

DERBYSHIRE COUNTY COUNCIL

AUDIT COMMITTEE MEETING

24 September 2019

Report of the Director of Finance & ICT, Director of Legal & Democratic Services and Assistant Director of Finance (Audit)

LOCAL GOVERNMENT GOVERNANCE AND ACCOUNTABILITY

1. Purpose of Report

To inform Members of the publication of the House of Commons Committee of Public Accounts (PAC) report 'Local Government Governance and Accountability'. This report follows the production of the Comptroller and Auditor General's report 'Local authority governance'.

2. Information & Analysis

The Comptroller and Auditor General produced his report on 14 January 2019 and noted that while elements of the local governance arrangements are locally defined, core components are set out in a statutory framework of legal duties and financial controls overseen by the Ministry of Housing, Communities & Local Government (the Department). He stated that good governance means that proper arrangements are in place to ensure that an authority's intended objectives are achieved. Key elements of the statutory framework which ensure that authorities remain financially stable include:-

- a statutory requirement for a balanced annual budget;
- a statutory requirement for there to be a chief finance officer (section 151 officer) to advise on the robustness of estimates and the adequacy of reserves, which members must consider as they take the budget decision;
- a statutory process (section 114 notice) by which the section 151 officer can cause the council to pause and reconsider spending decisions or budgets;
- legal requirements for councils to have a sound system of internal control, proper arrangements for managing their financial affairs and to have their statement of accounts and arrangements for value for money subject to external audit annually.

The report examined whether local governance arrangements provide local taxpayers and Parliament with assurance that local authority spending achieves value for money and that authorities are financially stable. The report made several recommendations addressed to the Department in order that it can be assured that an effective local governance system is in place (Appendix 1).

On the basis of the report by the Comptroller and Auditor General the PAC took evidence from the Department and key stakeholders regarding local authority governance and the Department's accountability for it.

The PAC report notes that local politicians and council officers operate within a governance framework which includes officers with statutory powers and responsibilities; internal checks and balances such as audit committees and internal audit; and external checks and balances such as external audit and sector led improvement overseen by the Local Government Association. This report states that there has been a significant reduction in central oversight following the government's decision to abolish the Audit Commission and the Standards Board for England. The report also notes that spend on services other than social care fell by a third in real terms from 2010-11 to 2017-18 and, whilst authorities are innovating in response to financial pressures, shared services, outsourcing and commercial activities can all add complexity to council governance arrangements.

The PAC report acknowledges that three key officers have been given legal responsibilities and protect good governance under the legal framework that the Department is responsible for overseeing; these are the head of paid service, the section 151 officer and the monitoring officer. However, the Department informed the PAC that information to assess the status and capacity of the statutory officers is not collected.

The Department recognises that concerns about external audit have been expressed reflecting a comment in the Comptroller and Auditor General's report that 'heads of paid service, section 151 officers and internal auditors raised concerns that the contribution of external audit to local governance has been reduced recently. Frequently, they linked this to the reduction in the audit fee paid by authorities.' The Department has committed to carrying out a post-implementation review of the new audit regime in 2019.

The PAC report reaches five conclusions and makes a number of associated recommendations for improvement (Appendix 2).

On 10 July 2019 the Secretary of State for Housing, Communities and Local Government announced that the government is to examine local authority financial reporting and auditing and stated that the government "was working towards improving its approach to local government oversight and support".

3. Considerations

In preparing this report the relevance of the following factors has been considered: financial, legal, prevention of crime and disorder, equality and diversity, human resources, environmental, health, property and transport considerations.

4. Background Papers

A file held by the Assistant Director of Finance (Audit).

5. Officers' Recommendation

That the Committee notes the content of this report and recent developments regarding local authority governance and accountability.

Peter Handford
Director of Finance & ICT

Janie Berry
Director of Legal &
Democratic Services

Carl Hardman
Assistant Director of
Finance (Audit)

Extract from the Comptroller and Auditor General's Report – Local Authority Governance

Recommendations

23 As steward of the system the Department has a responsibility for assuring itself that there is an effective local governance system in place.

- a The Department should work with local authorities and stakeholders to assess the implications of, and possible responses to, the various governance issues we have identified, including:
 - the status of section 151 officers and the efficacy of their statutory reporting arrangements;
 - the effectiveness of audit committees, and how to increase the use of independent members;
 - the effectiveness of overview and scrutiny functions and ways to enhance their impact; and
 - the sustainability and future role of internal audit.
- b The Department should address the system-wide gaps in its evidence base on governance.
- c The Department should set out its expectations of network partners and how they will work together to address the current weaknesses in local governance arrangements.
- d The Department, working with relevant organisations and delegating where appropriate, should lead the sector in considering the issues and concerns raised about external audit in this report to establish whether concerns in certain parts of the sector over the contribution of audit genuinely relate to audit:
 - Where concerns genuinely relate to audit the Department should work with bodies with responsibility for external audit within the governance framework, taking into account their ongoing or planned activity, to address any substantive issues.
 - Where concerns do not in fact relate to audit the Department should work with local authorities and other bodies in the governance system to identify how these needs and requirements can be addressed.
- e The Department should examine ways of introducing greater transparency and openness in relation to its formal and informal interventions in local authorities.
- f The Department should adopt a stronger leadership role in relation to overseeing and coordinating the network of organisations managing key aspects of the governance framework.

Conclusions and recommendations

1. **The Department is not yet providing effective leadership of the local governance system.**

Local authority governance arrangements have, in general, coped effectively with the significant challenges the sector has faced since 2010–11. However, there is still significant room for improvement. Existing weaknesses need to be addressed, and the framework's effectiveness needs to be maintained in the context of the rapidly changing local governance landscape. We are particularly concerned about the gap between substantial intervention powers of the Secretary of State and the daily operation of a largely unregulated sector. Rather than simply waiting until things have gone wrong locally and resorting to statutory intervention, the Department should be a system leader to ensure that the whole system is effective and that the key organisations involved in the framework are working in an effective and co-ordinated manner. The Department acknowledges that it has been too reactive in its oversight and leadership role. We therefore welcome the Department's commitment to improve its oversight and leadership of the local governance system. However, meaningful change must be delivered by the Department rather than just warm words. The Department still makes confusing statements that do not express clearly enough its overall ownership of the governance system. It needs to assure Parliament and the public that the promised local governance panel will be more than a talking shop. We are yet to be convinced: the Department has been unable to describe any new concrete actions that will flow from its new approach.

Recommendation: *The Department should write us within the next six months, setting out:*

- *its overall plan for improving its oversight;*
- *its progress in working more effectively with other government departments to understand overall pressures on service sustainability;*
- *its objectives for the promised local governance panel and the means by which the panel's effectiveness will be assessed;*
- *progress in setting up the new panel, including its work programme, the concrete actions the panel will take; the timetable and intended outcomes the panel will be working towards.*

2. **The Department does not know why some local authorities are raising concerns that external audit is not meeting their needs.**

The Department places great reliance on the work of external auditors, particularly in relation to value for money arrangements. It recognises that the importance of this work is heightened as council activities become more varied, complicated and commercial. However, a number of key representative organisations and councils told us that they had concerns about external audit. For instance, a quarter of finance directors at councils with responsibility for social care services for vulnerable people would like more value for money work from external audit, and the same proportion feel that audit fees are too low relative to the risk faced by their local authority. The Department believes the focus of external audit on whether arrangements are in place means that some local authorities are concerned that they no longer have sufficient assurance that their organisations are working effectively or that value for money decisions are being made. It has committed to addressing this 'expectations gap' as part of its review of external audit. The Department has not yet decided whether this will be an independent review or carried out by the Department itself.

Recommendation: *The Department's proposed review of the work of independent auditors should be conducted independently and should ensure that concerns from some local authorities over current fee levels and the contribution of external audit are examined fully and rigorously. The review should make an assessment of whether external audit is providing an effective service and meeting the needs of local authorities.*

Recommendation: *If the review identifies an 'expectation gap' as a factor underlying local authorities' concerns with external audit, then the Department should identify how these unmet expectations can be met.*

Extract from House of Commons Committee of Public Accounts Report – Local
Government Governance and Accountability

3. **The Department lacks reliable information on key governance risks, or relies on weak sources of information, meaning it has no way of pinpointing the at-risk councils.** The Department does not systematically collect detailed information on how well local governance is working. This is a remarkable oversight. Of the monitoring it does carry out, we were unimpressed with the Department's description of the information it holds on weaknesses and risks within local government governance. We are not confident that the current arrangements are enough to identify struggling councils that try to keep their problems to themselves, or to spot emerging wider weaknesses across the sector. The Department acknowledges that statutory officers play a vital role in local governance but does not collect or otherwise have access to information about the status and capacity of statutory officers across the sector. The Department is open about its reliance on 'soft intelligence' for information on the ways in which authorities may be seeking to circumvent rules, for instance through the creation of innovative delivery and investment vehicles. It accepts, however, that to some extent this information is akin to gossip. The Department also relies on journalism to identify issues, although the Government has recently said that it accepts that local newspapers can often struggle to dedicate journalists to investigative work. We welcome the Department's new commitment to 'thematic health checks' but need assurance about what this will mean in practice.

Recommendation: *The Department should assess the governance evidence base available to it currently and write to us by November 2019 setting out how it will address gaps it has identified.*

4. **The Department's monitoring is not focused on long-term risks to council finances and therefore to services.** The Local Government Association told us that reductions in central government funding to local authorities has meant that they need to increase their income and have taken on more risky commercial activities as a result. Some councils are borrowing very large amounts to fund commercial investment, creating long-term financial risks if investments do not deliver as expected. Councils need sound finances, now and in the future, to ensure they are able to deliver the services that local people expect. Our previous work has repeatedly shown that demand for local authority services is increasing, particularly within the adult social care and children's services sector, putting local authority finances under strain. The Department's risk monitoring is primarily aimed at identifying immediate financial concerns rather than the longer-term exposure of councils to financial risk. The Department's data on council debt levels does not allow it to assess the level of risk councils are exposed to as a result of that debt. The Department does not formally monitor council's commercial activities or non-traditional operating models.

Recommendation: *The Department should assess and monitor the scale of long-term risk that authorities might have exposed themselves to through their commercial investments and ventures.*

5. **There is a complete lack of transparency over both the Department's informal interventions in local authorities with financial or governance problems and the results of its formal interventions.** Residents and taxpayers have a right to know if there are serious problems, but current arrangements mean that if there is a problem with the finances of a local authority or how it is being run, then that information may not be available on a timely basis. We were told that the scale of Northamptonshire County Council's recent problems was 'an open secret' within the sector. But awareness only for those 'in the know' is not good enough. Peer reviews are an important source of information for the Department but these do not have to be published, unlike Ofsted reports, reducing the transparency about local authorities' performance to the public. We accept that there may be short critical periods where transparency is not appropriate but much more can be done than is at present. This is particularly true in instances where the Department itself has felt the need to engage informally with a particular authority. The Department accepts that greater transparency is desirable and is exploring options for enhancing it. However, the Department has previously said that it would explore publishing lessons from formal interventions but has yet to commit to doing so.

Extract from House of Commons Committee of Public Accounts Report – Local
Government Governance and Accountability

Recommendation: *The Department should set out how it will improve transparency over its engagement on governance issues with individual local authorities, including:*

- *a review of the information the LGA is required to publish under its sector-led improvement work funded by the Department.*
- *the steps the Department will take to publish information and learning following formal interventions.*