

Lessons from recent Public Interest Reports

June 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 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.

Summary continued

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.

“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 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

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.

<p>1. Selflessness</p> <p>Holders of public office should act solely in terms of the public interest.</p>
<p>2. Integrity</p> <p>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.</p>
<p>3. Objectivity</p> <p>Holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.</p>
<p>4. Accountability</p> <p>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.</p>
<p>5. Openness</p> <p>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</p>
<p>6. Honesty</p> <p>Holders of public office should be truthful.</p>
<p>7. Leadership</p> <p>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</p>

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.

Council leadership

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 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.

A question of degree continued

- 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 or in some cases granting them inappropriate levels of influence.
- Lack of control over financial and operational delivery, including of 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 un-checked 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.

