

Lessons from recent Public Interest Reports

2021



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Summary

2020 will be remembered as a tumultuous year in local government. The COVID-19 pandemic highlighted four essential factors we probably always knew about local government, have often said, but which are now much better evidenced:

- 1 Local government has provided fantastic support to its communities in working with the NHS and other partners to deal with the multifaceted challenges of the pandemic.
- 2 Britain's long centralised approach to government has been exposed to some degree in terms of its agility to tailor pandemic responses to regional and local bodies. This is recognised by the current government who continue to pursue the options for devolution of powers to local bodies. Track and Trace delivered centrally has not been as successful as anticipated and, according to government figures, local interventions have had more impact.
- 3 Years of reduced funding from central government have exposed the underlying flaws in the local authority business model, with too much reliance on generating additional income.
- 4 Not all authorities exercise appropriate care with public money; not all authorities exercise appropriate governance; and not all authorities have the capability of managing risk, both short and long term. Optimism bias has been baked into too many councils' medium-term plans.

The Public Interest Reports (PIRs) at Nottingham City Council (August 2020), the London Borough of Croydon (October 2020), and Northampton Borough Council (January 2021) were the first issued since 2016. All three are clear illustrations of some of the local government issues identified above. The audit reports are comprehensive and wide-ranging and a lesson for all local authorities. There are some quotes that seem particularly apposite for all councils to consider.

Governance models

Local authorities have a variety of different governance models. These range from elected mayor to the cabinet and a scrutiny system approach, while others have moved back to committee systems. Arguments can be made both for and against all of these models.

However, in the recent PIR cases, and for many other councils, it's less about the system of governance and more about how it operates, who operates it and how willing they are to accept scrutiny and challenge. There are a number of lessons to be learned from the recent PIR reports and these can be broken down into three key areas which will be explored further in this report:

- The context of local government in a COVID-19 world
- Governance, scrutiny, and culture
- Council leadership

“There has been collective corporate blindness to both the seriousness of the financial position and the urgency with which actions needed to be taken”.

London Borough of Croydon
Grant Thornton UK LLP October 2020

“Overall, the governance arrangements were overshadowed by the Council's determination that the Company should be a success, and this led to institutional blindness within the Council as a whole to the escalating risks involved, which were ultimately very significant risks to public money”.

Nottingham City Council
Grant Thornton UK LLP August 2020

“There was inadequate due diligence undertaken by the Director of Finance/Section 151 Officer, including an inadequate assessment of whether the work would generate assets capable of being refinanced by NTFC in order to repay the loans to the Council and of the financial viability of NTFC”.

Northampton Borough Council
KPMG LLP January 2021

It is also very pertinent to reflect on what the Best Value Inspection of Northamptonshire in 2018 said in its summary.

“In Local Government there is no substitute for doing boring really well. Only when you have a solid foundation can you innovate”.

Best Value Inspection by Max Caller CBE
- March 2018

An aerial photograph of a historic city, likely Bath, England, showing a dense collection of buildings with red-tiled roofs and stone walls. A prominent church with a blue dome is visible in the distance. The sky is blue with light clouds. A large blue rectangular overlay is positioned in the upper right corner, containing white text.

Local government in a COVID-19 world

There is no doubt that reduced central government funding has meant immense challenges for the local government sector. But, generally, councils have continued to provide good services to residents and, according to IPSOS MORI polling since 2010, the overall trust levels in councils have remained remarkably high in this period.

The reality of reduction in government grant has meant that councils have had to make considerable savings as well as draw on new income sources. Getting this balance right is difficult but it is a dilemma that has faced all councils. The levels of grant received by councils from government has varied considerably, as has their ability to raise income through council tax increases and to grow their business rates base due to differing local macro-economic circumstances.

Funding models

There are a number of government reviews looking at council funding which would have led to a reset of the basis of funding, which have now been postponed due to COVID-19. There are long running and heated debates on the fairness of both the existing and the proposed systems. What is very clear is that, as the overall local government 'cake' gets smaller, the intensity of the debate over who gets what share tends to grow sharper.

The onset of the COVID-19 pandemic has only exacerbated the financial challenges faced by local authorities which have existed for some years including significant extra demand for services. In the financial year 2020/21 the government has largely funded additional costs incurred by the sector as a result of the pandemic and provided considerable support to make up for income losses.

The funding settlement announced for 2021/22 should ensure that most councils get through this financial year but, with the renewed surge of the pandemic, it's difficult to assess the financial impact this will have on councils and any further income losses or additional costs they may incur. Our analysis, and that of the Local Government Association (LGA) and other reviews, suggests a funding gap remains in the local government sector from the financial year 2021/22 onwards.

Financial sustainability

To some extent, government support during the pandemic has frozen the financial sustainability of the majority of councils at the level it was pre-pandemic, and it's difficult to imagine a much better outcome in the circumstances, albeit from a challenging pre-COVID-19 base.

However, for a small number of councils, it has exposed their chronic financial instability. For other councils, even a net marginal downturn in their financial position has exposed insufficient reserves. There are many further risks posed from COVID-19 to all councils and their local economies, such as the future of the high street and increased demand pressures including for unemployment and care services linked to mental health.

Councils' financial sustainability is a topic that has been subject to very mixed messaging for a long period of time and government ministers have, in the past, complained about the high level of council reserves nationally. Some councillors themselves have also questioned locally why significant reserves are needed.

In our view, those councils who have, throughout the period of grant reduction, recognised and been committed to maintaining adequate reserves, have not only continued to provide strong services but have also put themselves in a position to ride out the current pandemic storm.

This, we believe, is the absolute and fundamental lesson from the PIRs issued in the last few months. Maintaining sound reserves is absolutely vital and a key indicator of sound financial governance. It should be at the heart of all medium-term financial plans. In our view, general fund reserves (including earmarked general fund reserves) should be a minimum of 5% of net spending and arguably should be somewhere between 5 and 10%. This level of reserves will provide councils with a vital cushion. The lower reserve levels are, and the more rushed, the more ill thought through and, in some cases, the more desperate some council schemes tend to get, leads to greater problems. Councils should ask themselves a simple question: can they balance their books without taking significant risks with taxpayers' money? If the answer is no, then a fundamental rethink of their business strategy is required, including a baseline assessment of the affordability of services in their current form.

Governance, scrutiny and culture



The vast majority of councils do have adequate scrutiny arrangements in place on paper. Most councils have audit committee arrangements, most have scrutiny committees, and they also have the vehicle of the full council meeting, albeit one that often feels like a local government version of Prime Minister's Questions (PMQs), a spectacle for partisans rather than a serious examination of the council's work. While we would argue that, in the majority of councils the correct governance arrangements are in place, in structural terms they are often found wanting.

Audit committees

Any committee with "audit" in its brief should provide an opportunity for councillors to examine the findings of internal and external audits and strongly challenge, and hold to account, officers and sometimes leading members for significant failings pointed out by the various audit functions.

Sometimes we find that audit committee structures are hindered by having too wide a brief. Some combine audit with a multitude of other functions including, finance, performance, HR, and IT, and this can mean that both internal and external audits are crowded out. Structurally, there needs to be more clarity on how both audit functions get a proper voice on the "audit committee".

There is also a clear case for more independent expertise as part of the audit committee as the complexity of accounting transactions as well as the wider accounting framework grows exponentially. Another important factor is to ensure that politics has no place in the audit committee. We believe this is largely achieved but, in some councils, the political nature of audit and scrutiny is not helpful.

Sir Tony Redmond in his report on local audit published in September 2020 has recommended that the external auditor reports to full council on audit findings at least once a year. Some councils have already maintained this tradition, which dates back to the Audit Commission era. One of the key lessons coming from the PIRs is the extent to which backbench councillors have represented that they felt disenfranchised and unaware of audit concerns and recommendations.

This plays to a much wider point, that all councillors need to be fully briefed on the views of audit and inspectorate findings including Ofsted or Care Quality Commission (CQC).

No councillor should be able to say they did not know. All members need to be very clear on the scope of external audit work and indeed its limitations. Neither internal nor external audit exists to capture every weakness in council controls. It is the responsibility of officers and members to ensure robust arrangements are in place internally to prevent and detect controls weaknesses.

Quality of scrutiny

Our experience is that the quality of scrutiny varies considerably. The role model for rigour in scrutiny in the United Kingdom is probably the Public Accounts Committee (PAC) of Parliament. Albeit with the significant resource of the National Audit Office (NAO) and the ability to summon politicians, officials and wider stakeholders. The key tenet of the PAC is the fact that it is chaired by a member of the official opposition and its members of all political parties are required to demonstrate robust challenge.

In those councils where PIRs have been issued by auditors recently, the level and depth of challenge was nowhere near strong enough. Indeed, it is difficult to identify any outcomes from scrutiny that changed the approach or the path to the public interest reports. There have been longstanding calls for local PACs to be introduced to provide that level of challenge across all public services in a geography. Reflection on the outcomes of the pandemic raised questions for central and local government as to how the scrutiny of the performance of local public services can be improved.

Even if setting up new scrutiny functions feels difficult at the moment, it's undoubtedly true that scrutiny functions in councils need more resources, need to be better briefed and need to hold political and officer leadership to account in a more robust and sustainable way. If scrutiny does not achieve change it has failed. No political or officer leadership is infallible. Scrutiny should be the keyway of ensuring that council policies are open to proper challenge and focus.

Culture

The recent PIRs showed that for some councils the culture is not right. Culture must be about selflessly following the Nolan Principles in all aspects of political and officer life. These principles are set out below:

- 1 Selflessness**
Holders of public office should act solely in terms of the public interest.

- 2 Integrity**
Holders of public office must avoid placing themselves under any obligation to people or organisations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family or their friends. They must declare and resolve any interests and relationships.

- 3 Objectivity**
Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.

- 4 Accountability**
Holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.

- 5 Openness**
Holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for so doing.

- 6 Honesty**
Holders of public office should be truthful.

- 7 Leadership**
Holders of public office should exhibit these principles in their own behaviour. They should actively promote and robustly support the principles and be willing to challenge poor behaviour wherever it occurs.

An open culture encourages challenge and criticism, it listens to ideas from opposition parties and it holds its leaders and officers to account for their actions. This needs to start with the political leadership and embed itself throughout the organisation. Being willing to listen to the perspectives of others is not only healthy in a democracy, it facilitates better decision making. In councils where PIRs were issued, auditors identified aspects of political culture that were not receptive to challenge, scrutiny or different perspectives. This meant that ill thought-out proposals, personal projects and poor stewardship of public funds were able to go unchecked.

Council leadership



The role of council leader is an extremely important one. The council leader should set the vision for the organisation, work in partnership with political colleagues and embrace key stakeholders in the council's broader community role. The leader or mayor should command respect based on their behaviours and values. Where it works well, an effective leader embraces change, embraces difference, and embraces different perspectives and welcomes challenge and scrutiny. This applies equally to cabinet members and portfolio holders.

In our view, one of the main reasons for the poor outcomes reflected in the recent PIRs was either the absence or the ineffective execution of the qualities described above. This led to the pursuit of political objectives with no effective scrutiny and challenge. Auditors have described outcomes which have led to:

- Failure to understand the inherent risk around investing in particular markets
- Failing to understand the crucial need to ensure financial sustainability of existing services before embarking on major new projects which brought extra layers of complexity and risk
- Salutary lessons to councils about conducting appropriate due diligence for investing and lending to third parties, however important they are to the local community.

A question of degree



The recent PIRs have made headlines because, up to this point, they stand out as rare examples of their kind. However, our work across a broad range of audit and consulting clients leads us to believe that it is often a question of degree, and perhaps a matter of timing, that separate these from a wider pool of councils with potentially similar governance failings.

The era of reduced central government grants, closely followed by the wholly unprecedented and as yet not fully understood post-COVID-19 landscape, is testing financial governance arrangements and risk mitigation strategies to breaking point. It is also bringing to light weaknesses in financial decisions that may have been made years ago and may otherwise have remained hidden. At an operational level, some of the common early indicators of future governance failings that we have seen over the past couple of years include:

- Lack of strategic alignment between financial, operational and political agendas, sometimes linked to a lack of corporate ownership of the medium-term financial plan and savings commitments.
- Disharmony or performance issues within the senior management team (or between members and officers) not being dealt with effectively. This results in poor co-operation, reinforces silos and in some circumstances can lead to directorates acting as semi-independent fiefdoms within the organisation.
- Financial and commercial decisions being made without sufficient transparency and consultation. In some cases, these are driven by trusted individuals in circumstances where there is a lack of opportunity for proper scrutiny.
- A lack of understanding of how to manage financial and commercial uncertainty and risk in the medium to long term. This can result in short-term financial strategies or, conversely, to overly risky long-term investments.
- Directorates left to develop financial plans and business cases, or manage commercial relationships, without sufficient oversight expertise, capacity, or resources. This heightens the risk of poor outcomes.
- Undue pressure placed on senior managers to set budgets using over-optimistic assumptions. This can allow a 'balanced budget' to be superficially achieved, but the issues inevitably manifest as recurring overspends at year-end which councils then struggle to mitigate.

- Gradual loss of financial control as roll-forward budgets become increasingly detached from actual activity and overspends are habitually netted off against underspends. This can disguise the root causes of directorate cost pressures and prevent them being addressed in a timely and effective way.
- Knowledge of how things really work or why decisions were made, becoming vested in a few key individuals. This makes the council vulnerable if these people were to leave. In some cases it grants them inappropriate levels of influence.
- Lack of control over financial and operational delivery, including remedial action plans. This is often due to insufficient oversight or a lack of timely and accurate management information, and timely and decisive action taken at corporate or committee level when issues are identified.
- Awareness of the significance of audit recommendations and qualifications and ensuring they are responded to properly and not ignored or side-lined.

When combined with the more general weaknesses in governance, scrutiny, culture and leadership, these more functional and operational weaknesses provide fertile ground for the kind of significant issues we might see in a Public Interest Report.

Recommendations



So, what can councils do now to root out some of these weaknesses and deal with them before they burst out on their own terms?

- Councils are now required to consider how they measure up against the Chartered Institute of Public Finance and Accountancy (CIPFA's) new Financial Management Code. This was greeted with some scepticism at first, but many are now seeing its value as a 'gold standard' against which arrangements can be tested. The Code emphasises that financial sustainability is the responsibility of all senior leaders, not just the finance team. Councils progress on delivering the Code will be a key part of auditors' value for money work going forward.
- Councils need to ensure that they are mindful of reserve levels at all times and ensure there is a clear strategy for maintaining adequate reserves. In our view this needs to be at least 5% of net General Fund expenditure flexed upwards to consider the macro-economic and local risks the council faces.
- Internal audit and risk assurance arrangements can be strengthened and emphasised as an asset to the organisation, rather than being side-lined. This will involve extra investment in these services but will have long-term benefits for the council's governance. External expert support should also be brought in at the right time and councils should open themselves up to a broad range of external perspectives, including benchmarking and LGA peer reviews.
- Greater focus on establishing a healthy management culture – starting with the “tone from the top” - that welcomes and encourages challenge rather than suppresses dissenting voices. Strong leaders are vital to getting things done, but it can be dangerous to vest too much unchecked influence in individuals.
- Look for opportunities to learn from the council's past experience and that of others. Use this to identify training needs for officers and members and make time to address them – common areas include options appraisal, optimism bias and prioritisation.
- Politics will always be there in the background, but council members should strive to work more collegiately, particularly when it comes to making strategic decisions with implications that reach many years into the future. Efforts to engender better cross-party co-operation, to improve transparency and embrace challenge from a wider cohort of members are likely to reap dividends in the long run, beyond the short-term expediency of decisions made behind closed doors.

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