

**REPORT TO: POLICY AND RESOURCES COMMITTEE - 9 MAY 2011**  
**REPORT ON: AN OVERVIEW OF LOCAL GOVERNMENT IN SCOTLAND 2010**  
**REPORT BY: DIRECTOR OF FINANCE**  
**REPORT NO: 241-2011**

## **1 PURPOSE OF REPORT**

To provide elected members with a summary of the above national study that has been undertaken by Audit Scotland on behalf of the Accounts Commission.

## **2 RECOMMENDATIONS**

It is recommended that elected members note the key findings arising from this national study, including Appendix 1 which identifies action points for Councils and questions for elected members to consider and assess how key issues are being dealt with and, in particular, to identify where further action may be required.

## **3 FINANCIAL IMPLICATIONS**

There are no direct financial implications arising from this report.

## **4 MAIN TEXT**

4.1 Each year the Accounts Commission asks the Controller of Audit (Audit Scotland) to produce an overview report on issues arising from annual local authority audits. The attached report 'An Overview of Local Government in Scotland 2010' provides an overview of how Councils have performed during 2009/10, how services are planned and delivered along with how resources have been used. The key messages of the report are that public finances are under significant pressure and councillors face difficult choices and decisions in prioritising the level and quality of services to be provided by Councils. The report concludes that fundamental changes to service delivery are required across Councils, in order to achieve the level of financial savings required whilst maintaining the quality of services provided.

4.2 The report is divided into the following main areas:

### Summary

This section includes an introduction and provides a summary of the key issues facing Councils based upon local government audit work carried out and other performance information that was published during the last year.

### Managing Resources

This section provides an analysis of Councils' aggregate finances for financial year 2009/10 including revenue and capital expenditure, pensions and reserves and balances. In addition, details of performance in key areas such as financial management and reporting, national fraud initiative, workforce requirements, asset management and procurement are also included within this part of the report.

### Challenges for 2011 and beyond

This section summarises the challenges, and outlines the key demand and resource pressures being faced by Councils. In addition, details of performance information including movements in statutory performance measures for key service areas, public performance reporting and a summary of findings from recent Best Value 2 pathfinder audits are provided. The importance of governance arrangements including the role of scrutiny committee, councillors and chief officers is also emphasised.

4.3 In addition, the report also includes a number of appendices that provide supplementary information. These include a list of key questions for elected members (Appendix 1) to help them to consider and assess how key issues are being dealt. It should be noted that Dundee City Council is already making progress in a number of these areas although this information is helpful to identify areas where further action may be required.

#### 4.4 Conclusion

Whilst the scale of the challenges that are highlighted within the overview report are significant, Councils should take encouragement from the following findings that should assist them in addressing these significant challenges:

- a continued relatively stable financial position for 2009/10
- with exception of one authority, all Councils achieved clean audit certificates on their 2009/010 financial statements
- significant developments within Councils such as corporate improvement programmes to review service provision
- improvements in financial planning and overall resource management
- strategic workforce planning and asset management improvements
- continued commitment from Councils in responding to Best Value and providing good quality outcomes for local citizens

4.5 It should be noted that the Council's appointed local external auditor (Audit Scotland) submitted their detailed report on the findings of their audit of Dundee City Council for 2009/10 to the Policy & Resources Committee on 13 December 2010 (please refer to 699-2010). The matters raised in this report have already been considered by the Council and an action plan has been agreed incorporating any "planned management action". The progress on implementing the agreed action points is ongoing and will be monitored through the Council's established procedures for dealing with external audit reports and reviewing previously agreed action plans.

## 5 **POLICY IMPLICATIONS**

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

## 6 **CONSULTATIONS**

The Chief Executive and Depute Chief Executive (Support Services) have been consulted on the content of this report.

## 7 **BACKGROUND PAPERS**

None.

# **An overview of local government in Scotland 2010**

**Prepared for the Accounts Commission**

January 2011

# The Accounts Commission

The Accounts Commission is a statutory, independent body which, through the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has four main responsibilities:

- securing the external audit, including the audit of Best Value and Community Planning
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- carrying out national performance studies to improve economy, efficiency and effectiveness in local government
- issuing an annual direction to local authorities which sets out the range of performance information they are required to publish.

The Commission secures the audit of 32 councils and 45 joint boards and committees (including police and fire and rescue services).

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

# Commission findings

## **The Accounts Commission welcomes evidence of improvement, and urges councils to build on this to meet the very significant challenges they face.**

Each year the Accounts Commission asks the Controller of Audit to produce an overview report on issues arising from local authority audits. The Commission has considered the report for 2010. We welcome the report, noting in particular its aim to provide both a review of recent audit work and an overview of the challenges facing local government in 2011 and beyond.

The Commission notes the relatively stable financial position achieved by councils in 2009/10 and welcomes the commitment shown by them to improving financial planning and overall resource management. Almost all councils have achieved clean audit certificates on their financial statements.

The Commission also acknowledges and welcomes:

- the continuing commitment of councils in responding to Best Value and providing good quality outcomes for local citizens
- evidence of significant developments by councils – such as corporate improvement programmes to review existing and alternative ways of providing services
- improved strategic workforce planning by councils
- improvements in asset management.

The Commission recognises the very significant challenges faced by councils in the coming years – both from reducing budgets and growing demand for services. We note the substantial work that councils have done to begin to address this very challenging financial outlook.

We acknowledge that councils and councillors are now faced with extremely difficult decisions in allocating funds and prioritising services. These decisions must be taken on the basis of full information on costs and risks. Councils urgently need to ensure that they have comprehensive and comparative baseline data on service costs and quality, and integrate this information into their approaches to performance management and options appraisal. There is also scope for significant further improvement in standardising and simplifying common processes and benchmarking costs.

The various service redesign initiatives under way require coordination if all developments are to achieve their maximum potential effect. We encourage councils to continue to work with partners including the Scottish Government to coordinate initiatives, remove barriers and support delivery of shared projects.

It is essential that focus remains on strategic workforce planning to manage the effect that staffing reductions in the short term will have on skills and councils' capacity to meet their service commitments effectively. Councils also still need to achieve better value for money from procurement and asset management.

The role that elected members play in scrutinising the use of resources and ensuring robust appraisal of options continues to be key to securing decisions that represent value for money. Given the financial position, councillors must continue to work to ensure that they retain the support of the public through their leadership and community engagement roles.

The Commission again has to emphasise a number of the findings that it has made in previous years.

We have highlighted the importance of robust performance management systems, sound governance and accountability and good quality information to support decision-making.

We have encouraged councils to make progress on these issues in recent years in order to secure Best Value. More than ever it is now absolutely essential that councils have them in place. Those that do will be best placed to make the difficult short-term decisions with a clear understanding of the effect these will have on their service users and citizens, while maintaining focus on the medium and longer term.

We encourage the local government community in its endeavours and look forward to continuing to work with it to address the issues in these findings.

# Summary

## **Public finances are under significant pressure, and councils face increasingly difficult choices and decisions.**

### **Introduction**

1. Scotland's 32 councils have a key role in communities and provide vital public services including education, social work, housing, roads, refuse collection and leisure services. They are also responsible for regulatory and licensing activities such as planning and environmental health. In addition, 45 related local authority organisations provide a range of local public services, including police services, fire and rescue services, and regional transport strategies.
2. These public services, delivered directly or in partnership with others, involve substantial resources. Councils spend around £20 billion each year, employ around 250,000 full-time equivalent staff and use assets worth about £32 billion.
3. This report provides an overview of the main issues arising from our audit work in local government in 2010. It draws on a range of sources to highlight strengths and areas for improvement, and examines the challenges and risks in 2011 and beyond.

## **Public finances are under greater pressure than at any time since devolution**

4. The financial challenges facing the Scottish public sector are well documented. In June 2010, the new UK government published an emergency budget, planning for a period of significant fiscal consolidation starting with an immediate UK budget reduction of £6 billion. The Scottish Government agreed that it would defer its share of this cut, estimated at £332 million, until 2011/12. It will have to implement this alongside reductions in the Scottish budget, announced in the UK Comprehensive Spending Review in October 2010, which resulted in a real terms fall of £3 billion over the four-year period from 2011 to 2015. The combined overall reduction is £3.3 billion (11.3 per cent), with the most significant impact in financial year 2011/12. The impact on capital spending is particularly marked, involving a 36.5 per cent reduction over the four years.
5. The Scottish Government's Cabinet Secretary for Finance and Sustainable Growth announced the draft Scottish budget for 2011/12 on 17 November 2010. After years of increases, the draft Departmental Expenditure Limit budget is £1.2 billion less than the previous year, a reduction of 4.2 per cent. The proposed settlement for 2011/12 for local government is £11.6 billion, which represents 34.5 per cent of Scottish Government expenditure, the same relative proportion as in 2010/11. Capital grants are due to decrease by £151 million (18 per cent in cash terms). The final settlement depends on whether authorities agree to meet national priorities including the council tax freeze. If they do, government grant money for services will go down 2.6 per cent in cash terms. If they do not, the reduction will be 6.4 per cent in cash terms.

## **Councillors face difficult choices and decisions**

6. There remains uncertainty about the financial implications for individual councils; the position will not become clear until they determine local budgets in February 2011. However, all councils face significant budget reductions over the medium term, at a time when there are already substantial financial pressures from reducing income and increasing demands on services, particularly demand-led services such as social work.
7. In view of the tightening financial position, it is unlikely that councils will be able to maintain and improve performance across all services. Councillors therefore face difficult choices in prioritising the level and quality of services to provide. Their community leadership role is vital to the success and well-being of their local areas, and their role in scrutinising the use of resources and value for money will be

increasingly important.

**8.** Adapting to this new context will not be easy. Almost half of the councillors elected in May 2007 were new to local government and have not had to deal with financial pressures of this range and scale. The strength of the political coalitions which currently dominate the local government landscape is likely to be tested. This comes at a time when national and local elections are to take place in May 2011 and May 2012 respectively.

**9.** The current financial context presents risks and challenges which require councils and councillors to consider radical changes in services. But it also provides an opportunity to design services that are more closely aligned to the needs of service users and citizens; that are more efficient; and which provide improved value for money and outcomes for the communities they serve.

## **Fundamental changes to service delivery are needed**

**10.** Councils are preparing for the challenges ahead and are setting out savings targets and financial plans which reflect the likely reduction in resources in the next few years. In many cases, councils have set up transformation programmes to review existing and alternative ways of delivering services, for example in partnership with other parts of the public sector, the private sector and the third sector. Fundamental changes to service delivery will be required if councils are to achieve the level of savings needed while maintaining service quality.

**11.** In the short term, councils need to act quickly to reduce expenditure. Staff costs account for over half of council spending and most are looking to cut staff budgets by reducing the number of people they employ. Typically this involves voluntary severance and early retirement schemes. While there is significant variation in local terms, the overarching requirement is that schemes are fully costed and funded, and provide value for money. There is likely to be a loss of experienced staff and there is therefore a risk to service performance, at least in the short term.

## **About our report and next steps**

**12.** This report informs the Accounts Commission of the key messages arising from the 2009/10 audits. It also highlights strengths and areas for improvement. The report is organised in two parts:

- Part 1 reports on how resources were managed by councils in 2010. This provides an indication of the basis from which councils will deal with the challenges ahead.
- Part 2 highlights challenges for councils in 2011 and beyond. This looks ahead and identifies key issues for councils as they prepare for the future.

**13.** Councillors and officers should review this report and identify how their council is dealing with the points raised. Appendix 1 sets out action points for councils and key questions for councillors, and Appendix 2 lists key reports and resources to support councils. Annual audit reports are already available for each local authority; these reports contain action plans setting out steps required locally. In addition, to help councils assess their financial position relative to others, we will publish the underlying financial data used in compiling this report on our website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)

## **Key messages**

### **Managing resources in 2010**

- The audited accounts for 2009/10 show a relatively stable financial position, with the overall level of reserves similar to last year. Capital expenditure continued to increase and financing patterns are changing, with more borrowing and less funding from capital receipts and grants.
- Clean audit certificates were issued on the 2009/10 accounts, except at Shetland Islands where the auditor again qualified the opinion on the accounts because the group accounts did not include



the Shetland Charitable Trust.

- There is evidence of improving resource management, with better planning for finances, workforce and assets, and with better connections across resource areas.
- Councils have some way to go before they can demonstrate Best Value through improved procurement practices.

### **Challenges for 2011 and beyond**

- Councils are faced with reducing finances and increased demands on their services. The scale of the challenge is significant. Councils are taking the financial challenge seriously and are planning to reduce budgets in 2011 and beyond.
- When considering alternative ways of providing services, councils should consider all options, including working with other parts of the public sector, private sector and third sector. There is scope to make better use of partnership working.
- Sharing services offers potential for efficiencies. But progress to date has been slow and is unlikely to yield substantial short-term savings.
- Service users and citizens are central to planning service delivery. Councillors need good information about service users' and citizens' current and future needs to make informed decisions about priorities.
- The financial position requires a clear focus on budgets alongside councils' continuing requirement to achieve Best Value. This includes: considering the impact of service changes on different groups; their wider responsibilities in relation to equalities; and sustainability and the longer term impact of service changes.
- Councils that have made most progress in embedding strong performance management and governance are best placed to deal with the challenges ahead.
- Strong leadership, in which senior officers – particularly the chief executive – and councillors work together for the good of an area, is crucial.
- The councillor role is key; their effectiveness will have a significant bearing on how well councils cope with tough budget decisions and on how well they perform in delivering vital public services to local communities.
- The chief financial officer role is particularly important in the current context and is fundamental to ensuring sound financial management and in establishing and maintaining strong financial controls.

# Part 1. Managing resources in 2010

## **Councils made further progress in managing finances, workforce and assets in 2010.**

### **The accounts showed a relatively stable financial position**

#### **Income and expenditure**

**14.** Exhibit 2 summarises council income and expenditure in the financial year to 31 March 2010. Local authority income from government funding, council tax, service charges, housing rents and other sources amounted to £17.9 billion in 2009/10, an increase of around 2.8 per cent on 2008/09.

Government funding (including housing and council tax benefits) was £13.8 billion, representing 77 per cent of total income (Exhibit 3).

**15.** The non-domestic rates redistributed by the Scottish Government increased by 19 per cent in 2009/10 due to the clearing of balances accumulated in previous years. Income from council tax totalled £2.3 billion (around 13 per cent of total income). The Accounts Commission's Statutory Performance Indicators (SPIs) show that most councils have steadily increased the amount of council tax collected that was due within the year, with collection rates increasing from 94.3 to 94.4 per cent in 2009/10 (although ten councils experienced small reductions).<sup>1</sup>

**16.** Councils spent £18.1 billion providing public services<sup>2</sup> in 2009/10, around 1.4 per cent more than in 2008/09. Spending across the main services was broadly similar to previous years.

**17.** Cost pressures in 2009/10 arose from the severity of the winter, higher social care demands and equal pay settlements. Despite spending pressures, most councils reported small underspends against budget and around £60 million overall was added to general fund reserves. Recruitment freezes and lower capital financing costs were important factors in offsetting spending pressures.

#### **Capital expenditure**

**18.** Capital expenditure has risen substantially over the past ten years. Total capital spending in 2009/10 was £2.2 billion, a small decrease compared with 2008/09. Planned expenditure figures for 2010/11 show the overall trend of increasing expenditure continuing in the current year. The increase in 2008/09 partly reflects initiatives to support economic recovery and affordable housing.

**19.** Key areas of capital spend were housing (including work towards meeting the Scottish Housing Quality Standard and developing affordable housing) and schools estates (including building programmes and refurbishment work). Other areas include community and leisure facilities, social work and care facilities, and roads and infrastructure.

**20.** Slippage in capital programmes is a recurring issue for most councils. The proportion of individual programmes affected is as high as a third. There is a need for councils to have more achievable capital plans and this will become increasingly important if councils are to get the best from the reducing funds available for capital projects. External factors also contributed to slippage with, for example, contractors going into administration and delays in negotiating contracts.

**21.** The economic context and future spending constraints pose significant risks for councils' capital plans, mainly from reducing availability of funding and reducing income from the sale of land and property.

## Financing capital

**22.** Amounts borrowed by councils to finance capital expenditure have grown steadily in recent years; the trend of increased borrowing and reduced capital receipts continued in 2009/10. In 2009/10, just over £1 billion was borrowed to finance capital projects. Budgets for 2010/11 indicate that this trend is likely to continue in the current financial year.

**23.** Overall, net borrowing increased by £765 million (8.9 per cent) in 2009/10, leading to an overall total across councils of £9.4 billion. Within this figure there is wide variation in the amounts borrowed by individual councils, reflecting different approaches to financing capital spending. Most councils use a combination of borrowing, asset sales, grants and current revenue. Public Private Partnerships/Private Finance Initiative (PPP/PFI) has also been used by many councils as a way of making capital assets available for services.

**24.** While each council's position on borrowing must be considered in the context of its overall financial strategy, analysis of long-term borrowing since the introduction of the Prudential Code<sup>3</sup> indicates wide variations in the pattern of long-term borrowing across councils.

**25.** The use of PPP/PFI has increased in recent years with, for example, the capital value of deals involving the provision of new schools totalling £3.6 billion. This year, the accounting arrangements for PPP/PFI projects changed. For the first time, they are shown on balance sheets in a similar way to other capital assets and loans, with interest charged to expenditure. The result is that PPP/PFI assets of £3.1 billion and debts of £2.9 billion across all contracts were recognised on council balance sheets for the first time.

**26.** Decisions on financing capital have long-term implications for council finances. Borrowing requires repayment of principal and interest, and PPP/PFI involves contractual payments over long periods. The common feature is that these commitments represent a fixed element of revenue budgets; as commitments increase, flexibility in revenue budgets reduces. In planning for the future, this may be an important factor affecting councils' ability to prioritise or commit budgets for other purposes.

**27.** Looking ahead, it seems likely that new issues will affect how councils finance capital projects. For example, the UK Comprehensive Spending Review signals an increase in interest rates on Public Works Loan Board (PWLB) loans, which will make the main sources of funding more expensive. Councils are also investigating other forms of financing capital expenditure. For example, the Tax Incremental Financing (TIF) scheme involves councils using forecast additional non-domestic rates from property developments to fund the cost of borrowing. Such schemes have the potential to stimulate development and economic activity, but there are also risks for councils if the additional tax income does not materialise to the extent anticipated.

## Reserves and balances

**28.** Councils hold reserves to ensure stability in cash flow, to build up funds for known and predicted costs, and as a contingency for unforeseen expenditure. Overall, there has been a significant increase in the level of cash-backed council reserves<sup>4</sup> over the past five years (Exhibit 8). While the overall level of council reserves at 31 March 2010 increased from the previous year by £23 million to £1.26 billion<sup>5</sup> (an increase of two per cent), the position at individual councils varies.

**29.** General fund reserves increased by £64 million (around 11 per cent) to £642 million (Appendix 3). Of this, £424 million was earmarked to meet known commitments such as PPP/PFI payments, single status and equal pay claims. This represents 66 per cent of the value of general funds and is broadly the same as previous years, but varies from council to council depending on local priorities and decisions.

**30.** Across councils, general fund reserves have risen from a level that would have supported 1.4 weeks' expenditure five years ago (2.7 per cent of net cost of services) to 2.8 weeks in 2010 (5.3 per cent of net cost of services). This increases flexibility and improves financial resilience.

**31.** The overall level of unallocated or non-earmarked balances was £218 million or 34 per cent of general fund reserves. This has risen over the past five years from one per cent to 1.8 per cent of net cost of services and within individual councils varies from zero to 4.4 per cent.

## **Financial management and reporting**

**32.** Clean audit certificates were issued on the 2009/10 accounts for all councils except Shetland Islands, where the auditor qualified the accounts for the fifth year in succession. The auditor reported that the council had failed to comply with proper accounting practice by not including the financial results of the Shetland Charitable Trust in its group accounts. The council disagree with this view. This issue had also resulted in the qualification of the previous year's accounts, and was – along with other issues highlighted by the auditor – subject of a hearing held in public by the Accounts Commission in June 2010 in Shetland. In its findings, the Commission stated that it saw no reason which would lead it to disagree with the auditor on this matter. The Commission asked the council to resolve the group accounts issue and address a range of serious problems relating to leadership, vision and strategic direction, governance, financial management and accountability.

**33.** While the accounts of Edinburgh City were unqualified, the auditor included an 'emphasis of matter' paragraph in the audit report describing the significant uncertainty – in terms of cost, timing and completeness – around the future of the project to introduce trams to Edinburgh.

**34.** When 'grouped' in accounting terms with related organisations, some councils' group balance sheets show total liabilities exceeding total assets. This is mainly due to increasing liabilities associated with police and fire pensions. However, all group accounts were prepared on a 'going concern' basis because pension liabilities will be funded as they fall due, through a combination of employee and employer contributions, government grants and council tax.<sup>6</sup>

**35.** Eight councils had investments totalling £46.5 million in Icelandic banks when the banks failed in October 2008. Amounts repaid by the end of October 2010 totalled £5.15 million. There has been no recovery to date for investments in two of the five banks involved (ie, Landsbanki and Glitnir banks). Recovery depends on whether councils are designated preferred creditors by the Icelandic courts and legal proceedings continue on this matter.

**36.** Councils are required to produce accounts for activities such as catering services and building maintenance services. These operations are known as significant trading operations (STOs) and are required by law to break even over a rolling three-year period. During 2009/10, 88 per cent of STOs met this requirement, a greater proportion than the previous year, suggesting that councils are improving financial management or dispensing with loss-making STOs in favour of other arrangements (Appendix 3). The total surplus for the year was £49.5 million, which is the highest surplus since STOs came into force. Where the break-even target was not achieved, the main reasons were one-off equal pay or reorganisation costs.

**37.** Reviews by councils have resulted in the amalgamation of trading organisations, the combination of trading activities and client departments, and outsourcing activity to the private sector. As a result, the number of STOs is now around half that in 2004/05. In 2009/10, there were 81 STOs across 29 councils (East Ayrshire, Orkney Islands, and Perth & Kinross have no STOs), eight less than the previous year.

## **Fraud**

**38.** The National Fraud Initiative (NFI) matches data from a wide range of public bodies to help identify fraud and error. The data includes information about benefit applicants, employees, individuals in receipt of council tax 'single person discount', disabled 'blue badge' holders, tenants and public sector pensioners.

**39.** We coordinate this exercise working with the Audit Commission in England which matches the data

on our behalf. At the end of March 2010, local government bodies had identified outcomes<sup>7</sup> from the 2008/09 NFI amounting to £19.7 million.

**40.** Between March and September 2010, councils reported further outcomes amounting to £2.7 million. These, and any further outcomes from 2008/09 matches, will be counted as part of the NFI 2010/11 exercise, which is now under way.

**41.** Across all public bodies that take part in Scotland, the cumulative value of NFI to the Scottish public purse over the last decade now exceeds £60 million. The 2010/11 exercise will be undertaken under new powers for data matching that commenced in October 2010. Because of these new powers, we have been able to extend the bodies that take part in NFI and permit 'cross-border' matching with data collected by the other UK audit agencies. The recent announcement that the Audit Commission in England is to be abolished will not affect the completion of the 2010/11 NFI.

## **Workforce numbers reduced but are set to fall more steeply**

**42.** The number of staff employed by local authorities is gradually declining and this pattern continued in the year to June 2010. The number of staff employed in local government (including police and fire and rescue) was approximately 249,700 full-time equivalent (FTE) employees.<sup>8</sup> This is a reduction of around 3,600 FTE (1.4 per cent) compared with June 2009. This includes reductions of 3.9 per cent in teaching staff, 0.7 per cent in social work, 0.6 per cent in other service areas and 1.8 per cent in fire and rescue services. Only police and related services, with 23,900 employed, saw no change over the same period.

**43.** Further and bigger reductions are predicted as councils respond to financial pressures. Around two-thirds of councils are currently planning voluntary early release agreements and some have already canvassed staff for voluntary severance or early retirement; staff have already left at some councils. There is significant variation in the terms available for staff. A small number of councils have not put any schemes in place. The main issues are affordability and value for money.

**44.** During 2009/10, most councils made progress in developing strategic approaches to workforce planning. This will help councils plan for future workforce needs and costs, but it is likely these will need to be reassessed as the full implications of reduced budgets become clearer. The impact of workforce reductions on service performance is a key medium-term issue for councils, with risks to maintaining service levels and quality where senior and experienced staff leave. Councils also need to be aware of equalities in workforce planning, as reductions in job numbers could have different effects on different employee groups.

**45.** Absence rates in 2009/10 remained broadly the same as in 2008/09. Rates were 7.6 days for teachers (compared to 7.4 days the previous year), 11.6 days for other council staff (a fall of 0.9 days) and 8.7 days for fire-fighters (an increase of 0.4 days). Sickness absence for police officers (which is calculated on a different basis) was 4.1 working days, a reduction of 0.2 days.

## **Councils have substantial workforce-related liabilities**

### **Pensions**

**46.** Spending to provide pensions for staff remains a significant cost pressure for councils. Between 2005/06 and 2009/10, councils' total contributions to the Local Government Pension Scheme (LGPS) increased by 24 per cent in real terms, from £542 million to £670 million. This included an increase of around £60 million in 2009/10, reflecting higher employer contribution rates flowing from the 2008 triennial valuation.<sup>9</sup>

**47.** The gap between the assets and liabilities of councils' pension funds widened from £3.8 billion at the start of the year to £9 billion at 31 March 2010. The market value of pension scheme assets increased by £4.5 billion but more significantly there was also a 53 per cent rise in the estimated cost of

future liabilities.<sup>10</sup> This is a snapshot of the position, reflecting the valuation techniques applied which can result in downward and upward movements in the net position.

**48.** The next triennial valuation of the LGPS in 2011 will set contribution rates for councils from April 2012. It will consider whether increases in employer contributions are required to help make up reduced returns on investments and the changing age profile of scheme members.

**49.** There is a high level of public interest and debate in public sector pensions, particularly about their sustainability in the longer term, and work to consider further reform of pension schemes is ongoing. The UK government has set up an independent commission to review fundamentally the way public sector pensions are provided.<sup>11</sup> In Scotland, the Scottish Government is funding a pension pathfinder project managed by COSLA to look at the scope for efficiencies in the LGPS in Scotland. It is expected to report in spring 2011.

**50.** The Auditor General and the Accounts Commission are currently preparing a follow-up to the 2006 performance audit on public sector pensions.<sup>12</sup> The report will be published in February 2011. It will provide an update position on the six main public sector pension schemes in Scotland, including the LGPS, current developments and the implications for public spending going forward.

### **Single status and equal pay**

**51.** All councils now have single status agreements in place.<sup>13</sup> As the basis of single status is non-discriminatory pay scales, equal pay issues are invariably associated with the adoption of these agreements. Up to the end of March 2010, the cost of meeting equal pay claims across councils was in the region of £420 million. Councils currently estimate future costs of settling claims at £180 million. However, there are still large numbers of cases at tribunal, and the potential outcomes present continuing uncertainty for councils.

**52.** Due to difficulties in generating the revenue funding to meet the costs, ten councils received specific authority from the Scottish Government in 2009/10 to borrow £62.3 million to meet the costs of equal pay and to spread the cost over a period of up to 20 years. One further council was granted consent in December 2010.

### **Asset management has improved but more work is required**

**53.** Councils manage and use assets totalling £32 billion. In 2009, the Accounts Commission reported that more than half of councils had yet to adopt a corporate strategy for managing assets and more could be done to share and jointly manage assets.<sup>14</sup> Since then councils have made good progress, with three-quarters now having corporate asset management strategies and plans in place.<sup>15</sup> Councils have also made good progress in improving information and monitoring systems and taking whole-life costing<sup>16</sup> into account in financial planning.

**54.** Councils also recognise that there is potential for gaining greater efficiencies from assets and many are actively looking at this, often involving local partners, for example in rationalising office accommodation and co-locating public services. But progress in joint asset management planning with community planning partners has been slow.

**55.** Last year, councils reported that around a quarter of their property assets were in poor or bad condition. The Commission's report on asset management projected that a total maintenance backlog would be around £1.8 billion. While this remains a concern, the SPIs show that the proportion of council buildings deemed to be in a satisfactory condition increased in the past year from 76.9 per cent to 79.4 per cent. In contrast, the proportion of council buildings deemed suitable for current use declined slightly from 72.1 per cent to 69.3 per cent.<sup>17</sup> When facing difficult budget decisions, there is a risk that councils may choose to achieve savings through cuts in maintenance expenditure, leading to problems in future.

**56.** The current economic climate and market conditions have reduced councils' ability to generate additional income through the sale of surplus assets. Councils need to carefully balance the cost of retaining assets against sale to ensure they achieve Best Value.

**57.** While progress has been made in developing corporate asset management plans, more work can be done to fully consider all types of council assets including property, roads, ICT, and fleet and vehicle assets. The Society of Chief Officers of Transportation in Scotland is helping councils prepare road asset management plans through the use of a number of guides and templates. We are undertaking a follow-up audit of the November 2004 report *Maintaining Scotland's roads*<sup>18</sup> and will report on progress in February 2011. We are also currently reviewing how effectively councils and their public sector partners are managing and delivering transport for health and social care services, how much is spent on these services, and whether this represents value for money. This will report later in 2011.

### **Common good**

**58.** At 31 March 2010, councils managed common good assets valued at £202 million. This is an area which attracts considerable public interest despite being relatively small compared with the overall value of assets which councils administer, ie £32 billion. Councils have generally taken action to comply with guidance<sup>19</sup> which requires separate identification of common good assets in the accounts and underlying records.

**59.** The guidance requires councils to take reasonable steps to ensure that common good asset registers are complete. However, because the origin of some assets may require research going back many years (in some cases hundreds of years), some councils are confirming title at the point of sale. This appears to be a pragmatic approach, given that a detailed search of all assets could be time-consuming and expensive. The key issue for councils is to ensure that all assets, including land and buildings and moveable assets such as works of art, are identified and recorded. Where ownership is confirmed, a distinction needs to be drawn between the income and expenditure flowing from assets of the common good, including those used in delivering council services, and the general body of council-administered assets.

### **Councils are not yet achieving Best Value from procurement**

**60.** Scottish local authorities spend around £4 billion annually in procuring goods and services, just over half of Scottish public sector procurement spend. The McClelland report in 2006<sup>20</sup> concluded that urgent action was needed across the public sector to improve the purchasing of goods and services.

**61.** In 2007/08, local authorities reported savings of £59 million from better purchasing. This fell to £32 million in 2008/09 but increased to £37 million 2009/10. In 2010, the Auditor General and the Accounts Commission noted that there is substantial potential still to be realised.<sup>21</sup>

**62.** In July 2009, the Scottish Government introduced a new assessment tool – the procurement capability assessment (PCA) – to monitor how far public bodies adopt good purchasing practice. The aim is to ensure all bodies can be assessed as at least 'conformant' (ie, operate essential good purchasing practice and control) by the second round of assessments due at the end of 2010.

**63.** The first round of PCAs was completed at the end of 2009. The local government sector was the only sector where, overall, the results were 'non-conformant' (only nine councils were assessed as being conformant). Councils were not acting illegally, but they were not achieving best value across their procurement activities.

**64.** Common reasons for councils attaining low assessments were related to how they specify goods and services for purchase, manage contracts with suppliers, and measure procurement performance. PCA reviews also found that councils would gain greater benefits from ensuring that the principles in the McClelland report were adopted across all council departments and procurement activities, and not seen as relating just to a centralised procurement function or department.

65. Councils have responded positively to PCA findings and have shown commitment to improving their arrangements through the revision of their procurement strategies and by developing improvement plans. While the initial PCA assessments were low, the measure of success of each council's procurement performance will be the level of improvement between PCA reviews. During 2010, a number of councils sought interim reassessments to measure the steps taken since the first PCA to improve the standards of their procurement activities. These showed a positive direction of travel. A second round of PCA reviews of all councils is scheduled to be completed and results made available in early 2011. Early indications of these results confirm this positive direction of travel.

- 1 SPI information is available at [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)
- 2 Excludes other operating expenses and accounting adjustments for charges, depreciation and pensions.
- 3 Councils determine the borrowing levels related to their capital investment programme. In doing so, they are required to adhere to a professional code developed by the Chartered Institute of Public Finance & Accountancy, *The Prudential Code for Capital Finance in Local Authorities*. This requires that capital plans are affordable, external borrowing is sustainable, and that treasury management decisions are taken in accordance with professional good practice.
- 4 Cash-backed reserves are reserves which are underpinned by resources which can be used for the future provision of services, acquisition of assets or repayment of debt. Non-cash reserves reflect valuations and provisions made to comply with proper accounting practice.
- 5 Excluding substantial funds held by Orkney Islands and Shetland Islands councils from harbour and other oil-related activities.
- 6 'Going concern' is an accounting concept which allows the readers of financial statements to assume that the organisation will continue to operate for the foreseeable future.
- 7 The value of NFI to the public purse is measured by: the amounts of overpayments (whether due to error or fraud) that are identified and stopped; estimates of amounts that bodies will save by stopping incorrect payments that would have continued if not identified by NFI; and, in some cases, attaching an appropriate value to other significant findings. We refer collectively to these as 'outcomes'.
- 8 *Joint Staffing Watch Survey*, Q2 2010, Scottish Government & COSLA.
- 9 Under scheme rules, local government pension funds are subject to triennial actuarial valuation to assess their assets and liabilities. Actuaries make a prudent assessment of expected returns on investment and liabilities which are used to set employers contribution rates for the following three years.
- 10 General reductions in interest rates have affected the value of the liabilities of the LGPS that are reported in councils' accounts. Interest rates – in particular, the return on high-quality corporate bonds – directly affect the discount rate that is used to estimate the reported pension liabilities each year. Consequently, historically low interest rates have had the effect of sharply increasing reported liabilities in the LGPS.
- 11 The Independent Public Services Pensions Commission has already published an interim report and will publish its final report, looking at options for long-term structural reform, in time for the 2011 UK budget due in March 2011.
- 12 *Public sector pension schemes in Scotland*, Auditor General for Scotland and Accounts Commission, June 2006.
- 13 The single status agreement was signed in 1999 with an intended implementation date of April 2002. It aims to harmonise the terms and conditions of employment of manual and administrative, professional, technical and clerical workers.
- 14 *Asset management in local government*, Accounts Commission, May 2009.
- 15 *Asset management in local government – impact report*, Accounts Commission, June 2010.
- 16 Whole-life costing looks at the cost of an item over the duration of its lifetime as opposed to the one-off cost of buying the item. As a result, it takes into account energy, maintenance, operating, staff training and disposal costs.
- 17 *Statutory Performance Indicators 2009/10*, Accounts Commission.
- 18 *Maintaining Scotland's roads*, Auditor General for Scotland and Accounts Commission, November 2004.
- 19 *Accounting for the common good fund: a guidance note for practitioners*, Local Authorities (Scotland) Accounts Advisory Committee, December 2007.
- 20 *Review of Public Procurement in Scotland: Report and Recommendations*, John F McClelland, Scottish Executive, 2006.
- 21 *Improving public sector efficiency*, Auditor General for Scotland and Accounts Commission, February 2010.



## Part 2. Challenges for 2011 and beyond

**Councils are taking the challenge seriously but more work needs to be done. Engaging with citizens, and strong governance and performance management are more important than ever.**

**The scale of the financial challenge is substantial...**

**66.** The unprecedented financial challenges facing the public sector are well documented. Urgent action is required by councils to deal with the effect of budget reductions. Plans to cope with this will need to be reviewed regularly to take account of any changes in the national budgets and the success, or otherwise, of actions taken locally.

**67.** In autumn 2010, councils indicated that they would need to make savings of between nine and 20 per cent over three years. They are now reviewing the position in light of the national budget announcement in November 2010 and will agree local budgets in February 2011.

**68.** Councils continue to report efficiency savings which exceed the national two per cent target. In 2010, they reported overall savings totalling £542 million,<sup>22</sup> of which £508 million was recurring and £34 million was non-recurring.<sup>23</sup> These are substantial. But the scale of the financial challenge means that efficiency savings at this level, or at the three per cent level anticipated in the Scottish Government's draft 2011/12 budget, will not in themselves be enough to bridge the gap between future spending and future funding. Relying on one-off non-recurring savings is not sustainable. Committing to efficiency savings is not new and it may be that those efficiency savings that are relatively easy to achieve have been realised already. New approaches need to be considered, including service redesign and more joint working and collaboration.

**... especially when combined with demand pressures and reducing income**

**69.** Pressures continue in demand-led services, eg social work services and housing and advice services, and in services where fee income is an important element of the budget, eg planning. Other pressures include the repair and maintenance of assets, eg roads and buildings, waste management and pension and equal pay commitments. More recently there are new costs associated with systems introduced to encourage reduced carbon emissions. There are also specific local pressures, for example in dealing with the effects of flooding and severe winter weather.

**70.** There are underlying financial pressures in social work related services from demographic projections which show the numbers of older people rising substantially in the medium and longer term; the population aged 60 and over is estimated to increase by 18 per cent between 2008 and 2018, and will be 50 per cent more by 2033. By 2016, the number of older people requiring some form of care is expected to rise by up to a quarter, rising to nearly two-thirds by 2032.<sup>24</sup>

**71.** The National Scrutiny Plan for Local Government refers to general risks associated with the overall financial position.<sup>25</sup> Beyond these risks, the plan highlights two other emerging themes which influence local outcomes, and which will be a principal feature of scrutiny work in the next three years. Firstly, the plan acknowledges a recognition by councils that they need to consider and mitigate the effects of their reduced funding on their local economy. Secondly, there is evidence in the AIPs of variation in the effectiveness of councils' operations in relation to the protection of vulnerable people, welfare and access. A significant proportion (70 per cent) of the scrutiny activity planned for 2010/11 focuses on these areas of risk.

**72.** Exhibit 12 summarises pressures on councils, including those that we saw in 2010 and those that are likely in the immediate future.

## Councils are taking the challenge seriously

### Financial planning

**73.** The combined effect of reducing income and increasing demand means that councils face some very difficult decisions. In order to develop realistic and deliverable medium-term financial strategies which link resources to priorities and which demonstrate value for money, councils need good information about service costs and value for money to compare the financial effects of different policy options.

**74.** Councils are taking the financial situation very seriously and a significant majority have established savings targets and outline financial plans. This will be assisted by the Scottish Government's commitment to publish illustrative budget figures for the years up to 2014/15. In preparing their plans most councils have built in some 'headroom', budgeting for more savings than they need, which provides a degree of flexibility in realigning budgets and prioritising spending. However, there are variations in approaches, with many councils frontloading savings targets toward 2011/12, reflecting the expected pattern of reducing central government support. Others have higher savings levels later in the period, and others have adopted an even spread.

**75.** Councils have therefore made a good start in preparing for the financial challenges, but more has still to be done.

### Risks to service quality and outcomes

**76.** Councils are urgently looking at ways of cutting considerable amounts of revenue and capital spending from their budgets. A key challenge will be to balance the need to find savings with that of maintaining the range and quality of the services they provide.

**77.** Overall, the lack of consistent and robust performance information means that it is difficult to provide a comprehensive overview of performance across all council services. SPIs do, however, provide some information across a range of services. The Accounts Commission is encouraging councils to take more responsibility in using performance information to drive improvement in services, and for reporting on those aspects of performance that are of most importance to local communities, to service users and to citizens. As part of this approach, the Commission has significantly reduced the range of information it specifies that councils must report through SPIs.

**78.** The SPIs for 2009/10 compared with those from two years ago indicate that service performance improved across most service areas covered. Exhibit 13 shows that only in waste management did indicators suggest a significant deterioration, although this reflects increasing refuse collection costs as councils strive to increase waste recycling rates. On a council-by-council basis, the improvement ratio for each council shows that no council had more indicators deteriorating than improving over the two years.<sup>26</sup>

**79.** More generally, local government has been active in taking forward its approach to better reflecting outcomes in its work. Councils published reports in October 2010 setting out progress against their Single Outcome Agreements (SOAs) in 2009/10.<sup>27</sup> These showed encouraging progress by councils and their partners in Community Planning Partnerships in defining desired local outcomes and in making some short-term progress against these outcomes.

**80.** However, it is difficult to draw any firm conclusions about progress as a whole. In February 2010, the Scottish Government published its overview of the 2008/09 SOAs. This report set out progress against the 15 national outcomes<sup>28</sup> and provided useful case studies of collaborative working at local level. But the report recognises that it will take time to see trends emerging and before progress can be robustly measured.<sup>29</sup>

**81.** The Society of Local Authority Chief Executives (Scotland) (SOLACE) is leading a Local Outcome

Indicators project. The project will develop and refine a menu of outcome indicators for use in tracking progress across Scotland's 32 SOAs. This is a positive development, and its success will lie in gaining a good level of ownership among councils and their community planning partners.

**82.** In achieving Best Value, councils are required to have regard to sustainability. *Protecting and improving Scotland's environment*<sup>30</sup> provides an overview of the Scottish public sector's performance against targets for four aspects of environmental sustainability: improving air quality; protecting and improving the water environment; protecting and improving biodiversity; and improving waste management. The report notes that all 32 councils' SOAs include an indicator relating to waste management, but that SOAs have less focus on the other three aspects. In relation to waste management, the current targets set by councils are not enough to meet European targets for the amount of waste that is sent to landfill after 2010. Meeting targets for landfill and recycling beyond 2010 will be very challenging, as the necessary reductions in landfill and increases in recycling become more demanding.

**83.** The follow-up report to *Improving energy efficiency* recommends that public bodies build energy efficiency considerations into asset management and estate rationalisation decisions, involving energy officers or teams wherever possible.<sup>31</sup> Councils are making progress in taking into account environmental sustainability in financial planning with about two-thirds now considering issues of sustainability, such as CO<sub>2</sub> emissions, as part of their model for proposed capital projects.<sup>32</sup>

**84.** The Scottish Household Survey provides data on the extent to which citizens believe their council provides high-quality services and does the best it can with the money available. This indicates that the level of satisfaction with the quality of services has been consistent, but there has been some deterioration in people's perception about the value for money of those services. This suggests that there is scope for councils to improve monitoring and reporting the value for money of their services. Value for money will become increasingly important for councils trying to maintain service quality with reducing resources.

**85.** There is considerable risk that councils will find it difficult to maintain the current quality of their services, user satisfaction, and desired outcomes as they look to find savings in their budgets. Looking ahead, it is important that councils ensure good dialogue with their citizens and communities in managing expectations about how the quality of services and desired outcomes may be affected.

## **Service users' and citizens' needs are central to effective service planning**

### **Understanding citizens' needs and managing expectations**

**86.** To make informed choices councils need good-quality information about the needs of people in the communities they serve. This is done through engaging with communities and taking account of user views in planning and managing services. It is particularly important where councils consider more radical approaches such as redesigning services or arranging for service delivery by providers other than the council, such as the private sector, third sector or communities themselves. There are examples of councils engaging with communities on current budget considerations but to date these have been largely limited to consulting on short-term proposals rather than medium-term priorities.

**87.** There is a wide variation in councils' approaches to engaging with citizens. Many use citizens' panels to gauge views, but these are most effective as part of a wider strategy which allows richer dialogue with local communities over time. Those councils with longer standing and more developed approaches, involving community planning partners and wide community representation, are best placed to engage fully with citizens and communities as to how services should be prioritised and reshaped. This can help manage expectations about what can be achieved within reducing budgets.

**88.** Councils are showing good commitment but could still do more to assess and monitor the impact of their activity on the needs of different groups within their communities. Follow-up work on councils' approach to their race equality responsibilities<sup>33</sup> showed improving consultation and engagement with

minority ethnic communities. But there is still scope to improve the quality of information on minority ethnic communities and their needs and to demonstrate how this is applied to improve services. The Equalities and Human Rights Commission recently found that while councils allocated resources to meet the needs of women, minority ethnic groups and disabled people, the process was in the large majority of cases not informed by equality impact assessments<sup>34</sup> or by a set of planned objectives and desired outcomes.<sup>35</sup>

### **Reporting performance to citizens**

**89.** Reporting performance to communities provides an opportunity to complete the cycle of engagement with service users and citizens, explaining the council's approach, achievements and areas where further work is required. There is also an opportunity to explain how resources have been applied and to manage expectations in times of reducing budgets.

**90.** Councils are making progress in meeting their public performance reporting (PPR) obligations, but the approach to and coverage of PPR is highly variable across councils and there is significant scope for further improvement<sup>36</sup>.

**91.** Councils could also do more in reporting financial performance to citizens and communities. For example, in their annual accounts they need to make better use of the explanatory foreword to show how the figures in the accounts relate to the budget for the year. Councils' financial statements are increasingly complex, and a good explanatory foreword can make it easier for councillors and the public to follow, and will make the financial position more transparent.

### **Partnership working offers substantial potential**

**92.** *Improving public sector efficiency*<sup>37</sup> states that the public sector needs to continue to develop collaboration and joint working to deliver more efficient and user-focused services. The key issue is that councils cannot on their own deliver the kind of radical change to service provision that is needed. The report sets out some practical examples of bodies working together across public, private and third sectors to improve services. We are currently undertaking two performance audits reviewing community health partnerships and local community planning partnerships, both of which will report in 2011.

**93.** Local Community Planning Partnerships bring together the relevant local interests to allow a strategic approach to service planning, and community plans set out how changes can be achieved. However, the level of maturity and influence of Community Planning Partnerships differs significantly from area to area. This is not necessarily indicative of a lack of commitment, but can reflect local personalities, politics, organisational structures, or even a lack of recognition of the potential value of the local community planning partnership. A restated commitment from all bodies – public, private and community – to community planning would help clarify the potential that exists.

**94.** The SOA can play an important part in demonstrating commitment to partnership working. Guidance for the current round of SOAs sets out what such commitment means for partner bodies.

### **Approaches to service provision are changing**

**95.** Most councils now have major improvement or transformation programmes in place to identify the best use of resources and to deliver efficiencies.

**96.** When considering different methods of delivering services, robust options appraisal supports effective and transparent decision-making. It should include analysis of the potential benefits and risks associated with each option. Options for alternative delivery methods for the provision of public services are wide-ranging.<sup>38</sup> Examples include: provision by the third or private sectors; social enterprise and community interest vehicles; services organised by user or employee-led mutual organisations; strategic delivery partnerships; joint ventures; public sector shared service units; or in-

house managed services.

**97.** Many of these models are either already used by councils, or are being actively considered. But councils need to get better at showing how such options are evaluated. This will help them better demonstrate how their proposals to reshape services show value for money and meet the needs of local communities.

### **Sharing services**

**98.** Shared services has the potential to contribute to more efficient and effective public services. There are many existing examples of long-standing arrangements which already demonstrate collaboration between councils, such as Tayside Contracts. At a national level there is also notable progress, such as:

- the joint development of the Myjobscotland Recruitment Portal, and the Public Information Notices Portal, with COSLA estimating overall savings of between £3 million and £4 million per annum<sup>39</sup>
- the joint continuous professional development framework for elected members, launched in 2010 and supported by the Improvement Service, and successfully tested through a pilot project involving two-thirds of elected members across six councils.

**99.** There are examples of continuing dialogue on sharing services, including in the group of eight councils that form the Clyde Valley Community Planning Partnership, which is looking at the potential from shared services in seven areas: waste management, health and social care, social transport and fleet management, property sharing and management, support services, charging, and economic strategy. Work is ongoing elsewhere, for example East Lothian and Midlothian councils are considering sharing services in education, social work and back office functions, and at Stirling and Clackmannanshire where the councils have agreed to appoint joint heads of service for each of its social work and education functions. Some projects elsewhere, however, have not been taken forward, due to disagreements over funding and governance.

**100.** While the onus is on councils to explore sharing services, the Scottish Government also has a role in encouraging more collaboration and looking at ways to overcome barriers to joint working. For example, the different legal status of the council and NHS board in Orkney previously led to problems when they tried to share services. More work is currently under way to explore the position. Other barriers to shared services include organisational structures, compatibility of systems, staff terms and conditions, and funding streams.

**101.** While councils are participating in a number of national and locally led shared services projects, discussions in many cases remain at an early stage. Overall, progress in delivering projects has been slow, and significant savings in the short term are unlikely.

**102.** Councils need to explore the potential of sharing services and take informed choices based on good quality information on costs, potential benefits and risks. Sharing services may not necessarily reduce costs although they may provide more effective service delivery. Shared services should be considered by councils and their partners as one option in an approach which considers the range of options for service delivery.

### **Service delivery through arms-length external organisations**

**103.** The use of arms-length external organisations (ALEOs), eg companies and trusts, continues to play an important part in local government service delivery. *Physical recreation services in local government*<sup>40</sup> found that the number of ALEOs set up to provide leisure services has almost doubled in the last decade, from 28 in 2000 to 44 (provided by 23 councils) in 2010. Other councils are considering ALEOs to deliver this type of service.

**104.** Councils opt to deliver services through ALEOs primarily to achieve financial advantages such as reduced value added tax and non-domestic rates, employee costs and overheads. Because finances and services are arms-length from the council, using ALEOs requires strong governance arrangements and a robust approach to monitoring finances and service performance. There are examples of cases where councils have had to provide additional unplanned financial support to ALEOs and, in more extreme cases, where councils have had to wind-up the ALEO and assume responsibility for its services and financial commitments.

**105.** A lack of effective performance monitoring can limit the ability of councillors to scrutinise services delivered through ALEOs. Some councils have strengthened monitoring through more effective and regular reporting to elected members, and by establishing a designated committee to oversee services delivered through ALEOs. Scrutiny is also improved through clarity of roles and responsibilities, including the expectations of those asked to take on responsibilities in ALEOs, for example as trustees or company directors, alongside their responsibilities to the council.

**106.** These findings re-emphasise the messages set out in *Following the public pound*,<sup>41</sup> and more recently, the report in the *How councils work* improvement series on roles and working relationships.<sup>42</sup> We will publish in 2011 the second report in the *How councils work* series, looking at wider issues arising from councils' use of ALEOs.

### **Working with the third sector**

**107.** Councils often work in partnership with the third sector, ie charities, social enterprises and voluntary organisations, to provide council-related services to particular groups in their communities. There is scope for the third sector to play a more active part in some more radical cross-sector approaches to service provision. Our work suggests that progress is being made in developing working relationships between councils and the third sector, such as through local 'compacts' between the different sectors, including ensuring clear representation of the sector on community planning partnerships. Councils need to make full use of this relationship in considering how public services can be reshaped.

**108.** Changes in short-term funding can have a significant effect on vulnerable groups and the third sector. For example, *Drug and alcohol services in Scotland*<sup>43</sup> highlighted that short-term and temporary funding do not always allow sufficient time to evaluate the effectiveness of services and may have a negative effect on service users. The Scottish Council for Voluntary Organisations (SCVO) states that the capacity of the sector to deliver services is already being affected by short-term cuts by local authorities.<sup>44</sup>

### **Good performance management remains vital**

**109.** An effective corporate performance management system is essential to enable councillors and senior managers to form an overall view of how their council is performing across all areas of activity. Working well, performance management provides balanced, sound information about improvement and provides a basis for demonstrating Best Value, ie continuous improvement in delivering services.

**110.** In the current context, performance management systems will be increasingly important in providing vital information about service performance which will allow councils to understand and manage the effects of spending decisions.

**111.** Better performing councils use a systematic approach, with trends tracked over time. Reports contain accurate and timely information and are in a format and level of detail which are tailored to the needs of the report users. There is also regular consideration of performance reports leading to informed and challenging scrutiny of individual services and improvement plans, progress against which is monitored over time.

**112.** Councillors need good-quality information to assist them making informed decisions. They are

generally aware of the total cost of their services, and budgets are monitored regularly. However they still do not have sufficient information on service costs and quality, user satisfaction, and performance information which compares performance with that of other service providers. This is essential information for managing and scrutinising performance, but is also needed to inform service users and citizens about the relationship between the costs, volume and quality of services. *Improving public sector efficiency*<sup>45</sup> concluded that further work is needed by councils to develop benchmarking programmes that cover all of their services. SOLACE Scotland is currently undertaking a review of benchmarking activity across local government.<sup>46</sup>

**113.** The performance management, monitoring and reporting processes of partnerships remain underdeveloped and there is a clear need to improve the way they report to the public on performance generally. It is important that the reporting of partnership activities within the council provides enough depth of information to ensure effective scrutiny of, and accountability for, the council's contribution to performance.

**114.** Performance management remains a high priority for councils in continuing to develop and refine their approaches. Exhibit 17 draws on the findings of the Best Value 2 pathfinder reports.

**115.** Self-evaluation involves councils critically appraising their performance and progress against objectives to provide a clear view of performance across all activities. Many councils are making greater use of quality and business excellence models such as the *Public Sector Improvement Framework* and *How Good is Our Council*. This has helped councils to be clearer on their priorities for improvement. But such self-evaluation needs to become more routine and systematic across all council activity, demonstrating actions taken as a result and including more emphasis on testing competitiveness and efficiency. More widely, the drive to reduce the overall level of scrutiny of local government depends on councils carrying out sound self-evaluation.

## **Strong governance and leadership provides the basis for success**

**116.** Good governance is about clear direction and sound control and is central to the success of all organisations. Councils are large, complex organisations and the strength of their governance arrangements has a significant bearing on how well their services perform and on how well they manage their finances. The current financial context and increasingly varied models of service delivery require an increased focus on governance.

**117.** *Roles and working relationships: are you getting it right?*<sup>47</sup> pointed to the need for governance arrangements to keep pace with the changing local government context. It underlined the key role of councillors in governance, specifically community leadership, decision-making and scrutiny.

**118.** The report explores the respective responsibilities of councillors and officers in governance and how they work together to lead and manage their councils to provide vital public services. The report finds that in successful councils, councillors and senior managers share a strong public sector ethos and work well together to put their plans for the council area into action. Common features include clearly understood political and managerial structures, professional and constructive relationships between councillors and between councillors and officers, a shared commitment to council priorities, and constructive debate at council and committee meetings.

**119.** The report reflects the substantial changes in the local government landscape in recent years and highlights the potential for the challenging financial circumstances to lead to strained working relationships. It is therefore vital that the current challenges faced by councils are supported by strong relationships between the chief executive, the council leader and leaders of other political groups.

**120.** After many years of sustained increases in funding, local government now faces a long period of working with reduced budgets. Councils are taking action to deliver savings and redesign and change services. In the shorter term, councils are taking pragmatic approaches to identifying savings. Most have put in place savings plans covering the next two or three years and it is important that councils

retain a longer-term perspective of the impact of their current plans on their local areas.

**121.** There has been progress in helping to equip councillors with the right skills through training and development and this will be further supported by new arrangements for continuous professional development<sup>48</sup> of elected members. However, more work is needed to ensure that councillors have the knowledge and skills necessary to scrutinise service options and financial and service performance.

**122.** The role of the audit committee or equivalent will become increasingly important and councils must make full use of this mechanism to challenge performance and demonstrate value for money. Good scrutiny in setting policy is also critical. Exhibit 18 demonstrates attributes of effective scrutiny.

**123.** *Roles and working relationships: are you getting it right?* also noted the vital role of statutory officers in supporting good governance and decision-making. Statutory officers have specific duties as set out in legislation and undertake these roles alongside their other responsibilities. They have an important, independent role in promoting and enforcing good governance.

**124.** The report notes that the chief executive must be impartial and accessible to all councillors, to retain their trust and confidence. In light of this, it is essential that councils make the right choice in appointing the chief executive. Open and transparent recruitment and performance appraisal processes, which clearly set out expectations and effectively monitor performance, help to build councillors' (and officers') trust and confidence in the chief executive.

**125.** The statutory officer for finance (also known as the section 95 officer) is fundamental to ensuring sound financial management and has an important role in establishing and maintaining internal financial controls and in providing professional advice to councillors on all aspects of the council's finances. In the current financial climate, this role is increasingly important in influencing the strategic direction of the council. Access to decision-makers and influence at a senior management level is therefore critical.

**126.** More generally, the systems of internal financial control will be increasingly important, and councils need to ensure that they have a modern, independent and focused internal audit function. In *A job worth doing: Raising the standard of internal audit in Scottish councils*,<sup>49</sup> the Accounts Commission set out six critical success factors for an effective internal audit function:

- Setting clear and properly focused objectives for internal audit.
- Maintaining internal audit independence.
- Planning and controlling the work of internal audit.
- Resourcing the internal audit work programme.
- Having effective reporting and follow-up arrangements.
- Holding internal audit to account for its performance.

**127.** There will be substantial changes to local government financial accounting in 2010/11 when International Financial Reporting Standards (IFRS) are adopted. This adds a further pressure on councils' finance departments and steps should be taken to ensure that the changes in accounting are achieved without compromising the other vital functions, such as budgetary control and the provision of timely and good quality information to elected members to support governance.

## **Preparing for the future**

**128.** The approach to budgeting is crucial. *Improving public sector efficiency* highlighted the need for a more fundamental approach to delivering public services in the future, including a priority-based approach to budgeting and spending which: identifies the money available; clearly demonstrates how



services contribute to national objectives and outcomes; and reviews each policy and service and decide if it delivers value for money. This involves identifying: which are absolutely essential to delivering outcomes and are already being delivered as efficiently and effectively as possible; which should continue but need to be redesigned or reshaped to deliver them more efficiently and effectively; and which could stop without affecting public services and outcomes.

**129.** *Scotland's public finances, preparing for the future*<sup>50</sup> presented some key questions for the Scottish Government, the Parliament and the wider public sector to consider when planning the delivery of public services in a time of severe resource constraints. These remain central and we have restated these in Appendix 1.

**130.** The Auditor General for Scotland and the Accounts Commission will publish a follow-up report on public finances in 2011. This will provide an overview of the impact of the Scottish budget on public sector budgets and will review how public sector bodies are planning and taking action to respond to future budget reductions.

**131.** The financial position requires a clear focus on budgets alongside councils' ongoing statutory requirement to achieve Best Value, ie continuous improvement. The Best Value principles are as important now as they have ever been, although the emphasis will shift to improving service areas which individual councils identify as priorities and providing value for money and good quality services with fewer resources.

**132.** Councils' Best Value responsibilities also continue to encompass equalities and sustainability. Councils' equalities responsibilities require a clear focus and good information on the effect of changing or reducing services on elements of the communities they serve. Current sustainability targets for protecting and improving the environment remain firmly on the agenda and extend well into the future.

**133.** For our part, we will continue to revise our approach to Best Value audit, building on the risk-based, proportionate approach established in our Best Value 2 pathfinder work and making clear judgements on councils' overall performance and their prospects for future improvement. We will continue to work with our scrutiny partners to ensure that the level of scrutiny which councils experience is proportionate. We will also continue to work in partnership with service inspectorates to develop our Best Value audit work in police and fire and rescue services.

**134.** Appendix 1 contains action points for councils and key questions for councillors. Appendix 2 sets out reports and other resources that can help councils and other local authorities deal with the challenges ahead.

22 Efficient government – efficiency outturn report for 2009-10, Scottish Government, October 2010.

23 Efficiency savings reported by councils have not been audited.

24 Reshaping Care for Older People, Scottish Government, March 2010.

25 The National Scrutiny Plan for Local Government is the key output from work led by the Accounts Commission to join up and streamline scrutiny in local government. The plan summarises the strategic scrutiny work for 2010/11 in each of the 32 councils' individual plans – the Assurance & Improvement Plans (AIPs). (AIPs can be found at <http://www.audit-scotland.gov.uk/work/scrutiny/aip.php#AIP>)

26 The ratio of improvement to decline compares the number of SPIs that a council has improved (by more than five per cent) over two years to the number that have declined.

27 <http://www.improvementservice.org.uk/library/577-single-outcome-agreements/681-phase-2-single-outcome-agreements-2009-onwards/752-soa-annual-reports-2009-2010/view-category/>

28 The Scottish Government has set out 15 desired national outcomes against which it measures progress in its Scotland Performs framework. More details at: <http://www.scotland.gov.uk/About/scotPerforms>

29 Single Outcome Agreement Overview Commentary: Progress in 2008/09, p.4, Scottish Government, February 2010.

30 Protecting and improving Scotland's environment, Auditor General for Scotland and Accounts Commission, January 2010.

31 Improving energy efficiency: a follow-up report, Auditor General for Scotland and Accounts Commission, December 2010.

32 Asset management in local government – impact report, Accounts Commission, June 2010.

33 The impact of the race equality duty on council services – impact report, Accounts Commission, July 2009.

34 The public sector duties for race, gender and disability require that public bodies assess the impact of their policies

and activities on different people. An equality impact assessment is a tool for carrying out such an assessment.

35 Counting the cost: final report, Equalities and Human Rights Commission, August 2010.

36 Local Government Act 1992: the Publication of Information (Standards of Performance) Direction 2008, Accounts Commission for Scotland ([http://www.audit-scotland.gov.uk/performance/docs/pi\\_direction\\_2008.pdf](http://www.audit-scotland.gov.uk/performance/docs/pi_direction_2008.pdf)).

37 Improving public sector efficiency, Auditor General for Scotland and Accounts Commission, February 2010.

38 Report of the Independent Budget Review Panel, paragraph 7.9, p.141, June 2010.

39 COSLA submission to the Education, Lifelong Learning and Culture Committee inquiry on the Scottish local newspaper industry, 2010.

40 Physical recreation services in local government, Accounts Commission, October 2010.

41 Following the public pound, Accounts Commission, December 2005.

42 How councils work: an improvement series for councillors and officers – Roles and working relationships: are you getting it right?, Accounts Commission, August 2010.

43 Drug and alcohol services in Scotland, Auditor General for Scotland and Accounts Commission, March 2009.

44 The Independent Budget Review: a response to the initial call for contributions from the Scottish Council for Voluntary Organisations, SCVO, April 2010.

45 Improving public sector efficiency, Auditor General for Scotland and Accounts Commission, February 2010.

46 SOLACE Scotland's submission to the Independent Budget Review Group, SOLACE Scotland, April 2010.

47 How councils work: an improvement series for councillors and officers – Roles and working relationships: are you getting it right?, Accounts Commission, August 2010.

48 <http://www.improvementservice.org.uk>

49 A job worth doing: Raising the standard of internal audit in Scottish councils, Accounts Commission, August 2001.

50 Scotland's public finances, preparing for the future, Audit Scotland, November 2009.

# Appendix 1.

## Action points for councils and key questions for councillors

Councils need to:	
<ul style="list-style-type: none"><li>• demonstrate that they have tested the longer-term impact and equalities aspects of workforce reduction plans (paragraph 44)</li><li>• provide assurance that they are not being compromised by a loss of experience from those staff (particularly long-standing staff) that they release (paragraph 44)</li><li>• carefully balance the cost of retaining physical assets against the short-term expediency of selling them, to ensure that they achieve Best Value (paragraph 56)</li><li>• do more to fully integrate the planning of the use of all types of council assets, including property, roads, ICT and vehicles (paragraph 57)</li><li>• continue progress in demonstrating Best Value in procuring goods and services (paragraph 65)</li><li>• regularly review financial plans to take account of changing national budgets and local actions (paragraph 66)</li><li>• ensure that medium-term financial planning includes evaluating the financial effects of different policy options, backed up by good quality information about service costs and value for money (paragraph 73)</li><li>• continue progress in taking into account environmental and long-term sustainability in financial planning (paragraph 82)</li><li>• consult fully with citizens and service users on short-term budget considerations, and in the longer term, on reshaping services for local areas, as an integral part of their wider approaches to engaging with their communities (paragraph 86)</li></ul>	<ul style="list-style-type: none"><li>• consider more transparent ways of reporting their accounts and financial performance (paragraph 91)</li><li>• work with their community planning partners to recognise the potential of community planning structures in setting out the shape of future provision of services in their local areas (paragraph 93)</li><li>• get better at showing how various options of models of service provision are properly evaluated (paragraph 97)</li><li>• consider shared services as one option in an approach which considers the range of options of service delivery (paragraph 102)</li><li>• make full use of the relationship with the third sector (paragraph 107)</li><li>• provide councillors with better information on service costs and quality, and user satisfaction (paragraph 112)</li><li>• make better use of comparative performance information and activities such as benchmarking (paragraph 112)</li><li>• work with community planning partners to improve their performance management, monitoring and reporting processes of partnerships (paragraph 113)</li><li>• use self-evaluation more routinely and systematically across all council activity, including testing competitiveness and efficiency (paragraph 115)</li><li>• make full use of the Accounts Commission report <i>How councils work: an improvement series for councillors and officers — Roles and working relationships: are you getting it right? to explore ways</i></li></ul>

<ul style="list-style-type: none"> <li>• in fulfilling their equalities obligations, better understand and demonstrate the impact of their activity on different groups (paragraph 88)</li> <li>• better meet the requirements of Public Performance Reporting (paragraph 89)</li> </ul>	<ul style="list-style-type: none"> <li>• of improving leadership and governance (paragraph 117)</li> <li>• make full use of scrutiny and audit to challenge performance and demonstrate value for money (paragraph 122)</li> </ul>
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<p>Key questions for councillors</p>	
<ul style="list-style-type: none"> <li>• How are decisions made between competing priorities? What will success look like in relation to service delivery on the ground?</li> <li>• Is there sufficiently good information on the cost, quality and quantity of services to support evidence-based priority setting?</li> <li>• What needs to be done to improve understanding of the links between spending, activities, performance and outcomes?</li> </ul>	<ul style="list-style-type: none"> <li>• What contribution beyond three per cent efficiency savings can be reasonably expected? What more could be done to improve understanding of productivity in public services as a basis for further action?</li> <li>• Is the balance right between short-term measures and long-term changes?</li> <li>• Is enough being done across sector and service boundaries to deliver efficient services that place the needs of users first?</li> </ul>

# Appendix 2.

## Reports and other resources to support improvement

### 2010 reports

- *Protecting and improving Scotland's environment*, Auditor General for Scotland and the Accounts Commission, January 2010
- *Improving public sector efficiency*, Auditor General for Scotland and the Accounts Commission, February 2010
- *How councils work: an improvement series for councillors and officers – Roles and working relationships: are you getting it right?*, Accounts Commission, August 2010
- *Physical recreation services in local government*, Accounts Commission, October 2010
- *The Scottish Police Services Authority*, Auditor General for Scotland, October 2010
- *Financial overview of the NHS in Scotland 2009/10*, Auditor General, December 2010

### Reports to be published in 2011

- *Public sector pensions: a follow-up report*, Auditor General for Scotland and the Accounts Commission, February 2011
- *Road maintenance: a follow-up report*, Auditor General for Scotland and the Accounts Commission, February 2011
- *Scotland's public finances: planning for the challenges*, Auditor General for Scotland and the Accounts Commission, May 2011
- *How councils work: an improvement series for councillors and officers – Arms-length external organisations*, Accounts Commission, spring 2011

### Other resources

Best Value toolkits:

- Asset management
- Challenge and improvement
- Community engagement
- Customer-focus and responsiveness
- Efficiency
- Equalities
- Financial management

- Governance and accountability
- Information management
- Partnership working and community leadership
- People management
- Performance management
- Planning and resource alignment
- Procurement
- Public performance reporting
- Risk management
- Sustainability
- Vision and strategic direction

# Appendix 3.

## Summary financial information

### Reserves

	31 March 2010 £ million	Change in 2009/10 £ million
General Fund	642	+64
Housing Revenue Account	107	-9
Capital Fund	262	-41
Capital Receipts Reserve	68	-9
Insurance Fund	78	-2
Repair and Renewal Fund	89	+6
Other	18	+14
Total	1,264	+23

### Performance of statutory trading organisations (STOs)

	2005/06	2006/07	2007/08	2008/09	2009/10
Number of STOs	140	117	108	89	81
Number of STOs breaking even over 3-year rolling period	103	91	81	75	71
Percentage of STOs breaking even over 3-year rolling period (%)	73.6	77.8	75.0	84.3	87.7
Total surplus over rolling 3-year period (£ million)	86	86.6	78.0	97.2	128.5