Grant Thornton

Lessons from recent auditor's annual reports

July 2024

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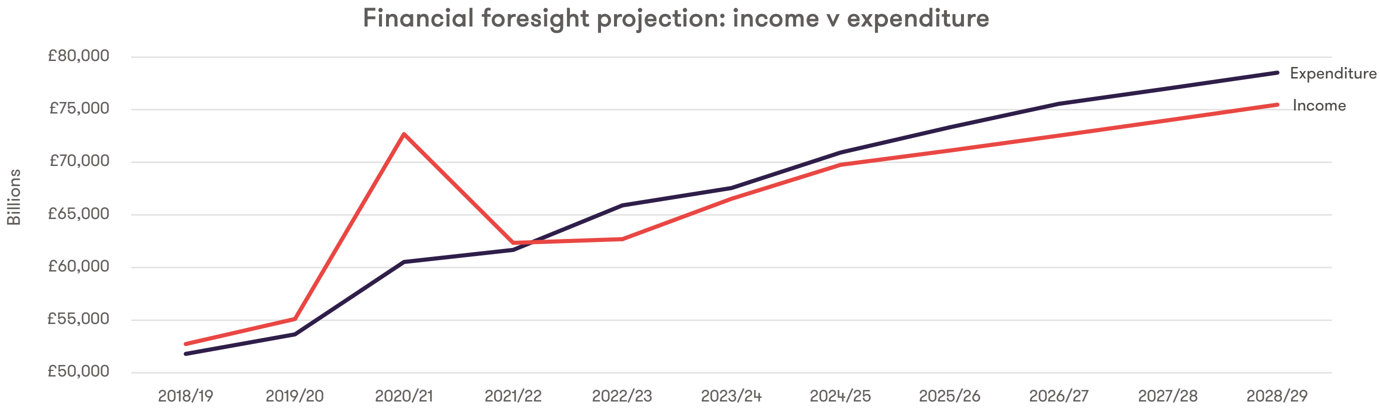
Lessons learned from recent auditor's annual reports

In April 2024, we reviewed 92 auditor's annual reports (AARs) produced by Grant Thornton for our local government audited bodies, which represents approximately 30% of councils in England. AARs are the key annual deliverable relating to our value for money audit work. These AARs covered the audit year 2022/23 and for thirty of these also 2021/22 due to joint reporting where audit work had been delayed. These AARs had been published between April 2023 and March 2024.

We found that only a small number of statutory recommendations were raised in the reports we reviewed (6 in total, covering late audited accounts, specific weaknesses in financial governance, and arrangements for the Housing Revenue Account) which related to four different councils. However, we also found that nearly 120 key recommendations relating to 40 different councils had been raised, and over 600 improvement recommendations relating to 82 different councils had been raised.

Local government has been dealing with austerity for almost 15 years, and more recent events such as Brexit, the Covid-19 pandemic, and the war in Ukraine and it's economic impact on the UK, have increased the pressure on the sector even further. There being just six statutory recommendations is a testament to the underlying resilience of the sector and the dedication of the staff working within it. Nevertheless, our recent report on preventing failure in local government (December 2023) highlighted a growing sector-wide gap between expenditure and income, driven by rising inflation, higher employee costs, and spiralling demand for some key services. We have recently updated our financial forecast for the sector which continues to highlight a medium-term gap between expenditure and income, driven by the same factors. Our latest projection forecasts that the sector-wide gap could reach £3 billion by 2028/29. Councils need to continue to manage significant financial changes in the absence of any change to the existing sector funding model.



A note on recommendations

Statutory recommendations are recommendations about significant weaknesses in relation to Section 24 (Schedule 7) of the Local Audit and Accountability Act 2014. They require a published written response.

Key recommendations are recommendations made about significant weaknesses and identified under the NAO Code of audit practice. They set out actions the council should take but do not require a published written response.

Improvement recommendations are recommendations which, if implemented, should improve the arrangements in place at the council, but are not a result of identifying significant weaknesses in the council's arrangements. Unaddressed weaknesses may become significant if left unchecked over time.

In the AARs that we reviewed, key recommendations in reports written between April 2022 and March 2023 showed an escalating rate of significant weakness in arrangements for financial sustainability. They also showed rising rates of significant weakness in arrangements for financial governance, internal control, performance management, and procurement; and in our view this is because the financial pressures some councils are facing is undermining other arrangements. We compared the key recommendations in AARs written between April 2022 and March 2023 with those in AARs written between April 2023 and March 2024. We found the number of key recommendations for the general fund had more than doubled in the second year.

Common issues between April 2023 and March 2024 related to:

- savings and transformation plans
- the dedicated schools grant, in particular Special Education Needs and Disability (SEND) services
- financial governance and internal control, sometimes linked to workforce issues
- performance management and procurement, sometimes linked to prior year recommendations.

When we reviewed improvement recommendations raised in relation to the 2022/23 audit year, we found that almost half of them related to the same issues as the key recommendations, but were not as significant areas of concern. Left unaddressed the financial sustainability and other issues identified in the improvement recommendations are likely to escalate, resulting in more significant matters for local government to resolve.

Value for money criterion	2021/22 number of key recommendations	2022/23 number of key recommendations	% increase 2021/22 to 2022/23
Financial sustainability	12	43	258
Governance	23	42	82
EEE	20	33	65

Source: Grant Thornton Annual Auditor Reports published between April 2023 and March 2024

Despite two of the statutory recommendations for 2022/23 relating to the Housing Revenue Account, there were very few key recommendations raised in 2022/23 about this ringfenced area of council expenditure. However, there were improvement recommendations that could escalate here too.

Recent years in England have seen sharp focus on the increasing demands for adults and children's social care, school transport, and homelessness. Housing safety, maintenance and service standards have however fallen at some councils during the same period. If the trend for improvement recommendations to escalate over time into key recommendations applies to housing as readily as it does to the other council services those councils responsible for housing services, will be facing even more financial pressures.

Significant challenges lie ahead for local government and a proactive approach from the future national government may make a difference to how well councils respond. Looking beyond 2024/25 , there are also opportunities for the sector. Careful action now may leave councils better placed to take advantage of new opportunities in the future. This report includes a checklist to gauge how closely the lessons learned from 2022/23 apply to support councils in reviewing their arrangements in place.

Case study

One council highlighted how issues can snowball over time, with the council going from having no significant weakness but room for improvement in 2020-21 to having a significant weakness, statutory recommendation, and improvement recommendation in 2021-22, and then to having a significant weakness, statutory recommendation, improvement recommendation, and an additional key recommendation in 2022-23. The report concluded that because the recommended budget monitoring had not been introduced in 2020-21, the council now had no plan to bridge its budget gap in 2022-23.

Spotlight on financial sustainability

Savings and transformation plans

Key recommendations from 2022/23 on financial sustainability highlight the challenges many councils face in developing and delivering savings and transformation plans. Councils that were slow to react to rising costs and to develop effective savings plans had to draw heavily on their reserves in 2022/23, whilst those that did develop plans often struggled to deliver the planned savings. The most common lessons from our auditor's annual reports are:

- start early
- avoid optimism bias
- and maintain detailed records of savings forecast delivered to allow for effective monitoring.

The importance of starting savings plans early was highlighted by a council where we found good financial results in prior years meant savings were not at the forefront of councillors' minds when they were preparing the budget for 2022/23. The council planned to draw £27 million from reserves during the year but had not fully developed its savings plans at the time the budget was set. As inflation took hold, the council could not contain costs and could not put new savings initiatives into action as quickly as it needed to. The actual draw on reserves was more than double the planned amount (£54.7 million). By the end of the year, reserves had depleted by 44% and the council was left with the lowest reserves of all metropolitan districts in England.

The case of one council highlights the importance of developing detailed transformation plans early. The council embedded savings from a transformation plan into its medium-term financial strategy for 2022/23 to 2024/25 but identified little in the way of large-scale projects, project plans and risk management to support the transformation plan. By the time the medium-term financial strategy for 2023/24 to 2025/26 was prepared, the level of savings and efficiencies generated from the transformation plan were not sufficient to address the budget gap over the medium term.

Example quote from an auditor's annual report

It looks likely that the council is going to have to engage with the department for Levelling Up, Housing and Communities in some way. Changes to the council's own record keeping may make this easier. Separate monitoring of savings and scenario testing for medium-term plans... (may)... make it easier to see and monitor the whole picture for the council, to determine where to direct effort, and to understand what the full scale of the risk is.

Optimism bias means that councils sometimes use savings and transformation plans to avoid difficult decisions about reducing services, before really challenging whether the savings and transformation plans are deliverable. One county council in the south-east of England planned to deliver £37.9 million of savings in a single year (2022/23) to set a balanced budget, without reducing services. It went on to overspend by £44.24 million during the year, due to a mixture of savings not being delivered and unforeseen costs. The council's plans were more ambitious rather than less ambitious the following year – a savings plan of £86.6 million for 2023/24 was introduced to set a balanced budget without having to reduce services. By the end of January 2024, new costs and undelivered savings meant the council was left facing a challenge to deliver £36 million of management action in just eight weeks if it was to achieve the planned target. There was little in the way of developed plans to support the eight weeks of management action – mainly the council was hoping to find short term one-off measures that could be applied until the year end.

Detailed plans for savings and transformation plans (outside the business as usual budget) can help to focus officer and member minds on whether they are realistic. We identified a council that had difficulty planning ahead for 2022/23. The council was relying on savings to balance the budget but had no tools for monitoring savings delivery outside of main budget monitoring. By the end of 2022/23, the council had used nearly £11 million of reserves to balance its budget – and was left with a general balance on reserves that was only £155,000 higher than its assessed minimum amount. This council had also been relying on savings to avoid difficult decisions about reducing services.

Our preventing failure in local government report's financial foresight projection (see page 3 of this report) shows that financial pressure on councils is likely to lessen in the future – inflation, and the associated cost of living are expected to fall after 2024/25, but the outlook for local government continues to remain uncertain, and councils need to remain relentless in their focus on managing their medium term finances. The AARs for 2022/23 show that relying on savings and transformation plans won't necessarily do this.

Example quotes from auditor's annual reports

Members need to recognize that some decisions around discretionary services will prove very unpopular with the public but do need to be made. Driving out material savings in high demand services is always possible but not a panacea in itself.

The council is now in a position where it must consider a re-alignment of priorities to coincide with securing financial sustainability. This may involve making unattractive or undesirable decisions in the interest of the authority's future viability.

The Dedicated Schools Grant

Key recommendations for 2022/23 show that councils have been challenged by the continued demand for education and health care plans (EHCPs), which has made it difficult for them to reduce their Dedicated Schools Grant (DSG) deficit, where this exists, even where support from government has been agreed. With the current statutory override due to end in 2026, our AARs for 2022/23 show that those councils affected are going to have to work more closely with schools' forums and parent groups to manage demand if they are going to protect their reserves balances in the coming years.

We identified councils across England who had DSG safety valve agreements in place with the Department for Education (DfE) for reducing their dedicated schools grant deficit (in particular, for special educational needs and disability), but who were failing to reach their year 1 targets under these agreements. For one unitary council in the south-west of England, we reported that the council would be likely to eliminate its deficit some five years later than had been agreed with the DfE at the current rate of progress. For another unitary in the north of England, we reported that the council was agreeing to delay completion of its safety valve scheme by one year, but only if additional funding was forthcoming from the DfE (otherwise the delay would be longer). We identified one county council in the south-east of England where extensive work had been undertaken to make savings, but the council was still behind with safety valve recovery because its underlying demand for EHCPs remained stubbornly well above the national average.

There are national issues to be resolved by central government around the DSG and the approach to EHCPs but that should not stop councils being proactive where they do have room for manoeuvre. Our AARs did highlight good examples at some councils of investment in early years support to reduce future EHCP demand and early working with adult social care teams to manage demand around transition. Clarity from central government may not be forthcoming for some time yet, given the forthcoming general election, and reaching out to peers to compare best practice within existing arrangements is likely to be important given that there are still several years to go under the current regime.

Spotlight on governance and on improving economy, efficiency and effectiveness

Financial governance, internal control and the workforce

Four of the six statutory recommendations raised for 2022/23 related to poor financial governance – including accounts not being prepared because of weak underlying finance systems or lack of appropriate capacity and skills; and wider weaknesses in financial planning and monitoring arrangements.

At the same time, the most common single area covered by key recommendations on governance for 2022/23 related to falling standards of internal control and/or falling standards of IT and data security. Often, this was linked to headcount reductions; vacant posts; and a reliance on contractors.

In the case of one council, external consultants concluded that internal controls were not fit for purpose after resources for the management accounting function had been reduced year on year for three years. The council was employing around 500 more people than is common for an organization its size, but in contrast there was a vacancy rate of up to 30% for the finance function. For a different council there was a key recommendation raised around lack of IT security for the many temporary staff coming and going – there was an unmitigated risk of data loss with each new starter and leaver.

Our AARs for 2022/23 also showed that significant weaknesses in workforce arrangements can impact on substantive service standards achieved as well as on the governance over those standards. This can be the case at council and provider level. For the city council in the Midlands previously mentioned, the AAR showed that reliance on temporary staff in children's services was preventing consistent quality standards being achieved, making it hard to move away from an Ofsted inadequate rating. For a county council in the north of England, we found that there were 300 people on the waiting list for homecare, but providers were handing homecare packages back to the council because they could not recruit staff to deliver them.

It is perhaps telling that lack of workforce strategy was one of the most common improvement recommendations made in 2022/23.

Statutory reccommendations 2022/23

2 inability to product statutory accounts due to weak financial accounting systems

2 weak weak financial planning and financial monitoring arrangements

1 HRA business plan not reviews, and HRA stock condition not surveyed

1 HRA service standards not met

Performance management, procurement, and implementing prior year recommendations

Lack of regular performance reporting was the most common single area covered by key recommendations on Improving economy, efficiency and effectiveness for 2022/23. During the Covid-19 pandemic many councils did delay or abridge their operational performance reporting, but several years have now passed since reporting could reasonably have been re-introduced. A common observation across our AARs for 2022/23 was that without effective performance reporting, councils did not know where to make savings effectively and could not tell what impact the savings they did make was having on service standards.

Key recommendations relating to procurement and contract management were also common in our AARs for 2022/23. This highlighted that in many cases, concerns around procurement and contract management had already been raised the year before. Typically, the concerns for 2022/23 surrounded legal compliance; sufficiency of procurement resources; and effectiveness of procurement oversight. It is worth remembering though that similar improvement recommendations on procurement and contract management were so common in our AARs for 2021/22 that we published a national report setting out lessons learned in December 2022[1]. That they feature again in 202/23 AARs as more serious key recommendations is an example of how issues can escalate if left unaddressed.

With over 600 improvement recommendations having been raised in our 2022/23 AARs included in our research , it will be important that the councils concerned do not allow these issues to escalate. It will be important that these are actioned promptly during 2023/24. A general tendency to delay actioning prior year improvement recommendations could be seen in many of the auditor's annual reports we reviewed, in many cases because staff had left the council or because new issues had emerged that the council was focusing on. In some rarer cases, there was evidence of the culture of the council's leadership not taking recommendations seriously.

Case study: a council overseen by an improvement and assurance board

Areas where significant work is still needed, and concerns remain, include financial sustainability; workforce strategic management; and the effectiveness of internal control. There are significant concerns around the pace of progress with improvement.

The council should engage fully and at pace with the next improvement or Intervention plan agreed with the Secretary of State and/or the improvement and assurance board.

The auditor's annual report detailed progress with eleven different key recommendations from the previous two years.

Case study: a council that needed to take a holistic approach to improvement

The council should strengthen its pace and tighten its corporate grip over progress with addressing key recommendations. A holistic approach should be taken towards improving financial sustainability, governance and performance across the board.

The auditor's annual report detailed an additional six key recommendations. The auditor's annual report showed that all six recommendations surrounded issues which had been reported in the previous year.

1 Local government procurement and contract management (grantthornton.co.uk December 2022)

The Housing Revenue Account

In recent years, although there has been a strong focus from councils on arrangements relating the general fund, Housing Revenue Accounts (HRA) have also come under increasing pressure. This includes inflationary cost increases and new regulatory costs outstripping increases in rental income; difficulties servicing debt; slippages in repairs and maintenance compromising safety; and delays to the implementation of the planned capital programme. London boroughs, estimated to be responsible for letting around 390,000 social homes, are particularly exposed. For one borough in London, the AAR highlighted that 13% of its housing stock was suffering from damp or disrepair. For another borough in the south of the capital, rental income for the HRA is expected to reduce by around £1.2 million per annum for an estimated two years because of delays in the planned building of new homes. However, problems with the HRA are not confined to the capital.

Councils across England who have this responsibility, need to take a strategic approach towards managing their HRA. Delaying capital investment in one year has led to increased needs for high-cost emergency repairs and maintenance work at some councils the next year. With new housing consumer standards being mandated from April 2024, any short-term savings in repairs and maintenance now could lead to very high costs in the future. Similarly, at some councils savings on rent collection and landlord costs in one year have led to reduced income in another year. However, at other councils, digital landlord roles are now being successfully explored. Common improvement recommendations for the HRA in our AARs for 2022/23 have related to:

- maximise rental income where possible, within the statutory constraints that exist
- maintain strong financial and performance reporting on the Housing Revenue Account
- keep stock condition records and repairs activity registers up to date so that gaps can be identified accurately
- ensure that committee oversight is effective. Is the same committee cited on housing risks as is cited on housing performance?
- explore efficiencies around the landlord role.

Checklist for success

Taking statutory, key and improvement recommendations together, our AARs that have been reviewed included just under 730 different suggestions for improvement across more than 100 councils. Suggestions were often very specific to individual councils, but there were still common themes that most councils can be mindful of.

As we have seen, the financial challenges facing the local government sector are expected to get worse rather than better between now and 2024/25, but we can also see that some of the key trends around inflation and rising demand may abate in the medium term. Local government is in a strong position to deliver nationally important policies, for example in relation to climate change, but the sectors finances remain uncertain over the medium term

It will be important that councils continue to effectively manage their financial resilience, governance and performance arrangements. Our checklist may be of interest to elected members, to use to determine how closely the common lessons learned from our AARs for 2022/23 may apply to your council.

External audit recommendations

- [ ] Do we have an up to date log of prior year external audit recommendations and rates of implementation?
- [ ] Are we briefed on progress with external audit recommendations?
- [ ] Has internal audit been engaged to monitor progress with external audit recommendations and to report on whether there are wider impacts for other areas of the business?

Savings and reserves

- [ ] Is the medium-term financial strategy updated regularly and does the latest update identify future budget gaps?
- [ ] Are savings and transformation plans granular, with named owners, detailed project plans, clear timelines and targets?
- [ ] When we make budget decisions, what confidence level do we have in savings and transformation plan delivery?
- [ ] Are savings and transformation plans included on the Corporate Risk Register?
- [ ] Is progress with savings and transformation plan delivery regularly monitored outside the main budget process? Did recent reports indicate delivery at expected rates?
- [ ] What is the current gap between non-schools general fund earmarked reserves and their estimated prudent minimum?

The Dedicated Schools Grant Deficit (Special Educational Needs and Disability)

- [ ] Do we have a dedicated schools grant deficit and if so, what arrangements are in place for closing it? Are those arrangements on track?
- [ ] Do we have a granular plan for reducing demand in our local area for EHCPs?
- [ ] Do we monitor progress with EHCP reduction regularly?
- [ ] Was our EHCP reduction plan developed after consultation with the schools forum, parent groups and peer councils?
- [ ] Is the Dedicated Schools Grant included on the Corporate Risk Register?

Workforce

- [ ] Do we have an up to date workforce strategy?
- [ ] What work has the council undertaken to identify its optimum workforce establishment (numbers and skills mix)?
- [ ] Have we tested how closely the actual workforce matches optimum establishment?
- [ ] Who is the risk owner for workforce recruitment and retention? How are workforce risks monitored and mitigated?

The Housing Revenue Account

- [ ] Do we have an up to date strategy for the Housing Revenue Account?
- [ ] When were governance and internal control arrangements for the Housing Revenue Account last reviewed?
- [ ] Is the Housing Revenue Account included on the Corporate Risk Register?

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