

# Financial Management in a glacial age

Audit Commission handout

October 2009

**The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.**

**Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.**

**As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.**

# Summary

**1** Local authorities face an uncertain financial future. For most, the recession has already led to increasing demand and decreasing income. Many expect public finances to get much tighter, putting local public bodies' financial standing at risk. The Audit Commission has produced this handout to help local authorities learn lessons from past financial failure and secure their financial stability. We have developed it from real-life examples of:

- possible causes of financial failure that bodies should watch for;
- key changes bodies can take to help with recovery; and
- steps management can take to improve financial standing.

**2** This document draws on several different sources, including national reports, public interest reports, and case studies from both local government and the NHS. We have identified some common themes and trends. Not all the factors leading to financial failure identified in this handout were experienced by each of the organisations. However, we did find a large degree of consistency, suggesting that lessons learnt from past failures, if understood and acted on, can reduce the risk of future occurrence.

**3** We have grouped the findings into three sub-themes:

- Leadership and management -  
for example leadership in the key posts of chief executive and finance director;
- Governance arrangements -  
for example, elected member participation in key committees; and
- Financial management -  
for example the organisation's culture of service management and financial management.

**4** The Audit Commission has developed an e-learning tool - Financial Skills for All - to help local public bodies improve financial management skills.

- It supports leadership and management by equipping non financial colleagues with core financial skills, thereby improving the understanding of financial matters throughout an organisation.
- It supports governance by equipping members with financial skills in order to ask more penetrating questions, and to hold the finance function and services to account.
- It helps improve financial management by raising the level of core financial management skills throughout an organisation; managers will understand the financial implications of their decisions and can take greater ownership of the financial consequences of their actions.

**5** This tool is free to use, and is available at [www.audit-commission.gov.uk/fmskills](http://www.audit-commission.gov.uk/fmskills)

# Possible reasons for financial failure

**6** Our reviews have found that financial failure is inseparable from wider organisational failure. Problems with money can be a symptom of wider difficulties.

**7** Set out below are common themes that may indicate that an organisation is facing financial difficulties.

## Leadership and management

**8** The following characteristics were exhibited by the leadership and management of failing bodies:

- Financial leadership was lacking and financial governance failed.
- Top-level managers lacked skills and capacity.
- Performance management was poor.
- Problems were not identified, or were considered to be external rather than internal.
- Problems were not dealt with immediately as they arose.
- There was a blame culture and failure to learn from mistakes.
- A high-profile, long established and charismatic organisational leader had recently departed.
- There were regular changes in leadership at senior levels - particularly the chief executive and director of finance.
- The finance director had sole responsibility for the recovery.
- Management was distracted by other matters, such as:
  - a merger or reconfiguration;
  - a large building project; or
  - a significant outsourcing project.
- Too many political priorities were competing for resources.
- Poor project management skills were exacerbated by a culture of expected failure.
- Service managers were detached from the core management of the organisation.

## Governance

**9** The governance of failing bodies often displayed the following characteristics:

- The audit committee did not hold managers to account, and members did not have the skills or knowledge to challenge them on financial matters.
- Corporate services were not monitored.
- Audit recommendations were not implemented.
- Internal audit work focused on key systems, but not on financial standing.

## Financial management

**10** The financial management arrangements in failing bodies often included:

- A reliance on short-term fixes, such as asset sales to raise cash.
- The use of reserves and investment income to balance budgets.
- A reluctance to commit to key financial decisions, such as budget-setting.
- Insufficient budget monitoring; especially at the start of the year.
- Misleading budget information; particularly information to audit committees.
- A disconnect between financial planning and other key functions, such as human resources.
- A lack of understanding of costs and their relationship with activities.

# Key changes towards recovery

**11** Organisations that have suffered from financial failure can take a range of actions to improve. The key successful changes identified in our review of organisations that turned around are set out below.

## Leadership and management

- 12** Senior managers took a number of actions, including:
- introducing a sound governance and accountability structure;
  - setting a clear framework of what to do, who did what, and how it linked together;
  - increasing the management capacity and capability;
  - recognising the problems and introducing internal measures to address them;
  - linking risk management through to service plans; and
  - holding service managers to account for their risk registers.

## Governance

- 13** Members also made number of changes, including:
- accepting that financial management was their responsibility;
  - attending training on local government finance, scrutiny and risk management;
  - introducing individual development plans that were linked to their roles;
  - ensuring officers focused on key priorities;
  - ensuring full or high attendance at meetings;
  - giving a specific committee responsibility for risk management scrutiny; and
  - ensuring internal audit had a key role in risk management.

## Financial management

- 14** Actions to improve financial management included ensuring that:
- service managers had direct ownership of income and expenditure budgets and were held to account;
  - all staff understood the cost of the services they provided;
  - basic budgetary control was in place by:
    - introducing or reintroducing a clear scheme of delegation with defined levels of accountability and powers to commit expenditure;
    - accurate, prompt reporting to budget holders of the current income and expenditure position;
    - holding budget holders to account promptly for variations, requiring corrective action rather than just an explanation; and
    - integrating activity and finance.
  - budgetary control was supported by an effective IT system; and
  - measures were immediately taken to curb expenditure.

# What steps can you take to improve your financial health?

**15** Our studies, audit and other work have identified characteristics of successful organisations. We believe these form key actions all organisations can take to improve their financial health.

## Leadership and management

**16** Leaders and managers can:

- ensure that finance directors are not unreasonably burdened, allowing them to focus on financial issues;
- focus on key priorities themselves;
- consider outsourcing;
- set strategic plans from the service plans, rather than the budget; and
- hold service managers to account for their service budgets.

## Governance

**17** In promoting good governance, organisations can:

- ensure vacancies on committees are replaced as soon as possible;
- identify the required performance standards of members and chairs, and where this has not been met, take action to replace them;
- review the appointments process to ensure members can be removed from committees if they are not performing to standard;
- introduce a member development programme;

- identify key performance indicators and monitor them regularly;
- ensure internal auditors:
  - include work on financial standing as part of their audit plans;
  - maintain regular dialogue with external auditors on concerns and highlight any delay in implementing recommendations about financial standing; and
  - present concerns in writing to the audit committee;
- evaluate financial performance against a range of financial ratios; and
- give scrutiny committees responsibility for holding officers to account for poor performance.

## Financial management

**18** The finance department can:

- give responsibility for budgets to senior operational managers;
- ensure budget monitoring includes information on outputs and outcomes;
- periodically undertake zero based budgeting exercises; and
- identify both the cost drivers for high expenditure areas and ways to reduce costs.

# References

## Case studies

- Available at [www.audit-commission.gov.uk/localgov/goodpractice](http://www.audit-commission.gov.uk/localgov/goodpractice)
- Notable practice case study - 5 Boroughs Partnership NHS Trust - Raising the profile of risk management.
- Notable practice case study - Medium Term Financial Strategy - Cambridge City Council (October 2008).
- Notable practice case study - Medium Term Financial Plan - London Borough of Brent (February 2009).
- Notable practice case study - Medium Term Financial Strategy - East Devon District Council (May 2008).
- Financial management case study - St Helen's Metropolitan Borough Council (December 2007).

## National Reports

- Learning the lessons from financial failure in the NHS [http://www.audit-commission.gov.uk/health/nationalstudies/financialmanagement/Pages/financialfailureinthenhs\\_copy.aspx](http://www.audit-commission.gov.uk/health/nationalstudies/financialmanagement/Pages/financialfailureinthenhs_copy.aspx)
- World Class Financial Management <http://www.audit-commission.gov.uk/aboutus/strategicobjectives/raisingstandards/Pages/worldclassfinancialmanagement.aspx>.
- Improving Medium Term Financial Planning [http://www.audit-commission.gov.uk/health/nationalstudies/financialmanagement/Pages/improvingmediumtermfinancialplanning\\_copy.aspx](http://www.audit-commission.gov.uk/health/nationalstudies/financialmanagement/Pages/improvingmediumtermfinancialplanning_copy.aspx)
- Risk and Return: English local authorities and Icelandic banks <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/riskandreturn.aspx>.
- Summing Up: a review of financial management in local government 2005-2008 <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/riskandreturn.aspx>

- Room for improvement: a review of strategic asset management in local government <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/roomforimprovement17jun2009.aspx>
- Valuable lessons: improving economy and efficiency in schools <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/valuablelessons.aspx>
- When it comes to the crunch: how councils are responding to the recession <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/whenitcomestothechunch12aug2009.aspx>
- Back to front: efficiency of back office functions in local government <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/backtofront.aspx>
- Financial implications of an ageing population (to be published early 2010) <http://www.audit-commission.gov.uk/nationalstudies/localgov/Pages/backtofront.aspx>
- Strategic Financial Management (to be published early 2010) [http://www.audit-commission.gov.uk/nationalstudies/upcomingnationalstudies/Pages/upcomingstudieslocalgovernment\\_copy.aspx](http://www.audit-commission.gov.uk/nationalstudies/upcomingnationalstudies/Pages/upcomingstudieslocalgovernment_copy.aspx)

## Public Interest Reports

- North East Lincolnshire Council Public Interest Report 2003/04 <http://www.audit-commission.gov.uk/localgov/audit/pir/Pages/Default.aspx>

## Other information sources

- Financial Skills for All e-learning tool [www.audit-commission.gov.uk/fmskills](http://www.audit-commission.gov.uk/fmskills)

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We welcome your feedback. If you have any comments on this report, are intending to implement any of the recommendations, or are planning to follow up any of the case studies, please email: [nationalstudies@audit-commission.gov.uk](mailto:nationalstudies@audit-commission.gov.uk)



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