WARWICK DISTRICT COUNCIL	**Finance & Audit Scrutiny Committee** **25 January 2011**	**Agenda Item No.** **5**

Title	Value for Money Conclusion
For further information about this report please contact	Mike Snow
Service Area	Finance
Wards of the District directly affected	N/A
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	Finance and Audit Scrutiny Committee 26th October 2010
Background Papers	

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	No
Included within the Forward Plan? (If yes include reference number)	No

Officer/Councillor Approval

With regard to officer approval all reports *must* be approved by the report author's relevant Deputy Chief Executive, Finance, Legal Services and the relevant Portfolio Holder(s).

Officer Approval		**Name**
Deputy Chief Executive		Andy Jones
Chief Executive		
CMT		
Section 151 Officer		Mike Snow
Legal		
Finance		Mike Snow
Portfolio Holder(s)		Andrew Mobbs

Consultation Undertaken

Please insert details of any consultation undertaken with regard to this report.

Final Decision?	Yes/~~No~~

Suggested next steps (if not final decision please set out below)

1. SUMMARY

1.1 The Council has agreed that the Finance and Audit Scrutiny Committee should monitor progress on the Use of Resources Action Plan. Details of the Value for Money conclusion which replaces Use of Resources have now been published.

2. RECOMMENDATION

2.1 That the Finance and Audit Scrutiny Committee note the position with regard to Use of Resources and the action plan.

2.2 That the Finance and Audit Scrutiny Committee note the position of the Value for Money conclusion and associated documents.

2.3 The Head of Finance report back to the 29th March 2011 Finance and Audit Scrutiny Committee details of the Value For Money conclusion self assessment and action plan.

3. REASONS FOR THE RECOMMENDATION

3.1 The Audit Commission have issued new auditor guidance on the Value For Money conclusion. This has replaced the work previously undertaken on Use of Resources. It is therefore recommended that the previous Use of Resources action plan be replaced with a new action plan based on the Value For Money guidance and incorporating any issues outstanding from the Use of Resources action plan.

4. ALTERNATIVE OPTION CONSIDERED

4.1 No alternative options are proposed.

5. BUDGETARY FRAMEWORK

5.1 The Council undergoes a Value for Money assessment as part of the audit of its Statement of Accounts

5.2 It is important that the Council provide value for money in all its activities. This is important to ensure all stakeholders receive value for money, and to ensure the best use is made of all resources, especially in the current difficult financial regime.

6. POLICY FRAMEWORK

6.1 By managing the Council's resources properly this will support the Council in achieving its corporate objectives and value for money.

7. **BACKGROUND**

7.1 Following on from the Comprehensive Area Assessment and Use of Resources assessment ceasing from May 2010, the Audit Commission have continued to be required to issue a Value For Money (VFM) Conclusion as part of their consideration of the Council's Statement of Accounts. The 2009/10 Value For Money conclusion was reported to members in July 2010. This was based on the work that had already been done in respect of Use of Resources, prior to it ceasing.

7.3 In the October 2010 report to Finance and Audit Scrutiny Committee on Use of Resources, it was stated that the Audit Commission were still considering their approach to the VFM conclusion from 2010/11. In December 2010 the Audit Commission published auditor guidance on the VFM conclusion on their website.

7.4 From 2010/11, local authority auditors will give their statutory VFM conclusion based on the following two reporting criteria, as specified by the Audit Commission:

Specified criteria for the auditor's VFM conclusion:

- The organisation has proper arrangements in place for securing financial resilience.
- The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

Focus of the criteria for 2010/11:

- The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
- The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

7.5 The VFM conclusion is not intended to be as comprehensive as the previous Use of Resources assessment. Appendix 1 reproduces extracts from the Audit Commission Auditors' guidance for these criteria, along with relevant risks and issues that should be considered. A full "self assessment" of the Council's performance against the new VFM conclusion is to be carried out. The Head of Finance will lead on this work.

7.6 Previously the Use of Resources action plan has been reported to Finance and Audit Scrutiny Committee for them to oversee. Most of the actions within the action plan had been completed and should be embedded within the Council. With the new VFM conclusion guidance, it is proposed to produce a VFM conclusion actionplan following on from the VFM self assessment.

7.7 The Audit Commission have also issued a publication “Strategic Financial Management in Councils – Delivering services with reduced income”. This publication is referred to within the VFM Guidance. This includes a Good Practice checklist, and a Self-assessment questionnaire. These will also be considered as part of the VFM self assessment.

Auditors' Value for Money Guidance

(Extract from Audit Commission website relating to local authorities)

4.1 Approach and specified criteria

From 2010/11, local authority auditors will give their statutory VFM conclusion based on the following two reporting criteria, as specified by the Audit Commission:

Specified criteria for the auditor's VFM conclusion:

- The organisation has proper arrangements in place for securing financial resilience.
- The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

Focus of the criteria for 2010/11:

- The organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
- The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

4.2 Key Sector Issues

4.2.1 Councils

This section covers the following issues relating to changes the coalition government is making:

- outcomes and impact of the 2010 Spending Review (SR) for local government, with a focus on central government funding of local government. The Commission will update this guidance to reflect changes as they emerge;
- the scale of the challenge for councils to maintain services and effectiveness with reduced funding;

- impact of the new public services transparency framework (which will replace previous national performance frameworks) and the reduction in inspection and accountability to government; and
- sector self-regulation and improvement.

Spending Review

On 20 October the coalition government published the Spending Review 2010, setting out government department budgets for the period 2011/12 to 2014/15. The Spending Review included plans to reduce funding over the period as follows:

- overall public sector spending by £81 billion by 2014/15;
- central government revenue grants to local government (excluding schools) by 28 per cent (more than 7 per cent a year in real terms, with the majority impacting in the first two years);
- capital funding from central to local government by 45 per cent;
- police revenue funding by 20 per cent in real terms; and
- central government revenue funding to fire and rescue authorities by 25 per cent, although this reduction is back loaded to 2013/14 and 2014/15.

The impact of the Spending Review on individual local authorities will be known when the provisional local government finance settlement is published in December 2010. At this time each council will find out how much formula grant (Revenue Support Grant, redistributed National Non-Domestic Rates and police grant) they are likely to receive for 2011/12.

Other government announcements included:

- an intention to end ring-fencing of all revenue grants to local government from 2011/12, except for simplified school grants and a new public health grant from 2013;
- £4 billion of separate grants to be rolled into formula grant to reduce the number of core revenue grants to less than 10;
- school funding to be increased by £3.6 billion in cash terms, equivalent to a 0.1 per cent real terms increase each year;
- Department for Education capital spending to fall by 60 per cent over the period;
- NHS funding to increase by 0.4 per cent in real terms over the period (includes an increase of 1.3 per cent in revenue budgets and a 17 per cent decrease in capital spending).The NHS is expected to make savings of up to £20 billion a year by the end of the period to be reinvested in the delivery of NHS services;
- the Ministry of Justice revenue budget to reduce by 23 per cent and its capital spending by 50 per cent over the period, but the impact on probation trusts is not yet known; and

- funding will be available to fund a council tax freeze in 2011/12.

As a consequence of the Spending Review:

- The Secretary of State for Communities and Local Government, Eric Pickles, wrote to all local authority leaders in England; and
- Director General, Social Care, Local Government and Care Partnerships, David Behan, wrote to directors of adult social service

Maintaining services and effectiveness with reduced funding

In the June 2010 budget, the coalition government announced that expenditure was set to fall in real terms by 4 per cent over the period to 2015/16. As the government has announced its intention to protect spending on health and overseas aid, other government departments could see average cuts to their budgets of 25 per cent over four years.

The coalition government reduced in-year funding for local government in 2010/11 by £1.166 billion (£805 million in cuts to revenue and £360.9 million to capital specific grants). The government also removed the ring-fence on £1.1 billion of specific grants (£158.8 of revenue and £948.1 million of capital). These measures will have had a significant impact on councils' ability to deliver their original 2010/11 budgets. These issues are relevant to auditors' work on the specified criteria for securing financial resilience and challenging arrangements for securing economy, efficiency and effectiveness.

The expected scale of the budget reductions for the SR period will have a significant impact on councils. For individual councils the impact will depend on the:

- council's grant funding and the timing of reductions required;
- extent to which the council relies on grant as opposed to other sources of income such as council tax and fees and charges. Typically, 70 per cent of a single-or upper-tier council's income comes from government grant, compared to 40 per cent of a district council's (based on 2008/09 figures). A comparative analysis of this will be included in the updated local government VFM profile tool; and
- councils' readiness and capacity to manage change and achieve savings.

Balancing their budgets will be challenging for councils but it seems unlikely they will be able to maintain services in their current form. Preparedness for the cuts in grant over recent months will prove critical. The Commission's national report: *Surviving the Crunch*, published 2010, found that achieving significant and sustainable savings while minimising the impact on services, tends to require major transformational change; such changes generally require a lead time. The current degree of uncertainty means councils should be preparing for a range of outcomes. Councils that are least prepared, or lack sufficient capacity to respond to the scale of change, are more likely to resort to straightforward budget cuts and increasing fees and charges.

The Commission plans to publish a further report on council finances in late 2010. This will focus on how councils are preparing for managing with less and will include examples from councils that have made or are planning transformational change to deliver significant and sustainable savings.

The robustness of estimates used in council budgets for planned savings, and their delivery within the planned timescales without slippage, will be critical to prevent unexpected budgetary pressures or deficits from occurring. Councils that do not have a good track record for managing change will be more at risk. The council's S151 officer (the officer with specific responsibility for financial matters under the provisions of the Local Government Act 1972) is required to report if there are concerns about the robustness of the estimates made for the calculations and adequacy of the proposed financial reserves.

The Local Government Group (LG Group) consists of the Local Government Association, Local Government - Improvement and Development, Employers' Organisation and others. The LG Group is leading work to enable the local government sector to put in place arrangements for councils to work together to deal with the scale of the challenge following the SR. It has set up a Place-based Productivity Programme, working with government. Work strands have been set up to signpost how best councils and their partners develop a better understanding of what drives cost and to implement new ways of managing challenging budgets. The work strands cover the following areas:

- democratic leadership (supporting and developing needs of elected members);
- tackling central government barriers and burdens that impede councils and local productivity;
- procurement, capital and shared assets;
- shared services;
- data and transparency including developing unit cost metrics and a national approach to sector benchmarking;
- shaping markets and new models for service delivery;
- workforce and skills - taking a wide-ranging view of opportunities for, and barriers to, improving workforce productivity;
- children's services; and
- adult social care.

The results of the reviews will be published over the next two years and will be a useful resource for auditors' local VFM work. The aim of the data and transparency workstream is to identify unit cost metrics for major areas of activity to provide measures of relative efficiency. The programme includes plans to develop a national approach to sector-owned benchmarking.

New public services transparency framework

Plans for the future framework are still emerging, however the principles underpinning it are clear. These are to turn accountability 'on its head' by making councils more accountable to local people rather than to central government. Councils will be required to be more open and transparent in their operations and performance so local people have the information they need to hold them to account. Parts of the new framework are expected to be published soon after the SR.

In terms of specific initiatives, more will be clear when the government publishes the Decentralisation and Localism Bill in November. *The Coalition: Our Programme for Government* set out plans aimed at increasing localism and reducing council bureaucracy. Proposals included:

- introducing a general power of competence;
- councillors to vote on the salary packages for senior staff;
- an option to return to a committee system; and
- referenda to elect mayors in the 12 largest cities.

The government is also consulting on requiring councils to hold referenda if they wish to make 'excessive' council tax increases instead of centrally imposed 'capping'.

The Secretary of State for Communities and Local Government has written to councils setting out proposals for a move to 'open government'. By September 2010 councils were expected to make details of spending on all goods and services above £500 available for the public to see and scrutinise online. All councils should be doing this as a matter of course by the start of next year, as well as publishing invitations to tender and final contracts for projects over £500. The letter also set out a route map to making further information available online including:

- local government salaries;
- councillor allowances and expenses;
- council minutes and papers;
- job vacancies;
- frontline service data;
- licensing applications and decisions;
- planning applications and decisions; and
- food hygiene reports for food outlets.

The LG Group has published guides to publishing spending and salaries.

This new openness may result in auditors being asked more questions by residents if they feel their concerns are not being dealt with satisfactorily by the council, or they believe spending may be unlawful.

This shift in policy away from accountability to central government may radically change the relationship between local and central government. Much of the current accountability framework is being dismantled, including local area agreements and the national indicator set. However, there will be an agreed single list of Whitehall data requirements for local government. CAA has been abolished and local government inspections are being cut. Ofsted and CQC are proposing significantly reduced programmes of inspections, targeting the most vulnerable. The Audit Commission's own programme of inspections is planned to end by 31 March 2011.

Government Offices, which have had a strong role in monitoring council performance and agreed local area priorities with partnerships, are likely to be abolished. The Government Office for London has already been abolished. The coalition government has abolished local area agreements. Public Service Agreements, which incorporated the government's targets for departments, and the national indicator set, will not continue. .

The eight Regional Development Agencies (RDAs) outside London, tasked with regional economic growth, will close by March 2012. The government is expected to approve up to 50 Local Enterprise Partnerships (LEPs) from October 2010 to replace them.

As a result of these changes, there will be fewer sources of independent analysis and information to help auditors identify and evaluate risks. The local government sector is planning to fill gaps left by the dismantling of the current performance framework.

Sector self-regulation and improvement

The LG Group is consulting with councils on a proposed 'sector-owned approach' to self-regulation and improvement. The consultation highlights the importance of shared and collaborative working by councils and their partners and sets out its role to support councils, for example by:

- developing the necessary tools, such as self-evaluation, peer challenge, and benchmarking to drive improvement;
- working with councils to develop ways of managing the risk of underperformance - identifying issues before they go wrong; and
- ensuring tools are available, including those developed by the market, to help localities with change programmes such as developing place-based budgets, improving productivity and promoting civil society.

These plans are still under consultation and we will update this guidance as they develop, assisting auditors to access the information and make best use of it. The extent of funding for improvement support is also likely to decrease. Government funding for Regional Improvement and Efficiency Partnerships will cease at the end of 2010/11 and 'top sliced' funding for local government improvement (which currently covers nine bodies) is under review. The updated guidance will also cover the outcome of this review

4.3 Guidance on the specified criteria

This section provides guidance on the application of the criteria specified by the Commission for the auditor's VFM conclusion. The guidance includes examples of the characteristics of proper arrangements authorities might have in place to secure financial resilience and challenge their arrangements for securing economy, efficiency and effectiveness.

The guidance and examples are not exhaustive or prescriptive, and should not be used as a checklist. Auditors will need to use their professional judgement to consider whether, and, if so how, the examples are appropriate to the local circumstances of the audited body, and to consider other relevant local issues.

The examples are grouped under topic areas for ease of reference. Auditors will however need to take a rounded view when considering their judgement against the specified criteria - auditors should not consider the topic areas in isolation.

4.3.1 Financial resilience

The organisation has proper arrangements for securing financial resilience

What do we mean by financial resilience?

The organisation has robust systems and processes to manage its financial risks and opportunities effectively, and to secure a stable financial position. The organisation's financial position should enable it to continue to operate for the foreseeable future.

The definition of 'foreseeable future' for the purposes of the financial resilience criterion is 12 months from the date of the auditor's report on the relevant set of financial statements. This is broadly consistent with the definition used in ISA (UK and Ireland) 570 (going concern). For police authorities due to demise in May 2012, the same period should be applied as the functions will continue to be provided by a direct successor body.

Why is this important?

The significant financial management challenge for councils, FRAs and police authorities over the coming years will be:

- managing the implications of the current economic climate;
- the significant reductions in the level of future central government funding; and
- possible freezing of council tax levels for 2011/12.

Increases in the demand for services linked to significant demographic changes, such as the ageing population and rising birth rate, are also contributing to financial pressures for public sector bodies. To meet this significant challenge, authorities must improve their efficiency and productivity, reduce their costs, and have sustainable financial plans to ensure they are financially resilient.

Characteristics of proper arrangements for securing financial resilience

Financial governance

The quality of financial governance and leadership within an organisation is critical in meeting the financial management challenges and for securing financial resilience. Good basic systems, processes and controls are important, but it is the overall financial culture that makes the difference.

The term 'leadership team' is used in this guidance. The definition is taken from the *CIPFA Statement on the role of the Chief Financial Officer in Local Government* (the CIPFA Statement) and refers to the board (the group of people charged with setting the strategic direction for the organisation and responsible for its achievement) and the management team (the group of executive staff comprising the senior management charged with the execution of strategy).

Typical characteristics of proper arrangements

The leadership team clearly understands the significant and rapidly changing financial management challenges and risks facing the organisation and is taking appropriate action to secure a stable financial position.

The chief financial officer is a key member of the leadership team (in accordance with the CIPFA Statement), being actively involved in all business decisions, and leading the promotion and delivery of good financial management. If the organisation's arrangements do not comply with the CIPFA Statement, this is disclosed in the Annual Governance Statement with an explanation of how the arrangements deliver the same impact.

The leadership team fosters an environment where there is good understanding and routine challenge of financial assumptions and performance, and a culture of transparency about the financial position. The leadership team considers the level of financial skill required for different tiers of management and ensures financial literacy and skills are developed throughout the organisation.

The leadership team provides constructive scrutiny and challenge on financial matters to ensure arrangements remain robust and fit-for-purpose. Members scrutinise and challenge financial performance effectively, holding officers to account.

The organisation has an objective, knowledgeable and effective audit committee. It provides effective challenge across the organisation and assurance on the arrangements for risk management, maintaining effective internal control, and reporting on financial and other performance.

Financial planning

An annual budget is not enough to secure financial resilience. Organisations should set the budget in the context of a longer-term financial strategy and a medium-term financial plan (MTFP) covering for example, a three-to five-year horizon. The MTFP needs to be realistic. Assumptions around inflation, income levels, demographics and future demand for services need to be modelled and based on reasonable predictions.

The financial position of an organisation will depend on a number of factors including the level of borrowing, receivables outstanding, investment risks, council tax collection rates and levels of reserves.

Typical characteristics of proper arrangements

Medium-term financial planning and annual budgeting reflects the organisation's strategic objectives and priorities for the year, and over the longer term. The organisation has reviewed and updated its longer-term strategy and MTFP in light of the current economic climate. This review includes for example, the impact of changes in priorities, inflation, funding, reductions in other revenue and capital income (for example planning fees, car parking and investment income) and changing demand for some services.

The organisation understands its sources of income and the risks arising from these, and has reviewed its approach to fees and charges to ensure it achieves value for money.

Financial and corporate planning processes are integrated, link to risk management arrangements, and incorporate strategic planning for other resources including the capital programme and workforce planning. The organisation's treasury management arrangements ensure it has sufficient cash to meet its needs - achieving a balance between security, liquidity and yield.

Financial modelling is used to help the organisation to assess likely impacts on financial plans and required savings for different scenarios, and help ensure short-term fixes are not achieved at the expense of long-term sustainability. The organisation models key expenditure drivers (for example population changes and demand for services), sources of income (for example income and government grant forecasts), revenue consequences of capital and resource requirements and balances. The organisation uses different planning assumptions (for example sensitivity analysis and scenario planning using realistic best, worse and most likely cases) and considers the impact on financial plans.

The organisation operates within a level of reserves and balances (including earmarked reserves and the general fund balance), approved by members, and appropriate to the strategic, operational and financial risks it faces. If the organisation is not at its target level for balances, there is planned action in place to achieve this, taking account of any associated risks to the council's financial position and delivery of its priorities.

Financial control

Authorities need to manage within their budget. Authorities therefore need to challenge their budget monitoring and reporting arrangements to ensure they are fit-for-purpose, and that they can respond to the even greater need to demonstrate value for money and achieve efficiencies.

Typical characteristics of proper arrangements

Financial monitoring and forecasting is fit-for-purpose and accruals based, helping to ensure a clear link between the budget, in-year forecasts and actual year-end position. The organisation analyses and extrapolates relevant trends and considers their impact on the projected final outturn. Forecasts are subject to risk and sensitivity analysis and management takes timely action to address any budget pressures, for example by taking corrective action to manage unfavourable variances or by revisiting corporate priorities.

The organisation has a good recent record of operating within its budget with no significant overspends.

The organisation's cashflow management arrangements ensure it has access to the required amount of cash at the right time, while achieving value for money. These include actively managing investments and cashflows, banking arrangements, money market and capital market transactions, and the effective management of risks associated with these activities.

The organisation sets and monitors challenging targets for the collection of material categories of income and arrears based on age profile of debt. Where targets are not being met, the organisation takes appropriate corrective action during the year to achieve the targets.

The organisation monitors its key financial ratios, benchmarks them against similar bodies and takes action as appropriate.

Reference material and further information

Strategic Financial Management in Councils: Delivering services with a reduced income, Audit Commission, 2010.

Collection rates for council tax and non-domestic rates in England for 2007/08 and 2008/09, CLG.

World Class Financial Management, Audit Commission, 2005.

After the Downturn: Managing Significant and Sustained Adjustment in Public Sector Funding, CIPFA/SOLACE, December 2009.

Under Pressure: Tackling the Financial Challenge for Councils of an Ageing Population, Audit Commission, February 2010.

Risk and Return: English Local Authorities and the Icelandic Banks, Audit Commission, 2009.

LAAP 77 Bulletin - Guidance on Local Authority Reserves and Balances, CIPFA, November 2008.

Surviving the Crunch: Local Finances in the Recession and Beyond, Audit Commission, March 2010.

Improving Budgeting: Modernising the Cycle, CIPFA, 2008 [this document is available to auditors on ACORN under the following path: Information for audits>CIPFA publication].

Application Note to Delivering Good Governance in Local Government: a Framework, CIPFA, 2010.

Statement on the Role of the Chief Financial Officer in Local Government, CIPFA, 2010.

Treasury Management in the Public Services: Guidance Notes for Local Authorities including Police Authorities and Fire Authorities, Fully Revised Third Edition, CIPFA, 2009 [This document is available to auditors on ACORN under the following path: Information for audits>CIPFA publication].

Treasury Management in Public Services: Code of Practice, Second Edition, CIPFA, 2009 [This document is available to auditors on ACORN under the following path: Information for audits>CIPFA publication].

The Prudential Code for Capital Finance in Local Authorities, Fully Revised Second Edition, CIPFA, 2009 [This document is available to auditors on ACORN under the following path: Information for audits>CIPFA publication].

Leading in Hard Times: Guidance for Everyone Involved in the Leadership of Public Services, CIPFA, 2010.

4.3.2 Securing economy, efficiency and effectiveness

The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness

What do we mean by securing economy, efficiency and effectiveness?

The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Why is this important?

Significant reductions in the level of central government funding mean that services may no longer be affordable, or may have to be delivered in different ways. The coalition government has stated that reducing the budget deficit is its most urgent priority. The *Spending Review framework 2010* also sets out clearly the expectation that resources will be prioritised within tighter budgets against tough criteria, to achieve more targeted services at lower cost.

All public bodies will now have to make difficult decisions about priorities, and find more efficient and innovative ways of delivering their responsibilities. Organisations which have proper arrangements for challenging how they secure economy, efficiency and effectiveness are more likely to be financially resilient and fit for the future.

Characteristics of proper arrangements for securing economy, efficiency and effectiveness

Prioritising resources

To make sustainable cost reductions, organisations will need to take a strategic approach to challenging all areas of spend, considering how spending matches the priorities of the organisation and the needs of the people it serves.

Typical characteristics of proper arrangements

The organisation has in place strong leadership and the capacity to deliver the scale of the spending reductions required of it. It is reviewing its strategic priorities and the cost-effectiveness of it activities. It is adopting a strategic approach to identifying cost reductions and challenging spending and investment decisions. It is taking a rational view of its priorities and of the short- medium- and longer-term opportunities for savings.

Where appropriate, there is input from or consultation with front-line staff and local residents to identify local priorities for spending. There is a willingness to challenge the existing approach to managing the organisation and delivering its services, including consideration of whether services are best delivered in-house, outsourced or through shared service arrangements.

The organisation bases decisions on cost reductions and prioritising resources on robust information on needs and on the costs it incurs in delivering its services and activities, including back-office functions, and the drivers that influence or change these costs. There is effective use of options appraisal and scenario analysis or similar techniques to evaluate proposals for, and the impact of, spending reductions, setting out risks, external factors and whole-life costs or benefits. The organisation is able to justify any areas of spending which are higher than at comparable bodies.

There is a clear understanding of the resources at the disposal of relevant partnerships, and the organisation considers the impact of proposed cost reductions in one area on other internal services and departments, and on external bodies. The organisation is actively managing the potential impact of resource changes and reductions on its ability to continue to operate effectively, for example where there are losses of key staff.

The organisation has a good record of identifying and challenging areas of high spending, and of effective action to deliver cost reductions. There are proven arrangements in place to monitor the implementation and impact of action to reduce spending.

Improving efficiency and productivity

To manage the impact of reducing government funding on local public services, organisations will need to make the best possible use of the resources available to them. They will need to increase productivity, achieving better output from more limited resources, to enable them to continue to satisfy local needs. This will involve challenging all aspects of their business and taking action to make sustainable efficiencies, which may involve changing the way they manage themselves.

Typical characteristics of proper arrangements

The organisation has access to good quality and timely comparative information on costs and performance, which is being used to evaluate options and plans for efficiency savings. The organisation has a record of producing and using robust information and data on unit, transaction and whole-life costs.

Costs and productivity of key services are consistent with or better than other organisations providing similar levels and standards of services, allowing for relevant local factors and priorities. The organisation makes use of comparative and benchmarking information to increase self-awareness and improve efficiency and productivity. It is working with partners, other service providers and external sources of support to improve its processes, costs and outcomes. There is evidence of improved productivity in recent years, for example through a gradual reduction in unit costs and increased service levels.

Alternative and innovative approaches to delivering services are being considered to achieve efficiencies while keeping services at a level that will satisfy local people. The organisation is considering the potential to manage the demand for services, and is seeking and evaluating new ways of delivering services and of improving efficiency, for example:

- use of business process re-engineering techniques, to improve processes and structures;
- use of shared services in back office operations;
- increased use of collaborative procurement;
- rationalisation of asset use; or

- working in partnership with bodies in other sectors, including the voluntary sector.

The organisation has a robust approach to evaluating options for making efficiencies, including considering the short-, medium- and long-term impact, and is ensuring input from front-line staff. There are strong monitoring arrangements to ensure planned efficiencies are achieved, and to understand the impact on services and on performance.

The organisation is setting itself challenging targets, and is working with others to achieve its priorities. Achievement of priorities is monitored and the risk and impact on the organisation's financial position of non-achievement is actively managed.

Reference material and further information

Strategic Financial Management in Councils: Delivering services with a reduced income, Audit Commission, 2010.

World Class Financial Management, Audit Commission, 2005.

After the Downturn: Managing Significant and Sustained Adjustment in Public Sector Funding, CIPFA/SOLACE, December 2009.

Leading in Hard Times: Guidance for Everyone Involved in the Leadership of Public Services, CIPFA, 2010.

Surviving the Crunch: Local Finances in the Recession and Beyond, Audit Commission, March 2010.

A short guide to structured cost reduction, National Audit Office, 2010

4.4 Risks relating to the specified criteria

The specified criteria for the VFM conclusion for councils, police and FRAs cover the audited body's arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

When planning work to support the VFM conclusion, auditors need to consider relevant risks relating to these criteria. The following tables set out risk indicators relating to the specified criteria. Auditors may wish to consider these indicators as part of their risk assessment.

The highlighted risks given are not exclusive or exhaustive, and their relevance and impact will depend on the local circumstances of individual audited bodies. **Auditors do not need to undertake specific work to address each of the risk indicators.** Auditors may be aware of other risks relevant to the criteria not included here that should also be considered as part of the risk assessment. The risk indicators provided below may help auditors to consider the extent and focus of their local VFM work.

Securing financial resilience: risk indicators

Financial governance
Director of Finance/Section 151 officer is not on the leadership team.
Lack of capacity in the finance department or high turnover ofsenior or specialist finance staff.
Lack of understanding by the leadership team of the current financial position and potential future implications.
A focus by the leadership team on thinking and operating in the short term.
Poor communication by the leadership team to staff and external stakeholders of the medium- to long-term financial strategy, current financial position and likely financial challenges.
Failure by the audit committee to provide robust challenge on financial matters within its remit.
2009/10 qualified VFM conclusion relating to the financial governance and leadership aspects of the VFM conclusion criterion on financial planning and financial health or the system of internal control aspects of the criterion on risk management and internal control.
Financial planning
Pending legal or regulatory proceedings against the body that may, if successful, result in claims that the body is unlikely to be able to satisfy without a significant impact on its financial stability.
Reliance on short-term fixes (for example asset sales) to improve the cash position.
Regular use of reserves and investment income to balance budgets or use of reserves to fund recurrent expenditure.
Low level of general reserves or significant fall in levels of reserves (general and earmarked) over the last two years.
Significant deterioration in the value of assets, the impact of which has not been recognised or is not being addressed in the MTFP.
Failure of the leadership team to understand fully the financial implications of risks.
Weaknesses in medium-to long-term financial planning, for example: • absence of an up-to-date sustainable 3-5 year medium-term financial plan (MTFP); • absence of realistic scenario planning; or • absence of a long-term (10 years or more) financial strategy taking into account the financial impact of demographic trends or other economic, environmental or social pressures.

2009/10 qualified VFM conclusion relating to VFM conclusion criterion on financial planning and financial health.
High dependence on one income source, poor understanding of income sources and their sensitivity to economic changes, or absence of a recent review of charging policies.
Financial risks are managed in the short term only with limited consideration of longer term implications.
Financial control
Poor in-year forecasting resulting in, for example, significant unexpected budget overspends or underspends in the last two years.
Non-compliance with capital or other statutory requirements, for example the Prudential Code, CIPFA Treasury Management Code.
2009/10 qualified VFM conclusion relating to the managing spending aspects of the VFM conclusion criterion on financial planning and financial health or the financial monitoring and forecasting aspects of the criterion on financial monitoring and reporting.
Significant prior year budget overspend.
Limited or no monitoring of key financial ratios.
Adverse key financial ratios.
Cashflow difficulties resulting in inability to pay creditors on due dates and/or inability to comply with loan agreement terms.

Securing economy, efficiency and effectiveness – risk indicators

Prioritising resources
Lack of leadership from senior management and members on prioritising resources and spending reductions.
Limited action to review and challenge strategic priorities and cost-effectiveness of existing activities in the context of the medium-term financial plan (MTFP), and the impact of changing circumstances, to identify where activities do not contribute sufficient value.
Lack of input from or consultation with front-line staff and local residents, where appropriate, to determine local priorities for resources or opportunities for savings.
Decision-making not based on appropriate or adequate information.
Inadequate cost-benefit analysis, options appraisal or cost information to evaluate or support cost reduction plans.
Lack of, or limited, consideration of alternative, lower cost options for delivery.
Focus is on high cost activities to the exclusion of other activities, or on short-term rather

than longer term options for reductions.
Inability to identify or justify high levels of spending compared to other comparable bodies.
Lack of understanding of resources at the disposal of relevant partnerships.
Cost reductions create unintended impacts on activities and increased spending or capacity gaps in other departments or other bodies.
Poor record of reducing spend on non-priority areas, or inadequate arrangements to monitor implementation of spending reductions.
Improving efficiency and productivity
Lack of, or limited, information on unit costs, transaction costs or whole life costs or poor understanding of what has driven changes in costs over time.
High unit costs compared to other comparable bodies or inability to justify higher unit costs.
Inward-looking and not open to using comparative data and sources of good practice (including relevant Audit Commission studies) to challenge arrangements for securing VFM.
Poor understanding of how costs (including unit and transaction costs) and performance compare to that of other similar bodies (for example limited use of the Audit Commission's VFM profile tool or other benchmarking information), or inability to justify higher costs.
Lack of robust efficiency plans, including timescales, setting challenging efficiency targets and how they will be delivered.
Inadequate evaluation of options for making efficiencies and focus on achieving short-term efficiencies rather than on long-term sustainable savings.
Lack of input from front-line staff to the efficiency savings programme.
Not challenging the way activities are delivered or exploring innovative and new ways of delivering activities, for example through outsourcing or shared service arrangements, or in partnership with other bodies or by using the voluntary sector or local community groups.
Inadequate arrangements to monitor achievement of efficiencies and reductions in unit costs, and the impact on service quality and provision. Lack of understanding of how savings impact on performance.
Poor record of achieving planned efficiencies or reductions in unit costs.
2009/10 qualified VFM conclusion relating to the VFM conclusion criterion on understanding costs and achieving efficiencies.