Counting Down to Competition

A Management Handbook on Financial Support Services
The Audit Commission

...promotes proper stewardship of public finances and helps those responsible for public services to achieve economy, efficiency and effectiveness.
Counting Down to Competition

1. Introduction: Financial Support Services in a Changing World

2. Successful Financial Service Providers

3. Developing Competitive Financial Support Services

4. Responding to CCT
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Preface

The Audit Commission has a long record of reports on, or pertinent to, local authority financial support services. These include:

- *Improving Cash Flow Management in Local Government* (1985), a report on a range of finance department activities, which included advice on transaction-based services such as payroll, creditor payments and collection of sundry debts;
- a number of papers on information technology (IT), and the 1994 executive report, *High Risk/High Potential: The Management of IT in Local Government*, along with *High Risk/High Potential: A Management Handbook on IT in Local Government*;
- *Behind Closed Doors: The Revolution in Central Support Services* (1994) on the client role for central support services (including financial services), and specifically on how users can obtain best value from these services.

These reports, and associated work by local auditors, have contributed to the impressive achievements of local authority finance managers in preserving the integrity of services in the face of rapid change over the last ten years. However, the pressure for further change and improvement is unrelenting. Notably, the requirement that an amount of authorities’ financial services be exposed to competition will pose major challenges. Accordingly, when the Commission consulted local authorities in 1993 on its prospective study programme, there was widespread support for a further study of financial support services, both to help authorities with the changes necessary for an effective response to compulsory competitive tendering (CCT) and to promote value for money in the services that would not be exposed to CCT.

The study has examined six services: accountancy, internal audit, payroll, creditor payments, sundry debtors and cashiers services. Through this study, the companion 1995 study of local authorities’ collection of taxes (Ref. 1) and the 1993 study of housing benefit administration (Ref. 2), the Commission has covered the overwhelming majority of the financial services embraced by the government’s definition for CCT purposes.

The study team undertook fieldwork visits to 17 authorities in England and Wales, and subsequently made shorter visits to five further authorities and to a range of non-local authority organisations. An extensive questionnaire was completed by 39 authorities, providing details (covering both central and service department-based operations) of costs, volumes, standards and service
delivery for each of the six support services. The Commission would like to thank all these authorities for their participation in the study.

This handbook is complemented by an Executive Briefing, From Administration to Management: The Management of the Finance Function in Local Government. The Briefing summarises the key messages from this study and the study of local tax collection.

The subject matter of this handbook features as part of the 1994/95 audit programme at metropolitan and London authorities, and at other authorities that have requested it. The performance of remaining authorities, including those newly created as a consequence of the Local Government Review (LGR), will be examined against this material as part of their audit programme in 1995/96. Assisted by the Commission's external auditors, authorities will have the opportunity to apply the good practices described here.

The study was carried out by a team consisting of Greg Wilkinson from the Audit Commission's Local Government Studies Directorate, and Simon Cookson and Geoff Delamere on secondment from District Audit, under the direction of Doug Edmonds. Consultancy assistance was provided, at different stages, by Brendan McCarron, Robert Barr, Philip Blake, Clive Hall and Bernard Johnson. During the course of the study, the Commission was assisted by an advisory group, members of which provided valuable advice and guidance. Additionally, a number of senior local authority finance officers have commented on drafts of the handbook. Nevertheless, the contents of this handbook remain the responsibility of the Commission alone.

But not all authorities were able to complete properly all parts of the questionnaire, so the number of data points in exhibits within the handbook will often be less than the full 39.
How to use this handbook

This handbook has two main objectives:

◆ to promote value for money in financial support services, by offering benchmarks and guidance on good practice;
◆ to help authorities respond to the extension of CCT to finance services.

The two objectives interact. For any or all of the six services explored by this handbook – accountancy, internal audit, payroll, creditors, sundry debtors, and cashiers – CCT is one way of obtaining improved value for money; and part of an effective response to CCT is an evaluation of the value for money offered by the existing service. However, an authority may wish to meet its CCT requirement by exposing other financial services, notably tax collection and benefits administration. The general advice in this handbook on CCT is of relevance to all financial services, not just the six covered here.

Selecting from the handbook – guidance for particular audiences

The handbook comprises four sections:

◆ Section 1 – an introduction covering the pressures for change, with a diagnostic framework for exploring cost variations, and advice on a strategic response to the challenges facing financial support services;
◆ Section 2 – on effective provider-side management, exploring issues that are common to all financial services (including tax collection and benefits services);
◆ Section 3 – on the specific value for money issues for each of the six financial services, with a chapter on each; and
◆ Section 4 – on responding to CCT.

Advice to its main audiences on the use of the handbook is set out in Box A (overleaf).
### Box A

**Using the handbook**

<table>
<thead>
<tr>
<th>User</th>
<th>Purpose</th>
<th>See</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Directors of finance</strong></td>
<td>• to assess how you and your authority manage the 'core' finance functions</td>
<td>3: Developing Competitive Financial Support Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1: Accountancy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2: Internal Audit</td>
</tr>
<tr>
<td></td>
<td>• to consider how your authority should meet the CCT requirements</td>
<td>4: Responding to CCT</td>
</tr>
<tr>
<td></td>
<td>• to ensure good practice in provider-side management across your in-house services</td>
<td>2: Successful Financial Service Providers</td>
</tr>
<tr>
<td></td>
<td>• to explore the scope for improvement when any of your services fail to meet the benchmarks listed (see Box B)</td>
<td>3: Developing Competitive Financial Support Services</td>
</tr>
<tr>
<td></td>
<td>• to focus attention on issues highlighted by your external auditors in their value for money audit programme</td>
<td>As appropriate</td>
</tr>
<tr>
<td><strong>Finance managers</strong></td>
<td>• to fulfill your responsibilities as a client</td>
<td>3: Developing Competitive Financial Support Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>As appropriate</td>
</tr>
<tr>
<td></td>
<td>• to prepare to let and manage a competitively tendered contract</td>
<td>4: Responding to CCT</td>
</tr>
<tr>
<td></td>
<td>• to fulfill your responsibilities as a service provider</td>
<td>3: Developing Competitive Financial Support Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>As appropriate</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Provider costs and competitiveness</td>
</tr>
<tr>
<td></td>
<td>• to prepare for exposure of your service to competitive tendering</td>
<td>4: Responding to CCT</td>
</tr>
<tr>
<td></td>
<td>• to assist in your negotiations with financial service providers</td>
<td>3: Developing Competitive Financial Support Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>As appropriate</td>
</tr>
<tr>
<td><strong>Managers of other professional services</strong></td>
<td>• to ensure effective provider-side management</td>
<td>2: Successful Financial Service Providers</td>
</tr>
<tr>
<td></td>
<td>• to gain insights into the preparation of your own service for competitive tendering</td>
<td>4: Responding to CCT</td>
</tr>
<tr>
<td><strong>Corporate policy staff</strong></td>
<td>• to help develop your authority’s corporate strategy for CCT</td>
<td>4: Responding to CCT</td>
</tr>
</tbody>
</table>
Selecting from the handbook – top level benchmarks

An authority’s interest in the detail of Section 3 will be determined largely by its assessment of the value for money offered by its present services. To assist with this assessment, authorities can compare their performance against top-level cost indicators for the six services (Box B). These have been derived from Commission survey data. Advice on how to calculate the benchmarks is provided in Appendix B.

The indicators are offered merely as a starting point for analysis and consideration. There is a variety of legitimate reasons why a service might exceed the benchmark: notably, high costs may result from high service standards as well as from high provider unit costs. However, unfavourable comparison with a benchmark should lead an authority to explore the issues raised in the relevant chapter/s of Section 3 and to take further action as necessary.

<table>
<thead>
<tr>
<th>Service</th>
<th>Shire districts (excluding ‘Big 11’ districts)</th>
<th>Other authorities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Accountancy</strong></td>
<td>£16,600</td>
<td>£7,800</td>
</tr>
<tr>
<td>Cost per £m NRE+HRA* p.a.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Internal audit</strong></td>
<td>£4,600</td>
<td>£1,800</td>
</tr>
<tr>
<td>Cost per £m NRE+HRA* p.a.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Payroll</strong></td>
<td></td>
<td>£51</td>
</tr>
<tr>
<td>Cost per authority employee p.a.</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Creditors</strong></td>
<td></td>
<td>£1.15</td>
</tr>
<tr>
<td>Cost per invoice paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Sundry debtors</strong></td>
<td></td>
<td>£4.83</td>
</tr>
<tr>
<td>Cost per debt raised</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cashiers</strong></td>
<td></td>
<td>£0.40</td>
</tr>
<tr>
<td>Cost per receipt</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* The authority’s Net Revenue Expenditure (NRE) plus its gross rental income from its Housing Revenue Account (HRA). Appendix C discusses the use of the NRE+HRA figure as a denominator.
This handbook identifies significant opportunities for improving value for money in financial support services. These opportunities, combined with the scale and proximity of the challenges (particularly the advent of CCT for finance services), suggest that finance directors and senior finance managers should address urgently the scope that exists to improve financial services in their authorities. For metropolitan and London authorities, the first CCT contracts will need to have started by April 1997 – only 21 months after the publication of this handbook. Even for LGR-affected authorities with less demanding CCT timetables, the pressure for rapid change is strong.

The handbook offers a systematic approach which will enable management to focus and prioritise their efforts. Moreover, it will help authorities manage change effectively. Authorities that have already begun to respond to CCT will find the handbook of assistance in reviewing progress to date.

Managers should use this handbook to develop action plans for their financial support services, concentrating on services designated for CCT and on services where the divergence between current costs and benchmark costs is greatest. Although the challenge facing financial support services managers is considerable, the solutions are clear. Authorities must examine the standards to which they are aspiring and assess whether they are affordable. They must also see if they can reduce the volume of work as well as the unit cost. Action therefore is needed by client and contractor. Authorities will need to:

◆ rethink their requirements for financial support services;
◆ develop competitive in-house providers where provision is not contracted out;
◆ develop effective relationships with private suppliers, where these are the best means of securing value for money service provision.

Through adopting these solutions, authorities can ensure that financial support services continue to play a central role in local government and help deliver high quality, value for money public services.
Section 1 Introduction: Financial Support Services in a Changing World

- What are the pressures for change on financial support services?
- How can costs and performance be analysed?
- What can be done to improve value for money and respond to these pressures?
Introduction: Financial Support Services in a Changing World

1.1 This handbook addresses the management and delivery of six financial support services:

- accountancy
- internal audit
- payroll
- creditor payments
- sundry debtors
- cashiers services

Definitions of these services are provided in Appendix A.

1.2 These services can be delivered by staff in a central department or by staff in service departments (whether based in the centre of these departments or devolved into business/service units). In practice, most authorities deliver services through a combination of central and service department staff. The study team estimates that, taken together, the six services account for nearly half of all local authority financial services expenditure (Exhibit 1.1); the remainder is accounted for by tax collection, benefits administration and a range of more specialist services such as treasury management, pensions management and insurance.

Exhibit 1.1
Expenditure on financial services

Financial support services account for nearly half of all local authority financial services expenditure...

Source: Audit Commission survey of authorities; CIPFA statistics 1993/94; Remote Control: The National Administration of Housing Benefits, Audit Commission, 1993
1.3 No national records exist of expenditure on financial support services. The study team estimates that in 1993/94, local authorities in England and Wales spent in excess of £1bn per annum on the six services, with accountancy representing nearly 50 per cent of the total. A clearer picture of expenditure on these services may emerge with authorities’ publication of their Statements of Support Service Costs (SSSC). The pattern of expenditure varies between authority type (Exhibit 1.2): in county councils, for example, cash collection is a negligible portion of financial support services expenditure, since counties do not have responsibility for tax collection or housing, whereas payroll is more significant (counties have greater numbers of employees).

1.4 The six services incorporate a diverse set of roles. All six provide support to other services (this includes support from one financial service to another); a number contribute to the exercise of control over the actions of service managers; and accountancy is central to corporate strategy and management (as well as to strategy issues for individual services). The corporate management and control roles are often referred to as the ‘core’ finance function – namely, the function that is central to the working of the authority as a whole and will remain whether or not services are contracted out. In most authorities, this ‘core’ has remained within the central finance department, whereas the support role is organised across both central and service departments. The advent of CCT for financial services will overlay a split between the client (or clients’ agent) and provider roles across this already complex organisational world (Exhibit 1.3, overleaf).

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Exhibit 1.2

Expenditure on financial support services by authority type

The pattern of expenditure varies between authority type...

Source: Audit Commission survey of authorities

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**Financial support services (average cost) (£m)**

<table>
<thead>
<tr>
<th></th>
<th>London boroughs</th>
<th>Metropolitan districts</th>
<th>Counties</th>
<th>Shire districts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cashiers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Creditors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal audit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sundry debtors</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accountancy</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Audit Commission survey of authorities
1.5 Historically, finance departments have given first priority to the strategy and control roles, not to the support role. This is not to assert that the support role has been neglected; rather, finance managers have seen their primary purpose as serving the body corporate, as opposed to individual managers in service departments. This is understandable, given that financial control has most prominence in law; it is central to the discharge of responsibilities under Section 151 of the Local Government Act 1972 (s151) and Section 114 of the Local Government Finance Act 1988 (s114) (see Box 1.A). Moreover, the emphasis on control has produced a largely impressive record of financial management (Ref. 3); local authorities generally produce budgets and tax demands on time, avoid overspending and endeavour to minimise fraud and corruption (Ref. 4).

Box 1.A
Statutory duties of the chief financial officer

<table>
<thead>
<tr>
<th>Section 151, Local Government Act 1972</th>
</tr>
</thead>
<tbody>
<tr>
<td>requires a local authority to “make arrangements for the proper administration of financial affairs” and to “secure that one of their officers has responsibility for the administration of those affairs”.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Section 114, Local Government Finance Act 1988</th>
</tr>
</thead>
<tbody>
<tr>
<td>places a duty on the chief finance officer personally to make a report to all members of the Council if it appears to him that the Council is about to make a decision or take a course of action that would result in unlawful expenditure or incur expenditure that would exceed the resources available.</td>
</tr>
</tbody>
</table>

Exhibit 1.3
The complex organisational world of financial support services

CCT overlays a split between client and provider...

Source: Audit Commission

Dimension 1

Provider

Client

Core Provider

Director of Finance/corporate client

Central support provider

Client agent

Departmental support provider

User client

Source: Audit Commission

Total shaded area = Total financial support services included within the Government’s definition of finance services for CCT

1.4
1.6 In recent years, however, finance managers have faced pressures for change and specifically for improved delivery of the support role. Changes in government legislation have created an array of end-users with powerful interests in value for money (such as schools, direct service organisations (DSOs), etc.). Moreover, the Chartered Institute of Public Finance and Accountancy (CIPFA) statement, on Accounting for Support Services (1991, updated 1995) has encouraged financial providers to respond to the demands of service department managers who bear the fully-apportioned costs of financial services. In some forward-thinking authorities, users have been able to exercise a strong influence over the delivery of financial and other central support services, making good use of service level agreements (SLAs), devolved budgets and an internal market.

Pressures for change

1.7 The environment for financial services is becoming ever more challenging. Whilst continuing to discharge their core and corporate responsibilities to high standards, finance managers must respond to a range of pressures:

♦ **Budgetary constraints** – many authorities face pressure on their budgets as a result of national public expenditure decisions and limits on local tax-raising opportunities. Financial services are subject to these pressures in the same way as other local authority services.

♦ **A more complicated financial regime** – the 1980s saw significant growth in the extent and complexity of central government policies and regulations concerning local spending (Standard Spending Assessments (SSAs), capping, formula funding for schools, more complex capital controls, greater use of bid-led funding, etc.). This has placed additional burdens on authorities’ accountancy sections.

♦ **Cultural change** – a number of authorities have embraced devolution of financial management and control, first to service departments and then further, to individual services or business units. Some authorities are also questioning whether some financial services even need to be provided by dedicated staff at all.

♦ **Rethinking the role and purpose of financial services** – devolution, cost centre accountability and technological change have led some authorities to question whether the traditional control role of financial services, particularly accountancy, is still appropriate. These authorities are also speculating whether some private sector models of the finance director’s role (placing more emphasis on developing corporate strategy and providing support to operational managers) may be more appropriate than the traditional ‘treasurer’ role.

♦ **Customer pressure** – in most authorities, devolved budget holders (especially in schools and social services establishments), DSOs providing services designated for CCT under the 1980 and 1988 Acts, and sections affected by the imminent extension of CCT to professional services (such as legal, construction-related, personnel and housing management) are
stating their requirements more assertively. They are putting pressure on the finance function, often via the mechanism of SLAs, to reduce charges and respond to needs.

- **Falling workload** – finance functions face the risk of large reductions in turnover through the loss of contracts by DSOs, the commissioning of private providers by schools, and the transfer of social services provision and housing stock to private ownership. This risk is exacerbated by the limited trading powers that authorities have, raising the possibility of a service’s existing market disappearing with no new market emerging.

- **Technological change** – recent moves towards open systems and UNIX applications have raised questions about the future of mainframe computing. There is the potential for radical redesign of transaction-based services. Growing PC literacy amongst non-financial managers raises the possibility of reduced reliance on the traditional methods of providing and manipulating financial information.

- **Reorganisation** – the conclusions of the LGR create the need to design or adapt the finance function for incoming authorities. The finance functions should reflect the views of the new authority members on the desired character and culture of the new authority. Yet from the first day of the incoming authorities’ existence, finance directors will need to ensure the smooth running of the function (in terms of budgetary control, payment of staff and creditors, etc.) (Ref. 5).

- **Voluntary outsourcing and a strengthening private sector** – there is a growing interest among authorities in outsourcing financial services. This development has been accompanied by an expanding and strengthening range of private companies offering financial services, especially exchequer services, to local authorities.

- **Extension of CCT to financial services** – following the Department of the Environment’s (DoE’s) 1991 White Paper, Competing for Quality, the Government has identified finance services as a designated activity to be subject to CCT.

1.8 For a number of authorities, the extension of CCT is likely to be the key short-term pressure. For Metropolitan authorities and London boroughs, the first contracts must commence by April 1997; authorities subject to reorganisation and new authorities face a variety of deadlines between October 1997 and October 1999 to comply with the legislation. The Government has determined that authorities must expose to competition a target minimum amount, or specified proportion, of their expenditure on the defined activity (after taking 65 per cent of financial services expenditure or £300,000, whichever is the larger, as a competition-free allowance, and deducting further amounts for permitted exemptions).

1.9 Financial services CCT poses two challenges for authorities. Firstly, they need to decide which services should be tendered to meet the specified proportion. Secondly, they need to prepare those services for the process of competition. This preparation will involve both clients and providers. Clients will need to rethink service requirements and turn these into specified packages.
against which bids can be sought. Providers must prepare their staff and their operations for the rigours of the market place.

Cost variations

1.10 These pressures are evolving against a backdrop of varying levels of expenditure by authorities on financial support services. Comparison of total expenditure\(^1\) on the six services as a percentage of net revenue expenditure plus gross rental income from an authority’s housing revenue account (NRE+HRA)\(^2\) reveals considerable variation between and within authority types. Some variation would be expected between authority types (resulting from, for example, the smaller turnover of most shire districts compared to most counties, and the higher staffing costs incurred in London); however, variation of plus or minus 50 per cent within each authority type is more surprising (Exhibit 1.4).

1.11 Four factors may lie behind this variation:

- **Standards** – variations between authorities in policies on target response times and levels of accuracy for transaction-based services may impact on the cost of those services. Similarly, variations in policy on the accessibility and availability of advice and information may have cost implications. Finally, variations in the level and quality of performance may have resource implications both in terms of the amount of resource required and the unit cost of that resource (especially the unit staffing cost).

- **Volumes** – service volumes can be defined as the number of units of service required, whether an output – for example, a payslip – or an input unit – for example, a day of internal audit activity, such volumes will have a strong influence on the level of expenditure. They will be

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Exhibit 1.4

**Expenditure on financial support services**

Expenditure varies by ±50 per cent within each authority type...

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Source: Audit Commission survey of authorities
determined by factors over which individual finance or client managers have little control (such as the size of an authority and the number of employees) and by policies over which managers can influence greater control (such as whether employees are paid weekly or monthly, whether payments are made by BACS or cheque, and whether to avoid raising debtors by the use of prepayments).

- **Substance** – some authorities may incur lower expenditure by reducing their use of dedicated staff to deliver financial services. Some authorities have harnessed technological and organisational change to devolve and ‘dissolve’ aspects of the service into front line service units, where they require only a small percentage of individual employees’ time. Small parts of front-line employees’ time will fall below the 50 per cent threshold for CCT purposes; moreover, this approach allows dedicated staff to be shed. Although this has an opportunity cost (front-line staff cannot be used for other tasks), this is often small and the approach can potentially, though not necessarily, bring an overall financial saving. The ‘substance’ of the service, in terms of the use of dedicated staff, is reduced, thereby yielding lower recorded expenditure on the service than an authority that has retained more dedicated staff.

- **Provider unit costs** – authorities’ expenditure may vary because the economy, efficiency and effectiveness of their providers varies. Financial services providers’ costs have four principal components: staffing, IT, accommodation and other overheads (primarily the service’s running costs and the departmental and corporate overheads or charges that the service bears).

1.12 These factors can be linked in a diagnostic model to explore cost variations in each of the services (Exhibit 1.5). Total cost is a product of service volumes (which may be determined by a combination of uncontrollable and controllable factors) and provider unit costs, but potentially both of these may be influenced by service standards. The substance of a service will impact on staff and IT provider costs, such that a ‘dissolved’ service should incur lower dedicated staff costs.

1.13 Variations in expenditure for each service can be explained with reference to one or more components of the model. Using this model can reveal insights about how to improve value for money, by:

- making explicit and coherent decisions on standards, and considering trade-offs between standards and costs, where these exist;
- eliminating unnecessary or undesirable service volumes;
- matching best practice in provider economy and efficiency (whether through in-house provision or through outsourcing), where this can be achieved without jeopardising the authority’s desired performance standards.
The management challenge

1.14 Central to this diagnostic approach is the recognition that value for money on financial support services requires not merely competitive providers but also a properly thought-through set of service requirements in terms of standards and volumes. In short, value for money opportunities arise from client-side as well as provider-side sources. But the challenge for financial support services managers is not merely to look for the improvement opportunities from both sources: it is also to realise these opportunities whilst at the same time responding to the pressures listed in paragraph 1.7 above.

1.15 Authorities can best respond to this challenge by exploring the opportunities to improve value for money in each service, looking at both client-side and provider-side issues. They can then formulate a strategic approach to the procurement and provision of financial services in the light of this exploration. This approach to procurement should consider how best to meet the statutory CCT requirement and, more generally, which organisational route offers the best way of achieving value for money. For the services where the authority has decided to retain (or try to retain) in-house sections, a strategic approach to provision should identify the overarching management practices which ensure that all in-house sections maximise economy, efficiency and effectiveness. This handbook has been structured to assist authorities with such an approach. It begins with an analysis of the common themes that emerge from a review of the management of financial services.

*Source: Audit Commission*
Section 2 Successful Financial Service Providers

How can providers improve efficiency and effectiveness, through:

- business planning?
- marketing and relations with users?
- people management?
- the use of IT?
- the design of service processes?
- the control of overheads?
- monitoring, learning and review?
Introduction

2.1 Certain principles of effective management are common to all services. (Exhibit 2.1). They relate to preparing, resourcing and delivering the service, then finding ways to monitor performance, learn from experience and develop a cycle of continuous improvement. This section provides guidance and best practice checklists for each of these issues. Authorities may find it helpful to compare themselves against these checklists: those that compare favourably should be reassured that they have explored thoroughly the opportunities for service improvement. They will then have a sound base to consider the issues that are particular to individual financial services, as explored in Section 3.

Preparing

Business planning

2.2 Effective provider management starts from:
- an understanding of ‘the market’ – service users and their requirements;
- an analysis of the environment within which the provider will be attempting to meet these requirements;

Exhibit 2.1
Effective service management

Certain principles are common to all services...

Source: Audit Commission
From these starting points, managers should produce a statement of aims and objectives that can be translated into meaningful action plans and targets. These plans and targets should address financial as well as operational matters. Quantitative indicators should be identified as one of the bases for monitoring performance against the plans. Such an analysis is appropriate even if the service is not subject to CCT and is always expected to remain in-house. Support service managers must still identify the needs of their customers and critically examine their own performance.

2.3 Many models of business planning are available to help providers work through these issues systematically. For example, Exhibit 2.2 (overleaf) gives one set of questions which follow the principles of SWOT analysis. Many finance departments are using business planning to structure and focus their activities. Delyn Borough Council has employed business planning techniques to clarify priorities for performance improvement. Newcastle upon Tyne City Council has adopted a ‘bottom-up’ approach to business planning, involving staff at all levels. At the end of this process, Newcastle published a summary of the plan in an attractive, easy-to-read document that has been circulated to all staff. This has been a key part of management efforts to communicate objectives and values to every provider employee, as well as a useful means of feeding back to staff the results of their participation in the process. Overall, business planning appears to work best where it is part of a continuing effort by management to assess direction, priorities and progress, not a one-off effort to produce a business plan that sits, unopened, on people’s shelves. In this sense, the planning process is more important than the plan.

Marketing and relations with users

2.4 Marketing is the process that enables an organisation to identify customer needs and explore ways of meeting them that are consistent with the organisation’s financial objectives – a process with just as much relevance for the public sector as for private companies.

2.5 The introduction of CCT gives marketing an even greater importance, for two reasons. Firstly, without a precise understanding of customer requirements, in-house providers run the risk of over-bidding and losing tenders (see Section 4, paragraph 4.45). Secondly, if in-house providers are to compete on quality as well as price, they need to be able to demonstrate a record of meeting customer requirements, since this is the central component of service quality.
### SWOT Analysis

<table>
<thead>
<tr>
<th>Stage</th>
<th>Question to be asked</th>
<th>Issues to be considered</th>
</tr>
</thead>
</table>
| 1.    | What are our strengths? | - Processing transactions, providing information?  
- Providing outputs according to statutory requirements?  
- Knowledge of the authority and its requirements?  
- Solving customer problems?  
- Maintaining good relationships with customers?  
- Delivering to high standards of accuracy/reliability?  
- Able, knowledgeable and motivated staff? |
| 2.    | What are our weaknesses? | - An old-fashioned approach?  
- Emphasis on control rather than support?  
- Slow to respond to customer requests?  
- A poor image?  
- Poor internal/external communications?  
- Poor staff productivity or experience?  
- A high hourly rate compared with the private sector?  
- Uncompetitive IT and accommodation costs? |
| 3.    | What do our customers think? | - Have we conducted a customer satisfaction survey in the last 12 months?  
- Are there clear complaint routes for customers?  
- Do we understand customer problems?  
- Are we reactive instead of proactive? |
| 4.    | What opportunities are there in the external environment? | - Maintaining market share?  
- Local government reorganisation?  
- Enhance user control of their businesses?  
- Clearer business role? |
| 5.    | What external threats are there? | - Loss of other white- and blue-collar CCT contracts?  
- The authority downsizing?  
- Finance function dissolving into users’ operations?  
- High quality/cheaper private competitors? |
| 6.    | How can we do better? | - Greater staff flexibility?  
- Automated operational procedures?  
- Removal of duplicated procedures?  
- Greater use of project management?  
- Financial modelling of contract scenarios?  
- Develop advice services?  
- IT training?  
- User training and empowerment?  
- Enhanced service provision? |
| 7.    | What are the views of our own staff? | - Do we encourage consultation with staff? |
| 8.    | Have we got the right information? | - Costing?  
- Customer base?  
- Performance?  
- Profitability? |
Financial support service providers have employed a variety of techniques to identify user requirements and secure feedback on performance. These are most advanced for customers in schools, as a result of local management of schools (LMS) and grant-maintained (GM) provisions (Case Study 2.1, overleaf). Overall, good practice authorities have:

- invested considerable time and effort in visits to schools and discussions with head teachers and key support staff to identify requirements and assess current provider performance;
- reviewed both the range of services and the way in which they were provided – deleting unwanted services, modifying the form of financial information and establishing new structures for customer contact (e.g. named individuals to act as the first point of call);
- moved from a homogenous, uniform delivery of services to offering a ‘menu’ of different service packages to meet the needs of their diverse customer base;
- reflected developments in these areas in revised SLAs;
- produced brochures and publicity material with details of service ‘menus’ and contact points;
- developed liaison structures (primarily periodic meetings with users) and monitoring devices (including customer satisfaction forms, complaint records and structured questionnaires) to elicit regular feedback from customers;
- compared feedback data between years, allowing managers to assess trends in customer satisfaction.

**Resourcing**

**Effective people management**

People are the most important resource in all financial support services. Typically, they account for between 60 and 80 per cent of the total cost of a service, with other costs, such as accommodation, driven by staffing levels. Moreover, the customer’s experience of many financial support services cannot be separated from the perception of the person providing them: a service may have competitive costs, but will fail to create customer satisfaction if it is delivered by an unresponsive, demotivated or unfocused employee. The challenge for financial providers is therefore to achieve competitive performance against the ‘hard’ measures of productivity and cost, but also to secure quality service delivery through attention to issues such as motivation and communication with staff.

Managers should adopt a systematic approach to the analysis of staffing costs, using a diagnostic framework (Exhibit 2.3, overleaf). Staffing costs per unit of service depend on productivity and unit staff costs. Productivity is the product of utilisation (the percentage of time that each member of staff is available to undertake work) and work rate (the output per unit of available time). Unit staff costs result from the provider’s staff mix and the level of overtime; they may be further increased by plus payments (for example, higher salaries in London). The relative importance of these factors will vary between financial services, but certain general principles can inform the strategy for improvement.
Surrey’s financial services providers have paid close attention to marketing and promotion, and to improving relationships with service users. This has been of particular importance in education where, in addition to the challenges posed by LMS, the authority has had to respond to a large number of its schools becoming grant-maintained. Marketing efforts have been made by both the central finance department and the education department:

Internal audit – the section’s promotional material contains generic information about the service, explaining internal audit’s role and purpose, how it is structured, how an audit is conducted, how users can get the best out of an audit and when they should contact the service, and tailored leaflets, giving more specific service details plus named contacts and direct telephone lines, for each of its major customer groups:

- County Council services
- education services (LM and GM schools)
- other organisations, primarily district councils in Surrey that have opted to buy the service from the County rather than set up their own internal audit sections.

Payroll – for schools, the section has produced a written statement of the full range of services available: this generic ‘proposal’ is then tailored to fit the particular needs of individual schools after discussion between the school and a senior payroll officer. Feedback is obtained by making a minimum of one visit per term to each school to discuss performance with the head and other staff. This approach has helped Surrey to continue providing payroll to 23 out of its 25 GM schools.

Education Finance Unit – Surrey has merged the education department finance staff and staff that have recently been outposted from the central finance department into a single Education Finance Unit. This has allowed both schools and provider units within the education department to have a single point of contact within the County structure.

- The Unit has undertaken two major questionnaire surveys of users in recent years, feeding back to users the results of the first survey in distilled form, along with an account of the action taken by the unit to rectify the concerns expressed.

- It has issued a service brochure containing details of the unit’s structure and staff. To reinforce the emphasis on personal service, the document contains photos of staff and direct lines/e-mail addresses. At the end of the document, there is a summary list of financial issues with an accompanying contact name within the unit for each issue.

- It has also established two user groups – one for school-based staff and the other for staff within the education department. They meet termly, and serve as forums for the dissemination of information, for expressing concerns and problems, and for learning and training (for example, on specific procedures or wider issues of financial management).

Through such initiatives, County services have been able to retain the loyalty, support and much of the custom of schools.
2.9 **Staff mix** is of particular relevance to accountancy and internal audit. Where a provider's staff costs per full-time employee (FTE) exceed the benchmarks given in Section 3, staffing policies should be reviewed, unless some benefit is obtained from this rich staffing mix – specifically, higher productivity allowing an overall reduction in staff numbers.

2.10 **Utilisation** can be improved by tackling the underlying problems of high absence rates and high levels of unproductive time. After accounting for annual leave, bank holidays and other leave (such as maternity leave), the two principal sources of absence are sickness and training. Sickness absence is less of a problem for financial services than for many other local government services. Nevertheless the Commission’s questionnaire returns revealed a variation between authorities in average days lost per financial services FTE per annum, due to sickness, from less than three to more than 12. All authorities should aim to contain sickness absence to no more than five days per financial services FTE per annum, using the sickness management techniques outlined by the Commission (Ref. 6). In addition, authorities should assess whether better performance management (see paras 2.17 to 2.21 below) may also help to reduce sickness levels by improving motivation. The London Borough of Camden’s finance department has been able to secure significant reductions in sickness by adopting a range of good management techniques (Case Study 2.2, overleaf).
Case Study 2.2
Sickness absence - the London Borough of Camden

As part of a corporate initiative on sickness absence, Camden’s finance department has secured a 13 per cent reduction in sickness levels over the period 1992 to 1994. This reduction has brought Camden’s sickness levels for financial support services below those of most authorities in the survey. The improvement was achieved through:

Commitment at all levels

Members have led the drive to reduce sickness levels: each department is required to report their sickness absence levels to the relevant committee in each cycle and explain their performance. The finance department’s management team considers absence levels on a quarterly basis, with senior finance managers placing pressure in turn on the cost centre managers, and front line managers and supervisors below them. This commitment has helped to instil a sense of responsibility for sickness in managers at all levels.

Improved information systems

The authority has introduced a new corporate payroll/personnel information system, into which absence data is loaded on a weekly basis. In addition to allowing managers to view on-line various data about employees, the system:

◆ produces standard management reports each month, summarising all absence by type (for example, special leave and absences due to training, as well as sickness absence);
◆ provides separate statements of short-term and long-term absence.

Revised procedures

The authority has introduced a new corporate sickness absence policy, aimed at reducing both long-term sickness and frequent short-term absences. The policy includes:

◆ tighter procedures for employees to report absences;
◆ a requirement for managers to meet with employees on their return from sick leave;
◆ a trigger level, whereby managers must consider formal action against any employee taking more than a set number of days sick leave in any 12 month period;
◆ a requirement on managers to monitor sickness beyond this trigger, looking in particular for any worrying patterns of absence (for example, regular Mondays and Fridays).

Corporate support

The finance department has been supported in its efforts by corporate facilities. The Occupational Health Scheme has been reviewed, leading to improved turnaround times and improved quality of advice to managers. Corporate personnel staff have trained all managers in operating the new procedure: training is also available to help managers improve their counselling skills.

The 13 per cent improvement has resulted both from retiring (and, on occasions, dismissing on grounds of incapability) people on long-term sickness absence and from achieving a drop in short-term absence levels as the new procedures have begun to impact on staff behaviour. Most importantly, the department has succeeded in changing staff and managerial attitudes: absence is no longer seen as an entitlement. This cultural change has been at the heart of Camden’s success.
2.11 Training absence requires a different approach. Training is an investment in people, and is central to the success of any service provider: it should therefore be optimised rather than minimised. Although achieving this is neither simple nor straightforward, certain guiding principles can be identified. Training should support actions prioritised in the business plan and areas where high failure rates are causing cost and service problems for the provider. Furthermore, good practice involves striking a balance between the needs of the organisation and the needs of individual employees. Finally, effective management involves control over the number of days set aside for training, to ensure that the dangers of either too much or too little are avoided. Preliminary benchmarks can be established by taking the good practice levels of training (excluding trainees working for professional qualifications) in sample authorities of:

- five days per FTE for accountancy and internal audit;
- two to three days per FTE for transaction-based services.

 Authorities significantly above or below these benchmarks may wish to review their approach to training.

2.12 Unproductive time can only be tackled effectively when managers have an understanding of the magnitude and incidence of the problem. Timesheets are an invaluable means both to this end, and to enabling managers to examine work rates in more detail. Yet their use is variable: whilst all surveyed internal audit sections and 90 per cent of accountancy sections used them, the figures were much lower for transaction-based services (50 per cent of sundry debtors, 47 per cent of payroll and 33 per cent of creditors sections). Many accountancy managers admitted that only recently had they begun to review the practices of their sections, and the work rates of individuals, as a result of receiving management information generated by the timesheet systems. Authorities should review their use of timesheets, especially for transaction-based services: if timesheets are not considered the most appropriate means to the end of management awareness, authorities should identify alternative means (such as workload analysis by supervisors). Where timesheets are used, authorities should ensure that proper use is being made of the information generated.

2.13 Even after improving utilisation, authorities will suffer from poor productivity if they cannot improve their work rate, i.e. their output per unit of staff time. The issue will be particularly difficult to assess where few measures of output exist, for example, accountancy and internal audit. Productivity problems may simply result from having too many staff to do the work. Changes in demand (for example, reductions in payroll volumes) or technology (for example, on-line input) may have created potential for staffing reductions that have not yet been realised.

2.14 Even if authorities have the right numbers of staff, they may not have taken full advantage of opportunities to match staff to workload peaks. Such fluctuations are a particular problem for payroll, creditors and accountancy,
where providers face peaks that cannot be shifted. A variety of options exist to make staffing more flexible, including:

- the use of overtime;
- the use of part-time staff – to meet weekly and monthly peaks;
- the use of temporary and agency staff – to meet year-end peaks, or to cover for maternity leave or long-term sickness absence;
- the deployment of staff at evenings and weekends – to allow more effective pursuit of certain debts and better value from accommodation charges;
- the use of home working.

2.15 Considerable flexibility can be gained by merging sections and giving staff broader responsibilities, so that they can be moved between services according to peaks, troughs and priorities. This approach is known as **multi-tasking** and is common in shire districts, where payroll and creditor payments staff are often interchangeable. Some authorities, such as Delyn Borough Council, take this flexibility further: apart from the most senior managers, all finance staff are on generic job descriptions and can be moved to any financial support service (Case Study 2.3). Private companies that have won contracts which cover a range of transaction services, for example, ITNet at Hertfordshire County Council, also practise multi-tasking.

2.16 Further work rate difficulties may arise from poor work processes (which create high error rates or large periods of downtime) and poor use of IT: these are addressed in the subsequent chapters of this section. Overall, the systematic identification of relevant staffing problems, their underlying causes and appropriate solutions will allow provider managers to improve their economy and efficiency (Exhibit 2.4).

### Case Study 2.3

**Multi-tasking – Delyn Borough Council**

**The issue:** Delyn is a small shire district (£16m NRE+HRA). All staff working on financial support services have been kept centrally in the Treasurer’s department – decentralisation is not viewed as cost-effective. Even with full centralisation, however, the authority faces potential disadvantages of scale for its transaction-based services.

**The solution:** Staff working on payroll, creditor payments and financial administration (i.e. providing support to the qualified accountancy staff) are trained in all three activities: they work to generic job descriptions and are interchangeable between the functions. Their work schedules are organised to follow the workload peaks for payroll and creditors, with accountancy support undertaken in between these peaks. Additionally, staff in financial administration and council tax undertake relief cashier duties and council tax staff provide relief cover in creditor payments and financial administration.

This ‘multi-tasking’ ensures high utilisation of staff time and low unit staff costs. Accordingly, Delyn has been able to achieve significantly lower overall unit rates for payroll and creditors than similarly sized authorities.
2.17 Addressing issues around the numbers and costs of staff is only part of a fully effective approach to the management of human resources. ‘Soft’ people management issues such as communication, motivation and job satisfaction are also important. In these areas, there is evidence to suggest that financial services managers perform less competently than other local government managers. A staff attitude survey conducted as part of the Commission’s recent study of people, pay and performance issues (Ref. 7) revealed that financial services staff feel lower job satisfaction, less control or influence over their work and poorer relations with managers than other groups of local authority employees. Of particular concern, given the demands that CCT will impose, is the finding that financial services staff have a more negative view of organisational change than other employee groups.
2.18 Fortunately, there is evidence to suggest that performance management techniques can improve staff motivation. Further analysis of staff attitudes and their relations with management action suggests that appropriate performance management techniques have a strong influence on employees’ understanding of their role at work, and that employees with a clear understanding of their role are more likely to experience higher job satisfaction, commitment and motivation (Exhibit 2.5).

2.19 Successful performance management involves:

- **specification** – the formation of aims for the organisation, translated into specific objectives for each employee, expressed as desired milestones and targets;

- **communication** – with service users to develop and amend aims and objectives and with staff to clarify their responsibilities and personal targets, as well as to bring about staff participation in planning;

- **evaluation** – the use of performance review to track organisational performance and identify actions necessary for improvement, and of staff appraisal to extend this to individual employees.

2.20 Performance management is not an original concept: it brings together a range of processes that are simply ‘good management’. Many financial providers will have already adopted much of this, through their efforts on business planning and marketing. Such efforts can be enhanced by effective communication with staff, the translation of organisational objectives into personal targets and the use of appraisal and other techniques to provide feedback and evaluation to individual employees.

2.21 A number of financial providers are adopting good practice in the area of performance management. In addition to the widespread circulation of its business plan, Newcastle upon Tyne City Council distributed regular CCT newsletters to all staff and set up joint working groups with management, employees and trade union representatives to address issues around the Council’s response to CCT. The internal audit section of the Royal Borough of Kensington and Chelsea has introduced a staff appraisal system that, in addition to the annual assessment of staff, includes documented feedback on performance at the end of every major audit project. By confining such feedback to major projects, the section avoids unacceptably high levels of unchargeable time, whilst encouraging learning and improvement amongst staff. Further advice on performance management is offered in the Audit Commission’s 1995 publications on people, pay and performance (Ref. 7). All authorities should explore how they can best implement this approach: although neither a panacea nor a quick fix, it is likely to be a key means by which provider managers can achieve change while maintaining high service standards. Moreover, neglect of these issues will make service failure more likely.
‘Know-how’ measures staff understanding of their role. The survey asked staff about the clarity, priority and difficulty of goals they were set, the feedback they were given, and how they thought they had contributed to these goals.

‘Feel-good’ measures satisfaction and commitment. The survey asked staff how they felt about the authority, in terms of personal identification, involvement and loyalty. They were also asked to assess their job satisfaction.

The ‘performance management index’ was devised during the study of people, pay and performance as a means of evaluating authorities’ policies and procedures in the area of performance management – the higher the score, the more comprehensive the authority’s performance management regime.

**Exhibit 2.5**
The relationship between staff attitudes and performance management

Employees with a clear understanding of their role are likely to experience higher job satisfaction, commitment and motivation...

**Source:** Calling the Tune: Performance Management in Local Government, Audit Commission, HMSO, 1995
2.22 The final ‘people management’ issue of importance to financial providers is management structure. This can be considered at two levels. Firstly, managers may need to consider the internal structure of individual provider units. Provider sections may suffer from excessive layers of middle management. One way of identifying such ‘bulging middles’ is to check whether the benchmark staffing rates are exceeded: if they are, excessive middle management may be the cause. Often, these managers are engaged in the checking or direction of junior staff efforts – work that could be eradicated with:

◆ improved training for lower-graded staff;
◆ the documentation of procedures;
◆ quality control techniques;
◆ development of performance monitoring data.

Reviewing management tiers may offer not merely opportunities for cost savings but also the chance for lower-graded staff to undertake more rewarding work. Such a review should also take maximum opportunity to use broad-based team approaches rather than perpetuating over-specialised, demarcated sections.

2.23 The second structural issue is the wider organisational framework for financial service providers. Wholesale reorganisation is not necessary to comply with DoE regulations on anti-competitive behaviour (see Section 4). Many options exist; most, but not all, involve retaining both client and provider functions within a single department under a chief financial officer (i.e. a director of finance or equivalent). The principal options are:

◆ establish stand-alone provider units;
◆ make each provider unit a DSO;
◆ bring providers together to form a single Finance DSO;
◆ join providers with other services (whether just white-collar or white-collar and blue-collar) in a multi-function ‘mega’ DSO.
2.24 There is no universally applicable solution to this issue: each council needs to decide for itself. In some authorities, the calibre of management may be such that the transfer of provider sections to an existing DSO or establishment of a new finance DSO, relatively autonomous from the director of finance, is best. In others, minimal change may be appropriate. However, any authority considering reorganisation should appreciate that this will involve significant management effort and energy that might be more productively deployed on other matters. One of the most useful checklists when considering reorganisation is an adaptation of Porter’s (Ref. 8) (Box 2.A).

2.25 Whether managers are planning a major reorganisation or just changes to staffing levels and practices, attention should be paid to securing and maintaining the support of staff. Staff who are unhappy and demotivated are unlikely to deliver quality services, and so managers should address how staff can be persuaded of the merit or necessity of change.

Information technology

2.26 Next to staffing, IT is generally the most important component in providers’ cost structures. IT varies in its significance between financial services: as a percentage of total expenditure, it ranges from less than five per cent for internal audit to 20 per cent of payroll. Analysis of payroll and accountancy suggest that, whilst there is no clear trade-off between staff and IT costs, the latter vary considerably (Exhibit 2.6, overleaf). The significance of IT costs and the levels of variation suggest that provider managers should review closely their use of IT. In this context, the financial provider is the customer and should act accordingly by aiming to exert influence and control over the service.

Box 2.A
Departmental reorganisation: checklist

- **Attractiveness to the authority** – will the new organisation provide a better standard of service or the same service standard at lower cost? Will it be in a better position to make a statutory rate of return or break even than the existing service?
- **Cost of reorganisation** – will the set-up cost of the new organisation (in terms of time and money) impede its ability to make a satisfactory return or be a drain on the authority’s resources?
- **Better off** – will the new organisation be more competitive and better able to survive in the marketplace than its present incarnation?
2.27 There is a notable scale effect (i.e. where unit costs fall as the level of activity rises) in payroll IT working against small shire districts which cannot obtain low processing costs (Exhibit 2.7). This suggests that, even if districts do not outsource the whole of their payroll operations, cost improvements can be secured from the outsourcing of the IT element.

2.28 Whether IT is supplied by an in-house section or a private company, providers should receive accurate and clear charges over which they can exercise control through SLAs and devolved budgets. The SLAs should be constructed on reliable base information and should offer incentives for users to alter behaviour in return for lower costs. For example, transaction-based services should be able to secure a reduction in charges by shifting their processing and on-line access away from peak office hours. Furthermore,
Charges should be transparent; the total IT charge will be set to recover all costs incurred in delivering the overall services package (Box 2.B, overleaf), but the charge should be disaggregated to identify each component service.

The Commission’s survey did not identify any relationship between the age of the IT used by financial support services and its cost. However, authorities that had updated applications in the last two to three years were more able to meet user requirements for management information and to create easy access to data for service managers.

Dissatisfaction is currently being expressed by a number of managers about mainframe computing in financial services. Some authorities are locked into long leases that give them little flexibility to vary their capacity requirements, thereby creating a risk of over-capacity. The January 1995...
CIPFA statement on accounting for overheads (Ref. 9) allows “unapportionable central costs”, including unused shares of IT facilities, to be charged directly to authorities’ General Funds. Authorities can therefore avoid recovering the costs of surplus IT capacity via higher charges on service users (although corporately they will still be left with the higher IT costs). Even with the option of this accounting manoeuvre, there remains a desire to move to smaller, more cost effective hardware. This is one of the reasons why greater interest is starting to develop in open systems – notably UNIX.

2.31 There is no evidence to suggest an automatic cost advantage in switching to UNIX, even though such a move may lead to improved effectiveness. However, two caveats should be placed on this. Firstly, a move to UNIX by an authority may create the potential for cost reduction in that authority, by allowing a reduction in staff: this may take time to achieve. Secondly, although there may be no across-the-board advantage in moving to UNIX, for an individual authority such a move may lead to a reduction in comparison with the costs that it previously incurred with its particular mainframe. In short, the case for systems change needs to be decided on an authority-by-authority basis.

2.32 The judgement about moving away from mainframe computing should be made on the basis of a proper and realistic investment appraisal, underpinned by cost projections for the particular authority. These cost projections should be finalised after authorities have explored the scope for renegotiation of any mainframe lease. Where a mainframe commitment exists, investment appraisal needs to balance corporate interests (the utilisation of corporate assets) against the individual financial support service’s interests. The CIPFA advice on unapportionable central costs (see paragraph 2.30 above)

**Box 2.B**
The composition of IT charges

<table>
<thead>
<tr>
<th>IT charges are likely to include some or all of the following:</th>
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</thead>
<tbody>
<tr>
<td>◆ Cost of depreciation, lease or rental of the hardware including networks and workstations charged to the service</td>
</tr>
<tr>
<td>◆ Cost of depreciation, lease or rental of software</td>
</tr>
<tr>
<td>◆ Software development costs</td>
</tr>
<tr>
<td>◆ Costs of writing and running reports</td>
</tr>
<tr>
<td>◆ Database administration costs – maintaining the database and preparing runs, BACS tapes, etc.</td>
</tr>
<tr>
<td>◆ Updating costs – regular and one-off software upgrades, for example, on changes in relevant regulations</td>
</tr>
<tr>
<td>◆ Accommodation costs for hardware – including cleaning</td>
</tr>
<tr>
<td>◆ Contingency costs (alternative arrangements)</td>
</tr>
<tr>
<td>◆ Cost of storage for records</td>
</tr>
<tr>
<td>◆ Operator training costs</td>
</tr>
<tr>
<td>◆ IT staff support</td>
</tr>
</tbody>
</table>
should allow authorities to avoid the scenario where individual services lose contracts, the number of IT users reduces, the costs of the corporate asset need to be spread across an ever-narrower base and the remaining services becoming increasingly expensive and less competitive. Nevertheless, it is not in the authority’s corporate interests to have a large amount of ‘unapportionable’ mainframe costs: such costs still need to be met, even if not via individual financial services.

2.33 If the authority is unable to reduce its IT charges to a competitive level, yet the corporate view is that all parts of the authority should continue with integrated mainframe-based computing, then one solution would be to consider outsourcing IT – a decision that potentially could benefit all financial support services. Outsourcing should not be undertaken without careful review of current performance and proper specification of requirements, otherwise financial savings are unlikely to result. Whether or not outsourcing is considered, all authorities should be working actively to extricate themselves from long-term, inflexible commitments to IT in whatever form – not merely to assist with cost improvements, but also to allow greater opportunity to be taken of technological developments.

2.34 In addition to open systems, a range of ‘smart’ IT applications are of potential relevance to providers. Document Image Processing (DIP) is currently being used in a number of transaction-based sections to improve efficiency and reduce storage costs. Electronic Data Interchange (EDI) is another application with potential relevance for creditors operations, although at this moment its actual use is limited and there are a range of audit issues associated with this technology. More generally, applications for many of the transaction-based services can be enhanced with sophisticated menus, which allow higher operator productivity and the facility for managers to model and monitor workflows through networked IT. Provider managers should assess the role that these and other ‘smart’ applications might play in reducing costs and improving service. In this assessment, managers should not take as gospel their IT supplier’s advice as to when smart IT may be appropriate – managers should ensure that it is they who determine when technological developments are introduced.

2.35 If providers identify IT needs, whether for ‘smart’ applications, UNIX facilities or merely an upgrading of software, then they are likely to face competition from other bids for the scarce capital and leasing finance necessary to meet these needs. Provider managers can give their proposals the best chance by proposing sound cases for investment: guidance on making a case is given in Box 2.C, overleaf. However, resourcing the investment is likely to be dependent upon the approach of decision-makers, notably authority members. Members may need to be reminded that a commitment to in-house provision of support services, like a commitment to front-line services for the public, requires financial as well as policy backing and that on occasions, IT investment will be necessary rather than merely desirable.
Box 2.1
Making a case for IT investment – a seven-step approach

1. **Describe existing approach**
   - Give background information on current service and its use of IT

2. **Identify current problems**
   - **Uncompetitive costs, for example, because of**
     - low staff productivity
     - duplication of effort
     - high levels of errors
     - high running costs
     - high storage costs
     - poor cash flow
   - **Poor quality, for example, through**
     - delays
     - backlogs
     - poor management information (slow, unsophisticated, inaccessible to service users)
     - high incidence of service failure

3. **Explore alternatives**
   - Show that options have been considered and detail the reasons for rejection

4. **Detail proposed IT**
   - Summarise proposed acquisition or enhancement

5. **Show benefits**
   - Demonstrate the **relevance** of the proposal to the problems
   - Amass **evidence** to support the proposal, for example, experiences of other users and results of trials
     (NB. avoid merely the recommendation of IT suppliers)
   - Ensure that the proposal contains **no hidden drawbacks**, for example, long lease or lock-in to proprietary technology
   - Ensure that the proposal complies with **corporate technical guidelines**

6. **Show anticipated costs**
   - Identify **full costs of the proposal** over its life cycle including
     - development
     - hardware
     - software
     - project management
     - training
     - redundancy
     - operating and maintenance costs
Other overheads

2.36 Accommodation costs vary in their significance for different financial support services: although they represent ten per cent of the cashiers service, this falls to only six per cent internal audit. However, the accommodation costs per employee (calculated on an asset rent basis) vary considerably between authorities (Exhibit 2.8), suggesting that this is an area for the attention of provider managers.

Exhibit 2.8
Accommodation costs

Costs vary considerably...

Source: Audit Commission survey of authorities

Accommodation costs per FTE (£000)

<table>
<thead>
<tr>
<th>London boroughs</th>
<th>Metropolitan districts</th>
<th>Counties</th>
<th>Shire districts</th>
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<tbody>
<tr>
<td>6</td>
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</table>
2.37 Providers with high accommodation costs will need to pursue solutions at a corporate level, to increase their control over occupancy and charges. Apart from reducing charging rates per unit of accommodation to a minimum, good practice in corporate accommodation policy involves:

◆ establishing charging policies that allow costs to vary with occupancy – so that service managers have an incentive to reduce their accommodation requirements;
◆ devolving budgets for property running costs – to provide incentives to occupants to control expenditure on gas and electricity;
◆ reviewing the extent of existing local authority accommodation holdings and the mix of owned and leased property, if the portfolio is such that service managers would be able to enjoy sizeable savings by moving out of local authority accommodation and renting office space from private companies.

2.38 Within this framework of good practice, provider managers should attempt to shave accommodation costs. This can be achieved principally through reviewing space requirements, either by reducing staff numbers, space allocation per employee or storage space. The latter is likely to be assisted by changes in IT: for example, through the introduction of DIP for creditor payments.

2.39 Other costs have three principal sources:

◆ charges from other central support services;
◆ departmental management overheads;
◆ running costs – primarily bank charges, printing, stationery and telephones.

2.40 In total, these other costs vary in significance from 11 per cent for accountancy to 25 per cent for sundry debtors. Because of their particular importance for creditors and debtors, the relevant chapters of Section 3 offer benchmark rates for these costs and service-specific advice on improvement opportunities. More general advice is provided in this section.

2.41 No doubt all departments with financial service providers will reassess their departmental management overheads with a view to their reduction. Beyond this, however, improvements can be pursued via two routes:

◆ controlling charges from central support services;
◆ reducing running costs.

2.42 For central support services, financial providers should find ways of making controllable what have historically been viewed as uncontrollable costs. Managers should be able to exercise control over central support service charges through SLAs and devolved budgets, negotiating changes to the volumes and levels of service supplied by other central support services and satisfying themselves that their unit rates represent value for money (Ref. 10).
Provider managers may be able to reduce running costs by:

- ensuring the accuracy of the charges, many of which will have been derived from apportionments of department-wide costs – often on inaccurate bases;
- implementing operational changes that impact on bank charges and cash handling charges – for example, increasing the use of BACS, cashless pay and payments via standing orders or direct debits;
- introducing innovations in income generation (for example, by advertising on payslips) that can offset running costs.

Delivering

Particularly for the transaction-based services, the design and operation of processes are critical to efficiency and effectiveness. Inefficient and ineffective processes feed through to higher costs: the first directly through higher staffing levels, the second through higher error rates. Errors are a consequence of high levels of variations and adjustments, especially where manual input is involved: their elimination should be a major priority for providers. The principal causes of errors can be addressed by a range of solutions (Box 2.D, overleaf). Accuracy can be further promoted through certain minimum levels of control:

- responsibility for accuracy, completeness and timeliness of processing is placed on individual employees;
- employees check the accuracy of their own work as it is performed;
- there is a set procedure for recording, analysing and rectifying all errors;
- managers are responsible for taking appropriate corrective action following analysis of errors and for ensuring the effectiveness of this action.

In addition to reducing errors, providers should explore opportunities for changing processes to improve efficiency. This is an area where managers may find it useful to buy in specialist systems expertise. There are three principal routes to improved efficiency:

- aligning processes between different services to allow multi-tasking of employees (see paragraph 2.15 and Case Study 2.3 above);
- rescheduling activities to minimise on-line processing at times of peak demand (when IT charges are at their highest);
- analysing value added at the different stages of the process, given that not all stages add value (Exhibit 2.9, overleaf). Authorities should identify low value-adding stages (for example, in transporting and storing information, and correcting errors) where the call on resources can be reduced or eliminated.
Further advantage can be gained from reviewing flows of work. In such a review, providers should explore three questions, again perhaps using specialist systems expertise:

- Can work be eliminated (for example, the production of unwanted and unused management reports), merged (for example, bringing together separate processes for mileage and expenses claims), or simplified (for example, through redesigning paperwork)?
- Can service users do more for themselves – for example, through on-line input?
- Can work be better scheduled, with an improved balance of work between different teams and individuals?
Financial support service managers in a number of authorities are reviewing their processes and documenting procedures as part of attempts to secure ISO9000/2 (formally known in the UK as BS5750) accreditation. Possession of such a ‘quality badge’ provides compelling evidence of quality when submitting a tender. Moreover, some authorities will already possess effective, extensive and properly documented systems and procedures; for these authorities, accreditation may prove straightforward, with little additional effort or expenditure required. However, accreditation is unlikely to bring any unassailable advantage when tendering: rival firms may have it, but even if they do not, it could be anti-competitive to require accreditation at the start of a contract rather than, say, within two years. Moreover, authorities can secure the benefits of process review without committing themselves to a potentially time-consuming and costly attempt at accreditation. In short, whilst accreditation brings undoubted benefits, and should be pursued if it can be achieved with ease, it is not essential for all financial support services and may not always justify the effort and cost required to achieve it.

Monitoring, learning and review

Once providers have deployed appropriate resources and designed efficient and effective processes, they need to find ways of monitoring and improving their performance. In this, managers should make reference to the aims, objectives and service commitments formed as part of their business planning and marketing programmes (see paragraphs 2.2 to 2.6 above). Best practice involves gathering information on performance from as many sources as possible, and using this to identify improvement opportunities. Providers should tap the variety of information sources at their disposal:

- **Budget and financial information** – timely and relevant management information is as important to financial service managers as it is to other authority managers. In particular, managers of some financial support services will need management accounting systems that allow costing and monitoring of income by job.

- **Performance indicators and monitoring systems** – generally service standards and financial targets can be translated into key performance indicators that allow managers to assess how well they are performing in quantitative terms. These are identified in the summary checklists in Section 3. CIPFA has identified a number of further potential indicators that providers may wish to consider (Ref. 11).

- **Timesheets** – these may help managers to control unproductive time and analyse work rates, and for project-based work (for example, internal audit), will help monitor progress against plans.

- **Workflow data** – particularly for transaction-based services, IT systems can generate information on workflows that may reveal backlogs, bottlenecks and poorly-performing staff.

- **Service users** – customers will express concerns and opinions at liaison meetings, through formal complaints and in response to evaluation forms and surveys. The more forward-thinking financial service
managers have recognised the value of customer feedback and make every attempt to obtain it.

- **Staff perceptions** – the staff delivering the services will have the best perspective on what is working well and what is not. Provider managers should consider how this knowledge can be tapped. Techniques range from suggestion schemes, through variations around the theme of quality circles, to discussions with individual employees.

* * *

2.49 Effective provider management is not merely about controlling the cost of resources. It is also about identifying customers, paying close attention to their needs and ensuring that people, technology and processes are combined to meet these needs effectively. Furthermore, it is characterised by efforts to review performance and identify ways of doing things better. Taken together, the techniques are likely to require major cultural changes to financial support services: in short, a move away from administration to active management. Such a move is a necessary foundation for many of the improvements that authorities will want to make in individual services. These improvements are the subject of the next section.
Good practice checklist

**Business planning**

1. Do you undertake business planning?

2. Does your planning process involve an analysis of:
   - your customer base,
   - the environment within which you will be operating,
   - your own strengths and weaknesses?

3. Does it generate a clear statement of aims and objectives and action plans?

4. Are these monitored, with regular reviews and updates?

5. Have you involved your staff in the planning process?

6. Have you communicated the key messages to all managers and staff?

**Marketing and relations with users**

1. Do you use a range of structures and techniques to obtain feedback from customers?

2. Do you meet periodically with service customers, to discuss their wants and needs, and listen to their views?

3. Have the results of these meetings caused you to change your service delivery?
4. If they have not, is this because customers are genuinely satisfied with all aspects of your performance?

5. Have you used customer feedback to generate a range of service options, thereby increasing customer satisfaction?

6. Have you produced publicity and promotional material to support marketing and service delivery efforts?

### People management

1. Does comparison with the cost benchmarks in Section 3 reveal a rich staffing mix?

2. If so, what benefits are you securing from this?

3. Do you have a comprehensive approach to sickness management, so that average sickness levels are below five days per employee?

4. Are managers exercising control over training absences, both in terms of the amount of time given to it and the content of training?

5. If not, are other methods used to analyse utilisation rates?

6. Do all staff complete timesheets?

7. What use do managers make of timesheet data?

8. Do you staff flexibly, including multi-tasking, part-time and temporary staff and the use of overtime, to match supply to workload?

9. Do you use performance management techniques, especially around communication and evaluation?
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<thead>
<tr>
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<tbody>
<tr>
<td><strong>10</strong></td>
<td>Is there scope to delayer the management structures of individual financial services?</td>
</tr>
<tr>
<td><strong>11</strong></td>
<td>Does the overall management structure allow financial providers to be competitive?</td>
</tr>
<tr>
<td><strong>12</strong></td>
<td>If not, will reorganisation solve your problems?</td>
</tr>
<tr>
<td><strong>13</strong></td>
<td>Can you carry the support of your employees for changes to staffing, people management and organisational structure?</td>
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### Information technology

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<table>
<thead>
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<th></th>
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<tbody>
<tr>
<td><strong>1</strong></td>
<td>Are you able to take advantage of scale opportunities in IT costs?</td>
</tr>
<tr>
<td><strong>2</strong></td>
<td>If not, have you considered outsourcing?</td>
</tr>
<tr>
<td><strong>3</strong></td>
<td>Are your charges easily understood and based on reliable data?</td>
</tr>
<tr>
<td><strong>4</strong></td>
<td>Do SLAs give you sufficient opportunity to reduce charges by changing the amount or time of use?</td>
</tr>
<tr>
<td><strong>5</strong></td>
<td>If you are considering a move away from mainframe computing, is this informed by a proper investment appraisal of all options, using cost projections from competing sources of supply to the authority?</td>
</tr>
<tr>
<td><strong>6</strong></td>
<td>If remaining with mainframe computing, have you explored the options for increasing the flexibility of supply, both in terms of lease length and variability?</td>
</tr>
<tr>
<td><strong>7</strong></td>
<td>Have you explored the opportunities for using ‘smart’ IT applications, especially in transaction-based services?</td>
</tr>
</tbody>
</table>
### Other costs

1. Do your accommodation charges vary with occupancy?

2. Are budgets for property running costs devolved?

3. Has there been a corporate review of accommodation holdings, to ensure that no sizeable savings can be obtained by sections moving out of local authority accommodation and renting from another source?

4. Are your central support service overheads controlled through SLAs and devolved budgets?

5. Are running costs apportioned accurately?

6. Has maximum opportunity been taken to reduce bank charges by moving away from cash and cheques?

### Processes

1. Do you have a systematic approach to error reduction or elimination?

2. Have you explored the scope for redesigning processes to increase efficiency, using value analysis techniques where appropriate?

3. Have work flows been reviewed?

4. Can work be eliminated, merged or simplified?
Can users do more of the task themselves?

Can work be better scheduled?

Monitoring to support learning and improvement

Do you have a range of information sources for performance monitoring, including information from your customers and your staff?

Do you use this information to review and improve services?
Section 3

Developing Competitive Financial Support Services
### Section 3: Developing Competitive Financial Support Services

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Title</th>
<th>Section</th>
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<tr>
<td>Chapter 1</td>
<td>Accountancy</td>
<td>3.3</td>
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<tr>
<td>Chapter 2</td>
<td>Internal audit</td>
<td>3.31</td>
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<td>Chapter 3</td>
<td>Payroll</td>
<td>3.51</td>
</tr>
<tr>
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<td>Creditor payments</td>
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<td>Chapter 6</td>
<td>Cashiers</td>
<td>3.95</td>
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</table>
Developing Competitive Financial Support Services

Chapter 1 Accountancy

Accountancy

- Is your authority above the benchmark for accountancy expenditure per £m NRE+HRA?
- How do service standards in your authority compare with good practice?
- Is there scope to reduce the number of accountancy days purchased? If so, how might this be achieved?
- How does your authority’s accountancy daily rate compare to good practice?
- What can be done to reduce costs without undermining standards?
Executive summary

Accountancy is a changing service. Most authorities are in a state of transition from the traditional approach to a more managed approach.

**Traditional**
- centralised staffing
- a centralist approach to s151
- ‘the authority’ seen as the customer
- accountancy staff place emphasis on control

**Managed**
- mix of central and service department staffing
- s151 is met through accountable decentralisation of financial management to align with operational responsibilities
- service managers are seen as customers
- accountancy staff place emphasis on support and advice as well as control

The total cost of accountancy is affected more by volumes (the number of accountancy days) than by provider unit costs (the cost per day). There is some relationship between this accountancy volume and an authority’s NRE+HRA, but wide variation around this relationship. High volumes are best explored with reference to the factors that separate the traditional and managed approaches, in particular:
- the organisation of the function and any duplication between central and service department staff;
- the approach to s151;
- whether the authority has reviewed the role and purpose of accountancy and revised volumes accordingly.

Unit costs are affected both by the grade mix of accountancy staff and by the amount of unproductive time.

Service standards vary but have no relationship with volumes or unit costs. High standards do not necessitate high costs, and so all authorities should aim for a high standard of performance.

Key benchmark data

<table>
<thead>
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<th>Volumes:</th>
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<tbody>
<tr>
<td><strong>Shire districts (excluding ‘Big 11’):</strong></td>
</tr>
<tr>
<td>Available accountancy days per £m NRE+HRA</td>
</tr>
<tr>
<td><strong>Other authorities:</strong></td>
</tr>
<tr>
<td>Available accountancy days per £m NRE+HRA</td>
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<table>
<thead>
<tr>
<th>Costs:</th>
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<tbody>
<tr>
<td>Costs per available day (£):</td>
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<tr>
<td><strong>Staff</strong></td>
</tr>
<tr>
<td>Staff</td>
</tr>
<tr>
<td>IT</td>
</tr>
<tr>
<td>Accommodation</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>Total</td>
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</table>

<table>
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<tr>
<th><strong>Staffing costs per FTE:</strong></th>
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<tbody>
<tr>
<td><strong>London</strong></td>
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<tr>
<td><strong>Elsewhere</strong></td>
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</table>
Developing competitive financial support services

Chapter 1 Accountancy

Introduction

3.1 The main elements of the accountancy function are:
◆ revenue budget preparation and monitoring;
◆ financial advice, including attendance at committee meetings to provide advice to members;
◆ the closure of accounts and the production of financial statements;
◆ core accounting;¹
◆ capital accounting.

3.2 Generally, this work is carried out by both staff in a central accountancy section and in service departments. Many local authorities’ central accountancy sections undertake additional non-accountancy tasks, including treasury management, insurance and superannuation. These consume relatively few resources and are variable in their incidence. They have been excluded from all cost comparisons.

3.3 Expenditure on accountancy as defined above, capturing the costs of sections at the centre of an authority and those of all staff in service departments spending more than 50 per cent of their time on finance work, varies widely. A comparison of authorities’ accountancy cost per £m of NRE+HRA reveals variation between and within authority types (Exhibit 3.1, overleaf). Expenditure is a product of volumes (accountancy days per £m spend) and provider costs (cost per accountancy day), but both may be influenced by standards. This section will explore issues for accountancy managers arising from the three factors – standards, volumes and provider costs – in turn.

Service standards

3.4 Local authority financial management is a complex and demanding area. This complexity extends to the assessment of service standards for accountancy which are particularly difficult to define and assess. There are few clear, generally accepted definitions of what constitutes a high quality, high standard accountancy service. Virtually all authorities’ accountancy sections meet certain minimum standards: they employ suitably qualified staff, comply with professional guidelines (accounting standards and CIPFA statements) and avoid challenge in respect of the various statutory duties concerning financial administration. But standards may vary above this minimum, with high levels of expenditure in some authorities perhaps resulting from their delivery of higher service standards than in lower spending authorities.

An umbrella term, incorporating all corporate, central and statutory activities apart from budget preparation and accounts closure. These include: Collection Fund accounting, VAT returns, co-ordination of grant claims, General Ledger maintenance (including suspense accounts and correction journals), feeder system monitoring, central cost allocation, administration of leases, and policy advice on corporate financial issues (such as revenue support grant and SSA allocations).
3.5 One way of assessing standards is to use a basket of attributes and policies which, together, would constitute a high standard accountancy service. In developing such a basket, care should be taken to minimise the impact of subjectivity in the assessment (whether that subjectivity is displayed by service providers or users).

A standard score

3.6 The performance of sample authorities has been assessed, using a weighted basket of eleven criteria. Performance against some criteria (marked with an asterisk) has been evaluated by authorities’ external auditors to provide an impartial assessment. The eleven criteria adopted are:

- **timeliness** – the date by which accounts are submitted for audit;
- **accuracy** – the extent of errors identified by external audit in authorities’ accounts;
- **accuracy** – the existence of material errors in authorities’ accounts;
- **quality of output** – the standard of final accounts working papers*;
- **quality of output** – the standard of grant claims submitted for audit*;
- **quality of staff** – the level of qualifications and experience of accountancy staff*;

The standard incorporates a judgement by the external auditor of the quality and auditability of the authority’s grant claims, and whether they are completed on time.
quality of staff – the nature and level of training given to accountancy staff*;

service delivery – the effectiveness of relationships between accountancy staff and service managers*;

accuracy of information – the speed with which an authority’s general ledger is updated to reflect committed and incurred expenditure;

timeliness of information – the promptness with which standard budget reports are distributed to service managers following the month end;

accuracy of information – the existence of a user-friendly commitment accounting facility for services where this is essential for proper financial control.

The criteria have been weighted to reflect generally accepted priorities, thereby allowing a single standards score to be developed for each sample authority. (Appendix D contains a detailed explanation of this standards assessment methodology.)

3.7 Analysis of authorities’ scores suggests that, whilst considerable variation exists from the very good to the poor, there is no link between high standards and high volumes of accountancy days, nor between high standards and a rich staff mix in terms of a high percentage of staff at Principal Officer grade and above (Exhibit 3.2, overleaf). In short, contrary to the widely-held view, high standards do not necessitate high costs, and so authorities can aim for high performance against the eleven criteria (as detailed in the summary checklist below) without needing to increase the size or cost of their accountancy sections.

Other standards issues

3.8 Part of a high standard accountancy service is the ability of accountants to respond effectively to queries and requests for advice. It is difficult to assess such performance accurately and objectively and for this reason, the basket of accountancy standards did not include an ‘advice’ criterion. A high standard of service would be demonstrated through promptness, reliability and fairness. Reliability and fairness are extremely difficult to specify and measure, although reliability would be evidenced by the avoidance of undesirable or disastrous outcomes. For one perspective on the reliability and fairness of advice, authorities may wish to track the satisfaction of service managers with the financial advice they receive. In Newcastle City Council, this is achieved by the accountancy section undertaking periodic customer surveys.

3.9 It is, however, easier to specify the speed of response to queries, and so authorities should establish target times for commenting on report drafts and responding to accountancy queries. Rather than set a single response time for all queries, it may be sensible to establish different targets for queries of differing complexity and a separate response time for queries from elected members. These response times should be incorporated into accountancy SLAs, with monitoring systems established to track performance.
3.10 Finally, a range of other attributes, identified in *Regular as Clockwork* (Ref. 12), should be present in a high standard accountancy service. These flow largely from good practice in the organisation of financial management and the closure of accounts. Authorities falling short of this standard should be able to improve their performance simply by better use of existing staff. The attributes include:

- use of budget profiling where this would be valuable to improve budget management, – for example, where a high percentage of expenditure is on items other than permanent staff;

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*Exhibit 3.2 Service standards, volumes and staff costs*

There is no link between standards and high volumes of accountancy days...

...nor between high standards and a rich staff mix...

---

*Source: Audit Commission survey of authorities*
effective maintenance of the general ledger – regular and auditable bank reconciliations, prompt clearance of suspense accounts, clear instructions to service departments for accurate coding, and designation of appropriate staff to manage control accounts;

properly planned and resourced accounts closure programmes, including the prompt completion of year-end accruals (a task that should be made easier by a user-friendly commitment accounting facility).

Consulting users

3.11 The chief financial officer should take responsibility for the overall framework of service standards. Nonetheless, there is scope for consulting service managers and other accountancy users, for example, on the form of budget reports and the user-friendliness of information systems (particularly for commitment accounting). Accountancy managers should establish mechanisms for consulting their service users. This consultation should result in improved information arrangements: for example, the opportunity for service managers to produce their own budget reports, perhaps by downloading information onto PC-based spreadsheet models, and tailor information from corporate systems to meet local management needs.

The s151 responsibility

3.12 No discussion of accountancy standards would be complete without consideration of s151 of the 1972 Local Government Act. Some assert that a high standard of service is achieved through a rigorous, extensive and firm approach by the director of finance and his or her staff (as opposed to alternative organisational approaches) to the s151 duty. In practice, this ‘centralist’ approach to s151 in accountancy involves tight central control of financial administration, with limited powers of virement and carry-over for service department managers and detailed reporting of expenditure to members.

3.13 Apart from a CIPFA statement (Ref. 13), little exists in the way of professional guidelines and case law to state precisely what is required to ensure compliance with s151. Indeed, a number of finance directors have expressed a desire for a clearer statement on this issue. But the s151 responsibility does not necessitate a ‘centralist’ approach: it is possible to be rigorous, extensive and firm without being centralist. Evidence from a number of authorities shows that a more decentralised approach can work, provided that:

- service department managers are given a clear statement of their responsibilities;
- budgeting and reporting systems are carefully organised to enable the director of finance to retain strategic control at the centre of the authority.
3.14 Moreover, tight central control of the minutiae of budgets is not desirable, for the reasons outlined in *Regular as Clockwork* (Ref. 12). In principle, effective financial management is best achieved by requiring service managers to exercise control over budgets, not by a centralist approach. Good practice in relation to s151 involves:

- the proper alignment of financial and operational management, with service and cost centre managers responsible for low level budgetary control and central finance staff responsible only for overall monitoring of the authority’s budget;
- reporting arrangements that allow potential overspends to be identified by service managers at an early stage, with the relevant department responsible for proposing actions to resolve the overspends;
- generous scope for virements and carry-overs (and the control of virements to lie largely with service managers).

3.15 These observations should not be interpreted as a downgrading of the s151 role. On the contrary, in times of increased devolution the role takes on an even greater importance, as authorities need to ensure that managerial autonomy does not result in any misuse of public money. Rather, the observations are designed to point out that the traditional approach to s151 is neither the only nor the best approach. In short, the proper discharge of the s151 responsibility is vital for the financial health of an authority, and finance directors have a difficult balance to strike between delegation and effective corporate control, but there is more than one way to achieve this balance.

Volumes

3.16 The accountancy function generates a wide and diverse range of outputs, many of which are difficult to define and measure. It is easier to compare authorities’ accountancy volumes using an *input* measure, namely accountancy available staff days per £m of NRE+HRA.\(^1\)

3.17 The accountancy days purchased by authorities vary widely with shire districts incurring proportionately higher volumes than larger authorities. For small shire districts (i.e. excluding ‘Big 11’ authorities), there is a strong relationship between accountancy volumes and the expenditure base of an authority; for other authorities, there is a weaker, but still notable, relationship (Exhibit 3.3). These relationships suggest that it is reasonable to develop rules of thumb for accountancy days per £m of turnover, for different groups of authority. By group, the lower quartile of authorities met the following benchmarks:

- small shire districts – 110 days per £m of NRE+HRA
- other authorities – 50 days per £m of NRE+HRA

Authorities above these benchmarks should explore the reasons for their higher accountancy volumes. Authorities at or beneath the benchmarks should reassure themselves that they have not achieved low volumes at the cost of poor standards of financial management: in this assessment, authorities should make reference to the issue of service standards explored in the previous section.

\(^1\) Calculated by taking 260 days per FTE and deducting 55 days for bank holidays, annual leave, special leave, other absences and training. The figure of 205 days was then adjusted for the recorded sickness absence per accountancy FTE (in both central and service department(s) in each surveyed authority. This is not the same calculation used to establish internal audit chargeable days – the latter also deducts unchargeable time spent on planning and management, and unproductive time. Reliable data on these activities could not be obtained for accountancy sections.
Little relationship was found between accountancy days and workload measures, such as the number of cost centres, journal entries and committee meetings attended by accountancy staff. Some relationship was identified between capital accountancy staff and the number of capital schemes (Exhibit 3.4, overleaf).

Higher volumes of accountancy resource might result from a greater degree of in-house service provision. As discussed in Appendix C, one problem with using NRE+HRA as a denominator is that it masks the issue of whether...
service provision is in-house or outsourced. An authority that delivers services in-house will, it is argued, create an in-house accountancy workload (for example, providing advice to DSO managers and producing DSO financial statements) that an outsourcing authority can avoid. The data collected partially supports this argument. Making a crude distinction between outsourcing authorities – where more than 50 per cent of the value of blue-collar CCT contracts has gone to private companies – and in-house providers – where more than 50 per cent has been won by DSOs – the outsourcing authorities tend to enjoy lower levels of accountancy resource, particularly in county councils (Exhibit 3.5).

Exhibit 3.4
Accountancy staff and capital schemes

There is some relationship between capital accountancy staff and the number of capital schemes...

Source: Audit Commission survey of authorities

Exhibit 3.5
Accountancy resources and the extent of outsourcing

Outsourcing authorities tend to enjoy lower levels of accountancy resource...

Source: Audit Commission survey of authorities; The Contracts Yearbook, 1995
3.20 The volume of accountancy days is not affected by the grade mix of accountancy staff. Some authorities have argued that more highly graded staff can achieve greater productivity and take responsibility for wider areas of an authority’s finances so that, overall, less staff are needed. If this reduction in staff numbers offsets the higher salary costs, the approach could yield better value for money. However, no such benefits were found in practice. A rich staff mix does not enable an authority to reduce its accountancy days (Exhibit 3.6).

3.21 Many senior finance officers argue that the last three to five years have seen an increase in the numbers of staff working on the accountancy function, especially on financial advice, responding to financial and management initiatives. There has been an increased need within service departments for support to handle new devolved management responsibilities and the introduction of internal markets and trading accounts. This, it is argued, has fed through to more accountancy staff and more accountancy days.

3.22 These trends have affected nearly all authorities to a largely similar degree. Most authorities have some aspects of devolved financial management; most have adopted some form of internal market. So, whilst these factors might have increased the total volumes of accountancy resource in local government in general, it is difficult to use them to explain the variation between individual authorities.

3.23 Where an authority has high volumes of accountancy days that cannot be explained by unit salary costs, the level of activity or the financial regime in that authority (Box 3.A, overleaf), the level of provision should be reviewed to assess whether a reduction is feasible.

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**Exhibit 3.6**

**Accountancy days and grade mix**

A rich staff mix does not enable an authority to reduce its accountancy days...

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**Percentage of staff at PO grade and above**

<table>
<thead>
<tr>
<th>Percentage</th>
<th>0</th>
<th>10</th>
<th>20</th>
<th>30</th>
<th>40</th>
<th>50</th>
<th>60</th>
<th>70</th>
<th>80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Available accountancy days per £m NRE+HRA</td>
<td>0</td>
<td>20</td>
<td>40</td>
<td>60</td>
<td>80</td>
<td>100</td>
<td>120</td>
<td>140</td>
<td>160</td>
</tr>
</tbody>
</table>

*Source: Audit Commission survey of authorities*
Reducing surplus accountancy provision

3.24 The obvious way to reduce accountancy days is by seeking efficiency improvements from the provider. (This is explored below under Provider costs and competitiveness.) Apart from this, opportunities for reducing accountancy provision lie in three main areas:

- a review of the approach to centralisation/decentralisation, and the extent of duplication;
- a reassessment of the authority’s approach to the s151 responsibilities;
- a more fundamental review of the purpose of the accountancy function.

Organisation

3.25 Most authorities deliver accountancy services with a mixture of central and service department staff (the latter may be based at the centre of service departments or fully devolved to business or service units).1 In many authorities, service departments have established their own finance sections, often following the devolution of financial management responsibilities. There is a danger that the division of labour between the remaining staff at the centre and the staff in service departments is not clearly defined, or that central staff ‘oversee’ and ‘validate’ the work of service departments. Decentralisation does not necessarily increase costs, but a poorly defined relationship does.

3.26 Some authorities are addressing this problem by outposting many central accountancy staff. This involves the physical transfer of staff into service departments and the creation of dual reporting lines (to both the service director and the director of finance), thereby allowing the merger of central and departmental establishments and the minimisation of duplication. Under this approach, the smaller residual central accountancy function limits its focus to core tasks (including authority-wide budgetary control).

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1 On average, survey authorities base one third of their accountancy staff in service departments.
Approach to s151

3.27 As mentioned above, a number of authorities still choose to interpret their s151 responsibilities in a way that requires rigid and extensive central control over service departments. Limited powers of virement and carry-over, excessive reporting to members (along with excessive attendance of senior accountants at committee meetings), and procedures requiring the involvement of central finance department staff in small-scale financial decision-making all generate the need for accountancy staff, without necessarily adding to the effectiveness of financial control. Authorities with such regimes may wish to reconsider their approach. Adopting a more decentralised approach, involving service managers closely in budgetary control and financial management, may bring savings, through reducing the volumes of accountancy days, without necessarily undermining standards or threatening the effective discharge of the s151 responsibility.

The role of accountancy

3.28 More fundamentally, managers and members should review the purpose of the accountancy function in a modern authority. Technological and cultural changes have combined to transfer large parts of the traditional finance department workload away from accountancy staff. For example, much budget preparation is now carried out effectively by service department staff who are not qualified accountants, and, with appropriate IT, many front-line service managers are able to exercise budgetary control by themselves with little, if any, assistance from specialist finance staff.

3.29 These trends should not lead managers to conclude that the need for accountancy will wither away. Accountants are still needed to discharge the core tasks – overall preparation and monitoring of the authority’s budget, closure of capital and revenue accounts, submission of complex grant claims and policing of legal and professional requirements (including the s151 and s114 responsibilities of the chief financial officer). Beyond these tasks, however, the approach to corporate strategy, support and control needs to be rethought to ensure that the valuable professional accountancy resource is used to best effect.

3.30 Some authorities have adopted a radical approach to these issues, both in terms of the designated purpose of the accountancy function and the way in which it is organised (Case Studies 3.1 and 3.2, overleaf). These authorities are not offered as blueprints for all to follow, but they give powerful examples of how the function can be reorganised and redesigned. From these authorities and others that have attempted to ‘reinvent’ accountancy, the following themes emerge:

◆ there needs to be a shift in emphasis for accountancy away from detailed control – more emphasis should be placed on core work, support work and corporate strategy;

◆ the core accountancy tasks should be tightly defined and specified, and differentiated from the provision of accountancy support services;
The approach: Newcastle has separated the strategic finance function, discharged by its treasurer with a small support department (around six employees), from the provision of financial services, discharged by Newcastle Finance and Information Technology (FIT), a financial services DSO located in a separate department. Apart from the few staff working for the treasurer, Newcastle FIT has line management responsibility for all finance staff, including internal audit and core accountancy staff.

Its purpose: The purpose of the reorganisation is threefold:
- to enable the treasurer, freed of significant line management responsibilities, to give his individual attention to strategic financial and IT issues;
- to ensure that financial providers focus on the needs of service department clients for support and advice (which can be overshadowed by the need of the s151 officer to exercise control over department spending);
- to enable the management of Newcastle FIT to focus, with a minimum of distraction, on the managerial and operational issues to be addressed to ensure that FIT can beat any external competition for finance and IT contracts.

Roles: The treasurer has three broad roles:

Control – the treasurer is the authority’s s151 and s114 officer and exercises ultimate control over the authority’s spending.

Corporate client – the treasurer acts as the client for core accountancy and internal audit services, giving direction to these sections and monitoring their performance. In addition, the contract monitoring and management role for all financial services is located under the treasurer, whether provided under CCT or under SLAs.

Strategy – the treasurer is the sole provider of advice to members on corporate financial issues (budget, accounts closure, treasury management, internal and external audit issues, insurances, etc.). FIT officers provide routine financial advice to service committees, within the context of corporate policy and requirements as advised by the treasurer. The treasurer now gives greater attention to how resources can be freed up in the authority’s budget-making process and redirected to member priority service areas. In addition, the strategic role has encompassed greater work on relations with outside bodies, including the EC, government departments, etc.

Relationships: The treasurer discharges these roles through close working with the chief internal auditor, the chief accountant and other senior staff – all of whom are employees of the provider, Newcastle FIT. The treasurer has frequent formal and informal meetings with these staff, who in turn work closely with the service accountants to gain the information needed by the treasurer. To ensure that this happens, there is an informal requirement that all senior FIT accountants will spend 20 to 30% of their time working on corporate financial management.

The benefits: Freed from the demands of corporate member meetings and with a reduced tension between support and control (as ultimate financial control is no longer a provider-side responsibility), the provider-side staff within FIT can give greater attention to the needs of service department managers and to the improvement of operational performance and quality. This customer orientation has been strengthened by outposting a number of FIT accountants into client department offices.

Overall, the reorganisation in Newcastle has helped to ensure that both sides of the finance function are delivered more effectively.
Brent’s approach to devolution:

Brent has undertaken a programme of radical devolution to its 150 business units. Business unit managers have full responsibility for preparing and managing their budgets and for most of the associated accountancy tasks, including the production of profit and loss accounts and balance sheets at the end of the financial year. Each unit operates with its own bank account and accounting system – these systems are generally PC-based, but some units operate with manual records. Each unit is responsible for its creditor payments (including transfers to other Brent business units), income collection, and maintenance of financial accounts. Business units have the opportunity to buy in accountancy support and advice to help them with these responsibilities – but many choose not to do so.

The impact on central finance:

This managerial revolution has resulted in the abolition of the authority’s General Ledger and the disposal of its corporate mainframe. Moreover, the central finance function has reduced from 140 staff to just 35, of which the accountancy staff number less than 20. The remaining accountancy staff are organised in the core finance unit and have no trading relationship with any business unit. The core unit’s roles are to undertake corporate accountancy tasks (for example, overall budget preparation, consolidation of accounts, grant claims, statutory returns, etc.), develop the financial frameworks within which business units operate and co-ordinate and check the returns from business units (see below). It reports to the Executive Director of Central Services, who is the authority’s s151 officer.

Exercising control:

Brent exercises control over this devolved regime primarily through requiring business unit managers to submit monthly returns to the core accountancy unit. Every month, each unit must supply details of income and overall expenditure against budget (and full year forecasts), a balance sheet and a bank reconciliation statement, a VAT return and a Construction Industry tax return. These are aggregated by the core unit to provide quarterly consolidated financial monitoring reports to members. The core unit does not monitor the detail of expenditure, only the total, and each business unit manager has total power of virement within the overall cash limit of the unit’s budgeted net expenditure.

Control is also exercised through a series of regulatory frameworks. These include a set of corporate standards that regulate business activity at officer level (including, for example, financial regulations covering issues such as separation of duties, contracts, etc.), a set of technical standards that set out more detailed financial management requirements and a set of requirements for annual accounting returns that are consolidated to form the authority’s overall set of accounts. These frameworks are reinforced by the internal audit function, which has been split into two parts – a Special Investigations Team (dealing with fraud and other irregularities) and a Compliance Support Team that concentrates on ensuring that business unit managers are operating in accordance with the corporate regularity framework.

Evaluation:

Brent’s regime of radical devolution has not been operational for long enough to allow a full assessment of its strengths and weaknesses. However, to date, the initiative has yielded large reductions in the cost of the accountancy function. Moreover, officers argue that the regulatory regime, aided by further controls over the issuing of cheques, enables the authority to reduce the potential for major fraud and to identify frauds more quickly than under a traditional financial management regime. Overall, officers feel that Brent’s approach allows the s151 responsibility to be discharged more effectively than in other authorities. Monthly returns and, in particular, monthly bank reconciliations by individual business unit managers ensure a much more detailed and regular degree of control than is often achieved by centralised financial arrangements.
- effective accountancy support involves the provision to service managers of expert advice on financial issues, including sophisticated management accountancy services and help with the financial aspects of change, especially change in response to government legislation;
- a key strategic role for the accountancy function is to help the authority obtain and use finances to achieve its corporate objectives – through medium term financial planning, efforts to obtain further government and EC grants, and advice on the formation of partnerships with the private sector.¹

Together, these themes suggest a smaller, more expert accountancy resource, organised in a different fashion to traditional accountancy sections in finance departments. They also raise the issue of training for accountancy staff, to ensure that these staff can develop the competencies that will be necessary to deliver the new types of service.

3.31 These themes of local authority review and innovation are echoed in the private sector. A 1993 report by the Institute of Chartered Accountants in England and Wales, *The Changing Role of the Finance Director*, noted trends in UK companies towards decentralisation of the financial control responsibility away from the finance department (and, in some cases, the department’s consequent ‘downsizing’), with greater emphasis being placed on the contribution that finance professionals make to corporate strategy. The report concludes that “the old idea of the finance department as an aloof, authoritarian department, checking and reporting on what other people are doing, is being replaced by a more participative and more open style”. These messages are reinforced by a study of US companies (Ref. 14), where the emphasis for the finance function was away from “command and control” to becoming part of a “competitive team”.

**Provider costs and competitiveness**

3.32 Authorities’ unit cost per available accountancy day varies widely between all authorities in the sample; even after excluding the upper and lower deciles, the variation is still nearly 60 per cent (Exhibit 3.7). Staff and IT costs are the most important elements of provider costs, together accounting for about 85 per cent of total costs; accordingly, this section concentrates on these two elements (more general advice on IT costs, and on accommodation and other costs, is provided in Section 2).

**Staff costs**

3.33 Staff costs per day are a product of the *staff mix* and the *utilisation rate*. As discussed above, a richer *staff mix* does not necessarily bring an increase in effectiveness through higher service standards (paragraph 3.7), nor does it necessarily improve costs by enabling fewer staff to be employed, with a consequent reduction in the number of accountancy days below the best practice volumes (paragraph 3.17).

3.34 Authorities with an average salary cost per FTE above £21,000 (for London authorities this should be raised to £26,000) have a comparatively

¹ Accountancy, as defined in this section, excludes treasury management – another means by which the financial position of an authority can be improved.
rich staff mix. These authorities should be able to identify some rationale for this mix and ensure that staff undertake work commensurate with their grade. For example, a reinvented accountancy function (see paragraphs 3.29 to 3.30) might result in less accountancy staff, but with those staff concentrating on complex core work. In such an accountancy section, the few remaining staff would probably need to be on comparatively high grades.

3.35 Where such a rationale cannot be identified, authorities may wish to explore options for removing some higher-graded staff, or for diluting the mix. These options could involve the removal of tiers to create flatter management structures, and the employment of more lower-graded staff working to extensively documented procedures. Section 2 of this handbook contains further guidance on such techniques.

3.36 Poor utilisation can flow from high levels of absence (particularly sickness absence) or high levels of unproductive time. Sickness levels are lower for accountancy than for transaction-based services, but an authority with more than 3 days sickness per accountancy FTE per annum should find the advice especially pertinent. The other principal source of controllable absence is training, accounting for an average of 5 days per accountancy FTE after excluding professional training. Accountancy sections should manage firmly the level of days given to training, avoiding both under-training and excessive lost time to be avoided. Section 2 contains general advice on good practice in reducing sickness absence.

3.37 Control of unproductive time is aided by the use of timesheets for all staff. These allow a record to be kept of time not charged to a specific activity (so that such time can be managed down) and also create a valuable source of information about the amount of time spent on particular tasks or on behalf of particular clients. They do not need to be paper-based: Surrey County

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Exhibit 3.7
Accountancy costs

Costs per available day vary widely...

Source: Audit Commission survey of authorities

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Cost per available day (£)

<table>
<thead>
<tr>
<th>Location</th>
<th>Lower quartile (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>London boroughs</td>
<td>138</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>138</td>
</tr>
<tr>
<td>Counties</td>
<td>138</td>
</tr>
<tr>
<td>Shire districts</td>
<td>138</td>
</tr>
</tbody>
</table>

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3.19
Council, for example, issues its staff with PSION organisers to allow for the electronic input of time information. Timesheets are only one means to the end of effective staff utilisation: they should be accompanied by a range of planning techniques – in particular, a resource plan that highlights key tasks and a schedule of staff time that will be deployed to meet each of them.

3.38 Such measures will help accountancy providers reach a competitive daily rate. Beyond this, costs can be reduced further by improving productivity. A more productive accountancy section saves its authority money by delivering the required service outputs (preparing budgets, closing accounts, etc.) from fewer days. Analysis of returns from survey authorities, for example, in relation to the time spent on budget preparation in London boroughs and shire districts, reveals a wide disparity in the staff time used to achieve a standard output (Exhibit 3.8), suggesting that significant opportunities exist to improve productivity. These improvements can result from:

- smoothing workload peaks and troughs;
- improving project management for larger tasks;
- reviewing procedures to eliminate time-consuming activities that add no value, because they do not help meet either the core requirements of the authority or the support requirements of individual client managers;
- increasing work rate;
- matching staff to workload;
- using appropriate IT.

3.39 Smoothing peaks and troughs, and project management – major workload peaks occur at two principal stages – budget preparation and the closure of accounts – with most authorities experiencing a smaller peak at the end of each month. These cannot be eliminated and are difficult to smooth.

Exhibit 3.8
Budget preparation

There is a wide disparity in the staff time used to achieve standard output...
However, they can be offset by greater use of part-time staff for the monthly peaks, and temporary and agency staff to undertake lower-level tasks as part of budget finalisation and accounts closure. Best practice authorities (Case Studies 3.3 and 3.4, overleaf) also use project management techniques for major tasks such as budget preparation and accounts closure, apportioning responsibility for components of the overall task and establishing critical paths.

3.40 Process review and improving work rate – in responding to client requirements, providers need to design efficient and effective operating processes and procedures. Well designed processes and procedures can reduce or even eliminate duplication between central staff and service department staff. In addition, process review can identify non-value adding activities (for example, excessively detailed budget reports that are not used by managers, or frequent attendance at Committee meetings without needing to give advice). Once identified, these can be dropped without detriment to the defined requirements of the accountancy function.

3.41 Matching staff to workload and improving IT – if accountancy managers ask not just ‘what is done?’ but also ‘who does it?’, they may be able to identify tasks undertaken by senior staff that are more appropriate for junior staff. For example, Newcastle upon Tyne City Council has been able to free up more senior staff time for complex and demanding support work by reviewing, standardising, documenting and reorganising its accountancy procedures. Finally, accountancy productivity can be improved by the use of appropriate IT. Authorities with antiquated financial management systems may need to deploy more staff time to meet the information requirements of service managers.

IT costs

3.42 Technological and cultural developments have allowed a number of authorities to move away from the traditional IT approach of mainframe-based general ledgers. Alternative approaches take two forms. Firstly, a number of authorities have taken advantage of technological opportunities. They have replaced their mainframes with UNIX-based open system solutions (as has happened in Woodspring District Council and Melton Borough Council) or a devolved accounting system working, for example, through PCs linked by a Novell distributed client-server network as at Broxbourne Borough Council. The London Borough of Brent has devolved responsibility for keeping accounts to the individual business units (see Case Study 3.2, above). Most of these units operate with their own PC-based packages, thereby removing the need for a general ledger and any substantial computing facility at the authority’s centre. Brent calculates that this radical devolution has saved it £2m in computing costs alone.
Trafford Metropolitan Borough Council’s successful record of accounts closure is demonstrated by:

◆ the consistent placing of its accounts on deposit before the end of June;
◆ the preparation of high quality working papers;
◆ the submission of all grant claims on time;
◆ the discovery of few errors (and no material errors) by the external auditor.

This performance has been achieved using less than 30 accountancy days per £m NRE + HRA.

Trafford’s success at accounts closure is attributable to a range of good management practices.

Priorities – sound financial management and prompt and accurate accounts closure has been historically high in the list of Trafford’s corporate priorities. The objective is understood at all levels throughout the Council and is reflected in a ‘culture’ which values financial discipline, proper record keeping and probity in all Council activity.

Planning, programming and managing the process – an assistant director of finance leads and closely supervises the accounts closure process. He considers this as his most important personal priority. He prepares a detailed programme in mid February, identifying all key tasks and deadlines and the responsibility of each accountancy section for them. The programme takes into account any relevant new issues (for example, changes in accounting practice), as well as specifically addressing problems identified in the closing and audit of the previous year’s accounts. Each accountancy section prepares subsidiary programmes, delegating responsibilities with deadlines to individual members of staff. The assistant director holds progress meetings with principal accountants at least fortnightly and more frequently during critical periods, enabling a swift response to problems. Overall, this ensures smooth progress towards an end of June deadline.

Skilled and experienced staff – the accountancy service has a relatively ‘rich’ mix of staff, both in terms of qualifications and experience, leading to a clear understanding of each individual’s specific responsibilities, and of how each task fits into the overall closing process.

Management responsibilities and relationships with service directorates – the relative responsibilities of service directorate and finance staff for accounts closure are clearly defined in financial instructions and guidance, thereby minimising the possibility of delays, errors or waste, because of confusion, disputed responsibility or duplication of functions. Accountancy staff have established and maintained good and respectful relationships with service directorate staff. Regular visits to and consultation with service directorates allow accountancy staff to receive early warning of any matter that may affect accounts closure.

Financial systems and procedures – corporate financial systems are highly customised to fit the Council’s financial arrangements. Effective accounts closure depends upon accurate financial records which are updated promptly: bank reconciliations are completed monthly, suspense items are cleared promptly (and the underlying causes investigated to ensure there is no repetition), and control accounts are properly managed.
Bolton Metropolitan Borough Council has improved its annual budget process by providing clearer guidance information and improving working relationships between central finance and service department staff.

**Improved guidance:**

The chief accountant has introduced a guidance note that sets out the steps involved in the process. The ‘estimates guidance’ has three objectives:

- to plan the budget setting process;
- to communicate responsibilities and deadlines to accountancy staff;
- to act as a ‘training device’ for those who are new to the budget setting process.

The document provides guidance on the timetable and reporting arrangements for budget setting and then deals with a series of general and specific issues that will improve the quality of the authority’s financial budget.

**On general preparation issues** – it emphasises a range of tasks, including some already undertaken as part of previous years’ accounts closure programme, that if taken into consideration will make the budget setting process easier:

- proper accounts documentation
- accuracy of recharges
- investigation of miscodings
- investigation of unusual expenditure trends
- aggregate budget monitoring
- a good three year forecast
- monitoring the impact of capital schemes on revenue financing
- agreed reporting procedures

**On specific preparation issues** - it provides detailed advice on calculating the main budget areas including those that may require special accounting treatment:

- salaries and wages
- capital
- repairs and maintenance
- City Challenge

(continued overleaf)
### Case Study 3.4 (continued)

- **DLO recharges**
- **general recharges**

The advice given covers issues such as the accounting treatment of demand-led items, inflation, current interest rates, the level of departmental flexibility in budget setting and the preparation deadline.

The guidance also contains details of the budget timetable, which is driven primarily by member requirements. The work to be completed by each relevant committee meeting is highlighted. Initial estimates (including a three year forecast) are prepared at the start of September and then amended throughout the following six months to take account of factors such as HRA rent rises and the SSA outcome. The final budget is presented for member approval in early March.

**Improve working relationships:** To support the effective use of the guidance in helping complete the budget on time, Bolton ensures that a close working relationship exists between the finance department accountancy section and the service departments. The key link is provided by six qualified ‘policy accountants’ who act as advisors to service departments. Two of these accountants are actually outposted while five have finance staff within service departments reporting directly to them. This arrangement enables the chief accountant, who is responsible for the provision of the budget to time, to monitor departmental progress.

**Summary:** As a result of these initiatives, Bolton uses fewer staff resources on budget setting than other metropolitan authorities surveyed.

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3.43 General advice on IT costs and the use of mainframes is given in Section 2. Authorities should compare themselves against the survey benchmark rates of £2,000 per accountancy FTE (£2,700 for London authorities). Analysis of accountancy IT costs from survey authorities revealed no clear cost advantages to date, either in terms of lower IT costs or lower staff costs, for non-mainframe based accountancy computing. However, accountancy sections intending to retain their mainframes should:

- explore the scope for minimising costly on-line time (for example, by doing more accountancy work on PCs away from the mainframe);
- review their coding structures to eliminate unnecessary codes that take up expensive mainframe capacity;
- explore emerging approaches to database software that allow greater access and flexibility than has historically been available from mainframe-held information.
Good practice checklist

Accountancy service standards

Key performance criteria

1 Does your accountancy function:
   ◆ submit accounts for audit well in advance of the 30 September deadline?
   ◆ produce accounts without material errors or large numbers of small errors?
   ◆ furnish external auditors with high quality final accounts working papers?
   ◆ produce grant claims for external audit on time and to a high standard?
   ◆ have, in the opinion of the external auditor, a suitably qualified and experienced workforce, with an appropriate training programme to maintain standards?

Information

2 Is accurate financial information available quickly and easily, through:
   ◆ a commitment accounting facility that can be easily understood and used by non-accountants?
   ◆ updates of the authority’s general ledger to reflect committed and incurred expenditure on the day of notification?
   ◆ on-line access for service users to corporate accounting systems?
   ◆ the distribution of standard budget reports to budget holders within five days of the month-end?

User consultation

3 Have budget holders and service managers been consulted over the form and provision of financial information?

4 Have their views been reflected in the information available?
### Accessibility of information

**5** Do service managers have the opportunity to produce their own budget reports, for example by downloading information onto PC-based spreadsheet models and tailoring information from corporate systems to meet local management needs?

### Queries and requests for advice

**6** Does your accountancy section have target response times for different types of query and request?

**7** Are these target response times publicised?

**8** Is performance against the target monitored?

### Other accounting issues

**9** Does your accountancy section meet a high standard of financial accounting, through:
- the informed use of budget profiling?
- regular and auditable bank reconciliations?
- prompt clearance of suspense accounts?
- clear instructions to service departments for accurate coding?
- the designation of appropriate staff to manage control accounts?
- a properly planned and resourced accounts closure programme, including the prompt completion of year-end accruals?
<table>
<thead>
<tr>
<th>Question</th>
<th>Details</th>
</tr>
</thead>
</table>
| **10** s151                                                               | Does your authority’s approach to s151:  
  - align financial and operational management, with service and cost centre managers responsible for low level budgetary control and central finance staff responsible only for overall monitoring of the authority’s budget?  
  - allow generous scope for virements and carry-overs (and the control of virements to lie largely with service managers)? |
<p>| <strong>Accountancy volumes</strong>                                                  |                                                                                                                                                                                                     |
| <strong>1</strong>                                                                    | If you are a small shire district, are you purchasing more than 110 accountancy days per £m of NRE+HRA?                                                                                               |
| <strong>2</strong>                                                                    | If you are either a ‘Big 11’ district, county, metropolitan district or London borough, are you purchasing more than 50 accountancy days per £m of NRE+HRA? |
| <strong>3</strong>                                                                    | Is a high volume of accountancy days in your authority partly explained by the level of capital activity or the extent of in-house provision?                                                        |
| <strong>4</strong>                                                                    | Is a high volume of accountancy days justified by the staff mix, so that the overall cost of accountancy is below the best practice level?                                                         |
| <strong>5</strong>                                                                    | Has your authority recently reviewed its split between the central and service-based finance staff to establish a clear and coherent division of tasks?                                                 |
| <strong>6</strong>                                                                    | Has your authority outposted central accountants?                                                                                                                                                     |
| <strong>7</strong>                                                                    | Does your authority’s approach to s151 avoid excessive reporting to members and the involvement of central finance department staff in small-scale financial decision-making? |</p>
<table>
<thead>
<tr>
<th>8</th>
<th>Has your authority reviewed its requirements of the accountancy function? Do the new requirements:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>◆ shift the emphasis away from detailed control towards core work, support and corporate strategy?</td>
</tr>
<tr>
<td></td>
<td>◆ tightly define the core accountancy tasks, and differentiate these from the provision of support services?</td>
</tr>
<tr>
<td></td>
<td>◆ focus the strategic role for accountancy on obtaining and using finances to achieve corporate objectives?</td>
</tr>
</tbody>
</table>

### Accountancy providers

<table>
<thead>
<tr>
<th>1</th>
<th>Is the cost per available accountancy day greater than £133 (£171 for London authorities)?</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>If your average staffing costs are greater than £20,000 per FTE (£26,000 for London authorities), what benefits are you securing from this rich staff mix?</td>
</tr>
<tr>
<td>3</td>
<td>Does your rich staff mix allow you to reduce volumes below the rules of thumb?</td>
</tr>
<tr>
<td>4</td>
<td>Are plans in operation to reduce sickness absence, and manage time given to training (see also Section 2)?</td>
</tr>
<tr>
<td>5</td>
<td>Do accountancy staff complete timesheets?</td>
</tr>
<tr>
<td>6</td>
<td>What use is made of the information, especially concerning the levels of unproductive time?</td>
</tr>
<tr>
<td>7</td>
<td>Are peaks and troughs smoothed with temporary, agency and part-time staff?</td>
</tr>
<tr>
<td>8</td>
<td>Are project management techniques used for major tasks such as budget preparation and the closure of accounts?</td>
</tr>
<tr>
<td>9</td>
<td>Has your accountancy section reviewed its processes to ascertain whether activities can be eliminated, and whether tasks currently done by senior staff can be given to more junior staff?</td>
</tr>
<tr>
<td>10</td>
<td>Does your accountancy IT allow you to directly meet service managers’ information needs efficiently?</td>
</tr>
<tr>
<td>11</td>
<td>If you intend retaining mainframe IT, is there scope to reduce on-line time by greater use of PCs, and reduce capacity requirements by eliminating unnecessary codes?</td>
</tr>
</tbody>
</table>
Internal audit

- Is your authority above the benchmark for internal audit expenditure per £m NRE+HRA?
- Is your authority’s audit plan based on a comprehensive assessment of risk?
- Do you have sufficient and appropriate staff to ensure proper coverage?
- How do service standards in your authority compare with good practice?
- How does your authority’s daily rate for internal audit compare to good practice?
- What can be done to reduce costs without undermining standards?
- How well managed is the internal audit section?
Executive summary

The key determinant of internal audit effectiveness is coverage. Authorities must ensure that they have assessed the internal audit coverage required using a rigorous risk assessment process.

The assessment of risk may highlight upward pressures on internal audit effort and resources, for example, delegation to locally managed schools and to cost centre managers. However, some authorities can reduce their existing effort by concentrating on a systems-based approach.

Internal audit staff should possess the appropriate skills to carry out the required audit work.

Standards vary but there is no relationship between standards and either unit costs or volumes. This suggests that high standards do not necessitate high costs and therefore that all internal audit sections should aim for high standards.

Unit costs (cost per day) are affected both by the skill mix of internal audit staff and the amount of unchargeable time. Authorities should strive to meet the benchmark rate of 175 chargeable days per FTE per annum.

Key benchmark data

<table>
<thead>
<tr>
<th>Volumes:</th>
<th>Shire districts (excluding 'Big 11'):</th>
<th>Available internal audit days per £m NRE+HRA Less than 23</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costs per chargeable day (£):</td>
<td>London</td>
<td>Elsewhere</td>
</tr>
<tr>
<td>Staff</td>
<td>151</td>
<td>133</td>
</tr>
<tr>
<td>IT</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Accommodation</td>
<td>13</td>
<td>8</td>
</tr>
<tr>
<td>Other</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>177</td>
<td>156</td>
</tr>
<tr>
<td>Staffing costs per FTE:</td>
<td>London</td>
<td>£26,200</td>
</tr>
<tr>
<td></td>
<td>Elsewhere</td>
<td>£20,600</td>
</tr>
<tr>
<td>Utilisation:</td>
<td>Chargeable days per FTE</td>
<td>At least 175</td>
</tr>
</tbody>
</table>

(NB. unless local risk assessment has identified good reason for variation)
Developing competitive financial support services

Chapter 2 Internal audit

Introduction

3.44 Internal audit must provide sufficient audit coverage to minimise the potential for financial loss. To achieve this, management must:

- plan – according to a rigorous assessment of risk – and manage the audit function effectively, including liaison with the external auditor;
- ensure appropriate resources are employed and that individual audits are delivered to a high standard;
- undertake systems-based audits (including computer and contract audits);
- undertake investigative-based audits and respond to service department requests.

3.45 Generally, this work is carried out solely by staff in a central internal audit section (although at some authorities some internal audit work has been outsourced), and is undertaken primarily to meet the director of finance’s s151 responsibilities.

3.46 Expenditure on internal audit varies widely, both between and within authority types (Exhibit 3.9). Expenditure is a product of coverage and provider costs and competitiveness. Each issue is explored in turn.

Exhibit 3.9 Internal audit

Variations in expenditure can be explored by looking at coverage and provider costs...

Source: Audit Commission survey of authorities
Coverage

3.47 The ultimate aim of any internal audit section is to minimise the potential loss to its authority arising from mismanagement, error, negligence or fraud. However, in the same way that it is impossible to determine how many fires an effective fire prevention campaign will prevent, equally it is impossible to assess the extent of financial loss a particular internal audit section has avoided or what contribution it has made to the discovery of known frauds. Therefore, in the absence of output measures to assess internal audit performance, it is necessary to focus on the inputs and procedures that should result in a quality service.

3.48 Internal audit should address areas at risk, to a sufficient depth, at an appropriate frequency, and in the right way. Central to achieving this appropriate coverage is a rigorous assessment of risk. Only when the authority’s risk has been assessed, should internal audit managers turn their attention to resources. The key influence on the number of audit days and the staff mix will be the risk assessment process.

3.49 In addition, whatever the coverage and resources required, internal audit should be effective and operate to a high standard. Therefore, any assessment of internal audit should be completed by an examination of standards. These issues will be explored under three headings:

- assessing coverage
- resources to achieve such coverage
- standards

Assessing coverage

3.50 Internal audit coverage should depend largely on the levels of risk within the authority. Risk should be systematically assessed using a methodology to ensure that the resulting audit plan reflects the needs of the authority. The problem is that there is no generally agreed methodology. Those authorities that have developed their own approach generally consider such issues as value, staff experience and legislative change (Box 3.B).

<table>
<thead>
<tr>
<th>Risk factors</th>
<th>Examples of high risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inherent systems risk</td>
<td>Cash systems, stock and materials</td>
</tr>
<tr>
<td>Key controls</td>
<td>No separation of duties, absence of reconciliations</td>
</tr>
<tr>
<td>Value of area</td>
<td>Costs, volumes and transactions</td>
</tr>
<tr>
<td>Staff experience</td>
<td>New or inexperienced staff</td>
</tr>
<tr>
<td>IT</td>
<td>No systems documentation</td>
</tr>
<tr>
<td>Legislative change</td>
<td>New responsibilities</td>
</tr>
</tbody>
</table>
3.51 These general issues should be complemented by an assessment of local factors:
- the history of fraud at the authority, both within the authority (which might be controllable) and external fraud, for example, housing benefits;
- the impact of the Managed Audit\(^1\) on the level of coverage required by the external auditor;
- the nature of the control environment within the authority;
- any significant changes within the authority that may lead to financial delegation, for example, the local management of schools;
- the incidence of manual staff paid by cash.

3.52 The risks need to be prioritised to determine the frequency of coverage. This will involve some form of weighting of criteria, probably based on a scoring system, for example, the value of an area may have a higher weighting than, say, the impact of legislative change. But equally, within an area of income or expenditure, the scoring system should reflect the level of risk, for example, the area of housing benefits is likely to have a higher weighting than, say, creditor payments. The logic here is that the higher the score, the more frequently the area will be subject to audit. This can lead to the development of ‘rules of thumb’ for the desired coverage. There is no definitive method for assessing such weightings or rules of thumb because of the impact of local factors. However, it is vital that there is a method for weighting and prioritising risk, and translating this into coverage, and that this method is reasonable and coherent.

3.53 Good practice involves not merely a rigorous risk assessment methodology, but also the use of its results to inform decisions and work plans. Specifically, the risk assessment should determine the required coverage and therefore the required staffing, i.e. staffing resources should be zero-based (Box 3.C). The Commission’s survey shows that 10 per cent of authorities claim to have adopted this good practice, with the remaining 90 per cent determining coverage on the basis of existing staff resources.

---

**Box 3.C**  
**Planning internal audits**

<table>
<thead>
<tr>
<th>Common Practice: planning based on existing staff resources</th>
<th>Good Practice: planning based on risk assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff resources</td>
<td>Risk</td>
</tr>
<tr>
<td>Available days</td>
<td>Coverage</td>
</tr>
<tr>
<td>Coverage</td>
<td>Days required (± existing staff resources)</td>
</tr>
<tr>
<td>Plan</td>
<td>Plan</td>
</tr>
</tbody>
</table>

---

\(^1\) The ‘Managed Audit’ is the opinion audit service that results from applying the principles of auditing and proper professional standards in conditions where the audited body has sound financial systems, effective controls, good internal audit, and reliable accounts production processes.

Where the audited body improves its standards of control over financial systems and becomes more efficient, then the external auditors should be able to achieve efficiency savings too.
Moreover, in good practice authorities the risk assessment should form the foundation of two documents:
(a) the annual audit plan;
(b) a longer term (say three to five year) strategic audit plan with projections of intended coverage to ensure that all areas of risk are covered over a given period.

The judgement about whether an authority’s volume of audit coverage – in terms of audit days required – is reasonable will depend crucially on the risk assessment. An authority is likely to be neither under- nor over-resourcing its internal audit function, provided that:
◆ the assessment has been completed properly;
◆ the conclusions are reasonable;
◆ the proposed volumes of audit days and staff mix flow logically.

This risk assessment-based approach to coverage will identify a level of required audit days. This may be more or less than an authority’s current level. Certainly there are changes common to all authorities, such as increased tendering and devolution of financial management, which suggest an upward pressure on internal audit and therefore potential difficulties in cutting the levels of coverage. But these are general trends, and individual authorities may find that their risk assessment allows them to reduce the current levels of provision to no detriment. Proper risk assessment may also help authorities absorb upward pressures without increasing the level of internal audit resources. The assessment may reveal the opportunities to reduce the level of routine establishment audit checks, outside the schools sector, (especially if greater emphasis is placed on systems-based auditing), thereby freeing up existing resources to respond to the upward pressures. Two examples of thorough risk assessment methodologies are to be found at Bolton Metropolitan Borough Council and Oxfordshire County Council (Case Study 3.5, and Case Study 3.6, overleaf).

Bolton Metropolitan Borough Council produced an audit needs (risk) assessment methodology for the local Institute of Higher Education which won praise from the Further Education Funding Council (FEFC). The audit ‘need’ is determined using five steps:
◆ identifying the potential areas for audit
◆ identifying risk
◆ evaluating risk
◆ applying the risk evaluation to audit areas
◆ determining the extent of audit coverage i.e. producing an audit plan

**Identifying potential areas:** 20 principal areas of financial activity were identified from the budget book for consideration of the associated risk.
Risk is identified using three factors:
- materiality
- inherent risk
- internal control risk

Materiality is the value of an area, with a higher value suggesting a higher potential risk. Inherent risk assesses factors that are largely outside the control of the audited body, for example, the complexity of the calculations involved (errors are more likely to occur) and the presence of valuable and easily moveable assets (such as personal computers). Internal control risk assesses the steps that an audited body can take to reduce the likelihood of any financial loss, for example, separation of duties.

Evaluating risk: the three types of risk need to be evaluated to determine the extent and frequency of coverage (i.e. the number of audit days). The needs assessment recognises that any given area may have a high inherent risk but a low control risk and vice versa. Therefore, all three risk assessment factors need to be considered together for each audit area.

Applying risk assessment: the evaluation is converted into a 1 to 5 numerical score for each potential audit area based on the results of the evaluation and the auditor’s professional judgement; a score of 1 would suggest an annual audit while a score of 5 would suggest that one audit in, say, three years should constitute sufficient coverage. This leads to a list of annual, bi-annual and three yearly audits for the Institute.

Planning coverage: the required coverage for each audit area is based on a standard number of days which is then adjusted to take account of the type of audit being undertaken, for example, systems-based, and past audit experience.

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**Case Study 3.6**  
Oxfordshire County Council - internal audit needs assessment

Oxfordshire County Council’s Internal Audit Division has prepared an audit needs assessment (ANA) methodology as a lead authority project for the Midlands Counties Chief Internal Auditors Group.

The ANA feeds into the production of the audit plan by contributing to decisions on:
- audit objectives
- areas to be audited
- the type of audit work
- the frequency of audit
- estimates of resources required

There are two basic steps in the ANA process: identifying the total need and prioritising the need.
The study collected information on the volume of audit coverage from sample authorities. Small shire districts incur proportionately higher volumes than larger authorities (Exhibit 3.10). Moreover, for both shire districts and other authorities, there is a strong relationship between internal audit volumes and the expenditure base of an authority. This allows the generation of basic volume benchmarks, which may be of assistance in assessing coverage. The lower quartile authorities meet the following benchmarks:

- shire districts – 23 days per £m of NRE+HRA
- other authorities – nine days per £m of NRE+HRA

Identifying the total need: various sources of information, including the budget book and auditor knowledge, are used to identify all areas requiring audit work. A number of criteria, including type of audit (i.e. systems-based), financial value and previous findings, are used to estimate the total days required if all identified areas were to be audited once in any one year. Determining total days involves an assessment of the ‘ideal’ staff mix required for each audit.

Prioritising the need: this involves prioritising the total need into a manageable annual workload, using a risk assessment model to determine the frequency that each audit should be undertaken. Risk is defined as ‘the likelihood of undesirable events occurring’. Therefore, audit work should concentrate on those areas with the greatest risk. To determine which areas are more subject to risk than others, a range of criteria have been adopted. These include:

- financial value of the area
- volume of transactions
- the extent of delegation
- whether the service is provided in-house or externally
- relevant systems factors
- the management and control environment
- the sensitivity of the area

Weightings are given to each criteria generally on a scale of 1 to 5 with 1 representing a ‘low risk’ and 5 a ‘high risk.’ These are then converted into a scoring system which determine the frequency of audit, from ‘more than annual’ to ‘if required.’

The skill mix of the existing staff resources is then considered to determine whether it is sufficient to undertake the proposed annual audit plan. This may lead to adjustments in the proposed plan; specifically, increasing or decreasing the days allocated to a particular audit if a different skill mix is used. Alternatively, it may lead to adjustments in the internal audit staffing resource; specifically, the plugging of gaps in the current staff mix that audit managers must address to be able to undertake a fully effective internal audit plan.
Once the required coverage has been assessed, authorities need to ensure that they have the appropriate staff to undertake the required coverage. Some of the factors considered below (as part of Provider costs and competitiveness) will have an impact on resourcing, for example, the number of auditors employed and the proportion of unavailable time and what can be done to control it. However, the two key considerations are:

- the type of audit work to be undertaken;
- the skill mix of the audit staff.

3.59 There are authorities that have consciously reduced volumes by moving the emphasis of the audit approach away from the more traditional probity audits (including establishment audits) to concentrate on a more systems-based approach. This approach places greater reliance on the operation of internal controls, rather than the detailed testing of large samples of transactions. However, staff must be properly trained to undertake what is more complex auditing. Lancashire County Council has undertaken this approach, allowing the authority to increase the number of higher graded staff whilst reducing their overall number of auditors and hence their costs.

3.60 Some authorities have argued that, providing they are properly trained, more highly graded staff can achieve greater productivity and take responsibility for wider areas of audit activity, so that overall, less staff are needed. If this reduction in staff numbers offsets the higher salary costs, the approach can yield better value for money. However, no such benefits were found in practice: no universal relationship could be identified between grade mix and internal audit days. A rich staff mix does not necessarily enable an authority to reduce its days (Exhibit 3.11, overleaf).
Standards

3.61 Following the assessment of risk and the determination of coverage, authorities need to set standards for the delivery of audit services. One way of assessing standards is to use a ‘basket’ of attributes or practices that, together, would constitute a high standard internal audit service. The study team assessed standards in sample authorities in two ways. First, by asking the authority’s external auditor to evaluate internal audit sections, and second, by asking each internal audit section to complete a self-assessment, measuring their approach to both planning and risk assessment.

3.62 The nine criteria adopted to compile this ‘basket’ of measures are:

- **independence** – the access internal audit has to the authority’s records;
- **service delivery** – the appropriateness and effectiveness of internal audit’s relations with service departments;
- **audit methodology** – the procedures in place to ensure that individual audits are properly planned, controlled, recorded and evaluated;
- **audit methodology** – the procedures in place to ensure that the findings from individual audits are based on sound evidence;
- **audit methodology** – the procedures in place to ensure that audits are undertaken with due care;
- **flexibility** – the existence of a contingency budget and the ability of internal audit sections to bring in additional resources when required;
- **timeliness of output** – the procedures in place to ensure that audit findings are reported promptly;
- **quality of output** – the appropriateness of audit recommendations;
- **quality of output** – the procedures in place to ensure the timely follow-up of recommendations.

### Exhibit 3.11

**Internal audit days and grade mix**

A rich staff mix does not necessarily enable an authority to reduce its days...

### Chargeable days per £m NRE+HRA

<table>
<thead>
<tr>
<th>Days</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>70</td>
<td></td>
</tr>
<tr>
<td>60</td>
<td></td>
</tr>
<tr>
<td>50</td>
<td></td>
</tr>
<tr>
<td>40</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td></td>
</tr>
<tr>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

**Source:** Audit Commission survey of authorities

### Percentage internal audit staff at PO grade and above

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>20%</td>
<td></td>
</tr>
<tr>
<td>30%</td>
<td></td>
</tr>
<tr>
<td>40%</td>
<td></td>
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<tr>
<td>50%</td>
<td></td>
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<tr>
<td>60%</td>
<td></td>
</tr>
<tr>
<td>70%</td>
<td></td>
</tr>
<tr>
<td>80%</td>
<td></td>
</tr>
</tbody>
</table>
3.63 The criteria have been weighted to reflect generally accepted priorities, thereby allowing a single standards score to be developed for each sample authority, Appendix D contains a detailed explanation of this methodology.

3.64 Analysis of authorities’ standards scores suggests that, whilst considerable variation exists, high standards necessitate neither high volumes of internal audit days nor a rich staff mix (Exhibit 3.12). In short, high standards do not necessitate high costs, and so all authorities can aim for high performance standards without needing to increase the size or cost of their internal audit sections.

Exhibit 3.12
Service standards, volumes and staff costs

High standards necessitate neither high volumes of internal audit days...

...nor a rich staff mix...

Source: Audit Commission survey of authorities
Another measure of service standards is the speed with which an internal audit section can respond to reported irregularities. Good practice would ensure that an authority has sufficient flexibility in its audit process to allow experienced staff to be redeployed quickly in the event of any suspected fraud and corruption.

Three other service standards issues need to be considered. First, as internal audit sections increasingly take on audit work for non-authority bodies, for example, further education colleges, the s151 officer needs to exercise proper client management to ensure that standards do not slip in the parent authority. In most authorities where this is the case, to guard against any such deterioration, the treasurer requires the chief internal auditor to report progress against the audit plan on a monthly basis. In addition, standards and overall performance could be measured by means of an audit committee, as suggested by the Commission in its submission to the Nolan Committee.

Second, there is scope, once the audit plan has been agreed, for internal audit to consult with service departments on the most effective way to undertake the audit programme. Finance directors and internal audit managers should ensure that they establish mechanisms for consulting user departments over these matters.

Finally, a range of other measures can be used to assess internal audit performance. These include:

- having proper working procedures in place, for example, business plans and audit procedures manuals;
- the independence to insist on an audit being undertaken;
- performance monitoring measures, for example, the promptness of reporting audit findings, ability to meet the audit plan and individual performance targets.

Provider costs and competitiveness

The lowest cost authorities enjoy daily rates that are less than half those of the most expensive authorities in the sample (Exhibit 3.13). Staff and other costs are the most important elements of provider costs, accounting for 79 per cent and 12 per cent respectively of total costs; accordingly, this section concentrates on these two elements. (More general advice on IT, accommodation and other costs is provided in Section 2.)

Staff costs

Staff costs per day are a product of the staff mix and the utilisation rate. A richer staff mix does not necessarily bring an increase in effectiveness through higher service standards (see paragraph 3.64), nor is there an automatic trade-off between staff mix and staffing levels (see paragraph 3.60). Authorities outside London with an average salary cost per FTE above the lower quartile of £20,600 (London authorities will need to adjust this benchmark to £26,200 to reflect their higher salary costs) should review their
internal audit volumes to determine whether their rich staff mix is bringing benefits (see Resourcing above).

3.71 Utilisation, in terms of available days per full-time equivalent auditor, varies significantly between authorities (Exhibit 3.14), with the most productive authorities achieving some 40 per cent more available days per FTE than the least productive.

**Exhibit 3.13**
Internal audit – cost per available day

The lowest cost authorities enjoy daily rates that are less than half those of the most expensive authorities...

**Exhibit 3.14**
Internal audit – utilisation

Utilisation varies considerably...

**Source:** Audit Commission survey of authorities
3.72 Poor utilisation can flow from high levels of absence (particularly sickness and training absence) or high levels of unproductive time. General advice is given in Section 2 on good practice in reducing sickness absence: sickness levels are lower for internal audit than for transaction-based services, but an authority with more than five days sickness per FTE per annum should find the advice especially pertinent. The other principal source of controllable absence is training: internal audit sections should manage firmly the level of days given to training, avoiding both under-training and excessive lost time.

3.73 A key device for the reduction of unproductive time in internal audit sections is the introduction of timesheets for all staff. Not only does this allow a record to be kept of time not charged to a specific activity (so that such time can be managed down), but it also creates a valuable source of information for managers, showing the amount of time required for particular tasks or for particular clients, and rates of productivity. Many internal audit sections already operate a time recording system, although in some authorities there was little evidence to suggest that the results were being used to control unproductive time.

3.74 The level of unchargeable time also varies across authorities (Exhibit 3.15). Non-chargeable time includes productive activities, such as planning and management, and it may be necessary for authorities to devote more resources to these activities to ensure a high quality audit based on proper risk assessment. However, there appears to be significant scope to reduce the time spent on non-audit activities. All authorities should aim to achieve the lower quartile target to ensure that daily rates remain competitive.

3.75 Valuable lessons can be learnt from well-managed internal audit sections, such as at the London Borough of Enfield (Case Study 3.7). These lessons are reinforced by a study of an NHS internal audit agency, providing services to NHS bodies (Case Study 3.8, overleaf).
Enfield’s internal audit section has secured ISO9002 (formerly known as BS5750) accreditation for the provision of internal audit services (its s151 work) and financial consultancy services (its value for money and consultancy work). Building on its methods of risk assessment and audit planning, Enfield has developed an integrated approach to delivery, monitoring and review, which assures a high quality of service.

**Delivering:** Flexible staffing – staff are not organised into fixed sections or teams, either on a client basis or a particular group of clients (for example, education audits) or on a particular type of audit (for example, contract or computer auditing). Instead, all staff below the head of internal audit services and the second-tier audit managers are in a pool from which they are allocated to projects, according to the demands of the plan and the suitability of individual auditors.

Procedures – projects are carried out in accordance with the requirements of the section’s ISO9002-accredited Audit Procedures Manual, which covers not merely the methods and techniques to be used but also prescribes the approach to working papers, filing, etc.

Management control of reports - to ultimately assure their quality, all reports are signed off by either the head of internal audit services or by one of the two audit managers.

Two-week target for reports – users want reports to be generated promptly. After further consultation with users, the section committed itself to producing reports within two weeks of completing audit work. This target has been incorporated into the section’s procedures and helped secure the award of ISO9002 status.

The section undertakes follow-up audits, six months after the original audit, to check progress against the original audit recommendations.

IT systems - the section uses a computerised planning, monitoring and charging system. After feeding in data on the plan and non-productive time, the system allows performance to be monitored against target work plans for individual auditors. This is achieved with the input of timesheet data. The system can also generate invoices, complete with details of the General Ledger code to which the charge should be posted.

**Monitoring:** In addition to monitoring performance against the overall audit plan, the head of internal audit services monitors more specific aspects of performance, using data from the section’s IT system (see above). Performance is assessed monthly against a number of quantitative targets:

- percentage of audits completed within target
- actual percentage of productive (i.e. chargeable) days versus target days available for chargeable work – the section aims for a specific target (excluding public holidays and annual leave)
- actual days spent against different categories of audit work versus planned

(continued overleaf)
Case Study 3.7 (continued)

- number of reports produced versus the target
- percentage of report recommendations implemented within six months

In addition, the head of internal audit services monitors service department satisfaction through completed client questionnaires. These are sent to departments at the end of each project and ask for service managers’ assessments of performance.

Review: In addition to an annual staff assessment, management and staff complete a four-side assignment report for all audits that last for more than five days. These reports function as mini-appraisals and provide feedback to auditors on their performance against five criteria: technical skills, communication skills, organisational skills, interpersonal skills and business awareness. This regular feedback helps to improve service delivery.

Case Study 3.8
Internal audit in the NHS: Kent Internal Audit Consortium

The Kent Internal Audit Consortium was created in April 1993 in response to the Health Service reforms. The existing health authority in-house internal audit sections did not fit the new structure of trusts and authorities in the area. Furthermore, they were not large enough to provide the full range of services demanded by the new clients and required by government standards. The consortium is an NHS agency – a half-way house between a private company and a conventional in-house operation. It has 21 staff servicing 14 clients (12 trusts and two health authorities) and is run by a management board, comprising directors of finance from the client bodies.

The key elements of the changes were:

Restructuring: The existing in-house units have been restructured, reducing the overall number of staff and standardising staff terms and conditions and grading.

Culture change: Moving to a more commercially and customer-oriented staff ‘culture’ has been vital in order to reflect the new, more ‘arms-length’ and contractual relationship with the clients. The audit product has to be delivered completely and on time if the consortium is to be paid. There are no allowances for ‘mitigating circumstances’ – agency staff have to cover for temporary staff vacancies. The cultural change has needed frank and open consultation on a regular basis with all staff to ensure their commitment to the process.

New relationships: The relationships between the consortium and the client bodies are considerably more complex than those between an in-house service unit and service users. Auditors are now having to deal with 14 clients, each with an audit committee and each with differing requirements. Senior audit staff have put in substantial time and effort, promoting the consortium’s services and meeting with clients to clarify their needs and priorities. The clients valued this advice and support as they grappled with the problems of their own reorganisation and this led to the establishment of good working relationships.
Furthermore, as authorities move toward a systems-based approach, there is increased scope to standardise internal audit procedures and working methods and hence improve productivity.

Other costs

Other costs relate primarily to the costs of training, which are likely to be higher for internal audit than many other financial services. However, some chief internal auditors claimed that they were being recharged costs that they had not incurred to make other services, such as transaction based services, more attractive to ‘purchasing’ departments. Audit managers should ensure that costs recharged to the internal audit section are properly analysed to ensure only genuine costs and recharges are incurred. (More advice on this area is given in Section 2.)
## Good practice checklist

### Internal audit coverage, volume of days, resourcing and standards

<p>| | |</p>
<table>
<thead>
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<tbody>
<tr>
<td>1</td>
<td>Is your audit plan based on a rigorous assessment of risk, rather than available staff resources?</td>
</tr>
<tr>
<td>2</td>
<td>Does your internal audit section produce both an annual and a longer term plan and monitor progress against them regularly?</td>
</tr>
<tr>
<td>3</td>
<td>Has your authority reviewed its internal audit requirements?</td>
</tr>
<tr>
<td>4</td>
<td>Do the new requirements enable the reduction of routine probity and establishment audits, and thus an increased emphasis on systems-based auditing?</td>
</tr>
<tr>
<td>5</td>
<td>If your authority is a shire district with an NRE+HRA below £100m, are you purchasing more than 23 audit days per £m NRE+HRA?</td>
</tr>
<tr>
<td>6</td>
<td>If your authority is a ‘Big 11’ district, county council, metropolitan district or London borough, are you purchasing more than nine audit days per £m NRE+HRA?</td>
</tr>
<tr>
<td>7</td>
<td>Does your authority’s internal audit section, in the opinion of the external auditor, perform to a high standard?</td>
</tr>
<tr>
<td>8</td>
<td>Is there sufficient flexibility to ensure that experienced staff can be redeployed quickly in the event of any suspected fraud or corruption?</td>
</tr>
<tr>
<td>9</td>
<td>Where your internal audit section undertakes work for non-authority bodies, are there proper client management procedures in place to ensure that standards do not slip at the parent authority?</td>
</tr>
</tbody>
</table>
10 Once the s151 officer has approved the audit plan, are service departments consulted to ascertain how the plan can be implemented most effectively?

11 Does your internal audit section:
- follow proper working procedures, set down, for example, in business plans or audit manuals?
- have the ability to insist on a particular audit being undertaken?
- monitor its performance, for example the promptness with which findings are reported and its ability to meet the audit plan?

### Internal audit provider costs and competitiveness

<p>| | |</p>
<table>
<thead>
<tr>
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<tbody>
<tr>
<td>1</td>
<td>Is the cost per available audit day greater than £156 (£177 for London boroughs)?</td>
</tr>
<tr>
<td>2</td>
<td>If your average salary cost is greater than £20,600 (£26,200 for London boroughs), what benefits are you securing from this rich staff mix? Does it allow you to reduce volumes?</td>
</tr>
<tr>
<td>3</td>
<td>Are plans in operation to reduce sickness absence, and manage the time given to training (see also Section 3)?</td>
</tr>
<tr>
<td>4</td>
<td>Do internal audit staff complete timesheets?</td>
</tr>
<tr>
<td>5</td>
<td>What use is made of the information provided by timesheets, especially concerning the levels of unchargeable time?</td>
</tr>
<tr>
<td>6</td>
<td>Are all the costs recharged to internal audit properly attributable to internal audit activities?</td>
</tr>
</tbody>
</table>
Are you above the benchmark payroll cost per authority employee?

How do your service standards compare with good practice?

Are there enough staff on your payroll to allow you to reach competitive rates?

How can you influence payroll volumes to reduce costs?

How does your cost per payslip compare to good practice?

How can you improve productivity and reduce unit costs?

Is your payroll function organised appropriately?
Executive summary

Payroll costs per authority employee depend critically on the size of the local authority. In-house payroll in smaller districts is intrinsically more expensive.

Some authorities were able to reduce costs by a combination of:

◆ paying staff monthly
◆ paying staff by BACS (or other automated methods)
◆ reducing the volume of payments requiring manual input
◆ multi-tasking by finance staff

Even so, small local authorities will continue to incur relatively high costs unless they outsource or identify some other means of overcoming their disadvantage.

The lower quartile cost is £2.26 per payslip. This is close to the average rates enjoyed by authorities that have outsourced their payroll operations to private companies. However, a low cost per payslip can be associated with high numbers of payslips per employee leading to a high total cost per authority employee.

The key indicator therefore, is the overall cost per authority employee: the benchmark for this is £51 per annum. This can be achieved by reducing volumes and improving provider efficiency.

Key benchmark data

<table>
<thead>
<tr>
<th>Overall cost:</th>
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</thead>
<tbody>
<tr>
<td>Total cost per authority employee per annum</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Payslips per authority employee per annum</td>
</tr>
<tr>
<td>Costs (per payslip (£))</td>
</tr>
<tr>
<td>Staff</td>
</tr>
<tr>
<td>IT</td>
</tr>
<tr>
<td>Accommodation</td>
</tr>
<tr>
<td>Other</td>
</tr>
<tr>
<td>Total</td>
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</tbody>
</table>

(Note - No separate London costs are given because the bulk of the service can be provided off-site.)

<table>
<thead>
<tr>
<th>Staffing costs per FTE:</th>
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</thead>
<tbody>
<tr>
<td>London</td>
</tr>
<tr>
<td>Elsewhere</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Productivity:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payslips per payroll FTE per annum</td>
</tr>
<tr>
<td>More than 13,000</td>
</tr>
</tbody>
</table>
Developing Competitive Financial Support Services

Chapter 3 Payroll

Introduction

3.78 The payroll function is made up of the following activities:

- **data input**
  - setting up, amending and deleting employee records;
  - inputting time sheets, bonus calculations and overtime payments;
  - inputting Statutory Sick Pay and Statutory Maternity Pay information;
- **processing** – running the authority’s payroll to calculate gross pay, deductions and net pay;
- **output**
  - BACS, cheque and cash payments, plus associated payslips;
  - postings to the general ledger;
  - returns to the Inland Revenue and Department of Social Security;
- the various control and administration tasks associated with the above three activities;
- **support** – providing training, information and advice to service department staff and handling enquiries from departments or individuals.

Some elements of these tasks may be performed by service departments.

3.79 A comparison of authorities using the headline indicator for payroll, cost per authority employee, reveals significant variation between and within authority types (Exhibit 3.16, overleaf). Authorities above the headline benchmark of £51 per authority employee per annum should explore the potential causes. Payroll cost per employee is the product of volumes (the number of employees and the number of payslips per employee) and provider costs (cost per payslip), with provider costs potentially influenced by standards. This section will explore issues for payroll managers arising from each of the three factors – standards, volumes and provider costs – in turn.

Service standards

3.80 An authority can be said to have a high standard payroll service if it:

- pays the right person the right amount at the right time – i.e. the service is delivered speedily and accurately;
- supports effective financial management within the authority, primarily through the prompt and correct posting of payroll information to the general ledger;
- complies with the necessary legal and related requirements;
facilitates a range of ‘add-on’ services to the basic payroll service, such as deductions at source for trade union subscriptions, attachment of earnings orders, etc.;

provides accurate, timely and relevant management information to service managers.

3.81 These attributes can be translated into quantitative performance standards. Against these standards, the performance of most authorities in the questionnaire sample was impressive:

- **accuracy** – 82 per cent of authorities achieved accuracy levels (in terms of paying the right person the right amount on the stated date) in excess of 99.5 per cent;
- **timeliness for new staff** - 90 per cent were able to add a new employee to the authority’s payroll within two days of receiving that employee’s details;
- **timeliness for updates** - 82 per cent updated the payroll to reflect pay awards within seven days of notification of that award;
- **timeliness for urgent payments** – all authorities could generate an urgent payment in less than two days, and some authorities had introduced higher charges for this service to discourage slack performance by service department users;
- **control** – 85 per cent posted data into the general ledger within one day of running the payroll, whilst avoiding significant levels of miscoding;
3.82 These consistent standards of performance suggest that standards are not the reason for the variations in cost. Therefore, all authorities should aim to meet these high standards, and any that fall short should review the adequacy of their payroll service. Poor performance on grounds of accuracy and compliance with the law should give particular cause for concern.

3.83 The adoption of high standards pushes the cost above that of a payroll bureau providing a ‘cheap and cheerful’ service. But simple comparisons between a rate offered by a private supplier and the in-house cost are often fallacious, since they may not be comparing like with like. Accordingly, if authorities are proposing to seek tenders for payroll and wish to maintain their high standards, they must ensure they are comprehensively reflected in the tender specification.

3.84 Other standards issues, such as the provision of advice (to departments or employees) and the supply of management information, do not generate clear and objective benchmarks. A high standard of payroll advice would be demonstrated through promptness and reliability. The latter is difficult to measure, but the former is not, consequently authorities should establish target times for responding to queries. A high standard of management information is evidenced by user satisfaction: payroll providers should therefore explore the form and provision of such information with their principal users – service managers and personnel staff. The system should be capable of generating:

- overtime analysis
- sickness and absenteeism data
- salary creep data
- staff costs
- employee data for central government returns such as ‘Manpower (sic) Watch’.

3.85 A high standard payroll service will include the creation and operation of monitoring mechanisms, to record performance against these standards and complaints and queries about the provider, as well as the provider’s response to these. With a client/provider split, this will be an important part of the client role; however, even before this stage, providers should be establishing such monitoring systems.
There are important variations in payroll volumes between authorities. The number of employees creates a scale effect so that, on the measure of payroll cost per authority employee, larger authorities are usually cheaper than shire districts (Exhibit 3.17).

This disadvantage to small districts of insufficient scale can be overcome to some extent by adopting highly efficient provider practices. The three best-performing districts in the Commission’s survey all pursued effective policies around sickness absence, the control of unproductive time and the use of multi-tasking.

Ultimately, however, such good practice in districts is insufficient to match the advantages that scale can bring (especially when scale benefits are complemented by effective provider management). With the restrictions on authority trading, in-house payroll sections are profoundly limited in their opportunities to increase their volumes. These problems will be exacerbated by the trends, which all authorities face, of falling employee numbers (through DSOs either shedding staff or losing contracts or both, and staff transferring out of local authority employment). Accordingly, small shire districts may secure better value for money by outsourcing their payroll function to a private supplier that can achieve scale benefits.

Questionnaire returns suggested that some types of employees (for example, firefighters) were more expensive to pay than others (for example, APT+C, teachers). However, the returns were not sufficient to allow conclusions to be drawn about whether the payroll mix had a significant impact on overall payroll costs. Turnover of staff in sample authorities did not vary sufficiently to explore the hypothesis that costs could be influenced by the volumes of starters and leavers. However, an authority with large numbers of...
short-term temporary staff, perhaps as a result of seasonal employment needs, may face higher payroll costs per employee.

3.90 Notwithstanding these external influences, factors under the potential control of authority managers have a significant influence on payroll costs:

- the frequency of payment – the extent to which staff are paid weekly, as opposed to four-weekly or monthly;
- the numbers of payments requiring manual input (unplanned overtime, non-automatic bonus calculation, etc.);
- the use of cheques or cash, rather than BACS.

3.91 Moving staff from weekly to four-weekly or monthly pay can bring substantial savings. Bank charges and other running costs (particularly stationery) are reduced; the time required to process data and run the payroll falls, thereby reducing IT costs; and the task of paying the workforce can be achieved with fewer payroll staff. Overall, for any given size of workforce, authorities with a smaller proportion of staff on weekly pay enjoy lower payroll per employee (Exhibit 3.18).

3.92 Paying somebody monthly will not lower the cost to a quarter of the weekly rate, but will still bring a large saving. Many authorities have successfully moved away from weekly pay: Surrey County Council has moved 95 per cent of its 9,000 manual staff to four-weekly pay; and the London Borough of Camden now has fewer than 5 per cent of its manual workers on weekly pay.

Exhibit 3.18
Payroll – the costs of weekly pay

For any given size of workforce, authorities with a smaller proportion of staff on weekly pay enjoy lower payroll costs per employee...

<table>
<thead>
<tr>
<th>&lt; 10,000 employees</th>
<th>&gt; 10,000 employees</th>
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<tbody>
<tr>
<td>86 4.97</td>
<td>50 3.59</td>
</tr>
<tr>
<td>114 3.94</td>
<td>63 2.35</td>
</tr>
</tbody>
</table>

Key: Larger number = average cost per authority employee
Number in italics = average cost per payslip

Source: Audit Commission survey of authorities
With compulsory competition for blue-collar services now almost universal, a move to monthly payroll is one that trade unions should welcome. So, authorities should aim to negotiate the end of weekly pay where this still exists. Certainly, all authorities should strive to reach the best practice level within the questionnaire sample, where the average number of payslips per employee is less than 17.

The other volume that can reduce payroll costs is the volume of payslips that require ‘positive’ payment, i.e. where the employee is paid only after the input of information for that week or month. Typically, this arises where employees are on non-automatic bonus schemes. Whilst the potential payroll service savings are unlikely to provide the prime motivation for authorities to review their use of such bonus schemes, the opportunity is nevertheless worthy of note.

Finally, authorities should review the use of BACS, rather than cash or cheque, as the method of paying staff. Most authorities have taken near-full advantage of the savings that BACS payments can bring (primarily in bank charges but also, if BACS replaces cash payment, in lower cash handling and security charges). One metropolitan authority, however, was still paying 15 per cent of its staff weekly in cash. Moving these staff to monthly BACS payments could yield savings of £50,000. Although savings of this magnitude would be unusual, all authorities should review the numbers of staff still paid by cash or cheque, with a view to transferring such payments to BACS.

**Provider costs and competitiveness**

Even after allowing for the effect of scale, authorities vary in their unit cost per payslip (Exhibit 3.19). Getting to the lower quartile cost per payslip – £2.26 – allows in-house sections to match the rates enjoyed by authorities that...
have outsourced their payroll to private companies. These authorities’ rates ranged between £1.26 and £4.38, with an average of £2.63 per payslip.¹

3.97 Authorities that do not meet the benchmark should review the efficiency of their providers. Staff and IT are the most important elements of provider costs, accounting for over 80 per cent of payroll costs; accordingly, this section concentrates on these two areas, with only a brief consideration of other payroll costs such as bank charges, postage and income. (More general advice on other costs, including corporate charges, and accommodation costs is provided in Section 2.)

3.98 Expenditure on staffing costs is the product of unit staff costs and productivity. Unit staff costs are broadly similar between authorities. Most opt for a similar staff mix and low use of overtime, resulting in staff costs per payroll FTE being grouped closely around a median of £15,000 (£21,000 in London) with a lower quartile of £14,300 (£19,700 in London). Authorities paying high salaries should assess whether these secure any benefits, and authorities with high levels of overtime should review the cost-effectiveness of this. In comparison with the reasonably consistent unit staff costs, however, the productivity of payroll staff varies widely, with the best practice quartile of authorities achieving throughput of 13,000 payslips per payroll FTE per annum. Higher productivity, rather than low staff costs, is the key to good performance (Exhibit 3.20).

¹ These rates include client-side costs.
Organisation

3.99 Some authorities have taken parts of the payroll task away from sections in finance departments or the centre of service departments and giving them to staff in front-line service units. This reduces the size of the payroll task that dedicated staff must perform, and allows a reduction in the dedicated staff establishment. Data preparation or on-line input by business or service unit administrators, as part of a diverse set of responsibilities, for example, reduces the need for dedicated staff at the centre of a department or an authority to prepare and load batch data.

3.100 More significant reductions in a central payroll section might result from getting front-line staff to undertake payroll processing or payroll output duties. However, there is a danger that this approach achieves only a notional saving (because of the opportunity cost for front-line staff of taking on additional duties), and that it actually reduces efficiency by denying the benefits of any scale effect. Moreover, full devolution of payroll brings significant risks of loss of control and of fraud. In practice, compared with creditor payments, very few authorities have allowed such a ‘dissolution’ of the payroll function, because of the potential cost disadvantages and loss of control that this might bring.

3.101 Although the use of business or service unit administrators for payroll processing and payroll output is low, the use of service department staff (whether at the centre of a department or based in front-line units) for payroll input is considerable. Where payroll is to be delivered using a combination of centre and service department sections, care should be taken to avoid duplication and maximise productivity.

3.102 Different authorities have reached different conclusions on this issue. Some have decided that best performance can be achieved by giving the service departments no role apart from furnishing starter and leaver details and supplying overtime and bonus forms. All other work is done by the finance department. On the other hand, others have streamlined their finance department payroll sections by requiring departmental personnel staff to do the bulk of payroll input, and starter and leaver changes. The central sections are left with just the processing of the payroll and the statutory returns to the Inland Revenue. This latter approach requires more sophisticated IT to facilitate on-line input of data, but both authorities believe overall that it has saved money.
Improving productivity

3.103 In short, either the centralised or the decentralised approach can lead to a cost-effective and competitive payroll service. It is therefore not sensible to recommend a single right approach, applicable to all authorities. Each authority will need to reach its own conclusions, perhaps by modelling different permutations of centre/service department effort and assessing the staffing and IT implications of each.

3.104 However staff are organised, productivity can be analysed by examining utilisation and work rate. For all financial support services, poor utilisation may inhibit productivity, either through high levels of absence (particularly sickness absence) or high levels of unproductive time. (Section 2 offers general advice on reducing absence.) Some authorities and private sector providers have achieved notable gains; in Hertfordshire, the private company taking over the staff previously used in the in-house operation was able to reduce sickness absence in the payroll section by a quarter.

3.105 It is more difficult to reduce unproductive time. The payroll operation contains significant peaks and troughs that work against the productive utilisation of staff time and are difficult to alter. Many authorities have addressed this problem by the use of part-time and temporary staff who can be scheduled to meet the peaks, whether at year-end (the production of P60s and Inland Revenue returns) or in the weekly and monthly payroll cycles. Similarly, the size of each weekly or monthly peak can be reduced by arranging for different groups of employees to be paid on different days, thereby creating a staggered range of smaller peaks that allow greater staff utilisation.

3.106 A more radical approach to improving utilisation is multi-tasking. This involves breaking down barriers between the payroll functions and other exchequer and revenue functions, making the staff interchangeable and shifting them between functions according to peaks and priorities. A number of shire districts have introduced multi-tasking, concentrating on flexibility between the payroll and creditors functions, and this has helped them to secure significant reductions in the cost of payroll per employee. The three cheapest shire districts in Exhibit 3.17 (above) all practise multi-tasking.

3.107 Finally, opportunities exist to improve productivity through increasing the work rate. This is most likely to come about through the introduction of new systems: specifically, such investment should spur a review of procedures employed in the payroll function, looking in particular at methods of data input (for example, whether on-line input could reduce paperwork and the duplication of effort) and checking (whether management or supervisory time is taken up with excessive checks that add little or no value). Enfield’s payroll section was able to reduce the number of supervisory staff by increasing its use of sample checks to replace more extensive methods; private sector suppliers have also mentioned this as a fruitful route to cost reduction.
Information technology

3.108 Improved payroll software can bring further benefits in terms of effectiveness: questionnaire authorities that have updated software in recent years were more able to produce the required management information without incurring hefty additional programming charges. Perhaps the key concern for most payroll sections, though, is the need to secure reductions in the overall charge for IT, of which hardware is usually the most significant element. Authorities above the lower quartile IT cost per payslip of £0.46 will be particularly keen to explore the scope for cost reduction.

3.109 Many payroll sections have argued for the right to operate with stand-alone facilities employing UNIX operating systems. This, they feel, will enable them to avoid high charges resulting from their authority’s mainframe and any overcapacity that the authority may need to finance. Section 2 provides general advice on this issue. However, the data collected in the study suggests that authorities using non-mainframe systems for payroll did not necessarily benefit from lower IT costs or lower staff costs than authorities using mainframes.

Other costs

3.110 Finally, a number of opportunities exist to improve the payroll function through reviewing other costs and income. Surprisingly, the study identified some authorities that were sending payslips to employees’ homes via the Royal Mail: such authorities may wish to review this practice and reduce their postage costs by using their internal post system to distribute payslips. As already discussed, greater use of monthly pay and BACS payments will reduce bank charges. In addition, authorities may wish to consider offsetting the cost of payroll by generating income from advertising in payslip envelopes – as practised, for example, by the London Borough of Newham (Case Study 3.9).

Case Study 3.9
Income generation – the London Borough of Newham’s payroll service

Newham partially offsets the costs of its payroll service by allowing advertisements inside payslips and P60s. Payslips are in sealed-envelope form with three perforated edges, creating two internal spaces for text; one of these contains payroll information and the other is made available to advertisers.

Initially, only advertisements for Council services (for example, leisure facilities and grounds maintenance services) were permitted, but the facility is now also being offered to private companies. For example, the 1994/95 P60 advertised personal loans from a leading building society and a recent monthly payslip advertised home insurance. The payroll section has minimised the time spent on marketing the facility by using an intermediary a firm that purchases space for advertising agencies. In return for a percentage of the Council’s income from the advertising space in the payslips, the firm liaises with agencies to identify potential clients and also arranges contracts and payment. The Council has retained full control over the use of the space, to ensure that only products that it deems suitable are advertised.

The income from advertising has reduced payroll charges by between one and two per cent.
### Case Study 3.10

**West Sussex County Council’s payroll service**

West Sussex enjoys one of the lowest payroll costs of any authority in the study sample. In addition to the inherent advantages it enjoys by operating at a large scale – the authority has over 40,000 employment records – West Sussex has achieved low costs by both reducing controllable payroll volumes and improving the efficiency of its in-house section.

**Reducing volumes:**

The authority has retained a substantial blue-collar workforce, but has shifted a significant number of these employees from weekly to four-weekly or monthly pay. In addition, the authority has abandoned most bonus schemes that require the positive input of information, thus making all bonus payments automatic. These two changes have meant that a larger proportion of payments can be made automatically thereby reducing the workload for payroll staff and leading to a commensurate reduction in payroll unit costs.

**Improving efficiency:**

**Utilisation**

The section has gradually increased its use of part-time staff, by replacing some departing full-time staff with part-timers and by allowing staff to move from full-time to part-time status and not filling the vacancies in the establishment. The hours worked by these part-time staff are aligned with workload peaks to ensure maximum productivity.

**Organisation**

The central payroll section undertakes virtually all payroll input and processing work, following receipt of base information from service departments. This is felt to bring greater advantages of scale and lower unit costs.

**Productivity**

Able staff, effective on-the-job training, clear procedures and internal computer checks enable the section to deliver the service with minimal checking and low levels of supervision. The section undertakes a formal review of performance every six months: management and staff come together to assess the effectiveness of systems and procedures, identifying areas of difficulty and tasks that can be redesigned or eliminated.

**User relations**

The payroll section has established a user group that meets three times each year, allowing the provider to listen to the concerns and suggestions of service department managers with a view to providing a high quality service at the most economic price. The meetings have been of particular value in helping the provider to shape and hone management information products to meet more effectively the needs of managers in the authority.

**Control of costs**

Detailed unit costs are calculated for each payroll. These and total costs are monitored regularly. The payroll section produces a business plan which contains, among other things, a financial target for each year.

### 3.111

Most of these good practice attributes are found in the payroll section of West Sussex County Council. Here, efficient provider management combines with the benefits of large scale operations to bring one of the lowest payroll costs in the survey (Case Study 3.10).
### Good practice checklist

#### Payroll standards

**Does your payroll section:**

1. achieve accuracy levels (in terms of paying the right person the right amount on the stated date) in excess of 99.5 per cent?

2. add a new employee to the authority’s payroll within two days of receiving that employee’s details?

3. update the payroll to reflect pay awards within seven days of notification of that award?

4. generate urgent payments in less than two days, whilst taking steps to discourage high levels of such payments?

5. post data into the general ledger within one day of running the payroll, whilst avoiding significant levels of miscoding?

6. issue P60s to employees within one month of the financial year-end?

7. avoid fines by the Inland Revenue for failing to meet year-end deadlines (evidenced by no fines over the last three years)?

8. offer the facilities for deductions and attachment of earnings within its basic service?

9. Do target times exist for responding to queries?
11 Does your payroll service consult with users over the form and provision of management information, and does it reflect these user views in the service offered?

12 Is there a monitoring system in place to check performance against standards?

13 If payroll is being exposed to competitive tendering, have all these requirements been included in the service specification? If not, have they been included within an SLA?

Payroll volumes

1 Is the number of employees sufficient to allow your authority to reach the benchmark payroll cost of £51 per employee per annum?
   ◆ If you are a shire district and you are above this benchmark, has your authority considered outsourcing its payroll function?
   ◆ If not, what plans exist to enable your payroll section to match this benchmark?

2 Have you reduced the number of employees on weekly pay to the extent that the average number of payslips per employee per annum is less than 17?
   ◆ Has your authority maximised opportunities to move staff to four-weekly or monthly pay?
   ◆ Are more than 99.5 per cent of payroll payments made by BACS?
   ◆ Has your authority eliminated cash payment of wages?
### Payroll providers

1. Is the unit cost per payslip less than £2.26?

2. Do the rates paid to employees and the levels of overtime bring your authority into line with the benchmark staff cost of £14,300 per FTE (£19,700 for London)?

3. Is the productivity, in terms of payslips per member of the payroll section, greater than 13,000?

4. Has the authority reviewed its organisation of the payroll function?

5. Has it considered options around ‘dissolving’ parts of the function into front-line service units, and around the split of responsibility between dedicated staff in a central department and dedicated staff in service departments?

6. Is there confidence that the current approach maximises efficiency, whilst ensuring that designated service standards can be met?

7. Are plans in operation to reduce absence (see also Section 2)?

8. Does the payroll section have a strategy for minimising the impact of peaks and troughs, for example through the use of part-time or temporary staff and multi-tasking?

9. Have all payroll procedures been reviewed to minimise duplication and assess the value added by checking?

10. Does the payroll software allow the provider to meet the service standards listed earlier, and enable the section to meet benchmark levels of productivity?
11 If a move away from mainframe computing is considered, has there been a proper investment appraisal, using cost projections from competing sources of supply to the authority?

12 Are other costs being minimised through controlling bank and postage charges?

13 Is income being generated through the use of advertising on payslips?
Section 3
Chapter 4  Creditor payments

Developing Competitive Financial Support Services

Creditors payments

- Are you above the benchmark creditors cost per invoice?
- Is your creditors function organised appropriately?
- How do your service standards compare with good practice?
- How can you improve productivity and reduce unit costs?
Executive summary

The volumes of creditor payments are driven by supplier invoices and are therefore largely uncontrollable, so authorities should concentrate on meeting high standards and reducing unit costs.

The lower quartile cost for in-house sections is £1.60 per payment but private sector rates are lower, suggesting a benchmark of £1.18. There is no ‘scale effect’, so this benchmark can be achieved by authorities of all sizes.

Opportunities exist to make savings by devolution and ‘dissolving’ the function into front-line service units. But this approach necessitates improved IT, and requires careful evaluation and planning. A devolved approach requires close attention to the framework of controls.

Unit costs are primarily affected by:
- the amount of time spent on authorising and processing payments
- the way paid invoices are stored
- the payment method – BACS or cheque

Improved IT, which enables on-line input, electronic storage and automated payments, can also help reduce unit costs.

Key benchmark data

<table>
<thead>
<tr>
<th>Costs:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs per payslip (£):</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Staff</td>
</tr>
<tr>
<td></td>
<td>IT</td>
</tr>
<tr>
<td></td>
<td>Accommodation</td>
</tr>
<tr>
<td></td>
<td>Other</td>
</tr>
<tr>
<td></td>
<td>Total</td>
</tr>
</tbody>
</table>

(Note - no separate London costs are given because the bulk of the service centre can be provided off-site.)

<table>
<thead>
<tr>
<th>Staffing costs per FTE:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>£18,900</td>
</tr>
<tr>
<td>Elsewhere</td>
<td>£13,500</td>
</tr>
</tbody>
</table>

| Productivity:           |     |
| Invoices per creditors FTE per annum | More than 24,000 |
Developing Competitive Financial Support Services

Chapter 4 Creditor Payments

Introduction

3.112 The purpose of an authority’s creditors function is to authorise, process and despatch payments required from the authority, excluding housing benefits and council tax benefits. The scope of the creditors function is more precisely defined in Appendix A. This section considers the full range of creditor payments, from building materials through to educational awards.

3.113 An authority’s creditors system has to reconcile the needs of the authority with the requirements of those dependent on the authority for payment. Suppliers and end users, whether a firm supplying materials to a building maintenance DSO, a student receiving a grant, or an officer waiting for travel expenses prefer prompt payment from the authority. But the authority will want to optimise its own cash flow, which will normally require payment not being made until the due date.

Variations in cost and volume

3.114 The best quartile of authorities in the survey processed each creditor invoice for an average administrative cost of £1.60 or less. But getting to this lower quartile rate is not sufficient to match the rates enjoyed by authorities that have outsourced their creditor payments services to private companies. These outsourcing authorities’ rates ranged between £0.65 and £1.49. If in-house providers are to compete, they must get closer to the performance levels of private suppliers. Best practice in-house rates for each cost element (i.e. staff, IT, accommodation and other costs) create a competitive benchmark rate of £1.18 per invoice. Since there is no scale effect (Exhibit 3.21, overleaf), this benchmark rate can be pursued by the in-house sections of all authorities, no matter what size.

3.115 Creditors volumes – and therefore the total cost of the operation – are to a large extent determined by the overall level of local authority activity: the more purchases an authority makes, the greater the volume of creditor payments. Service standards and provider management are more fruitful areas for management attention: this chapter will concentrate on these issues, focusing only briefly on volumes.

Service standards

3.116 No matter how the creditors function is organised, service standards need to be established for speed, accuracy, user satisfaction, and control. Two principal components of speed are timeliness and responsiveness. For instance, in a centralised creditors system, individual service departments should have the facility to specify payment dates, subject to the constraints of any corporate policy on speed of payment. Nearly 80 per cent of surveyed
authorities had such a facility. Once the payment has been made the creditors system should reflect this by updating the general ledger within a day.

3.117 A timely service will, on occasion, need the facility to make ‘urgent’ payments (i.e. the same day or the next day). While the capacity to make such payments is good practice, urgency creates extra work by disrupting a routine. Some authorities address this problem through charging a premium for urgent work. The centralised creditor payments section in Coventry City Council levies an additional charge of £5 for an overnight payment and £10 for a same day service; these have reduced urgent payment requests from service departments to a trickle. Authorities that have adopted good practices around premium pricing should ensure that, if their creditors service is submitted to CCT, this practice is laid down in the specification to ensure that an in-house bid is not disadvantaged.

3.118 A high service standard would be reflected in an accuracy target of 100 per cent. To work towards this figure first requires monitoring, and then active management to eliminate, as far as possible, the causes of all errors – particularly chronic ones. More subtly, checks for error or fraud should be set at a level which act as a deterrent; the checking itself does not add value and should be minimised. The checks should be on a sample basis which is biased towards relatively high values of payment, rather than an attempt to check all payments. Full checks are rarely cost-effective, and sometimes actually reduce accuracy, especially if those responsible for authorising payment take their responsibility less seriously because they know that an extra ‘layer’ of checkers is employed.

3.119 In addition to speed accuracy, a high standard of service is evidenced by high levels of user satisfaction, particularly with the form and accessibility of the management information received. Creditors section managers should discuss these issues with their principal users in service departments. More

Exhibit 3.21
Creditor payments – costs and volume

There is no scale effect...
generally, user satisfaction will require a prompt response to queries: targets should be set, not only for authority staff but also for the service’s external customers – the suppliers awaiting payment. Users and customers should be given clear points of contact, ideally named officers, to which queries can be directed.

3.120 **Control** needs to cover day-to-day managerial direction of the service, and high level ‘internal audit style’ guidance. The managerial direction in a well run system should be exercised through clear written guidance approved by the internal auditor and supplemented by periodic checks from the auditor to ensure compliance, as practised in Delyn Borough Council (Case Study 3.11). The s151 officer will require a clear separation of duties between those authorising payments and those despatching payments. Guidance notes may also highlight policy commitments on the speed of payment.

---

**Case Study 3.11**

Documenting procedures and guidance – creditor payments at Delyn Borough Council

<table>
<thead>
<tr>
<th>The problem:</th>
<th>Some years ago, Delyn’s creditor payments operation was bedevilled by high levels of errors, resulting primarily from inaccurate or incomplete paperwork from service departments.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The solution:</td>
<td>Staff in the finance department produced <strong>guidance notes</strong> for all staff involved in the process of creditor payments. These took the form of a double-sided laminated A4 sheet. One side of the laminated sheet contains a list of the ‘top ten errors’ and a five-point statement of good practice, with graphics to reinforce the message (see below). The other side contains a more detailed statement of the procedure to be followed. This statement references the stages and tasks to an adjoining reproduction of the creditor payment proforma, to ensure that staff put the right information in the right part of the form. The guidance sheet has been circulated throughout Delyn and has contributed to a significant reduction in errors. This has streamlined the central payment operation in the finance department and has helped to cut costs.</td>
</tr>
</tbody>
</table>

---

**SIMPLE GUIDE TO THE PAYMENT OF CREDITORS**

**GOOD PRACTICE**

**THE TOP TEN ERROR**

1. **Missing letters**
   - ACE not ACED
2. **No letters**
   - AC
3. **Wrong letters**
   - AC instead of CA
4. **Incorrect amount**
   - £10 instead of £1
5. **Incorrect currency**
   - £ instead of $£
6. **Incorrect description**
   - “Rent” instead of “Rent paid”
7. **Incorrect date**
   - 01/01/2020 instead of 01/01/2023
8. **Incorrect payment method**
   - Bank transfer instead of cheque
9. **Incorrect payment account**
   - 12345678 instead of 12345678
10. **Incorrect supplier information**
    - Supplier name not matching the proforma

---

3.73
Volumes

3.121 As mentioned in paragraph 3.115 above, there is little scope to alter creditor volumes which are driven mainly by the number of invoices. However, there is some scope to reduce costs by aggregating more than one invoice from a supplier into a single payment. Authorities should see whether their IT can perform such aggregation, and explore options for less frequent payment to larger, more regular suppliers. One approach adopted by Hampshire County Council is the use of tape exchange schemes with large suppliers (notably the utilities): this has allowed Hampshire to secure a reduction in the frequency and cost of such payments.

Provider costs and competitiveness

3.122 Staff costs are, as with all financial support services, the most important component of the overall expense of paying creditors, but make up on average only half of the total. The other half of the costs derives from IT charges, accommodation and other provider overheads, such as telephones, postage, stationery and bank charges (Exhibit 3.22).

3.123 Staffing costs will be influenced by the authority’s approach to the organisation of the creditors function. Some authorities are using the opportunities presented by IT developments to decentralise creditors activities by processing payments within service departments. The advantages of decentralised operations are that departments can more easily:

◆ specify their own precise needs;
◆ control costs;
◆ employ staff who are familiar with the goods or services that have been used.

Exhibit 3.22
Creditors – cost analysis

Half the costs derive from IT, accommodation and other provider overheads...

<table>
<thead>
<tr>
<th>Cost Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff costs per invoice</td>
<td>£0.59</td>
</tr>
<tr>
<td>IT costs per invoice</td>
<td>£0.25</td>
</tr>
<tr>
<td>Accommodation costs per invoice</td>
<td>£0.10</td>
</tr>
<tr>
<td>Other costs per invoice</td>
<td>£0.24</td>
</tr>
</tbody>
</table>

Benchmark total cost per invoice: £1.18

Source: Audit Commission survey of authorities
Some authorities have not stopped at decentralisation, but have continued with further devolution to front-line service units. These authorities have used IT to ‘dissolve’ parts of the function to front-line units, where staff authorise and input payment details as part of their everyday duties. This approach can reduce costs by allowing authorities to shed staff in central finance departments and at the centre of service departments, with staff in front-line service units undertaking the function as a small proportion, perhaps only 10 to 20 per cent, of their overall duties. The creditors function is thus carried out largely without dedicated staff. Provided that this approach is properly appraised and planned, with adequate controls built in, as at the London Borough of Bexley (Case Study 3.12, overleaf), it can achieve significant cost reductions and efficiency improvements.

One of the drawbacks of decentralising or devolving purchasing and payments is that it can lead to increased volumes of work, and increased costs if discipline is not imposed by a central policy. With printing supplies, for example, it is cost effective for most authorities to buy from a single supplier and distribute within the authority, rather than sanction individual departments to buy their own. In addition to any bulk buying discounts that can be attracted by this approach, the authority can make savings in its creditor payment operations as it will need to make fewer payments. This illustrates the point that creditor systems need to be aligned with purchasing policy – if purchases can be consolidated on an authority-wide basis, it follows that creditor payments should be too. Effective use of IT is the best way of ensuring that consolidated purchases are matched by consolidated payments.

Providers should aim to meet a productivity benchmark of 24,000 invoices per FTE per year. If this is not being achieved, further analysis might show that poor performance is caused by bad staff scheduling, poor operator skills – maybe suggestive of a training deficiency – or too high a mix of supervisory to operational staff. Multi-tasking (see Section 2) can also be of assistance: Delyn Borough Council, for example, achieves high productivity for creditor payments by sharing staff between the payroll and creditor functions.

IT charges typically make up between 15 per cent and 25 per cent of costs in an efficient creditors section. The benchmark rate is £0.25 IT cost per invoice. Although improved technology is allowing the decentralisation of the creditors function, old-fashioned housekeeping remains important if costs are to be minimised. Systems that are not purged regularly develop voluminous and expensive data records – which make them cumbersome and more expensive to operate. It is now possible to purge automatically out-of-date supplier records at little extra cost, to ensure that the system operates as efficiently as possible every time it is used.
The plan: Bexley is in a period of significant organisational change. Key elements include the separation of enabler and provider responsibilities and the continued and controlled devolution of responsibility, including financial administration tasks, to all appropriate levels of the organisation.

The approach: During 1994, extensive work was undertaken to determine the most appropriate model for Bexley to decentralise its routine payment and income financial administration tasks. This work was based on earlier successful decentralisation that transferred selected accounting and financial management tasks away from the finance department to service departments.

During the evaluation of alternative decentralisation approaches, it became clear that existing computerised ‘legacy’ financial systems would not support decentralisation, and replacement financial systems would be required to support such an initiative. A business case was prepared which compared the potential benefits of decentralisation with the costs associated with modern on-line systems. The business case showed that over the anticipated life of the proposed systems, decentralisation could be achieved and savings would accrue, mainly due to staff reductions, after an initial payback period.

In parallel with this work, an extensive definition of user requirements was prepared after meetings with all key service managers to determine current and future financial information requirements. This work was embodied into an invitation to tender that was issued to a shortlist of software suppliers. Tender responses provided estimates of cost as well as useful insights into how computer systems could be used to map the operational aspects of Bexley’s decentralisation requirements.

Effecting change: The implementation stage of the project has followed good project management practice closely. In particular:

- **Project Control** – a multi-departmental executive group oversees the project with particular emphasis on the model of decentralisation that is being developed and implemented. A major private management consultancy advises the Council on implementation and performs a quality control function. The Council’s internal audit section is also closely involved in the project advising on all internal control aspects.

- **Personnel Aspects** – extensive consideration has been given to the personnel aspects of the project. In particular, training features as a very high priority and is being phased and geared to the specific needs of each group of users, covering both the necessary skills to transfer areas associated with decentralisation (technical payment and income tasks including areas such as Construction Industry Tax and debt recovery procedures) and application software training.

- **Piloting** – one department of the Council will undertake the new decentralised functions and run the new financial systems on a pilot basis (in parallel with existing financial systems) for three months prior to full implementation across the whole Council.

Benefits: The decentralisation of financial administration tasks is intended to assist in the process of empowering service managers, enabling them to assume far more financial control of their services at the same time as increasing their accountability. The closer alignment of financial duties
with service delivery, along with new financial systems and local on-line entry and enquiry, should allow for a more flexible and quicker response to a wide range of expenditure and income activities.

Finally, the role of the finance department will change. Residual financial administration tasks and computer system administration will be undertaken by a new Central Systems Team. The Team will have responsibility for overall system reconciliations and user security controls. The Team will also be the provider of on-going training and support for both existing and new staff.

3.128 **Accommodation** charges are typically lower than IT costs – but it is still important to manage accommodation efficiently. Space is needed for secure record storage as well as for staff. Creditors records should be reviewed to establish what is required, for how long and in what form. The s151 officer may have an interest, external audit staff may request access to records, while outside bodies such as the Inland Revenue and Customs and Excise may also need to check paperwork. Minimum effort should be put into storage commensurate with these operational, legal and statutory requirements. Technological developments mean that authorities can now benefit from the application of DIP, which can improve operations and reduce storage costs. But consideration of such options needs to avoid over-specification, if the saving in storage costs is not to be outweighed by the IT cost of running the imaging system.

3.129 Normally over 20 per cent of the costs of making a creditor payment cannot be attributed to staffing, IT or accommodation. Bank charges explain much of the gap; requesting return of local authority cheques is particularly expensive. One authority processing 155,000 payments reported bank charges of £40,000 per annum – just short of 40p per payment. These charges can be reduced by increasing the level of creditor payments made by BACS rather than by cheque. Given the additional advantages of BACS as a means of controlling the timing of creditor payments, authorities should aim to increase their use of this facility, perhaps by setting targets for the percentage of invoices paid by BACS.

3.130 The despatch of a remittance advice creates an almost inevitable postage and packaging expense, but some authorities have attempted to keep this to a minimum by standardising the advice form. Instead of returning the supplier’s own documentation, a standard authority advice slip is posted, allowing the use of auto-enveloping machines. By standardising their remittance advice, Coventry City Council has not only been able to reduce non-staffing running costs but has also freed up staff time that would otherwise have been spent on sorting and manual despatch.
Good practice checklist

Creditors standards

Promptness

1. Can service departments specify payment dates for invoices?

2. Is the general ledger updated to reflect creditor payments within one day of their payment?

3. Is there a facility to make urgent (i.e. same day) creditor payments, yet is this discouraged through charging a premium for the facility?

Accuracy

1. Is there a target of 100 per cent accuracy?

2. Is performance monitored against this target?

3. What use is made of monitoring information to identify and examine causes of errors?

4. Are payments checked on a sample basis that reflects invoice values?

Relations with users

1. Does the creditors service consult with users over the form and provision of management information?

2. Do target times exist for responding to queries – whether from authority managers or external suppliers?
3. Are there clear points of contact within the creditors section for queries?

**Control**

1. Do clear guidance notes and procedures exist for the payment of creditor invoices?

2. Have these been approved by the s151 officer?

3. Does the authority's internal audit programme provide for periodic sample auditing of payments?

**Creditors volumes**

1. Has your authority reduced creditor volumes by consolidating selected invoices into single payments?

**Creditor provider-side management**

**Costs**

1. Is the unit cost per invoice less than £1.18?

**Organisation**

1. Have you:
   - reviewed the organisation of your creditors function?
   - considered options around ‘dissolving’ parts of the function into front-line service units, and splitting responsibility between dedicated staff in a central department and dedicated staff in service departments?
   - satisfied yourself that your current approach maximises efficiency, whilst ensuring that designated service standards can be met?
## Productivity

1. Is the productivity, in terms of payments per member of creditors staff, greater than 24,000?

2. Does your creditors section have a strategy for minimising the impact of peaks and troughs, for example through the use of part-time and temporary staff, multi-tasking and overtime payments?

## IT and other costs

1. Is there a clear policy on data storage, which meets with the approval of the s151 officer and government revenue officials?

2. Are creditors IT systems regularly purged to control data storage costs?

3. What use is made of DIP and other electronic imaging technologies? Has use of smart IT resulted in lower accommodation costs?

4. What use is made of BACS to reduce creditors sections’ bank charges? Does your authority have a target level of creditor payments to be made by BACS?
Sundry debtors

- Are you above the benchmark sundry debtors cost per invoice raised?
- What steps are you taking to avoid raising debts?
- What standards are in place to ensure that debts are pursued promptly and vigorously?
- How do your service standards compare with good practice?
- Is your sundry debtors function organised appropriately?
- How can you improve productivity and reduce unit costs?
Executive summary

Total expenditure on the sundry debtors service depends more on volumes (the number of invoices raised) than unit costs (the cost per invoice). The number of debts can be reduced by:

- increasing prepayments
- setting minimum invoice values
- combining invoices to multiple debtors
- billing less frequently

For the debts that are raised, authorities should ensure prompt billing and collection, creating a virtuous circle with collection rates and low unit costs of collection. This favourable state is achieved by clear policy frameworks, good information bases, clear guidelines and procedures (around the pursuit and write-off of debt) and a readiness to learn from aspects of commercial operations.

The lower quartile debtors unit cost is £5.94 per invoice raised but the average private sector price is £4.83. The lower figure is the benchmark. The unit cost of the service is affected by the amount of recovery work; prompt billing and speedy recovery action reduces this work.

Key benchmark data

<table>
<thead>
<tr>
<th>Volumes:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoices per £m NRE+HRA:</td>
<td></td>
</tr>
<tr>
<td>London boroughs</td>
<td>160</td>
</tr>
<tr>
<td>Metropolitan districts</td>
<td>125</td>
</tr>
<tr>
<td>Counties</td>
<td>60</td>
</tr>
<tr>
<td>Shire districts</td>
<td>340</td>
</tr>
<tr>
<td>All authorities</td>
<td>125</td>
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</table>

<table>
<thead>
<tr>
<th>Costs:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs per invoice (£)</td>
<td></td>
</tr>
<tr>
<td>Staff</td>
<td>2.73</td>
</tr>
<tr>
<td>IT</td>
<td>0.90</td>
</tr>
<tr>
<td>Accommodation</td>
<td>0.27</td>
</tr>
<tr>
<td>Other</td>
<td>0.93</td>
</tr>
<tr>
<td>Total</td>
<td>4.83</td>
</tr>
</tbody>
</table>

(Note - no separate London costs are given because the bulk of the service can be provided off-site.)

<table>
<thead>
<tr>
<th>Staffing costs per FTE:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>£18,900</td>
</tr>
<tr>
<td>Elsewhere</td>
<td>£13,500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Productivity:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoices per debtors FTE per annum:</td>
<td>More than 5,200</td>
</tr>
<tr>
<td>(NB. including identified legal staff)</td>
<td></td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Performance:</th>
<th></th>
</tr>
</thead>
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<tr>
<td>Invoices outstanding for six months or more</td>
<td>Less than 4%</td>
</tr>
<tr>
<td>Debt aged six months or more</td>
<td>Less than 3%</td>
</tr>
<tr>
<td>Total invoices written off</td>
<td>Less than 3%</td>
</tr>
<tr>
<td>Total debt written off</td>
<td>Less than 0.5%</td>
</tr>
</tbody>
</table>
Developing Competitive Financial Support Services

Sundry debtors

Introduction

3.131 Local authorities are responsible for collecting substantial amounts of money through council tax, non-domestic rates and council house rents. They also collect lesser amounts from various sources which include commercial rents, housing mortgages, car park fines, and charges for social services, environmental health services and trade refuse collection. This latter group is commonly termed ‘sundry debtors’. For authorities other than counties, it typically comprises between 5 per cent and 10 per cent of income1, and forms the subject of this section. In certain authorities, recharges for educational services, known as ‘recoupment’, and commercial rents contribute significantly to sundry debts. Some authorities also extend the sundry debtors function to include activities directed at recovering the repayment of overpaid housing benefits. Taken together, the value of all these sundry debts is considerable.

3.132 Questionnaire returns show that the balance of effort between a central department and service departments varies over different stages of the sundry debtors function (Exhibit 3.23). About two-thirds of invoices for sundry debts are raised in service departments. However, about two-thirds of all invoices are actually sent out by a central finance section and about 80 per cent of debt recovery is undertaken by central finance department staff.

---

Exhibit 3.23
Sundry debtors – departmental split

The balance of effort between a central department and service departments varies over different stages of the sundry debtors function....

<table>
<thead>
<tr>
<th></th>
<th>Finance department</th>
<th>Service department</th>
</tr>
</thead>
<tbody>
<tr>
<td>Invoice raising</td>
<td>37%</td>
<td></td>
</tr>
<tr>
<td>Invoice sending</td>
<td></td>
<td>70%</td>
</tr>
<tr>
<td>Chasing debt</td>
<td></td>
<td>80%</td>
</tr>
</tbody>
</table>

Balance of effort

Source: Audit Commission survey of authorities

---

1 Here, ‘authority income’ does not include income from housing rents.
Variation in overall cost

3.133 A comparison of authorities using the headline indicator, sundry debtors costs per £m NRE+HRA, reveals significant variation between and within authority types (Exhibit 3.24). Authorities performing poorly by comparison with similar authorities should explore the potential causes. The sundry debtors cost per £m NRE+HRA is a product of volumes (the number of debts raised) and unit costs (the cost per invoice), with both potentially influenced by service standards.

Avoiding sundry debts

3.134 There are various ways to improve the sundry debtors service. The first is to ‘design the function away’ – not issuing an invoice where a sensible alternative exists. Good practice involves setting minimum invoice values, requiring prepayments and encouraging regular users to pay by direct debit. Some authorities, such as the City of Sunderland, have adopted comprehensive policies aimed at reducing the number of sundry debts raised (Case Study 3.13). Operating, where possible, in this way cuts out the possibility of non-payment for a service and removes the need for efforts (and hence costs) spent on debt raising and chasing.

---

Exhibit 3.24
Sundry debtors costs

There is significant variation between and within authority types...

---

3.84

All costs incurred in raising, sending and recovering debts have been included: see Appendix B for further details of how to calculate this indicator.
Although the survey data does not reveal a clear relationship between the number of debts raised and the cost of the sundry debtors service, some authorities have been able to enjoy lower levels of expenditure by raising fewer debts (Exhibit 3.25, overleaf). Authorities should therefore explore options for avoiding sundry debts before turning their attention to service standards.

**Service standards**

3.136 The majority of invoices are paid in full and require no recovery work, but those that necessitate recovery action contribute disproportionately to the overall cost of the sundry debtors service. It is more expensive to chase bills than to create and issue invoices. Through its study of local taxes (Ref. 1), the Commission has examined the recovery process in detail. The study showed that high recovery costs almost inevitably result from late invoicing and poor records. Authorities can find themselves in a vicious circle, with high levels of
sundry debtors expenditure but poor performance. Such a situation is likely to be exacerbated in those authorities where communication between departments responsible for raising invoices and those pursuing debts are poor. Conversely, authorities that bill promptly and accurately require fewer staff to chase fewer arrears – in short, a virtuous circle. Whether an authority gets into a vicious or a virtuous circle depends in large part on whether it adopts high service standards.

3.137 A high standard of sundry debtors service necessitates a clear policy framework that defines objectives and working methods, and is supported by performance targets for the age of debt and the percentage levels of write-off. The sundry debtors service exists to ensure that customers are efficiently billed for goods and services, and that money is recovered at the minimal administrative expense consistent with required rates of collection. Translating this objective into more detailed methods and procedures will require central departments to consult with their clients in service departments. Some departments, such as those dealing with rents for the authority’s property portfolio, may wish to adopt a more vigorous commercial approach to debt collection than other departments operating in areas such as personal social services.

3.138 Once the policy framework is established, authorities should ensure that they have a clear and up-to-date debtor database, which can reliably underpin day-to-day operational duties and inform recovery operations. This should show the name and address of the debtor, the value of the debt, and instances of any previous debts to the authority. It should also show debt recovery options, together with a timetable to be followed.

Exhibit 3.25
Sundry debtors – costs and volumes

Some authorities have been able to enjoy lower levels of expenditure by raising fewer debts...

Source: Audit Commission survey of authorities
3.139 It is important to establish a policy of prompt billing, based on correct information about the debt and the debtor. If a bill can be delivered by the provider of the service, or sent out very promptly by the service department, the chance of payment without recovery proceedings is higher. To avoid the need to pursue debt, debtors should be given incentives for prompt payment. For example, most London authorities issue parking excess charge notices for £40 which are reduced to £20 if paid within 14 days; more radically, the London Borough of Wandsworth has instituted a policy of charging interest on overdue statutory debts and on those following a court order, a similar policy to that operated by the Inland Revenue for tax collection.

3.140 In those cases where an invoice is sent and no payment is received, a speedy and systematic recovery process is necessary. Inevitably some pursuit of debt is necessary; debt advice agencies agree that prompt action is necessary to avoid debts escalating to unmanageable levels. The first stage of debt recovery should always be to send a computer-generated reminder letter, ideally one day after the due date.

3.141 When the remainder letter fails, the authority must decide how to pursue the outstanding debt. It must decide how to target and focus the efforts of sundry debtors staff, making reference to the guidelines established as part of the authority's policy statement. Selected and targeted pursuit of debtors is an effective and cost-efficient method of pursuing persistent debtors and should increase overall payment rates. Maximum media coverage can be obtained for a few such cases. Overall, most local authorities now adopt an approach which targets the 'won't pays' rather than the 'can't pays'.

3.142 But no customer can be allowed to treat a bill, however small, as unimportant. Full-scale recovery action, right through to court proceedings, should be undertaken for a proportion of small debts, even if the value of the debt is likely to be exceeded by the cost of the action. Pursuing a proportion of small debts operates as a deterrent to others and can be cost-effective, in much the same way that a ticket inspector on a train can be cost-effective by preventing fare dodging rather than by collecting fares from passengers who have not paid.

3.143 Local authorities could benefit from observing the behaviour of some commercial organisations in dealing with debtors. Private sector operations tend to have quite sophisticated control systems, principally established to deny credit to a customer or to deny access to further services. This may be easier for a firm than it is for a local authority – securing income from the sale of electrical goods is less sensitive than securing income for the provision of personal social services to people in need. Nevertheless, there are circumstances where withholding of credit will be an important part of local authority debt recovery (if only to prevent arrears getting worse). These should be explored in the authority’s policy statement and in operational procedures.

3.144 One major difference between competitive private companies and most local authorities is the awareness amongst managers of the importance of cash income and a sense of ‘ownership’ of debts raised. Many service departments
have little concern about whether money is actually collected, since they are credited for the income once the bill has been issued. An alternative approach, adopted by a small number of authorities (see Case Study 3.13 above), is to credit departments with the income only when it is paid. Another way of increasing service departments’ sense of ownership is to separate out recovery costs and charge these accurately to the departments, rather than incorporating them into a single recharge for all debtors’ work.

3.145 For management purposes, statistics should be collected to monitor performance of an authority’s sundry debtors section against standards and targets. These should identify problem invoices and problem areas of the authority’s operations, and also debtor characteristics. In particular, the extent to which one debtor has unpaid invoices across several areas (including council tax and council rents) should be picked up through a central information system. At a minimum, any useful system should contain the following indicators by department:

- numbers of invoices processed;
- value of invoices processed;
- number of invoices in arrears;
- percentage arrears rate;
- average value of arrears invoices, and distribution of values by price category;
- an age profile of outstanding debts.

3.146 Few local authorities are yet in a position to produce information of this type as a matter of course. The Commission’s view is that further investment in good information systems is likely to be worthwhile. Wherever possible, information should be produced with trend data. Good, centrally provided information is a prerequisite to getting all managers to understand the profile of their own department’s debts, and to act on it efficiently.

3.147 There are many reasons for having to write off invoices, ranging from the identification of errors in the debtor database to the disappearance, bankruptcy or death of a debtor. Write-offs should be governed by guidelines issued by the s151 officer that:

- prevent debt being carried over indefinitely;
- state when debts can be written off;
- state who can write it off and to what level;
- identify when member approval is needed.

Write-off policy varies between authorities both in terms of the proportion of invoices considered void, and the sums of money involved (Table 3.1).
3.148 Finally, as with other transaction-based services, a high standard of sundry debt collection involves the establishment of mechanisms for consulting service users and allowing them regular and easy access to information, and for monitoring their satisfaction with the service received. Much of this will be achieved through consultation over the authority’s debtor policy statement (see above), but good practice authorities supplement this with surveys and liaison forums.

Volumes

3.149 The number of invoices is a major factor in determining the overall costs of the debtors function. But, unlike payroll services, there is no ‘scale effect’ impacting on the unit cost of issuing an invoice (Exhibit 3.26); good practice small authorities are as cost efficient as good practice large authorities. This is the reason why it is relatively common for service departments to issue their own bills; there are few advantages to be gained from having a centralised invoice-generating service.

### Table 3.1
Recovery operations

<table>
<thead>
<tr>
<th>Item</th>
<th>Average</th>
<th>Better</th>
<th>Worse</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of invoices raised</td>
<td>36,000</td>
<td>52,000</td>
<td>9,700</td>
</tr>
<tr>
<td>Number paid with no reminder</td>
<td>26,000</td>
<td>49,000</td>
<td>5,500</td>
</tr>
<tr>
<td></td>
<td>(72%)</td>
<td>(94%)</td>
<td>(57%)</td>
</tr>
<tr>
<td><strong>The numbers:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• attracting a first reminder</td>
<td>10,000</td>
<td>3,000</td>
<td>4,100</td>
</tr>
<tr>
<td>• generating a second reminder</td>
<td>6,000</td>
<td>55</td>
<td>2,600</td>
</tr>
<tr>
<td>• receiving a summons</td>
<td>320</td>
<td>200</td>
<td>40</td>
</tr>
<tr>
<td>• requiring enforcement action</td>
<td>88</td>
<td>40</td>
<td>39</td>
</tr>
<tr>
<td><strong>And the number written off is</strong></td>
<td>1,300</td>
<td>400</td>
<td>410</td>
</tr>
<tr>
<td></td>
<td>(3-4%)</td>
<td>(less than 1%)</td>
<td>(4.2%)</td>
</tr>
</tbody>
</table>

Source: Audit Commission survey of authorities

Exhibit 3.26
Sundry debtors – cost and volumes

There is no scale effect...
Some authorities have a low unit cost but an abnormally high volume of invoices; this is often a consequence of not having introduced measures that can avoid raising debts in the first place (see paragraphs 3.134 to 3.135 above). For many services, there is no alternative to issuing an invoice after the service has been provided. But for regular debtors, for example trade waste collection and inter-authority purchase of education services, there are usually options to restrict the frequency of invoices raised. This should result in average invoice values being increased as more services are billed on one invoice, rather than being spread over several invoices. Provided that the amounts are not so large as to cause significant loss of income through reduced cash flow, authorities should consider a reduction in invoice frequency for regular customers.

The value of invoices varies – from around £15 to hire a room, to values well in excess of £1,000 for commercial rents. Through avoiding large numbers of small invoices, good practice authorities are able to obtain an average invoice value in excess of £900. This level rises to £1,100 if the larger amounts due from commercial rents and educational recoupment are included in the standard file of invoices to be raised.

Good practice is also displayed by the sundry debtors section not taking responsibility for the pursuit of housing benefits overpayments. These debts, which are very difficult to pursue, are best addressed by adjustments to future housing benefit payments (unless the debtor has moved away or is no longer in receipt of benefit). Such debts are best handled by an authority’s housing benefit function, not by the sundry debtors section.

Provider costs and competitiveness

Taken together, the three principal components of the sundry debtors function – raising invoices, billing customers and recovering money owed – cost, in good practice authorities, £5.94 or less for every invoice raised. But getting to this lower quartile rate is not sufficient to match the rates enjoyed by authorities that have outsourced their sundry debtors service to private companies. These authorities’ rates range between £3.13 and £5.18 per invoice. If in-house providers are to compete, they must get closer to the performance levels of private suppliers to local authorities. Best practice in-house rates for each cost element (i.e. staff, IT, accommodation and other costs) create a competitive benchmark rate of £4.83 per invoice. Since there is no scale effect (Exhibit 3.26), this benchmark rate can be pursued by the in-house sections of all authorities, no matter what size.

Direct staff costs make up the highest proportion of the overall cost – on average, just over half of the total (Exhibit 3.27). The workload of the sundry debtors function is subject to less dramatic peaks than most transactional services and is fairly steady through the year; the volumes of invoices and likely recovery actions should be predictable within narrow limits. Staff levels can normally be easily aligned to cope with work flows. However, flexible staffing can help to ensure that telephone recovery work is undertaken when the debtor is most likely to be available: on occasions, this will necessitate evening work.

These rates include client-side costs.
3.155 Good practice is evidenced by each FTE involved in the sundry debtors service processing on average 5200 invoices or more each year. Authorities with productivity below this benchmark may simply have more staff than necessary to discharge the function; alternatively, they may face a greater workload because more of their debts require some recovery action. As discussed in the paragraphs above on service standards, a good practice authority that is able to bill and collect promptly can enjoy a virtuous circle, devoting less resources to the time-consuming and expensive process of recovery and therefore enjoying lower costs. In short, an inefficient and uncompetitive in-house provider may be a victim of the poor framework of policy and performance standards within which it is required to operate, rather than of poor staff or poor day-to-day management.

3.156 Recovery work pushes up the unit cost of staffing as well as the amount of staff time required. Better trained and more senior staff tend to be employed in pursuing bad payers – legal staff may be involved if court work arises. A provider of sundry debtors services should be sparing in the use of qualified legal staff; for run-of-the-mill debtors work, finance section staff can be just as effective as legally qualified personnel and normally cost less.

3.157 Accommodation costs may be between 40p and 50p per invoice sent, mainly because of the need to have full records in the event of non-payment. These costs can be controlled in part by a clear storage policy and by greater use of IT (see paragraphs 3.138 and 3.145 above) to supply data on debtor and debt history without reference to paper files.

3.158 The cost of telephone calls and postage can approach an average of £1 for every invoice sent because of the particular difficulties of dealing with non-payers. Personal reminder telephone calls by a named sundry debtors employee can be used to good effect, encouraging prompt payment and a reduction in court action and write-offs. Compared with the effort of writing and posting letters, telephone calls at the right time can be both cheap and effective.
Good practice checklist

Avoiding sundry debts

1 Has your authority explored thoroughly the range and extent of its sundry debts to identify all opportunities to avoid raising invoices?

2 Specifically:
   - is there a policy to ensure maximum use of prepayment?
   - are there clear policy guidelines on economic invoice values, below which it is not cost-effective to raise an invoice?
   - have these policies been communicated to managers of front-line services?

Sundry debtors standards

1 Is your sundry debtors operation governed by a clear policy statement, which sets out objectives and working methods, and has been developed after consultation with service departments?

2 Are there clear targets for the speed of debt collection, the age of debt and the levels of debt write-off?

3 Is the percentage of invoices written off less than three per cent of the total number issued, and is the average value of these invoices less than £275, such that overall the value of debt written off is no more than 0.5 per cent of the total?

4 Do you aim to have no more than four per cent of invoices and three per cent of debt over six months old?

5 Is there a clear policy governing which officers committees can write off debts to different values?
<table>
<thead>
<tr>
<th></th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Do operational procedures support these targets?</td>
</tr>
<tr>
<td>7</td>
<td>Are there clear timetables for invoicing and follow up work?</td>
</tr>
<tr>
<td>8</td>
<td>Do you provide incentives for paying promptly, and/or disincentives for not paying promptly?</td>
</tr>
<tr>
<td>9</td>
<td>Do you issue a first reminder within 21 days of the invoice?</td>
</tr>
<tr>
<td>10</td>
<td>Are systems in existence to restrict credit to bad debtors?</td>
</tr>
<tr>
<td>11</td>
<td>Is effort focused on the ‘won’t pays’ rather than the ‘can’t pays’?</td>
</tr>
<tr>
<td>12</td>
<td>Can your IT systems identify customers who owe money across more than one service?</td>
</tr>
<tr>
<td>13</td>
<td>Have you fostered a sense amongst service departments of ‘ownership’ of the debts raised for their services, for example, by crediting income only when it is actually received?</td>
</tr>
<tr>
<td>14</td>
<td>Does your IT system allow effective monitoring and control?</td>
</tr>
<tr>
<td>15</td>
<td>Does your IT system provide you with sufficient management information about debtor volumes, and arrears rates and values?</td>
</tr>
<tr>
<td>16</td>
<td>Do you assess regularly the satisfaction of users with the service?</td>
</tr>
</tbody>
</table>
### Sundry debtors volumes

1. Is the overall average invoice value greater than £900 for all debts apart from education recoupment, or greater than £1,100 including recoupment?

2. Has your sundry debtors section avoided the burden of recovering housing benefit overpayments?

### Sundry debtors provider-side management

1. Is the unit cost per invoice less than £4.83?

2. How do your cost components compare with the target rates shown in Exhibit 3.27?

3. Is the productivity, in terms of invoices dealt with per debtors staff FTE, greater than 5,200?

4. Is the use of sundry debtors staff for debt pursuit maximised, with legal staff involved only for court action?

5. What use is made of telephone calls and named points of contact as a means of pursuit and thus of reducing costs and improving effectiveness?
Cashiers

- Are you above the benchmark cashiers cost per receipt?
- How do your service standards compare with good practice?
- Is there scope to reduce the number of cash offices or to use alternative payment channels?
- Can you encourage moves away from cash payments?
- How can you improve productivity and reduce unit costs?
Executive summary

Total costs are affected more by service standards and volumes than by unit costs.

Authorities should strive to reduce the volume of counter transactions by encouraging the use of standing orders and direct debits.

Alternative payment facilities (the use of automated teller machines (ATMs) or contracts with the Post Office, banks or building societies) may be cheaper than in-house staffed cash offices.

After having reduced counter transaction volumes and reviewed the scope for using alternative facilities, authorities should assess whether the extent of cash office provision is justified, or whether any should be removed.

For the cash offices that the authority decides to retain, clear public service standards should be set.

The benchmark unit cost per receipt is £0.40 (£0.74 for London authorities); there is no ‘scale effect’ and so these rates can be achieved by all authorities.

Unit costs can be reduced by flexible staffing and attention to running costs.

Key benchmark data

<table>
<thead>
<tr>
<th>Costs per invoice (£):</th>
<th>London</th>
<th>Elsewhere</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff</td>
<td>0.54</td>
<td>0.30</td>
</tr>
<tr>
<td>IT</td>
<td>0.02</td>
<td>0.02</td>
</tr>
<tr>
<td>Accommodation</td>
<td>0.09</td>
<td>0.03</td>
</tr>
<tr>
<td>Other</td>
<td>0.09</td>
<td>0.05</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>0.74</strong></td>
<td><strong>0.40</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Staffing costs per FTE:</th>
<th>London</th>
<th>Elsewhere</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£18,900</td>
<td>£13,500</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Productivity:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over-the-counter receipts per cashiers FTE per annum</td>
</tr>
<tr>
<td>Total receipts per cashiers FTE per annum</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Throughput:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over-the-counter receipts per open hour for finance department cash offices</td>
</tr>
<tr>
<td>Over-the-counter receipts per open hour for housing department cash offices</td>
</tr>
</tbody>
</table>
Developing Competitive Financial Support Services

Cashiers

Introduction

3.159 The local authority cashiers function covers not merely the collection and processing of cash and cheques at cashiers offices (whether in a finance department or in a housing department) but also the processing of postal receipts and of payments made by standing order and direct debit. These receipts are generated principally from council tax, non-domestic rates, housing rents and other sundry debts. Of these four sources, council tax and housing rents dominate the overall volume of receipts.

3.160 Some departments may have specialist units or staff dealing with, amongst other things, the receipt of income. Two examples would be the collection of parking fines, which may be managed by a separate section in the engineers or environmental services department, and the collection and banking of cash receipts at leisure centres. Such staff are not part of the cashiers function as explored in this section.

3.161 While many authorities are making progress in encouraging non-cash payments, it is likely that a cash collection function will survive in local authorities for the foreseeable future to:

- enable any person to pass over relatively small amounts of money (say, less than £10);
- serve those who do not have bank accounts;
- provide services to those disinclined or unable to use credit card type methods of payment;
- provide a face-to-face service, often as part of a wider authority policy of customer care or service access.

Variation in costs

3.162 The benchmark unit cost per receipt is 40p for authorities outside London, and 74p for London authorities. In line with the definition supplied in paragraph 3.159, authorities should calculate their cost per receipt figure by taking total cashiers expenditure and dividing by the total number of receipts, whether they be over-the-counter or in another form. The benchmark is likely to be exceeded where there are:

- high service standards with many separate offices and long opening hours;
- high provider costs – large numbers of cashiers in relatively expensive accommodation.

There is little relationship between the unit cost per receipt and the volume of receipts (Exhibit 3.28, overleaf).
Service standards

3.163 The cashiers service is unique amongst financial support services in that it involves extensive direct contact with the public. This means that an extra dimension has to be added to service standards to accommodate public expectations and perceptions. Members of the public are likely to compare the service that they receive at a local authority cashiers office, with what they find at a ticket office in a railway station, at a Post Office or bank, or at a Benefits Agency office.

3.164 It is relatively easy to write down in a contract specification the core procedural requirements of a cashiers service to be followed when taking, recording, reconciling, moving and banking money. It is less easy to incorporate the ‘intangible’ factors relating to the public’s impression of the cashiers service; few authorities are yet in the position where they can translate those intangible service standards into formal requirements as part of a contract specification. From a customer’s viewpoint the most important standards are:

- the location of cashiers offices;
- the quality of the cashiers office environment – whether it is physically accessible, comfortable, attractive and secure;
- the opening hours of offices;
- the length of the queues for service and the speed with which people are seen;
- the manner in which they are dealt with by cashiers.

3.165 The most important issue is that of cash office location. An extensive network of cash offices around the authority may constitute a high service standard in terms of accessibility, but it also entails a higher total cost (and a
higher unit cost, as the number of additional receipts made as a result of more cash offices is unlikely to be commensurate with the additional cost of those extra offices. The distribution of cash offices is a strategic decision for the authority, and, as the major determinant of service cost, it needs careful consideration by members. Members should endorse the location and opening hours of all cashiers offices after being advised of the financial implications of different levels of provision. Members should satisfy themselves that the benefits of their cash office network justify the costs, taking note of the levels of throughput at each cash office and making explicit decisions about individual cash offices with low levels of use.

3.166 Authorities can develop an extensive network of paying-in-points without incurring expenditure on local authority cash offices, by authorising Post Offices to accept cash payments. Post Offices are widely distributed and provide easy access to all groups of people, including, in most cases, the physically disabled. They also have sophisticated security arrangements in place which can accommodate the relatively small amount of additional cash collected by housing authorities. They are open for five and a half or six days each week, and most of their staff are used to handling cash receipts on behalf of other agencies (for example, payment of gas and water bills and road fund licences). All authorities should carry out a cost appraisal of the potential role of Post Offices (Box 3.D, overleaf): the approach is equally applicable to other potential suppliers, such as banks or building societies.

3.167 Dealing with large amounts of cash has inevitable security implications. In practice, decisions on the distribution and mix of cashiers offices may be greatly influenced by security. Remote offices require secure premises, precautions for staff safety, and specialised transportation facilities for cash collected.

3.168 In addition to these control requirements which are essentially driven by external factors, the s151 officer should lay down clear procedures and guidelines covering the operation of the ‘core’ cashiers service – in particular, around banking and the updating of accounts. Targets should be set for the speed of banking and updating; ideally, all tasks should be completed within one working day of receipt.

3.169 Having an effective ‘core’ service (i.e. one that collects, records and banks receipts) and an adequate network of offices and paying-in points without the guarantee of prompt and courteous service is unlikely to satisfy a clientele increasingly familiar with better service elsewhere. Accordingly, authorities should determine explicit customer care standards. These should be quantified, wherever possible, to assist users’ understanding and clients’ monitoring: for example, authorities should set a standard for how long people can expect to queue or wait before they are seen. Customer satisfaction with the cashiers service should be monitored via user surveys, as practised, for example, at Leicester City Council.
The speed with which the public can be dealt with depends on:

- the number of ‘teller’ windows;
- the ability of the provider to staff the windows;
- the queuing system;
- the use of ATMs;
- the complexity of the transaction.

Cost tends to increase as the number of windows, and therefore the staffing requirements, increase. However, efficient single queue systems, such as those increasingly used in major Post Offices and banks, smooth the overall flow of customers at least cost to the provider. They also prevent customers becoming annoyed as a consequence of choosing the shortest queue and ending up behind a complex transaction. Target queue lengths will be harder to achieve during peak periods: one way around this is to supplement staffed windows with ATMs (see paragraph 3.175 below). Finally, once the customer gets to a

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**Box 3.D**

Evaluating the potential for involving the Post Office

1. **Estimate the authority’s total cashiers cost**
   - What is the cost per cash receipt?
   - Where are the costs highest?

2. **Consider what sort of service the Post Office could provide**
   - Could the Post Office deal with the volumes?
   - Would the local authority clientele have easier access to Post Offices than to existing or proposed council offices?

3. **Consider what the Post Office service would cost**
   - What contractual arrangements would be needed?
   - What would be the Post Office charge per transaction?
   - How much of this should the debtor be asked to bear, and how much is the authority prepared to absorb?
   - Would using the Post Office lead to staff savings through lower expenditure on in-house cashiers facilities?
   - Would it improve efficiency in other ways?

4. **Consider the likely effects of change in more detail.**
   - Would the level of rent arrears increase if Post Offices were used instead of housing offices?
   - What does a transfer of cash from the Post Office to an authority revenue system cost?
   - How much will it cost to update authority records? (Tape transfers of information will be required to update debtors records.)

5. **Decide on an authority approach**
window and completes the transaction, their view of the service will be enhanced if they deal with empathic and helpful staff: authorities should address this through appropriate recruitment, training and performance management.

**Volumes**

3.171 The principal volume measure that authorities should attempt to influence is the number of receipts resulting from standing orders and direct debits, as opposed to receipts from cash and cheque payments. Analysis of surveyed authorities suggests that higher percentages of standing order and direct debit receipts allow a reduction in the unit costs of the cashiers function (Exhibit 3.29), as a result of reductions in staff time, cash handling and bank costs. Securing high levels of use of standing orders and direct debits will prove easier for authorities with relatively affluent populations; however, all authorities should explore this route to cost reduction.

3.172 Greater use of standing orders and direct debits should have an influence on member decisions about the extent of in-house cash office provision. If fewer counter transactions are made, then the arguments for reducing the number of offices or the level of service become stronger, simply because throughput drops. Key measures of throughput are the number of counter transactions per FTE and the number of counter transactions per open hour. In a good practice authority:

- each FTE cashier is likely to carry out over 30,000 counter receipts and a total of 55,000 receipts each year;
- each finance department cash office should surpass the target of 70 counter receipts per hour;
- each housing cashiers office should achieve an average of at least 45 counter receipts per hour.

---

**Exhibit 3.29**

*Cashiers - the influence of receipt type on cost per receipt*

Higher percentages of standing order and direct debit receipts allow a reduction in costs...

<table>
<thead>
<tr>
<th>Cashiers costs per receipt (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.6</td>
</tr>
<tr>
<td>1.4</td>
</tr>
<tr>
<td>1.2</td>
</tr>
<tr>
<td>1</td>
</tr>
<tr>
<td>0.8</td>
</tr>
<tr>
<td>0.6</td>
</tr>
<tr>
<td>0.4</td>
</tr>
<tr>
<td>0.2</td>
</tr>
</tbody>
</table>

0 5 10 15 20 25 30 35 40 45 50

Direct debit/standing order receipts as percentage of total receipts

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Source: Audit Commission survey of authorities

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1 And in doing so, authorities may wish to make reference to the relationship, identified in the Commission’s work on council tax collection, between direct debit rates and the DoE index of local conditions (Ref. 15).

2 The target for housing cashiers offices is lower because the processing of rents will frequently involve discussion of benefit entitlements.
3.173 Authorities below these target throughput rates should consider whether the number of cash offices and their opening hours could be better aligned with the demand for cash payments. This should be part of the overall review of cash office provision (see paragraph 3.165 above) aimed at identifying under-utilised cash offices which may need to be closed or have their opening hours reduced.

Provider costs and competitiveness

3.174 Over 70 per cent of cashiers costs go on staffing (Exhibit 3.30). In this service, more than any other, it is vital to have staff who are deployed flexibly to align with the peaks and troughs of service demand. Potentially, this means being able to work through lunch periods, on Saturdays, on pay days, and at times that coincide with rent demands. Providers of cashiers services need to develop flexible and responsive methods of providing additional trained cashiers at short notice. One approach is to employ part-time staff; another is to cross-train employees from other financial services, who can then be on call to staff up the cashiers offices during peak periods. The City of Sunderland, for example, has three part-timers in its main cashiers office working from 11am to 2pm; the authority has also trained two council tax staff to be on call as emergency cashiers.

3.175 Technology can also be used to align demand and supply. Some authorities have emulated the widespread practice amongst banks and building societies of using ATMs in conjunction with staffed windows. Customers with simple payments wishing to avoid long waits can use the machines and the providers can deal with such receipts in slacker periods. Coventry City Council uses ATMs as part of its workload management strategy to help achieve lower costs (Case Study 3.14).

<table>
<thead>
<tr>
<th>London</th>
<th></th>
<th>Elsewhere</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total cost per receipt</strong></td>
<td>£0.74</td>
<td>£0.40</td>
</tr>
<tr>
<td><strong>Staff costs per receipt</strong></td>
<td>£0.54</td>
<td>£0.30</td>
</tr>
<tr>
<td><strong>IT costs per receipt</strong></td>
<td>£0.02</td>
<td>£0.02</td>
</tr>
<tr>
<td><strong>Accommodation costs per receipt</strong></td>
<td>£0.09</td>
<td>£0.03</td>
</tr>
<tr>
<td><strong>Other costs per receipt</strong></td>
<td>£0.09</td>
<td>£0.05</td>
</tr>
</tbody>
</table>

Source: Audit Commission survey of authorities
3.176 In their quest for flexibility, authorities should not lose sight of the customer care objectives they have set as part of their consideration of service standards (see paragraph 3.169 above). All cashiers staff, whether full-time or part-time, should be adequately trained in customer care.

3.177 Best practice in accommodation costs is evidenced by a rate per FTE of £1,600 or less (£2,700 in London). These rates are higher than for other financial services, primarily because of the requirements generated by contact with the public. Cashiers offices need to have effective security and better than normal cleaning arrangements, and will also experience increased wear and tear from customer use. As more cashiers offices are opened, however, the accommodation cost per FTE increases, reflecting the point that four people can normally be employed more cheaply in one office than two people each in two separate offices.

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**Case Study 3.14**

**Coventry City Council’s cashiers service – smoothing workload peaks with ATMs**

<table>
<thead>
<tr>
<th>The problem:</th>
<th>Coventry City Council’s cashiers section, like most, faces workload peaks at certain times (notably lunchtime), but wishes to provide a prompt service throughout the day. Rather than ease the peak-time pressure on service windows by employing more staff, the authority has supplemented its staff capacity with three ATMs.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The solution:</td>
<td>On a paying-in envelope, customers record: ◆ their name and address ◆ the account the payment refers to (council tax, housing loans, etc.) ◆ the account reference number ◆ the amount paid ◆ the method of payment (cheque or cash)</td>
</tr>
<tr>
<td>Effecting change:</td>
<td>Customers then place the payment in the envelope and deposit it into the ATM. An acknowledgement slip is automatically produced. Cashiers empty the machines during quieter periods and then treat the payments as any other over-the-counter receipt. The ATMs are open throughout the day and the section aims to process the receipts before the end of the next working day.</td>
</tr>
<tr>
<td>Summary:</td>
<td>There was some initial reluctance from the public to using the ATMs and errors occurred completing the envelopes. However, the setting up of a temporary help desk, together with clear instructions on the envelopes themselves, appears to have successfully tackled these problems. In addition, the system also allows for regular payment books to be deposited, receipted and posted back to the payee. The Council has achieved savings from reducing staffing levels as a direct result of the introduction of the ATMs. The innovation has helped Coventry to achieve one of the lowest cashiers service costs per £m NRE+HRA of any authority in the survey.</td>
</tr>
</tbody>
</table>
### Good practice checklist

#### Cashiers standards

<table>
<thead>
<tr>
<th></th>
<th>Question</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Have your members endorsed the location and opening hours of all cashiers offices?</td>
</tr>
<tr>
<td>2</td>
<td>Has policy been formed after the full financial implications have been made clear?</td>
</tr>
<tr>
<td>3</td>
<td>Has the authority considered use of Post Offices as a supplement or alternative to authority cash offices?</td>
</tr>
<tr>
<td>4</td>
<td>Have options been evaluated using reliable cost data?</td>
</tr>
<tr>
<td>5</td>
<td>Are there clear guidelines and procedures covering the operation of the service, laid down by the s151 officer?</td>
</tr>
<tr>
<td>6</td>
<td>Are there targets for the speed of banking and updating accounts?</td>
</tr>
<tr>
<td>7</td>
<td>Are customer care standards explicit, comprehensive and, where possible, quantified (for example, target queue lengths)?</td>
</tr>
<tr>
<td>8</td>
<td>Are standards monitored with user surveys?</td>
</tr>
</tbody>
</table>
## Cashiers volumes

1. What attempts have been made to increase the percentage of payments made by standing order and direct debit?

2. Have the number of offices and the number of hours open been aligned with actual levels of demand, such that each FTE cashier achieves the benchmark throughput rate of 30,000 counter transactions per annum, and 55,000 total receipts per annum?

3. Has your authority reviewed throughput at each office?

4. Are any offices under-utilised and should they be closed, or alternatively, should opening hours be reduced?

## Cashiers provider-side management

1. Is the unit cost per payment 74p or less in London authorities and 40p or less elsewhere?

2. How do your cost components compare with the targets shown in Exhibit 3.30?

3. What use is made of flexible staffing techniques, especially the use of part-time staff working reduced hours each day to coincide with peaks in demand?

4. What efforts have been made to train staff in customer care techniques and how is performance in this area monitored against defined standards?

5. What use is made of ATMs to reduce the need for staffed tills?

6. Is there control over the number of cashiers offices?
Responding to CCT

- Which services will you expose to competition?
- How will work be packaged?
- How will you ensure quality when specifying and evaluating?
- What should providers do to make their bids competitive?
Section 4

Responding to CCT

Introduction

4.1 In May 1995, the government confirmed that "finance services" would be added to the list of designated activities to which CCT legislation applies. The umbrella term "finance services" includes all six of the financial support services covered by this handbook, together with local collection of taxes, benefits administration and a range of other specialist services. For the precise definition of which services are affected, authorities should consult the relevant statutory instrument.

4.2 In some ways, the CCT requirements for white-collar services will be as laid down in the Local Government Act 1988. However, unlike the services affected by the 1988 Act, authorities will not have to expose all of their white-collar services to competition, only a proportion. For finance services, the target specified proportion has been set at 35 per cent of authority expenditure on the defined activity, less certain credits. Different types of authority face different deadlines for meeting this percentage target (Box 4.A).

4.3 To meet their CCT requirements, each authority must first estimate the total amount they spend on finance services (including client-side activities) as defined by the statutory instrument. In this, they will be helped by the production of their Statement of Support Service Costs (Ref. 16). From this total, authorities can subtract a de minimis provision (£300,000 or 100 per cent minus the defined percentage, whichever is the larger) and a further range of items of expenditure as credits.

Box 4.A

CCT deadlines

- April 1997: London Boroughs and Metropolitan boroughs
- October 1997: reorganised authorities where shadow authorities are created in 1995
- October 1998: reorganised authorities where shadow authorities are created in 1996
- October 1999: reorganised authorities where shadow authorities are created in 1997
- October 1997: authorities subject to LGR but unchanged, where the decision was announced before 1/4/95
- April 1998: authorities subject to LGR but unchanged, where the decision was announced between 1/4/95 and 30/9/95
- October 1998: other authorities subject to LGR but unchanged

1 Including, for example, finance services to schools with devolved budgets and to DSOs that have won work in competition, and finance services that have been exposed to voluntary tendering under certain conditions; for full details and further guidance, authorities should consult the DoE.
4.4 If, after making this calculation, a residual amount remains, authorities must expose to competition finance services with a value at least equal to this residual amount (known as the specified proportion). This can be achieved via two principal routes: either by purchasing direct from private companies, or by a tendering process in which an in-house bid is compared with rival bids.

4.5 In any tendering process, an authority will have scope to assess the quality offered by competing bids and to make trade-offs between price and quality. The authority will be able to reject the lowest bid, if it has good reason. In this, and more generally throughout the tendering process, authorities will need to ensure compliance with DoE guidance on anti-competitive behaviour and with the 1993 EC Services directive that governs public procurement in Community nation states.

4.6 An authority’s response to CCT should not be seen as separate from other efforts to improve value for money. Authorities should be pursuing value for money in all services, whether or not they are to be exposed to CCT. However, competition is both a means and an incentive to improving value for money. Any services that an authority decides to expose to CCT should be reviewed using the guidance offered in Sections 2 and 3 of this handbook. But CCT creates three further challenges for authorities:

- **Overall strategy** – authorities must decide which components of their financial services expenditure should be exposed to CCT to meet the specified proportion.
- **Client issues for individual services** – authorities must decide how to organise the client role, package work into contracts, turn requirements into a specification, evaluate competing bids and establish effective working relations between the client and the provider once the contract starts.
- **Provider issues for individual services** (if an in-house bid is to be made) – in-house providers must determine how to price and bid to maximise their chances of success when tendering. The other necessary pre-condition of success is the thorough preparation of all aspects of the service, its staffing and its costs to ensure match fitness for competition: detailed advice on all aspects of this is provided in Sections 2 and 3.

4.7 This section explores each of these three challenges in turn. The advice it contains is of relevance to all financial services, including those (notably council tax collection and benefits administration) not covered in Section 3. Authorities that identify tax collection or benefits administration, or both, for competition are referred, for detailed advice on benchmarks and best practice, to the Audit Commission’s handbook, *Collecting Local Taxes* (Ref. 1), and its 1993 publications on housing benefits administration (Ref. 2).

**Overall strategy**

4.8 Full competitive tendering of a financial service, involving bids from an in-house section and private companies, is only one means of achieving the objective of value for money in service provision. Other approaches include:
deciding not to expose a service or an element of a service to competition (i.e. offering other services to meet the government target), but ensuring that the in-house section achieves competitive costs and adopts best practices;

- partial outsourcing of a financial service (for example, contracting with a private company to supply IT support);

- full outsourcing – going directly to a private supplier through a tendering process without an in-house bid.

4.9 The strategic challenge facing authorities is to examine each financial service and decide which approach is best for each individual function in order to achieve the authority’s overall objectives (of which value for money will undoubtedly be one, and compliance with the CCT requirements another). In short, each authority needs a **procurement strategy**. This is similar to the strategic decisions that private companies make about whether to ‘make or buy’ and how to identify and manage suppliers.

4.10 After having developed a comprehensive list of financial services and the amount spent on each, one approach to developing a procurement strategy is to assess each service against four key criteria:

- **Significance** – is the service of fundamental strategic significance to the authority?

- **Specifiability** – can the authority readily specify its requirements?

- **Supplier competitiveness** – does the current supplier (particularly an in-house supplier) deliver, and can it continue to deliver a service at a competitive cost when compared to other suppliers?

- **Market competitiveness** – is there a thriving, competitive market of competent private suppliers?

4.11 Authorities may wish to supplement these key criteria with other factors:

- **Transferring risks and difficulties** – for some voluntary contracting authorities, outsourcing is a means of shifting difficulties away from their direct responsibilities to a private firm. Examples would include the risk of transaction-based services facing falling workload volumes and consequently higher unit costs, and the difficulties inherent in the direct management of large numbers of staff.

- **Protecting organisational innovation** – this might suggest that decentralised and devolved financial services are less suitable to tendering than functions that remain at the centre of an authority.

- **Tackling poor performance** – some authorities might wish to expose their worst-performing services to competition (though if the performance problems can be resolved by changes in specified standards or volumes, or if there is not a strong market of private suppliers, this approach may not be sensible).

4.12 The four key criteria identified in paragraph 4.10 can be linked in a decision tree: the answers to the questions will determine which procurement approach should be adopted for each service. Provided that the answers enable
the target CCT percentage figure to be met, authorities will have complied with the legal requirements and developed a rational solution to the ‘make or buy’ problem (Exhibit 4.1). This approach may identify more than the designated percentage of financial services expenditure as suitable for tendering or outsourcing: if so, authorities have a choice about whether to stop at the government target or take full advantage of all the benefits that the authority believes may be gained from competition or outsourcing.

Using the decision tree

Service significance

4.13 Each criterion in this decision tree warrants careful exploration. Many authorities will, for example, assert that all accountancy and internal audit activities are of strategic significance (as they relate to the s151 responsibility and the overall setting of the budget and closure of accounts), and therefore that they should not be outsourced or exposed to competitive tendering.

4.14 A distinction can be made between core accountancy functions and accountancy support services. The latter can be outsourced without undermining the authority’s ability to discharge its core functions (including that of overall financial control) and retain an in-house accountancy section that can contribute to corporate strategy. Moreover, even within the ‘core’ accountancy and internal audit workload, there are routine tasks that could be packaged and let as small contracts. Although authorities should ensure that such contracts are cost-effective, examples include the use of consultancy staff for value-added tax returns and routine establishment audit work at schools.

Exhibit 4.1

**Procuring financial services**

Authorities can develop a rational solution to the ‘make or buy’ problem...

---

**Source:** Audit Commission
4.15 Some authorities have taken a more radical line and argued that even services of strategic significance, such as core accountancy or s151 audit work, can be outsourced. South Oxfordshire District Council has outsourced its accountancy services (Case Study 4.1), while the London Borough of Hackney has outsourced its planned systems audit work (Case Study 4.2, overleaf). Such radical solutions are feasible, provided the authority develops a client-side capacity with sufficient expertise and competence.

Specifiability

4.16 Financial support services with simple, measurable outputs, such as payroll and creditor payments, are easier to specify than more complex services such as accountancy and internal audit. Moreover, it is easier to specify quality standards for transaction-based services, where the requirements for timeliness and accuracy allow error rates (or collection rates for council tax) to form a key plank of the specification.

4.17 While some other financial services requirements are difficult to specify, none are impossible. For example, policies on council tax recovery can be translated into codes of practice (covering, for instance, the use of bailiffs): authorities can include these within specifications and make compliance with them a condition of contract. For professional services such as accountancy and internal audit, outsourcing authorities have been able to specify their needs through a combination of:

- **input requirements** – for example, a minimum percentage of qualified accountant time on the contract work;
- **process requirements** – for example, compliance with legal and accounting standards in discharging the work, and a requirement that tenderers’ operating systems and procedures meet a defined quality standard;
- **output requirements** – for example, stipulating that budgets will be prepared and accounts closed by specified target dates;
- **outcome requirements** – for example, provision of financial advice that is sufficiently robust to avoid challenge, a designated level of user department satisfaction, the satisfaction of the external auditor, etc.;
- **method statements** – asking tenderers to include in their bids a statement of how the service would be organised and delivered to meet defined objectives (such as the provision of ‘timely financial information’).
### Background:
South Oxfordshire District Council took the first step towards outsourcing accountancy services in 1991 when it let a contract for the preparation of its 1992/93 revenue budget. In 1992, the Council let a contract for the closure of its 1991/92 accounts. The success of these contracts convinced the authority that it could deliver a core function through the use of an external contractor, and so in 1992 it let a contract for all accountancy work, as part of a wider contract for financial services.

### An output-based approach:
The accountancy function was broken down into seven components, each of which had a discrete section within the specification. These sections followed a common four-part format:
- introduction
- outputs required
- quality criteria
- supporting data about the service

Organisational and operational matters were left for the contractor to determine, although the contract included a requirement to use the existing IT and accommodation facilities.

### Tendering and evaluation:
South Oxfordshire invited firms to submit a fixed price tender for the work, supported by a daily rate for additional authority requirements that might arise during the course of the contract. Nine firms submitted tenders, of which four were placed on a final shortlist and invited to make presentations. Final evaluation was based on both tender documentation and presentations, and was based on five key criteria:
- ability to deliver the required outputs
- price
- staff experience and expertise, particularly of the firm’s proposed contract manager
- experience of other authority work
- financial status of the firm
- the views of in-house staff who would transfer to the contractor

### Award:
The authority awarded the contract to the lowest bid, submitted by a firm that did not have extensive experience of local authority managed services work. Across the whole of the contract, outsourcing is estimated to have saved South Oxfordshire between 35 per cent and 40 per cent of its previous in-house costs. These savings resulted from the authority’s review of its service requirements (in terms of the amount of accountancy work undertaken) as well as from lower provider-side unit costs.

### Monitoring:
Contract monitoring and management are undertaken by two senior officers, both of whom have other duties: the authority’s assistant treasurer and its head of financial and technical services. These officers possess strong technical expertise on accountancy issues, sufficient to enable the authority to direct and evaluate contractor performance. They meet once a month with the contractor on a formal basis to discuss performance, but have informal contact on an almost daily basis.
The client-side pays close attention to the opinions of service department managers on the information reports and financial advice they receive from the contractor. The other key user of the service, whose views are also central to the evaluation of contractor performance, is the chief executive, who is the authority’s s151 officer. In both cases, the satisfaction of the customer is paramount in the assessment of quality.

Conclusion: Overall, the authority is satisfied that the contractor is delivering the specified service outputs. Outsourcing the accountancy function has enabled South Oxfordshire to realise significant financial savings without experiencing any loss of control or service quality.

Case Study 4.2
Outsourcing core financial services – the London Borough of Hackney’s planned internal audit programme

The problem: In the late 1980s, Hackney’s internal audit service experienced difficulties in staff recruitment and retention while having to undertake high levels of fraud and other special investigations work. As a result, the Council failed to achieve its planned audit programme (with fundamental systems work suffering particularly), attracting criticism from the external auditor.

The solution: In 1990, Hackney undertook a fundamental review of its internal audit service. The function was split into planned work and other work, primarily non-routine investigations. Non-routine investigations were retained in-house. Since planned work was readily specifiable and there was a strong market of private sector suppliers, it was viewed as suitable for outsourcing.

Hackney issued a brief specification of its requirements for planned work and details of a fixed budget within which tenderers had to provide the service. Firms’ bids had to include details of risk assessment, coverage and staff mix, feeding through to an audit plan.

Hackney awarded a three-year contract to a ‘big six’ accountancy firm, with the budget for planned work effectively ‘ringfenced’. The firm achieved 100% of the audit plan in each of the three years of the contract. The client officer was the assistant chief finance officer (audit), who also managed the remaining in-house staff working on fraud and special investigations.

The Council was happy with the outsourced arrangements, as was the external auditor, who undertook an independent review of the service part-way through the contract. In 1993/94, Hackney tendered the work, inviting bids from six accountancy firms. While improving upon the contract documentation and the specification of requirements, the approach adopted in the 1990 tender was essentially retained.

◆ Again the Council provided a short output-based specification and a fixed budget cap, with limited base information about
the authority and a statement of priority issues to be addressed by tenderers in their proposals for planned audit work;

- And again it required tenderers to produce an assessment of risk and an outline audit plan – the detail of the plan to be worked out after award, through consultation with service department managers, as well as with the corporate client in the financial and corporate services department;

- Hackney also placed the onus on tenderers to develop a customised audit procedure manual and identify appropriate audit methods, quality systems and quality measures that would demonstrably meet the Council’s requirements;

- It evaluated bids using eight criteria:
  - understanding of the Council’s requirements
  - rigour of risk assessment methodology
  - balance of proposed audit work (i.e. coverage)
  - total days offered
  - staff mix
  - level and calibre of supervision
  - experience of staff
  - arrangements for quality control

- The Council traded off price and quality by selecting the cheaper of the two leading bids, after satisfying itself that the cheaper bid allowed its quality requirements to be met.

**Conclusion**

Overall, outsourcing planned internal audit work helped to solve the problems of the late 1980s and strengthened the discharge of the s151 responsibility, with no loss of management control by the Council over this strategically significant service.

**Competitive providers**

4.18 Authorities should use the benchmark costs and advice on good practice provided in Section 2 to assess whether their in-house provider is competitive, and, if not, whether it could achieve competitive costs. Where scale effects exist, primarily for payroll but also for internal audit and accountancy, small authorities are unlikely to be able to match commercial benchmarks and so should consider seeking an alternative supplier where the service is specifiable and not of strategic significance. Even authorities with competitive costs should review whether these can be maintained over time, given the possibility of falling volumes (for example, if DSOs lose contracts, schools go to other suppliers, and housing or social service provision is transferred out of direct local authority control) and legal restrictions on trading.

4.19 As an alternative to full outsourcing, authorities may wish to consider outsourcing the management of their IT facilities – a policy that could help overcome the disadvantages of insufficient scale. Another way of overcoming
scale disadvantages would be to explore the scope that exists in law for joint provision with other authorities, for example through consortia, and for provision of services to districts from counties. Such approaches may be of particular relevance to incoming authorities following local government review.

**Competitive markets**

4.20 When deciding whether to compare private tenders with an in-house bid or go directly for outsourcing, authorities should assess the strength of the private sector market for the service. The market for payroll, for example, is well-developed, suggesting that a competitive price could be achieved with or without the spur of an in-house bid. But there are fewer private firms with any substantial track record in local tax collection. This suggests that competitive prices cannot be guaranteed from private suppliers, and that authorities should consider submitting an in-house bid. Market competitiveness is likely to increase over time, as new firms enter markets and existing firms become more experienced.

4.21 Authorities may wish to integrate their assessment of this issue with their assessment of the specifiability of services, by plotting each service on a matrix (Exhibit 4.2 shows one possible positioning of services by way of illustration). Services in the upper quadrants are more suitable for tendering than those in the lower quadrants. Those in the upper right-hand quadrant would be favoured candidates for outsourcing (especially if the in-house bid was unable to achieve benchmark rates), whilst those in the upper left-hand quadrant would benefit from the submission of an in-house bid.

4.22 The combination of specifiability, strong private suppliers and potentially weak in-house provision may make payroll a strong candidate for outsourcing. A number of NHS organisations, including Harefield Hospital NHS Trust (Case Study 4.3), have followed this route, generating lessons that may be of interest to local authorities.

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**Exhibit 4.2**

*A market strength/specifiability matrix*

Authorities may wish to integrate their assessment of market competitiveness and the specifiability of services by plotting each service on a matrix...

*Source: Audit Commission*
### Case Study 4.3
#### Externalising payroll: Harefield Hospital NHS Trust

<table>
<thead>
<tr>
<th>The problem:</th>
<th>Harefield Hospital NHS Trust spends £30m per annum and employs 750 staff. Reorganisation of its existing payroll supplier (a Health Authority) forced it to evaluate alternative options. The new supplier would have to meet the increased demands for management information and control that accompanied the change to trust status.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The evaluation:</td>
<td>An in-house solution was quickly discounted. The Trust is too small to provide the necessary expertise to develop and maintain a cost effective in-house service. The best solution was offered by a private company that had been borne out of the health service sector, and was therefore familiar with health requirements. The computer system chosen offered the necessary flexibility and allowed users to undertake readily a wide range of analyses and interrogations of the payroll database. The contract was let in Autumn 1994 for three years with an option to extend to five.</td>
</tr>
<tr>
<td>The solution:</td>
<td>♦ The service provided by the contractor includes the payment of staff, the maintenance of the payroll database and the provision of a range of management information. ♦ The Trust owns the data on the database and users have access to a wide range of standard reports, on-line query facilities and a user-friendly report-writing application. These facilities succeed in meeting almost all of the management information needs of the Trust. ♦ The Trust controls all amendments to the payroll database. The entry of data onto the system is, however, a two-stage process: data for new starters, regradings, etc. is, in the first instance, entered on-line by the Trust’s personnel section; input documentation is batched and sent to the contractor where the data is verified before being imported into the main database. ♦ The contractor provides training to all service users as part of the contract. In addition, day-to-day advice is readily available from the contractor by telephone and through regular ‘payroll clinics’ attended by contractor staff. ♦ The contract includes a provision for a range of ad hoc support services provided on a consultancy basis, for example, additional reports, bespoke training, etc.</td>
</tr>
<tr>
<td>Effecting change:</td>
<td>There have been a number of teething problems (for example, a large number of errors on the first payroll run). Most of these could have been avoided if there had been more time to prepare for the contract. A longer lead-in period would have afforded more extensive consultation with service users, more disciplined project management, and the opportunity to clean up the data provided to the new contractor. The initial problems have now been overcome. The ease and speed with which this has been achieved is attributed to the effectiveness of the payroll arrangements and the strength of the client/contractor relationship. The Trust is very pleased with the new payroll service which provides a considerably enhanced service, meeting all its requirements at a lower cost. The relationship between the Trust and the contractor represents a ‘good fit’, allowing the Trust to have a high degree of control over service inputs and outputs at the same time as benefiting from the economies of scale, quality assurance, expertise and responsiveness available externally.</td>
</tr>
</tbody>
</table>
Client-side issues

4.23 Once the authority has decided which financial services should be exposed to competition, it must ensure that it has a competent client function to implement these decisions. The client role for tendered services is now well understood within local government (Ref. 17). It must undertake a wide range of tasks (Box 4.B). For the financial services client, five key challenges stand out:

- organising the client role;
- packaging work into contracts;
- specifying service requirements;
- evaluating competing bids, in particular the price/quality trade-off;
- managing the supplier, whether in-house or private, after the award of the contract.

Organising

4.24 Organisation of the client role is closely bound up with definitions of who are the clients for a service. The s151 officer is the legitimate client for core and corporate financial management, but service departments and service managers have an equally legitimate claim to the client role for other financial support services.

4.25 In theory, each service department or service unit could discharge its client role for itself. In practice, depending partly on the way in which work is packaged, it may be more sensible for these requirements to be co-ordinated by a single client agent. The client agent should ensure that all users are consulted on their requirements, and identify the most cost-effective way to meet these stated requirements. In doing so, the client agent will need to ensure that user requirements are consistent with core accounting requirements and with the s151 responsibilities.

4.26 For the services designated for CCT, whether or not a single client agent is to be created, each authority will need to implement a split between client and provider staff. This need not be the first step that authorities take in responding to CCT. Indeed, over 90 per cent of sample authorities had made no split in any of their financial support services at the start of 1994/95.

4.27 Although a formal organisational split need not be an early priority, authorities must assign responsibility for client tasks to designated staff in sufficient time to enable statutory deadlines to be met. Authorities that do not wish to establish a separate client unit should nevertheless comply with DoE guidance on anti-competitive behaviour. This states that staff involved in the preparation and submission of an in-house bid should not be involved in the evaluation of that bid or the award of the contract.
Once the client role has been assigned, the next task for the authority is to decide upon contract packaging. Authorities should answer the following packaging questions:

- **Financial services packaging:**
  - Will the contracts offer a whole financial service (for example, all internal audit work except the client role), or just components of one (for example, payroll processing)?

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### Box 4.B

**The client role – key tasks**

<table>
<thead>
<tr>
<th>Organising</th>
<th>understanding the requirements of UK and EC legislation governing service contracts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>identifying target amounts and deadlines to ensure compliance with legislation</td>
</tr>
<tr>
<td></td>
<td>drawing up timetables to allow deadlines to be met and to ensure sound overall project management</td>
</tr>
<tr>
<td></td>
<td>clarifying policy objectives for services</td>
</tr>
<tr>
<td>Packaging</td>
<td>packaging services into contracts</td>
</tr>
<tr>
<td>Specifying</td>
<td>consulting users about their requirements</td>
</tr>
<tr>
<td></td>
<td>writing specifications</td>
</tr>
<tr>
<td></td>
<td>writing contract conditions</td>
</tr>
<tr>
<td>Tendering and evaluating</td>
<td>placing advertisements with details of the work and the tendering process</td>
</tr>
<tr>
<td></td>
<td>vetting interested firms</td>
</tr>
<tr>
<td></td>
<td>deciding which firms should be invited to tender</td>
</tr>
<tr>
<td></td>
<td>responding to tenderers’ queries and requests for additional information</td>
</tr>
<tr>
<td></td>
<td>evaluating tenders (making the trade-off between price and quality if necessary)</td>
</tr>
<tr>
<td></td>
<td>awarding the contract</td>
</tr>
<tr>
<td>Managing</td>
<td>supervising pre-contract preparations</td>
</tr>
<tr>
<td></td>
<td>monitoring contractor performance in conjunction with service users</td>
</tr>
<tr>
<td></td>
<td>liaising with the contractor over performance and variations in service requirements</td>
</tr>
<tr>
<td></td>
<td>supervising contract payments and ensuring budgetary control</td>
</tr>
<tr>
<td></td>
<td>managing default and penalty point systems</td>
</tr>
<tr>
<td></td>
<td>reporting to interested parties on contractor performance</td>
</tr>
<tr>
<td></td>
<td>terminating contracts either at the end of the contract’s duration or earlier, in the event of unacceptable performance</td>
</tr>
<tr>
<td></td>
<td>contingency and recovery planning</td>
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</tbody>
</table>
- If just components are to be offered, will these cover solely the work done centrally or include work that is devolved?
- If devolved work is being offered, will it be in user-based packages?
- Should contracts combine more than one financial service (for example, creditors and payroll)?

◆ Financial services/IT packaging:
- Should contracts integrate finance and IT, or should they solely cover financial services?

◆ Financial services/other designated services packaging:
- How should finance contracts link with contracts for other designated activities, in particular housing management?

4.29 In packaging financial services, authorities should balance opportunities for synergy (and consequent cost or service improvement) against the need to avoid anti-competitive behaviour. Districts that have secured cost reductions in payroll and creditors through multi-tasking, for example, may wish to combine these services in a single contract. On the other hand, larger authorities wishing to expose accountancy support services to competition might consider packaging the work into a series of smaller contracts. This would give small firms the chance to provide accountancy support to a single service department or group of service departments.

4.30 Authorities must also decide on financial services and IT purchasing. In doing so, they should be mindful of issues around price, service, accountability and anti-competitive behaviour. Given the centrality of IT to most financial support services, the pros and cons of separate and integrated contracts largely come down to cost considerations (Exhibit 4.3). Provided that authorities are not locked into lengthy and inflexible IT leases (or do not own IT assets with a high residual value), they should consider contracts that integrate IT and finance unless they have compelling evidence that separate contracts will enable overall costs to be reduced. If an integrated finance/IT contract is offered and the work goes to a private supplier, there is a danger that in-house IT provision for other services will become less viable. Authorities should therefore develop contingency plans for dealing with this eventuality. This will be of particular importance to district councils exposing their tax collection services to competition.

4.31 Finally, authorities should consider whether they wish to integrate finance work with tenders for other designated services. Government guidance gives authorities the opportunity to postpone the tendering of housing-related financial support services until the deadline for housing management, where the latter follows the deadline for financial services. In addition, there are arguments for integrating relevant financial support services, such as creditor payments and budgetary control, with aspects of construction-related services. In this and in all other considerations on packaging, authorities need to be mindful of DoE guidance on anti-competitive behaviour.
Specifying

4.32 Once packages have been selected, authorities will need to develop service specifications. There may be a need to specify across all four dimensions of a service: inputs, processes, outputs and outcomes. As far as possible, specifications should be output and outcome-based, referring to service standards (see Section 4). However, for professional services such as accountancy and internal audit an entirely output-based approach may not be feasible. Here, authorities have two choices:

- include input clauses within the specification – for example, the extent of staff experience and qualifications and possibly guidance to contractors on the volumes of inputs (in terms of staff days);
- require tenderers to submit method statements that detail the inputs and processes they will deploy in order to deliver the required outputs.

4.33 Early thought should also be given to quality standards, both in terms of the required outputs and the procedures that contractors will be required to follow in order to deliver them. Authorities should make use of the guidance produced by the Local Government Management Board and the local authority associations on quality issues (Ref. 18).
Lessons from voluntary contracting authorities

4.34 Some of the lessons learnt by authorities that have already contracted on a voluntary basis will be of relevance to authorities facing compulsory competition. They fall into two categories: reviewing requirements, and ensuring requirements are met. When reviewing requirements, the following lessons are pertinent:

- **Reliable information on levels and volumes of service is necessary** as the basis for any specification. Failure to gather this data may lead to additional expenditure in variation orders or in over-payments to the contractor.
- **Service users should be consulted on the content of the specification.** Particular attention should be paid to areas of divergence between different users’ requirements and the way in which these might be overcome (for example, through negotiated compromise or through the inclusion of a menu of variations).
- **All requirements should be included within the specification.** For example, specifications for exchequer services should include not merely the basic service of paying employees and suppliers but also the provision of management information to users and financial information for the authority’s general ledger. (Requirements for the latter will probably include the form in which the information must be supplied.)
- **Authorities should make any policy changes on volumes before releasing the specification to potential tenderers.** This will ensure that the authority, and not the contractor, secures the benefit from service reductions. For payroll, such policy changes could relate to a review of cash or weekly payments, based on broad volume bands.

4.35 To ensure that service requirements are met, authorities that have voluntarily contracted out have employed a range of techniques and tactics. These include:

- retaining as much flexibility as possible for the authority within the contract – for example, through a requirement on tenderers to submit prices for different volume bands. This allows an authority to vary contract payments if volumes fall (and, although less likely, if volumes rise);
- drawing up clear guidelines on IT responsibilities for security – ensuring that the information loaded onto the system is adequately secured against inadvertent or deliberate loss or misuse;
- having clear guidelines for upgrades to IT hardware and software – ensuring that maximum benefit is obtained from technological developments over the life of the contract and that upgrades allow information to be transferred between different systems;
- setting out clear criteria for service failure and contract termination – allowing a poor performing contractor to be removed with minimum difficulty and for the authority to retain ownership of data.
Other contractual issues

4.36 Authorities should also address the possibility of contractor liquidation. Although proper assessment at the stage of issuing invitations to tender should minimise the likelihood of liquidation occurring, such a risk can never be eliminated entirely and so authorities should formulate contingency and recovery plans to be put into operation if disaster strikes. These plans should include clauses in the contract conditions to ensure the authority retains ownership of data and to allow it access to databases and other sources of information. They may also include the identification of reserve contractors.

4.37 In preparing specifications and associated contract documentation, authorities will need to consider the implications of the Transfer of Undertakings (Protection of Employment) (TUPE) regulations. There is a danger of overestimating the significance of TUPE: it will not guarantee in-house success, deter private firms or protect staff conditions in perpetuity. But it imposes upon authorities a series of obligations:

- A preliminary decision should be reached on the applicability of TUPE in advance of issuing the contract documentation – and, given the tortuous nature of the issue, this decision should be made after legal advice.
- The decision should be made clear within the contract documentation.
- If TUPE is felt to apply, then appropriate data on staffing conditions and costs should be made available to potential bidders.
- The implications of TUPE for tender evaluation purposes (for example, the non-relevance of redundancy costs if TUPE is found to apply) should be taken into account.
- In the event of transfer, authorities should satisfy themselves that the new employer has comparable pension arrangements. This may require independent actuarial advice.

4.38 If authorities decide to outsource, they must address the approach to outsourcing in their specification. Authorities have two options:

- **Host site outsourcing** – they can contract with a single firm that takes over the authority’s staff and IT facilities and operates on-site at the authority; the firm uses the facilities and the staff to meet the authority’s requirements and uses spare capacity for other clients.
- **Marginal capacity** – they can wind down their in-house sections, and buy the spare capacity of other ‘host site’ firms. The authority could obtain its requirements from a single firm’s spare capacity or through buying slivers of capacity from a number of firms. This approach has been adopted by some London authorities for their payroll requirements.
4.39 Authorities should explore the pros and cons of each approach (Exhibit 4.4), focusing in particular on the tension between service costs and purchasing overheads, as lower service costs may only be achievable by spending more on the client effort required to purchase the service. Neither strategy can be right for all authorities at all times, because not everybody can be a host site. Accordingly, authorities will need to consider not merely their own preferences but also whether there is any interest from the private sector in absorbing a further amount of service capacity.

Evaluating

4.40 In evaluating competing bids, authorities will be able to apply the many lessons learnt from blue-collar CCT. However, the extension of CCT to professional services will bring a new challenge: how to make the trade-off between price and quality. In this, authorities will find the guidance on quality issues from the Local Government Management Board and the local authority associations (Ref. 18) of general assistance. Forthcoming finance service-specific guidance from CIPFA (Ref. 19) should also be of use. Throughout, authorities will need to be mindful both of the EC services directive and any additional guidance from the DoE on anti-competitive behaviour in this area. In addition, the following guidelines should be observed:

- authorities should decide how the emphasis on quality is divided between the evaluation of potential tenderers at selection stage and the evaluation of bids;

Exhibit 4.4

Outsourcing – host site or marginal capacity?

Authorities should explore the pros and cons to each approach...

<table>
<thead>
<tr>
<th>Host site</th>
<th>Authority contracts with single firm that takes over IT and staff and operates from authority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marginal capacity</td>
<td>Authority buys from several contractors each of which are utilising spare capacity and operating from different sites</td>
</tr>
</tbody>
</table>

**Pros**

- **Host site**: Security of supply, Low client workload, Protection of in-house staff through TUPE
- **Marginal capacity**: Lower price, Diversity of contractors

**Cons**

- **Host site**: Higher price, Reliance on a single contractor
- **Marginal capacity**: Less secure supply, Higher client workload, In-house staff redundant if TUPE does not apply

Source: Audit Commission
• authorities should draw up evaluation procedures, which should include methods for evaluating quality and balancing price and quality, **before** receiving the tenders (Box 4.C, overleaf);

• provided that minimum quality requirements (such as a given level of professionally qualified staff) are met, the bulk of the quality evaluation should be driven by an assessment of method statements. Again, advice on this subject from CIPFA’s Competition Joint Committee (Ref. 20) should be of use.

Managing contracts

4.41 Once the work has been awarded and the necessary pre-contract preparation completed, authorities will face the challenge of managing the contract. Valuable lessons from the management of blue-collar contracts have been summarised in the Audit Commission’s bulletin, *Making Markets* (Ref. 21). Further lessons have emerged from authorities that have voluntarily tendered financial services.

• There is a need for **regular and effective communication** between the client, the provider and service users to identify problems (especially those that relate to unclear responsibilities) and develop action plans to improve performance. In this area, authorities can learn from the good communication techniques employed by Hertfordshire County Council (Case Study 4.4, overleaf);

• Good practice involves **keeping client monitoring costs** to a minimum by involving service users (of particular relevance for transaction-based services) and using information on performance generated by provider management systems;

• An essential role for the client monitoring staff is to **produce timely and relevant reports**, which summarise performance with key indicators (relating to output-based service standards) and are circulated to users, members and, where appropriate, corporate management bodies;

• Client staff need to use monitoring data to generate **proposals for change** when reviewing the service at the end of the contract period.
1. **Determine the list of quality criteria to be considered**
   - Refer to specification requirements – all factors in quality evaluation should tie back to provisions in contract documentation
   - Refer to EC criteria for selecting the most economically advantageous tender
   - Decide whether accreditation (for example, ISO9000/2 or equivalent) is to be a criterion

2. **Construct a model for quality evaluation.**
   - Adopt scoring system for criteria (for example, a mark out of 3 or 5)
   - Weight criteria to allow an overall mark
   - Decide how each criterion is to be evaluated (for example, consideration of method statement, CVs, documentation in support of tender, references, interviews, visits to contractor sites)
   - Decide what (if anything) will disqualify a tenderer because it pushes them below the authority’s quality threshold - for example, failure on any one of a series of key quality criteria, or against more than a given number of criteria, or less than a certain overall score

3. **Open tenders and gather the necessary information**
   - Are tenders complete?
   - Do questions need to be asked to clarify aspects of any or all bids?
   - Will there be presentations and interviews? If so, how are these to be recorded?
   - Is there a need for visits to sites where the contractor is currently working? If so, how are these to be recorded?

4. **Evaluate quality using the model and give each surviving bid a quality mark**

5. **Establish the price of each surviving bid.**
   - Refer to Local Government (DSOs) (Competition) Regulations 1993 (SI8484)
   - If appropriate, take into account redundancy costs, the costs of trainees and disabled staff, and the use or non-use of IT and accommodation assets

6. **If the cheapest surviving bid is not the best quality, make the trade-off**
   - The four principal options are:
     - accept the cheapest bid that is adequate, in terms of quality, for the authority’s purpose
     - discount the price of each tender to reflect the quality of the bid
     - using a predetermined weighting of price and quality and a formula for scoring price, construct a single combined score and award the contract to the bid with the best score
Background:
Hertfordshire’s payroll, creditor payments and sundry debtors services, along with a number of other services, are provided under contract by ITnet. Service departments submit the necessary documentation (i.e. invoices or amendments to standing data) to allow ITnet to produce the required outputs and update the financial accounts. ITnet report their performance, against set targets, on a monthly basis to a corporate client officer.

The problem:
One of the monthly performance reports submitted by ITnet to the corporate client officer showed the level of uncoded payroll costs to be approaching £1m. In most cases, the department incurring the costs could be identified, but not the actual cost centre. Although just over 50% of this total related to one department, uncoded costs were identified for most of the other county departments. In the same month, approximately two-thirds of all payroll amendment forms submitted by departments to ITnet for processing did not show the cost code.

The solution:
ITnet and the corporate client officer organised a seminar for all departmental staff involved in payroll amendments (about 50 employees). This included both front-line users and service department finance staff. Following an introduction from ITnet’s manager outlining the purposes of the seminar, all those present divided into smaller syndicate groups to discuss what they thought was causing the problem and potential ways of overcoming the problem.

The main issue arising was a confusion as to who was responsible for putting the cost code on amendment forms in the first place – front-line users or service department finance staff – and who was responsible for finding out the codes if they were not entered – service department finance staff or ITnet.

The results of this seminar were:
◆ revised procedures outlining clearly the responsibilities of service departments and ITnet;
◆ a review of progress with service departments was carried out after six months;
◆ the review led to a payroll working party being formed to meet monthly. Membership is drawn from service departments, ITNet and the corporate management team and reports quarterly to SLA holders.

Case Study 4.4
Effective relationships – Hertfordshire County Council

Authorities should:
◆ determine their approach in advance of receipt of tenders
◆ inform contractors in advance of the evaluation approach
◆ whichever option is adopted, ensure that proper records and documentation are kept to support and justify the decision

Section 4 Responding to CCT
Effective client functions – a suppliers’ perspective

4.42 The client role can be discharged most effectively if the authority understands the need for partnership between client and supplier (whether in-house or private) in order to meet defined authority objectives. This partnership model highlights the need for clarity in setting objectives, flexibility in the methods and tactics that can best achieve these objectives, and commitment to developing effective working relationships. In such a partnership, the client needs to appreciate the supplier’s perspective on what helps to deliver effective results (Box 4.D).

Provider-side issues

4.43 Many in-house providers will need to undergo a profound change in their attitudes and culture if they are to respond effectively to the changing environment for financial services, and especially the challenge of CCT. This change can be summarised as a move from administration to management (Ref. 22). Successful in-house providers will adopt those private sector practices that will help them win contracts and meet user needs, while retaining the public service ethos that has always been the hallmark of the best local authority financial support services. Most of the necessary changes are outlined in Section 2. However, there are four challenges that relate specifically to the tendering process and the submission of bids.

Box 4.D
What makes a good client – a private supplier’s perspective

- Hold meetings with potential contractors before formal tender stage – to discuss approach, form of specification, contract length, etc.
- Be clear about objectives for contracting – what does the authority want, for example, must all aspects of a service be on-site, or is a mere ‘front of house’ presence sufficient?
- Be flexible about working methods and approaches – give contractors freedom provided that their proposals can achieve the stated objectives
- Write output-based specifications
- Allow flexibility over the life of the contract – to encourage innovation in technology or service delivery
- Use method statements to evaluate suppliers – but do not ossify arrangements by a contractual requirement to enforce the method statement over the contract’s duration
- Guard against client units having a direct role in service delivery – leave service delivery to the contractor
- Review the need for in-house internal audit to check contractor systems – with clear PIs, reporting systems and penalties for failure, such audit checks are rarely necessary
- Keep contract lengths flexible – for example, four years with the opportunity to extend by one to two years
- Allow a start-up period of at least three months – to help the contractor get everything in place for the formal contract commencement
4.44 Providers should analyse their potential competitors. This should involve not merely attempts to identify commercial rates for work (such as the private sector costs quoted in chapters of Section 3), but also an analysis of what lies behind the rates – namely the sources of potential competitive advantage (Box 4.E). Working out which of these potential advantages can be matched or countered will help providers prepare for competition.

4.45 Providers must respond to the specification that is laid down, and no more. There are two reasons for this. Firstly, clients will have reviewed requirements when developing the specification: what is specified may not accord with previous practice. Secondly, private bidders will only respond to what is specified: accordingly, providers may be placing themselves at a price disadvantage if they do not follow suit. Several examples were given by fieldwork authorities of their bids for college and GM school work being

<table>
<thead>
<tr>
<th>Box 4.E</th>
<th>The private sector’s potential advantages</th>
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<tbody>
<tr>
<td>Cultural</td>
<td>♦ Greater focus – transaction services are the company’s core business</td>
</tr>
<tr>
<td></td>
<td>♦ Less political pressure from authority members</td>
</tr>
<tr>
<td></td>
<td>♦ Less organisational ‘politics’ – so fewer distractions</td>
</tr>
<tr>
<td></td>
<td>♦ Stronger motivation – contract payments involve ‘real’ money, not just internal transfers</td>
</tr>
<tr>
<td>Economic</td>
<td>♦ Access to greater scale – allowing better utilisation of IT</td>
</tr>
<tr>
<td></td>
<td>♦ Can spread other overheads over a potentially wider base</td>
</tr>
<tr>
<td></td>
<td>♦ Resources for IT investment more easily accessible than for LA in-house sections</td>
</tr>
<tr>
<td>IT</td>
<td>♦ Close working with IT suppliers to develop tailored applications</td>
</tr>
<tr>
<td></td>
<td>♦ Spot buying of IT processing capacity, because not locked in to a single supplier</td>
</tr>
<tr>
<td></td>
<td>NB – significant use of innovative IT not a likely part of firms’ competitive strategy</td>
</tr>
<tr>
<td>Managerial</td>
<td>♦ Single site operations delivering a range of contracts</td>
</tr>
<tr>
<td></td>
<td>♦ Sharing innovations between different contracts and different sites</td>
</tr>
<tr>
<td></td>
<td>♦ Flatter management structures than local authorities</td>
</tr>
<tr>
<td></td>
<td>♦ Lower levels of absence (especially sickness) than local authority in-house sections</td>
</tr>
<tr>
<td></td>
<td>♦ Flexible staffing – all staff interchangeable between functions</td>
</tr>
<tr>
<td></td>
<td>♦ Individual pay awards – no pay scales or across-the-board pay awards</td>
</tr>
<tr>
<td></td>
<td>NB – lower pay rates not necessarily a part of firms’ competitive strategy</td>
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</tbody>
</table>
undercut by private suppliers because in-house bids were based on historic service levels, whereas companies had bid simply to meet the lower specifications issued by colleges and schools.

4.46 **Providers must base their bids on an understanding of how costs behave over different volumes, and of how volumes might vary.** Many contracts are likely to consist of a specification for which a single price (or ‘lump sum’) will be required, along with a schedule of additional requirements, which will be priced on a unit basis. Providers must be able to price each of these elements accurately, so they will need information (probably from timesheets) to identify the amount of staff time necessary to undertake different components. Moreover, if clients follow the advice given above on specifications, providers will be required to submit a range of prices for different volumes. This will require an understanding of which costs are fixed, which are semi-fixed and which are completely variable, and from this, how overall costs will vary as volumes rise or fall. Simple PC-based financial models should be sufficient for this work.

4.47 **When putting together the documented tender submissions to support their price bid, providers should ensure that submissions help, rather than hinder, their chances of success.** Analysis of successful tenderers, including Bolton’s payroll section and Surrey’s payroll and internal audit sections, suggest the following:

- emphasise the strengths of in-house operations – primarily, the intimate knowledge of the authority and of users’ requirements;
- where the specification is output-based, focus most effort on writing the method statement;
- recognise the importance of presentation and produce attractive, easy-to-read documents – both in relation to tender submissions and any supporting documentation, such as promotional brochures that detail the range and menu of services on offer;
- extract lessons from previous experiences, for example, in bidding for work at GM schools and colleges.

4.48 **These and other lessons are borne out by the experience of in-house providers that have been successful in voluntary competitive tendering.** Southwark’s revenues and benefits section, for example, won the work in voluntary competition in 1994. Although much of the reason for their success can be put down to efficiency and cost reduction measures, their approach to costing the stated client requirements and submitting a bid was an important ingredient in their success (Case Study 4.5).
In the 1993/94 financial year, the London Borough of Southwark exposed collection of local taxes and benefits administration to voluntary competition under a single contract. Bids were received from two major private firms and the in-house section. The contract was awarded to the in-house section which, although slightly more expensive than the lowest private bid, was deemed to be of sufficiently higher quality to justify retention in-house.

The keys to in-house success were:

- in addition to two major staff reviews in 1991 and 1992, the in-house section undertook a further comprehensive review of its processes and staffing levels before submitting a bid. This review was informed by productivity and staff mix benchmarks obtained through the gathering of market intelligence;
- duplication and surplus activities were eliminated, and workloads rearranged to ensure a more appropriate fit between the grades of staff and their duties. Accuracy targets of processing staff were increased;
- the in-house organisational structure was reviewed, allowing a 25 per cent reduction in the number of sections and the consequent removal of management posts;
- not all improvements were incorporated into the price for the first year of the contract. The tender submission was based on a commitment to achieve further reductions in staffing levels after the first year of operation, with a consequent reduction in contract price for subsequent years;
- considerable attention was paid to quality in the tender submission, with emphasis placed on procedure manuals and evidence of the improvements in performance that had recently been achieved.
# Good practice checklist

## Strategic issues

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<tbody>
<tr>
<td><strong>1</strong></td>
<td>Can you produce full details of your authority’s financial services portfolio – the individual services it contains, and how much is spent on each?</td>
</tr>
<tr>
<td><strong>2</strong></td>
<td>Can you calculate your authority’s specified proportion for finance services?</td>
</tr>
<tr>
<td><strong>3</strong></td>
<td>Do you have a method for developing a procurement strategy, which can determine when these services are to be kept in-house, when exposed to competitive tendering with an in-house bid, and when outsourced?</td>
</tr>
<tr>
<td><strong>4</strong></td>
<td>Is your method based on clear criteria, such as service significance, specifiability and issues of competitiveness?</td>
</tr>
<tr>
<td><strong>5</strong></td>
<td>Have you applied this method and reached decisions on which financial services or their component parts are to be exposed to competition?</td>
</tr>
<tr>
<td><strong>6</strong></td>
<td>Do these decisions allow you to meet the specified proportion for CCT, after approved credits have been taken into account?</td>
</tr>
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</table>

## Client-side issues

### Organising:
- Have you designated staff to undertake the client role?
- Will these staff be organised into a single ‘client agent’ section or will they be spread across the finance department and service departments?
- How will the s151 officer vet specifications?
- Who will co-ordinate CCT efforts to ensure that the statutory target is met?
- Do you know what you currently do – in particular, do you have access to accurate information about levels and volumes of service?
2 Packaging:

◆ Have you decided how financial services work should be packaged into contracts?
◆ Should the packages include or exclude IT?
◆ What should be the links between financial service contracts and contracts for other designated services, especially housing management?

3 Specifying:

◆ What balance will be struck in your specifications to inputs, processes, outputs and outcomes?
◆ Have you included all your requirements in the specification, i.e. have you considered all outputs?
◆ If you have decided to make policy changes that will impact on service volumes, have you reflected these within the specification issued to tenderers?
◆ If volumes are likely to vary, have you asked tenderers to submit prices for different volume bands?
◆ Does your specification allocate responsibility for IT security and IT upgrades?
◆ Does your specification contain clear criteria for service failure and contract termination?
◆ Have contingency and recovery plans been developed and are they supported by appropriate conditions in contract documentation?
◆ Have you considered the implications of TUPE, and have these been followed through in your specification?
◆ If outsourcing, have you decided whether to seek the transfer of your facilities to an on-site contractor, or do you wish to remove your in-house section and purchase capacity from other suppliers?

4 Evaluating:

◆ Have you developed tender evaluation procedures?
◆ How will you evaluate quality, both at the stage of selecting firms for invitation to tender and at the stage of tender evaluation?
◆ How will you balance price and quality considerations?

5 Managing contracts:

◆ What structures will you establish for regular and effective communication between the client, the provider and service users?
◆ How will you involve service users in contract monitoring?
◆ In what form will the client report on performance, and to whom?
### Provider-side issues

<table>
<thead>
<tr>
<th></th>
<th>Question</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Have you analysed the sources of competitive advantage amongst your potential competitors?</td>
</tr>
<tr>
<td>2</td>
<td>Have you based your bid on the requirements of the specification, as opposed to the service you have traditionally provided?</td>
</tr>
<tr>
<td>3</td>
<td>Does the client require you to tender for different volumes and if so, have you considered how volumes might vary over time?</td>
</tr>
<tr>
<td>4</td>
<td>Have you identified which of your costs are fixed, and over what timescale?</td>
</tr>
<tr>
<td>5</td>
<td>Have you modelled these factors to inform your pricing decisions?</td>
</tr>
<tr>
<td>6</td>
<td>Does your bid emphasise what you see as the strengths of the in-house service?</td>
</tr>
<tr>
<td>7</td>
<td>Have you given due attention to writing your method statement as well as to setting your price?</td>
</tr>
<tr>
<td>8</td>
<td>Is your tender submission attractively presented and easy to read and understand?</td>
</tr>
<tr>
<td>9</td>
<td>Have you extracted all relevant lessons from any previous attempts to bid for financial services work – for example, for colleges or GM schools?</td>
</tr>
<tr>
<td>10</td>
<td>Have you reviewed your service to identify all improvements in organisation, cost and performance (see Sections 2 and 3)?</td>
</tr>
</tbody>
</table>
A Service definitions for financial support services
B Calculating service benchmarks
C The use of NRE+HRA as the denominator for certain indicators and benchmarks
D The methodology used to measure service standards for accountancy/internal audit
Appendices  Good practice checklist

Appendix A  Service definitions for financial support services

Service definitions for financial support services

For the purposes of this study, the six financial support services under review are defined as comprising the following activities and tasks. These activities and tasks may be carried out within either a Finance department section or in service department support units. DLOs and DSOs are treated as service department(s).
Appendices  Good practice checklist

Appendix A  Service definitions for financial support services
payroll types
For the purposes of this study, information was requested across eight payroll types:

(i) APT&C (including any external or voluntary bodies);
(ii) Police;
(iii) Fire;
(iv) Pensions;
(v) Manual employees;
(vi) Teachers;
(vii) Supply teachers claims; and
(viii) any other claims or administered schemes that are paid through the payroll system (e.g. Members Allowances, Car Loans scheme).
Creditors Payments Types

The above activities and tasks relate to the following creditor payments categories:

- supplier invoices;
- contract payments;
- car allowances;
- leased property rents;
- child care allowances;
- petty cash claims;
- expenses (members and officers);
- relocation expenses; and
- miscellaneous payments.

However, for analysis purposes, the study grouped these categories into three types:

- regular (or normal) payments;
- periodic payments; and
- urgent (same day) payments.

Note:

Housing Benefits payments are excluded.
Debtor Types

For the purposes of this study, the major types of sundry debtor are:

◆ commercial rents;
◆ recoupment; and
◆ other debtors (including, mortgages, excess charge notices (ECNs), other rents, trade refuse, hiring charges, planning applications and building regulations (if applicable), specific social services charges, and other miscellaneous charges).
Cashiers Services
The service covers all over-the-counter receipts at cashiers outlets (including housing rent income, Council Tax and NNDR where appropriate). In addition, the service covers dealing with postal payments and counting and banking cash income.

For analysis purposes, the study identifies four types of receipt:
- Postal Receipts;
- Counter Receipts;
- Standing Orders & Direct Debits (S/O & D/D); and
- Post Office & other non-authority collection points.

Note: till in leisure facilities are not included.
Appendices

Appendix B

Calculating service benchmarks

The purpose of this appendix is to explain the basis on which the figures in this handbook have been calculated. Authorities wishing to compare themselves with the benchmarks should use this appendix to ensure that the comparison is on a like with like basis.

Function definitions
The definitions detailed in appendix A were contained in each questionnaire. Sample authorities were asked to record their staffing levels and other costs according to these definitions.
The questionnaires for each of the six financial support services asked authorities to indicate details of any additional work undertaken by staff delivering that support service, including details of the proportion of staff time spent on these additional activities. These proportions were deducted from the staffing and cost figures to ensure like with like comparisons.

Costs

Financial year
The figures in the report are based on 93/4 actual expenditure.
Where authorities undertook significant organisational changes that would make 93/4 information irrelevant for comparative purposes, 94/5 estimates (subject to a deflating factor) were used.
In addition, most authorities recorded expenditure on IT and accommodation in 93/4 on a historic cost basis: the figures resulting from this approach have been replaced with estimates of what the 93/4 charges would have been under the new approach to asset accounting (outlined in the capital accounting provisions of the CIPFA Code of Practice on Local Authority Accounting).

Staffing costs
Survey authorities were asked to include in their returns the numbers and costs of all staff spending 50% or more of their time on finance functions (note that 50% could equate to 10% on payroll, 20% on creditor payments and 20% on sundry debtors), whether based in a central department or in service departments. Only those staff employed whole-time in schools were excluded. The exercise was relatively straightforward for most finance departments, but often required extensive questioning of service departments to identify the full complement of finance staff: not all staff working 50% or more of their time on finance functions were employed at the centre of service departments.
The proportion of senior finance staff time that, under the CIPFA regulations on accounting for support services, is charged to 'corporate management' has been excluded from the figures.

**Asset costs (IT and accommodation):**
As mentioned above, authorities were asked to state these on a basis consistent with the new capital accounting provisions. In effect, this allowed four options:
(a) if accommodation is rented, the annual rent;
(b) if the asset has been acquired under an operational lease, the average cost over a five year period (regardless of the actual lease period);
(c) & d) if the asset has been required under a finance lease, then either:
- a depreciation charge over the useful life of the asset plus a 6% interest charge on the value of the asset, or
- a market rent.

**Other costs**
These include all non-staffing costs other than IT or accommodation. They cover finance section running costs (such as printing, stationery, telephones, postage and bank charges) and charges from other central support services such as legal or personnel.

**IT/Accommodation/other costs in service departments:**
Authorities were asked to provide full details of all non-staffing costs, for service department finance sections as well as for a central finance department. Where an authority was unable to provide these figures for service department finance sections, similar overhead rates were applied to those borne by the central finance section.

**Indicators**

**Accountancy available days:**
This was calculated by allowing 260 days for each recorded accountancy FTE, then deducting 55 days for annual leave, bank holiday leave, special leave, other absences and training (not all authorities were able to submit a return for training days). The figure of 205 days per FTE was then adjusted for the average level of sickness per accountancy FTE (both central and service department accountancy staff) in that authority.

**Internal audit chargeable days:**
Survey authorities were asked to submit full details of their internal audit plans for 94/5. After making the above deductions, plus further deductions for planning, management and other time, all authorities were able to identify a total amount of chargeable days. To convert the figure into a per head figure, the total was divided by the number of FTEs.
**Payroll cost per authority employee**
Generally, it proved straightforward to identify the number of employees in each authority. The most difficult categories were supply teachers and other claims processed via the payroll since these do not translate straightforwardly into employee numbers. For these categories, payments were multiplied to create `employee equivalents': so, with supply teachers, if the staff are paid monthly and 1,200 payments to supply teachers were made in a year, then the authority was assumed to have 100 supply teacher `employees'.

**Payroll – cost per payslip**
The number of payslips was obtained by adding:
- the average number of monthly paid staff multiplied by 12;
- the average number of four-weekly paid staff multiplied by 13;
- the average number of fortnightly paid staff multiplied by 26;
- the average number of weekly paid staff multiplied by 52; and
- the total number of supply teachers and other claims.

**Creditors**
The denominator is the number of invoices processed, not the number of payments.

**Debtors**
The denominator is the number of sundry debtor invoices (whether raised by a central debtors section or by service department-based debtors staff) – this includes invoices to other authorities for education recoupment income.

**Cashiers**
The denominator is the total number of receipts, not merely the number of over-the-counter receipts.
Appendices

Appendix C

A note on the use of NRE/HRA as the denominator for certain indicators and benchmarks

Net revenue expenditure plus gross rental income from an authority’s Housing Revenue Account (NRE plus HRA) has been selected as the denominator for a number of indicators used in this handbook, including the top level indicator of FSS expenditure per £m NRE+HRA in section 1 and the headline indicators for accountancy and internal audit of spend per £m NRE+HRA.

There are four significant ways in which this may not be the ideal denominator for comparative purposes:

(a) some aspects of the six services under review will be influenced by income (e.g. the level of internal audit days will be higher in authorities with a significant cash income from local service provision, such as seaside authorities);

(b) tax collection responsibilities will create an additional workload for the accountancy and internal audit functions, which will drive up costs for non-county authorities and therefore make overall comparisons less valid;

(c) the denominator does not reflect the work undertaken by financial support services in pursuit of additional sources of income, such as City Challenge/SRB funding and EC grants; and

(d) authorities with a similar NRE+HRA may have widely differing needs for financial support services, in particular because of the differences in provision that NRE+HRA may hide. Most importantly, an outsourcing authority may have an identical NRE+HRA to an authority that has kept all services in-house, but the latter is likely to incur higher financial support service costs because of the demand from its DSOs for financial support.

These are arguments for treating the headline analyses with care, and not drawing rash conclusions. Indeed, one of the strengths of the cost tree approach adopted throughout this handbook is that it allows an enquiring authority to explore in depth the reasons for cost variation. An authority with high levels of in-house provision may score highly on the single headline indicator of total FSS expenditure per £m NRE/HRA but be revealed to enjoy competitive costs for the transaction-based services when the denominator of employees or invoices is used. Importantly, the extent of in-house provision has a far stronger influence on payroll and creditors payments costs than on accountancy or internal audit – the latter being the
only two services where NRE/HRA continues to have an important role to play in detailed cost analysis. This suggests that the ‘DSO criticism’ (point d) above) is not as powerful as may have first appeared to be the case.

In accountancy and internal audit, the indicator of available days per £m NRE+HRA is offered as a starting point, to stimulate analysis and reflection. There may be factors, such as those mentioned above, that place upward pressure on the levels of accountancy and internal audit and are not reflected in NRE+HRA. Provided that these factors are genuinely the causes of higher volumes and are not being used as a smokescreen to mask some of the other causes of high volumes identified in section 3, then there is no overwhelming argument for an authority to reduce its accountancy or internal audit provision.

These criticisms and caveats should not lead authorities to assume that NRE+HRA is inappropriate as a denominator. Although not ideal, it can be shown to be superior to the other obvious candidate for headline comparisons, namely gross expenditure. Using gross expenditure would involve taking all income into account, and much of authorities’ income (particularly transfer payments) does not drive any expenditure on financial services. The notional ‘ideal’ denominator, which would reflect those aspects of income that drive FSS expenditure whilst ignoring those that do not, would only be achievable through making a series of adjustments to authorities’ gross income (a time consuming process) and would not have the advantages of accessibility and familiarity that using NRE+HRA brings.

In conclusion, as with all comparative analysis, caution and care is advised. NRE+HRA-based comparisons, on their own, will not reveal all the salient considerations. But a combination of NRE+HRA-based indicators and other indicators and analysis, as suggested in the sections of section 3, should allow authorities to gain powerful insights into the health of their financial support services performance.
Methodologies for assessing accountancy and internal audit standards

Service standards have been assessed for accountancy and internal audit in sample authorities using a weighted basket of criteria leading to a single standards score (scores are shown in brackets). Performance against some criteria (marked with an asterisk) has been evaluated by authorities’ external auditors to provide a dispassionate assessment. The criteria adopted are:

for Accountancy, 11 criteria covering

- **timeliness** – the ability to submit accounts for audit by the 30 September deadline (max. 4)
- **accuracy** – the extent of errors identified by external audit in authorities’ accounts (max. 4)
- **accuracy** - the existence of material errors in authorities’ accounts (max. 4)
- **quality of output** – the standard of final accounts working papers (max. 3)*
- **quality of output** – the standard of grant claims submitted for audit (max. 3)*
- **quality of input** - the level of qualifications and experience of accountancy staff (max. 3)*
- **quality of input** – the nature and level of training given to accountancy staff (max. 3)*
- **service delivery** – the effectiveness of relationships between accountancy staff and service managers (max. 3)*
- **timeliness of information** – the promptness with which standard budget reports are distributed to service managers following the month end (max. 3)
- **accuracy of information** – the speed with which an authority’s general ledger is updated to reflect committed and incurred expenditure (max. 2)
- **accuracy of information** – the existence of a commitment accounting facility (max. 1)

Maximum score available is 33.

for Internal Audit, 13 criteria covering

- **independence** – the access internal audit has to the authority’s records (max. 3)*
- **quality of input** - the level of qualifications and experience of internal audit staff (max. 3)*
quality of input – the nature and level of training given to internal audit staff (max. 3)*

service delivery – the appropriateness and effectiveness of internal audit’s relations with service departments (max. 4, of which 3*)

audit methodology – the procedures in place to ensure that individual audits are properly planned, controlled, recorded and evaluated (max. 6)*

audit methodology – the procedures in place to ensure that the findings from individual audits are based on sound evidence (max. 3)*

Internal Audit (cont.)

audit methodology – the procedures in place to ensure that audits are undertaken with due care (max. 3)*

planning - the existence of both annual and strategic audit plans (max. 4)

risk assessment – the existence and use of a rigorous risk assessment methodology to effectively plan audit coverage (max. 10, of which 3*)

flexibility - the existence of a contingency budget and the ability of internal audit’s to bring in additional resources when required (max. 2)

timeliness of output – the procedures in place to ensure that audit findings are reported promptly (max. 5)

quality of output – the appropriateness of audit recommendations (max. 3)*

quality of output – the procedures in place to ensure the timely follow-up of recommendations (max. 3)*

Maximum score available is 52.
### Counting Down to Competition

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Service definitions for financial support services

For the purposes of this study, the six financial support services under review are defined as comprising the following activities and tasks.

These activities and tasks may be carried out within either a finance department section or service department support units. DLOs and DSOs are treated as service department(s).
Appendix A  Service definitions for financial support services
Appendices

Appendix A  Service definitions for financial support services
Calculating service benchmarks

This appendix explains the calculation of the indicators used in this handbook. Authorities wishing to compare themselves with the benchmarks should use this appendix to ensure that the comparison is on a like-with-like basis.

Function definitions

The definitions detailed in Appendix A were used in each questionnaire. Sample authorities were asked to record their staffing levels and other costs according to these definitions.

The questionnaires for each of the six financial support services asked authorities to provide details of any additional work undertaken by staff delivering that support service, including the proportion of staff time spent on these additional activities. Unless otherwise stated in Section 3, these proportions were deducted from the staffing and cost figures to ensure like-with-like comparisons.

Costs

Financial year

The figures in the report are based on 1993/94 actual expenditure.

Where authorities undertook significant organisational changes that would make 1993/94 information irrelevant for comparative purposes, 1994/95 estimates (subject to a deflating factor of 2.5 per cent) were used.

In addition, most authorities recorded expenditure on IT and accommodation in 1993/94 on a historic cost basis: the figures resulting from this approach have been replaced with estimates of what the 1993/94 charges would have been under the new approach to asset accounting (outlined in the capital accounting provisions of the CIPFA Code of Practice on Local Authority Accounting).

Staffing costs

Survey authorities were asked to include in their returns the numbers and costs of all staff spending 50 per cent or more of their time on finance services (note that 50 per cent could equate to 10 per cent on payroll, 20 per cent on creditor payments and 20 per cent on sundry debtors), whether based in a central department or in service departments. Only those staff employed whole-time in schools were excluded. The exercise was relatively straightforward for most finance departments, but often required extensive questioning of service departments to identify the full complement of finance
staff: not all staff spending 50 per cent or more of their time on finance services were employed at the centre of service departments.

The proportion of senior finance staff time that, under the CIPFA regulations on accounting for support services, is charged to ‘corporate management’ has been excluded from the figures.

Asset costs (IT and accommodation):
Authorities were asked to supply asset costs on a basis consistent with the new capital accounting provisions. In effect, this allowed four options:
(a) if accommodation is rented, the annual rent;
(b) if the asset has been acquired under an operational lease, the average cost over a five year period (regardless of the actual lease period);
(c) & (d) if the asset has been acquired under a finance lease, then either:
   - a depreciation charge over the useful life of the asset plus a 6 per cent interest charge on the value of the asset; or
   - a market rent.

Other costs
These include all non-staffing costs other than IT or accommodation. They cover finance section running costs (such as printing, stationery, telephones, postage and bank charges) and charges from other central support services such as legal or personnel.

Accommodation and other costs in service departments:
Authorities were asked to provide full details of all non-staffing costs, for service department finance sections as well as for a central finance department. Where an authority was unable to provide these figures for service department finance sections, similar overhead rates were applied to those borne by the central finance section.

Indicators

Accountancy – available days
This was calculated by allowing 260 days for each recorded accountancy FTE, then deducting 55 days for annual leave, bank holiday leave, special leave, other absences and training (not all authorities were able to submit a return for training days). The figure of 205 days per FTE was then adjusted for the average level of sickness per accountancy FTE (both central and service department accountancy staff) in that authority.

Internal audit – chargeable days
Survey authorities were asked to submit full details of their internal audit plans for 1993/94. After making the deductions listed in the note above on accountancy available days, plus further deductions for planning, management
and other time, all authorities were able to identify a total amount of chargeable days. To convert the figure into a per head figure, the total was divided by the number of FTEs.

**Payroll – cost per authority employee**
Generally, it proved straightforward to identify the number of employees in each authority. The most difficult categories were supply teachers and other claims processed via the payroll since these do not translate straightforwardly into employee numbers. For these categories, payments were multiplied to create ‘employee equivalents’: so, with supply teachers, if the staff are paid monthly and 1,200 payments to supply teachers were made in a year, then the authority was assumed to have 100 supply teacher ‘employees’.

**Payroll – cost per payslip**
The number of payslips was obtained by adding:
- the average number of monthly paid staff, multiplied by 12,
- the average number of four-weekly paid staff, multiplied by 13,
- the average number of fortnightly paid staff, multiplied by 26,
- the average number of weekly paid staff, multiplied by 52,
- the total number of supply teachers and other claims.

**Creditors – cost per invoice**
The denominator is the number of invoices processed, not the number of payments.

**Debtors – cost per invoice**
The denominator is the number of sundry debtor invoices (whether raised by a central debtors section or by service department-based debtors staff) – this includes invoices to other authorities for education recoupment income.

**Cashiers – cost per invoice**
The denominator is the total number of receipts, not merely the number of over-the-counter receipts.
The use of NRE+HRA as the denominator for certain indicators and benchmarks

Net revenue expenditure (NRE) plus gross rental income from an authority’s Housing Revenue Account (HRA) has been selected as the denominator for a number of indicators used in this handbook, including the top level indicator of financial support services expenditure per £m NRE+HRA in Section 1 and the headline indicators for accountancy and internal audit of spend per £m NRE+HRA.

There are four significant ways in which this may not be the ideal denominator for comparative purposes:

(a) some aspects of the six services under review will be influenced by income, for example, the level of internal audit days will be higher in authorities with a significant cash income from local service provision, such as seaside authorities – an influence that is not reflected in the NRE+HRA denominator;

(b) tax collection responsibilities will create an additional workload for the accountancy and internal audit functions, which will drive up costs for non-county authorities and therefore make overall comparisons less valid;

(c) the denominator does not reflect the work undertaken by financial support services in pursuit of additional sources of income, such as City Challenge or SRB funding and EC grants;

(d) authorities with a similar NRE+HRA may have widely differing needs for financial support services, in particular because of the differences in provision that NRE+HRA may hide. Most importantly, an outsourcing authority may have an identical NRE+HRA to an authority that has kept all services in-house, but the latter is likely to incur higher financial support service costs because of the demand from its DSOs for financial support.

These are arguments for treating the headline analyses with care, and not drawing simplistic conclusions. Indeed, one of the strengths of the cost tree approach adopted throughout this handbook is that it allows an enquiring authority to explore in depth the reasons for cost variation. An authority with high levels of in-house provision may score highly on the single headline indicator of total financial support services expenditure per £m NRE+HRA but be shown to enjoy competitive costs for the transaction-based services when the denominator of employees or invoices is used. Importantly, the extent of in-house provision has a far stronger influence on payroll and creditors payments costs than on accountancy or internal audit – the latter
being the only two services where NRE+HRA continues to have an
important role to play in detailed cost analysis. This suggests that the ‘DSO
criticism’ (point (d) above) is not as powerful as it may appear at first sight.

In accountancy and internal audit, the indicator of available days per £m
NRE+HRA is offered as a starting point, to stimulate analysis and reflection.
There may be factors, such as those mentioned above, which place upward
pressure on the levels of accountancy and internal audit and are not reflected in
NRE+HRA. Provided that these factors are genuinely the causes of higher
volumes and are not being used as a smokescreen to mask some of the other
causes of high volumes identified in Section 3, then there is no overwhelming
argument for an authority to reduce its accountancy or internal audit provision.

These criticisms and caveats should not lead authorities to assume that
NRE+HRA is inappropriate as a denominator. Although not ideal, it can be
shown to be superior to the other obvious candidate for headline comparisons,
namely gross expenditure. Using gross expenditure would involve taking all
income into account, and much of authorities’ income (particularly transfer
payments) does not drive any expenditure on financial services. The notional
‘ideal’ denominator, which would reflect those aspects of income that drive
expenditure on financial support services, whilst ignoring those that do not,
would only be achievable through making a series of adjustments to
authorities’ gross income (a time-consuming process) and would not have the
advantages of accessibility and familiarity that using NRE+HRA brings.

In conclusion, as with all comparative analysis, caution and care is advised.
NRE+HRA-based comparisons, on their own, will not reveal all the salient
considerations. But a combination of NRE+HRA-based indicators and other
indicators and analysis, as suggested in the chapters of Section 3, should allow
authorities to gain powerful insights into the health of their financial support
services performance.
Appendices

Appendix D

The methodology used to measure service standards for accountancy and internal audit

Service standards have been assessed for accountancy and internal audit in sample authorities, using a weighted basket of criteria, leading to a single standards score (scores are shown in brackets). Performance against some criteria (marked with an asterisk) has been evaluated by authorities’ external auditors to provide a dispassionate assessment.

For **Accountancy**, there are 11 criteria covering:

- **timeliness** – the ability to submit accounts for audit by 30 September deadline (maximum 4)
- **accuracy** – the extent of errors identified by external audit in authorities’ accounts (maximum 4)
- **accuracy** - the existence of material errors in authorities’ accounts (maximum 4)
- **quality of output** – the standard of final accounts working papers (maximum 3)*
- **quality of output** – the standard of grant claims submitted for audit (maximum 3)*
- **quality of input** - the level of qualifications and experience of accountancy staff (maximum 3)*
- **quality of input** – the nature and level of training given to accountancy staff (maximum 3)*
- **service delivery** – the effectiveness of relationships between accountancy staff and service managers (maximum 3)*
- **timeliness of information** – the promptness with which standard budget reports are distributed to service managers following the month end (maximum 3)
- **accuracy of information** – the speed with which an authority’s general ledger is updated to reflect committed and incurred expenditure (maximum 2)
- **accuracy of information** – the existence of a commitment accounting facility (maximum 1)

with the maximum score being 33.
For Internal Audit, there are nine criteria covering:

- independence – the access internal audit has to the authority’s records (maximum 3)*
- service delivery – the appropriateness and effectiveness of internal audit’s relations with service departments (maximum 4, of which 3*)
- audit methodology – the procedures in place to ensure that individual audit’s are properly planned, controlled, recorded and evaluated (maximum 6)*
- audit methodology – the procedures in place to ensure that the findings from individual audits are based on sound evidence (maximum 3)*
- audit methodology – the procedures in place to ensure that audits are undertaken with due care (maximum 3)*
- flexibility – the existence of a contingency budget and the ability of internal audit to bring in additional resources when required (maximum 2)
- timeliness of output – the procedures in place to ensure that audit findings are reported promptly (maximum 5)
- quality of output – the appropriateness of audit recommendations (maximum 3)*
- quality of output – the procedures in place to ensure the timely follow-up of recommendations (maximum 3)*

with the maximum score being 32.
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