies consulted stakeholders on savings plans

46. Engaging with communities and service users is an important component of priority-based budget setting. It can provide information on demand and help to ensure budgets are allocated where they are needed most. In most cases, auditors reported that public bodies consult people who use or are affected by services on financial and savings plans, and on how these are likely to affect the services delivered. Consultation activity was more common in local government and the NHS than in central government bodies. Most councils and NHS bodies had consulted on major decisions such as relocating services or decisions that had implications for staff. However, some public bodies had taken no action to consult the public.

47. Where public bodies decide to change how services are delivered, they need to ensure these decisions are based on the needs of the people who use that service. A decision to deliver a service in an alternative way can change long-standing arrangements and have far-reaching consequences for service users, systems and staff. By consulting with the public and staff, public bodies can manage expectations about what they can achieve within available budgets.


Public bodies need to use benchmarking data to gain a better understanding of their costs and performance

48. Benchmarking is measuring how an organisation is performing against one or more other organisations. It helps to identify areas for improvement, highlight opportunities and validate successful performance. Auditors reported that contributing to benchmarking exercises is common across the Scottish public sector. Auditors for both central government and NHS bodies reported there were few examples of measurable benefits derived from benchmarking activities. In local government, auditors reported that councils could benchmark more effectively and do more to demonstrate its benefits. SOLACE,¹⁷ COSLA¹⁸ and the Improvement Service have been leading on work to establish a new benchmarking framework in local government. The new framework provides comparative benchmarking across all major service areas, covering costs, performance and customer satisfaction.

49. Improving the use of benchmarking data across the public sector can help identify potential inefficiencies. Throughout the year, public bodies need to monitor their performance against benchmarking data to explore opportunities for improvements, reducing costs and changing the way services are delivered within the boundaries of the money available.

Non-executive directors and councillors need training to support them in budget-setting and scrutinising performance against budgets

50. In the quickly changing context set out in [Part 1](#) of this report, it is more important than ever that non-executive directors and councillors are supported in their role. The introduction of different methods of paying for major capital investment, such as tax incremental financing and NPD, is an example of a complex area where support may be required to ensure public sector leaders are fully aware of the key issues, risks and impact on public finances.

51. Effective budget-setting and budget scrutiny can only take place when these people have the right skills and support to carry out their roles. Our report [An overview of local government in Scotland 2014 \(PDF\)](#)  found that there is demand and more need in councils for training for councillors. All public bodies should assure themselves that they provide appropriate training and support for

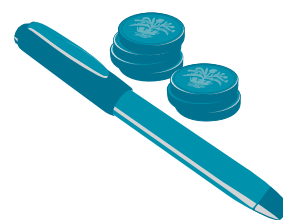
individuals in these roles. Awareness and understanding of how budget setting and scrutiny links with the overall organisation are other important aspects that public bodies can support through training and development for non-executive directors and councillors.

Recommendations

Public bodies should:

- implement an approach to budgeting that focuses more on priorities and links planned spending more closely with the outcomes they want to achieve
 - develop a longer-term approach to financial planning that takes account of priorities, risks and liabilities and provides assurances on long-term affordability
 - support effective scrutiny by ensuring that good-quality information is available and that councillors and non-executive directors have the right skills to carry out their scrutiny roles.
-

Endnotes



- ◀ 1 This is the Departmental Expenditure Limit budget.
- ◀ 2 *NHS financial performance 2011/12*, October 2012; *NHS financial performance 2012/13*, October 2013; *An overview of local government in Scotland*, March 2012, March 2013 and March 2014 *Scotland's public sector workforce*, November 2013; *Scotland's colleges: current finances, future challenges*, October 2012; *Scotland's colleges 2013*, August 2013. All Audit Scotland.
- ◀ 3 *SCVO State of the Sector report*, Scottish Council for Voluntary Organisations, April 2014.
- ◀ 4 The Scottish Government's draft budget for 2014/15 uses GDP deflators from June 2013, therefore there may be minor differences between figures quoted in this report and the draft budget document.
- ◀ 5 Non-Profit Distribution caps returns to the private sector, with surpluses reinvested in the public sector.
- ◀ 6 This is based on major capital projects valued at over £20 million and includes revenue finance methods such as Non-Profit Distribution, Hub and Regulated Asset Base (RAB).
- ◀ 7 *Scottish Budget: Draft Budget 2014/15*, Scottish Government, September 2013.
- ◀ 8 The capital DEL budget for 2015/16 includes £285 million in real terms of borrowing from the National Loans Fund introduced under the provisions of the Scotland Act 2012.
- ◀ 9 Funding from non-domestic rates is classified as Annually Managed Expenditure and is outwith the DEL budget.
- ◀ 10 *UK Budget 2014*, HM Treasury, March 2014.
- ◀ 11 *Economic and Fiscal Outlook*, Office for Budget Responsibility, March 2014.
- ◀ 12 *Agreement on Joint Working on Community Planning and Resourcing*, National Community Planning Group, September 2013.
- ◀ 13 In March 2014, the Accounts Commission published *Options appraisal: are you getting it right?* as part of their *How Councils Work* improvement series. The report is aimed at councillors, senior officials and managers in councils and is intended to stimulate change and improve performance through better options appraisal.
- ◀ 14 NHS financial plans are generally required for a three-year period. A five-year plan is required when there is a major capital project in development, brokerage arrangements are in place, an underlying deficit of over one per cent of baseline revenue funding, or major service redesign. A five-year capital plan is required by all boards.
- ◀ 15 *Scotland's public sector workforce*, Audit Scotland, November 2013.
- ◀ 16 Local authorities must appoint a statutory/proper officer for finance, under section 95 of the Local Government (Scotland) Act 1973.
- ◀ 17 The Society of Local Authority Chief Executives and senior managers.
- ◀ 18 The Convention of Scottish Local Authorities.

Appendix



List of public bodies where local audit work was carried out

Local government sector

- 29 councils
- Strathclyde Partnership for Transport

Health sector

- All 14 territorial health boards
- National Waiting Times Centre Board (Golden Jubilee National Hospital)
- NHS 24
- NHS Education for Scotland
- NHS National Services Scotland
- NHS Health Scotland
- Scottish Ambulance Service
- The State Hospital

Central government sector

- Care Inspectorate
- Creative Scotland
- Crown Office
- Forestry Commission and Forest Enterprise (Scotland)
- Highlands and Islands Enterprise
- Historic Scotland
- Scottish Court Service
- Scottish Enterprise
- Scottish Environment Protection Agency

- Scottish Funding Council
- Scottish Natural Heritage
- Scottish Prison Service
- Scottish Qualifications Authority
- Skills Development Scotland
- Sportscotland
- Transport Scotland

Scotland's public finances

A follow-up audit: Progress in meeting the challenges

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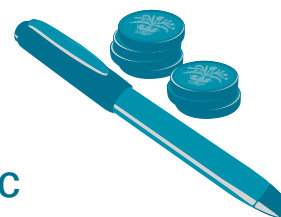
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Scotland's public finances – a follow-up audit



Checklist to support councillors' scrutiny of public finances (Local Government)



Introduction

The following checklist is designed to help councillors with their important role in budget-setting and overseeing financial plans and financial performance. It also provides a basis for discussions in councils on the budget-setting process, long-term financial planning and the availability of good information to support effective scrutiny of public finances.

The questions should help councillors to seek evidence, and subsequently gain assurance, on their council's approach in dealing with ongoing financial pressures. The applicability of the checklist will vary according to the responsibilities of each councillor.

If the answer to any question is 'no', then we would encourage councillors to speak with the council's Director of Finance (section 95 officer), or, where appropriate, the Chief Executive, to discuss how improvements can be made.

The checklist is divided into three sections and should be read in conjunction with the report [Scotland's public finances: a follow-up audit \(PDF\)](#) published in June 2014. This report provides a high-level update on the financial position and on how public bodies are meeting the challenges of reduced public spending. It considers the importance of budget-setting linked to outcomes, long-term financial planning and robust scrutiny of finances.

Section 1: Budget-setting – roles, responsibilities and approach

The following questions focus on the roles and responsibilities of those involved in the annual budget-setting process. Questions also cover the budgeting approach and how budget-setting links to the achievement of outcomes. [\(See main report paragraphs 29 to 33\)](#)

Budget-setting – roles, responsibilities and approach		Y/N
<p>1. Do I have a good understanding of how the budget-setting process works within my council?</p> <ul style="list-style-type: none"> Do I have confidence that budget proposals are realistic? Are the roles and responsibilities of individuals and committees involved in budget-setting clearly documented and understood? Am I clear about my own specific responsibilities within the budget-setting process? 		
<p>2. Has my council developed a priority-based approach to budget-setting which makes connections between planned spending and intended outcomes?</p> <ul style="list-style-type: none"> Are budgets clearly linked to the council's priorities and outcomes as set out in strategy documents? Does the council work well with community planning partners to ensure budget-setting takes full account of shared priorities, such as those included in the Single Outcome Agreement? Are different spending options made available to decision-makers, including new ways of delivering services, and have I seen them? Are the costs and benefits (financial and non-financial) of each option clearly documented including the impact on service users and related risks? Do spending options consider the unit costs of services and benchmarking data and how these will change over time? 		
<p>3. Is there a clear mechanism for monitoring and reporting how, over time, spending decisions are contributing to outcomes?</p> <ul style="list-style-type: none"> Is sufficient time built into the budget-setting process to allow for effective scrutiny and challenge of spending plans? Is sufficient attention given to current year spending against the current year budget when setting budgets for future years? 		

Section 2: Long-term financial planning

The following questions consider councils' financial strategies and plans over the short (one year), medium (two to five years) and longer-term (five to ten years). [\(See main report paragraphs 34 to 38\)](#)

Long-term financial planning	Y/N
<p>4. Does my council have a long-term financial strategy (covering 5 to 10 years)?</p> <ul style="list-style-type: none"> • Does the council also have detailed financial plans that outline spending commitments over the short (one year) and medium-term (two to five years)? • Do the financial strategy and financial plans provide me with an overall understanding of the financial health of the council? • Are the financial strategy and financial plans subject to scrutiny by the finance committee and full council on a regular basis? • Where assumptions and forecasts are used are they clearly stated? Are they reasonable? 	
<p>5. Does the financial strategy consider:</p> <ul style="list-style-type: none"> • the cost of providing individual services? • the main cost drivers for each activity? • evidence-based options for achieving savings? • details of one-off and recurring savings? • scenario planning to outline best, worst and most likely scenarios of the financial position? • details of assets, liabilities and reserves and how these will change over time? • an analysis of levels of service demand and projected income? • any income or funding shortfalls and how to deal with these? • clear links to other relevant strategies such as workforce and asset management? • the risks and timescales involved in achieving financial sustainability? 	
<p>6. Do detailed short and medium-term financial plans clearly link and align to my council's longer-term financial strategy?</p> <ul style="list-style-type: none"> • Do short and medium-term financial plans take account of the overall resources available in the community planning partnership area? 	
<p>7. Am I satisfied that appropriate action is being taken to address potential future funding gaps?</p> <ul style="list-style-type: none"> • Am I aware of all significant financial risks facing the council and their implications? • Am I satisfied with the council's approach to holding, moving and using reserves? • Am I aware of all contracts which will have a significant long-term financial impact on the council? • Am I aware of the long-term financial impact on future budgets of using revenue-finance methods (such as non-profit distribution and tax incremental financing) to pay for capital investment? 	

Section 3: Information to support effective scrutiny of public finances

The following questions consider the importance of good quality information for financial scrutiny. They also consider the training provided to councillors to support them in their role. [\(See main report paragraphs 39 to 51\)](#)

Information to support effective scrutiny of public finances		Y/N
<p>8. Am I provided with good financial and performance information which enables me to effectively challenge spending proposals and decisions?</p> <ul style="list-style-type: none"> • Do I know whom to ask for explanations or if the information is not what I require? • Am I able to gain assurance that any questions raised are addressed and resolved? 		
<p>9. Is there a culture of openness and transparency in providing information for scrutiny and in the scrutiny process itself?</p> <ul style="list-style-type: none"> • Is information provided: <ul style="list-style-type: none"> – reliable? – timely? – complete? – transparent? – consistent across time periods? 		
<p>10. Do I receive financial and non-financial information in a form that enables me to easily understand my council's financial position?</p> <ul style="list-style-type: none"> • Do I receive good information about the changing environment within which the council operates including: <ul style="list-style-type: none"> – financial and service pressures? – impact of public service reforms, such as welfare reform and health and social care integration? – the effect of policy decisions such as no compulsory redundancies and national pay policies? – the introduction of, and changes to, legislation? – actions by other councils, public bodies and private and third sector organisations? • Is benchmarking data made available about other councils on comparable services and is this used to inform decision-making? • Is trend information available to allow a clear understanding of the organisation's progress towards achieving financial sustainability? • Are satisfactory explanations provided for all significant changes in comparing budgets with actual spending? 		
<p>11. Am I confident my knowledge of public finances enables me to challenge and review financial and performance information?</p> <ul style="list-style-type: none"> • Am I provided with, and take up, sufficient training to support me in my scrutiny role? • If sufficient training is not provided, do I know who is responsible for resolving this? 		