



National Audit Office

Report

by the Comptroller
and Auditor General

Ministry of Housing, Communities & Local Government

Local authority governance

Key facts

28.6%

real-terms reduction in local authorities' spending power (government funding plus council tax), 2010-11 to 2017-18

£2.5bn

increase in local authority spending on acquiring land and existing buildings from 2015-16 to 2017-18, much of which is for commercial investment purposes

34.2%

real-terms decrease in spending on corporate and democratic support services by local authorities from 2010-11 to 2017-18

- 27%** of local authorities' external auditors in our survey thought risk profiles had increased from 2016-17 to 2017-18
- 77%** of chief finance officers (section 151 officers) in our survey agreed that their finance function was sufficiently resourced
- 89%** of chief finance officers (section 151 officers) from single tier and county councils in our survey are on their senior leadership team
- 98%** of chief finance officers (section 151 officers) in our survey agreed or strongly agreed that they felt able to provide challenging information to elected members
- 32.7%** of local authorities' audit committees have at least one independent member
- 48%** of external auditors in our survey agreed or strongly agreed that audit committee members in their authority were appropriately trained to deliver their role
- 18.5%** of local authorities' whistleblowing policies published on their websites advised people to contact the Audit Commission, which was abolished in 2015
- 25%** of chief finance officers (section 151 officers) of single tier and county councils in our survey felt that their audit fee for 2017-18 was too low relative to the risk faced by the authority

Summary

1 Local authorities are accountable to their communities for how they spend their money and for ensuring that this spending represents value for money. Local politicians and officers operate within local governance frameworks of checks and balances to ensure that decision-making is lawful, informed by objective advice, transparent and consultative.

2 While elements of 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). The Department is responsible for ensuring that this framework contains the right checks and balances, that it works, and for changing the system if necessary. The Department sets out the core elements of this system in its Accounting Officer System Statement (**Figure 1** overleaf).

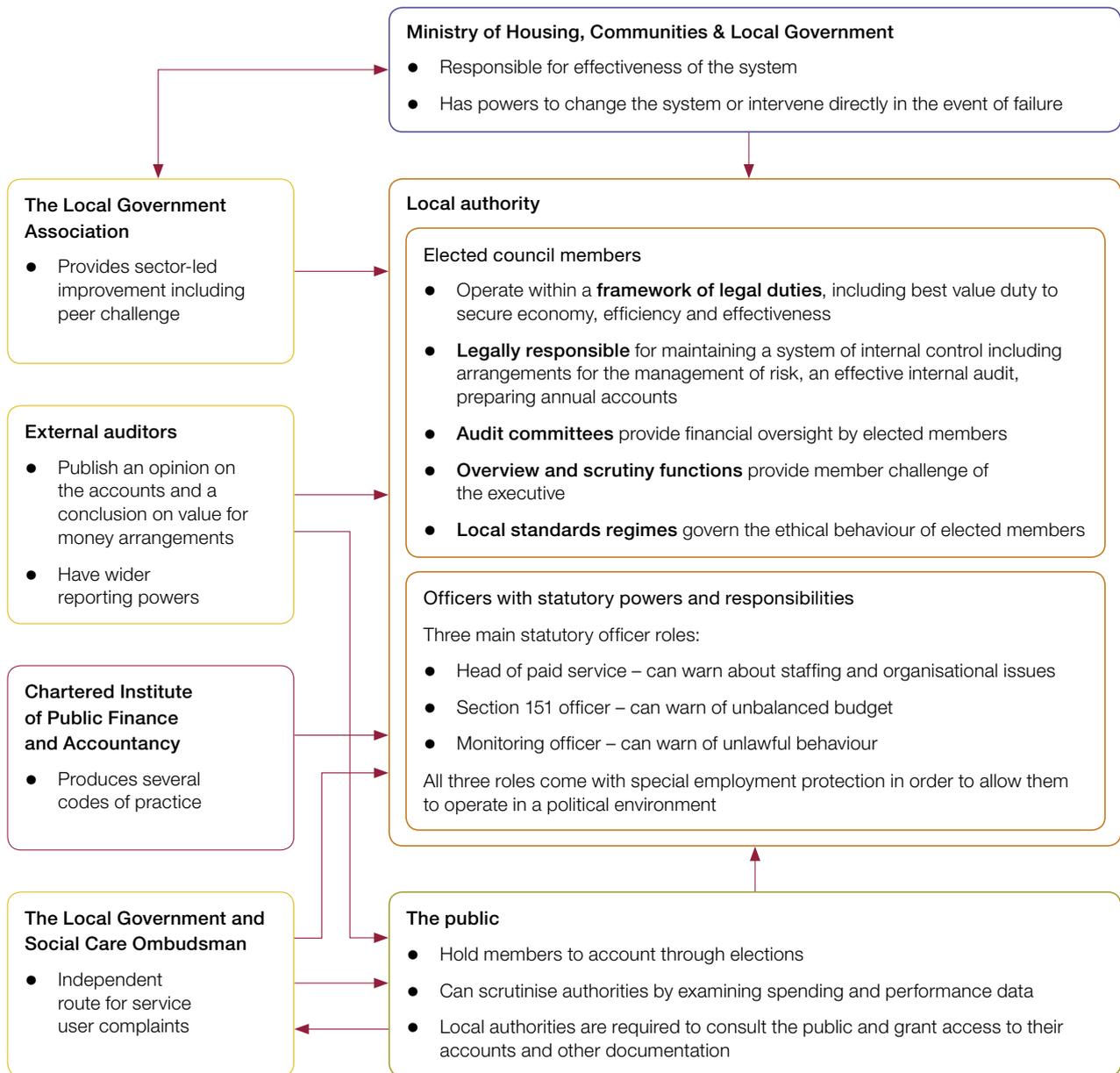
3 Good governance means that proper arrangements are in place to ensure that an authority's intended objectives are achieved. Key elements of the statutory framework ensure that authorities remain financially sustainable. These elements include:

- a statutory requirement for a balanced annual budget;
- a statutory requirement for there to be a chief finance officer (section 151 officer) and for that officer to advise on the robustness of the estimates and the adequacy of the reserves allowed for in the budget, 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; and
- 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.

Unlike police bodies and combined authorities, there is no statutory requirement for English councils to have an audit committee. However, the position of the professional body for local authority finance is that an audit committee is required as part of proper arrangements for financial management.¹

¹ Chartered Institute of Public Finance and Accountancy, *CIPFA's Position Statement: Audit Committees in Local Authorities and Police*, CIPFA, 2018.

Figure 1
Core local governance framework



- Sets standards or defines practice
- Ministry of Housing, Communities & Local Government
- External checks and balances
- Local authority
- The public

Notes

- 1 Links with other departments and service inspectorates not shown.
- 2 There are other statutory roles in an authority but the three listed in the chart are our main focus.
- 3 Arrows show the main influences acting on local authorities' governance arrangements.

4 Our study on the *Financial sustainability of local authorities 2018* found that authorities have faced significant challenges since 2010-11 as funding has reduced while demand for key services has grown.² Governance arrangements have to be robust in this challenging context or this creates a risk that authorities will not be able to deliver their objectives. Effective governance is particularly significant as funding has diminished because authorities' objectives are now increasingly fundamental and relate, for instance, to securing their own financial survival and continuing to meet statutory service obligations. Accordingly, the focus of this study is on those governance arrangements most closely associated with financial sustainability.

5 Not only are the risks from poor governance greater in the current context as the stakes are higher, but the process of governance itself is more challenging and complex. Governance arrangements have to be effective in a riskier, more time-pressured and less well-resourced context. For instance, authorities need to:

- maintain tight budgetary control and scrutiny to ensure overall financial sustainability at a time when potentially contentious savings decisions have to be taken and resources for corporate support are more limited; and
- ensure that they have robust risk management arrangements in place when making commercial investments to generate new income, and that oversight and accountability is clear when entering into shared service or outsourced arrangements in order to deliver savings.

Our report

6 Our report examines whether local governance arrangements provide local taxpayers and Parliament with assurance that local authority spending achieves value for money and that authorities are financially sustainable. The report addresses this question in three separate parts:

- Part One examines the pressures on the local governance system;
- Part Two explores the extent to which local governance arrangements function as intended; and
- Part Three assesses whether the Department is fulfilling its responsibilities as steward of the system.

2 Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018.

7 We examine the roles of statutory officers and arrangements for internal and external checks and balances. Given the scale and scope of local arrangements and the lack of national data, we have focused on key elements of governance in securing financial sustainability locally instead of seeking to cover the whole system.

8 We recognise that the National Audit Office, through its responsibility for the Code of Audit Practice, is an element of the overall local governance framework. We have not examined our own role.

9 We have published a report on *Local auditor reporting in England 2018*.³ Some of the analysis in the *Local auditor reporting in England 2018* report overlaps with elements of the analysis contained in this report on *Local authority governance*. However, the former report covers 495 local government bodies and focuses purely on the outputs of local auditors and the way these have been used by local bodies and departments. In contrast, this report on governance focuses solely on the 353 principal councils and examines authorities' views on the scope and contribution of local external audit as part of their overall governance arrangements.

Key findings

Challenges to local governance arrangements

10 Risk profiles have increased in many local authorities as they have reduced spending and sought to generate new income in response to funding and demand pressures. Local authorities have seen a real-terms reduction in spending power (government grant and council tax) of 28.6% between 2010-11 and 2017-18. Demand in key service areas has also increased, including a 15.1% increase in the number of looked after children from 2010-11 to 2017-18. These pressures create risks to authorities' core objectives of remaining financially sustainable and meeting statutory service obligations. Furthermore, to mitigate these fundamental risks, many authorities have pursued strategies such as large-scale transformations or commercial investments that in themselves carry a risk of failure or under-performance. External auditors responding to our survey indicated that risk profiles were higher in 37% of single tier and county councils in 2017-18 than they were in 2016-17 (paragraphs 1.10 to 1.18 and Figures 2 to 5).

³ Comptroller and Auditor General, *Local auditor reporting in England 2018*, Session 2017–2019, HC 1864, National Audit Office, January 2019.

11 Local checks and balances need to be effective in a more complex and less well-resourced context for local decision-making. Authorities' responses to the challenges they face have tested local governance arrangements. Specific challenges include elected members in some authorities having to take more locally contentious decisions to deliver savings, sometimes weighing statutory service requirements against local priorities. New delivery arrangements adopted by authorities to secure savings or generate income such as shared services, outsourcing and commercial activities can also add greater complexity to governance arrangements. Resources to support governance also fell by 34.2% in real terms between 2010-11 and 2017-18. Authorities' governance arrangements need to be robust enough to function effectively in this more challenging environment (paragraph 1.19 and Figure 6).

12 Effective governance arrangements are an important aspect of ensuring financial control at a time of financial pressure. We have said previously that the sector trends in relation to overspending and use of reserves were not financially sustainable over the medium term.⁴ Among single tier and county councils, 61.8% overspent on their service budgets in 2017-18. A loss of effective budgetary control and budget setting scrutiny were identified as significant factors in the one case since 2010-11 where the section 151 officer has had to issue section 114 notices. A governance inspection of this authority commissioned by the Secretary of State indicated that Northamptonshire County Council had lost tight budgetary control and abandoned effective budget setting scrutiny. The report concluded that in local government, "... there is no substitute for doing boring really well. Only when you have a solid foundation can you innovate" (paragraphs 1.13 and 1.20).

The operation of local governance arrangements

The role of the section 151 officer

13 While section 151 officers as a whole are positive about their ability to deliver their role, those that do not report directly to their chief executive are less positive than those that do. Our survey of these officers showed that the great majority of respondents felt they were able to discharge their responsibilities effectively. For instance, 98% agreed or strongly agreed they felt able to share challenging information with elected members. However, the survey also showed that where these officers do not report to the chief executive and have a lower status they are less positive about their engagement with their senior leadership teams and elected members across a range of measures. To a degree, this reflects a broader concern expressed by some stakeholders about the status of these officers within the current decision-making environment and their ability to bring their influence to bear on material decisions (paragraphs 2.3 to 2.9 and Figures 8 to 10).

⁴ See footnote 2.

Internal checks and balances

14 Our survey of external auditors raised concerns about the effectiveness of a range of internal checks and balances. Local authorities are required to maintain a sound system of internal control, including risk management, internal audit, and whistleblowing arrangements. Our survey of external auditors indicated that while in the majority of cases auditors agreed that suitable arrangements were in place, this was by no means universal. For instance: 27% of auditors did not agree that **audit committees** provided sufficient assurance about authorities' governance arrangements; in 18% of cases external auditors did not agree that **internal audit** was effective; and for **risk management**, and **scrutiny, challenge and debate**, 17% and 16% of auditors respectively did not agree that arrangements were effective.⁵ Our analysis of authorities' whistleblowing policies shows that they are not always kept up to date. Of those that we could find on authorities' websites, 24.2% were out of date and 18.5% advise people to contact the Audit Commission, which was abolished in 2015 (paragraph 2.17 and Figure 11).

15 There is a sizeable group of local authorities with multiple issues with these internal checks and balances. From our survey of external auditors we selected six key internal checks and balances (audit committees, ethical standards for member behaviour, internal audit, risk management, overview and scrutiny, and statutory officers). Our analysis of survey responses indicates that where auditors have concerns about these checks and balances these tend to be concentrated in particular authorities. In 50% of cases, auditors had no concerns about any of the six elements, and in 19% there was concern with only one element. However, auditors had concerns with two or more elements in 30% of authorities, including 9% with four or more. Our analysis showed that authorities with higher levels of governance issues also tended to have higher risk profiles. There is therefore a substantial body of authorities where governance arrangements are showing signs of stress in the context of the financial pressures acting on the sector (paragraphs 2.23 to 2.27 and Figure 12).

External checks and balances

16 Auditors concluded that in 2017-18 nearly one in five single tier and county councils did not have adequate arrangements in place to secure value for money. External auditors produce an annual conclusion on an authority's arrangements to secure value for money. For 2017-18, 4.6% of conclusions issued for district councils and 19.3% issued for single tier and county councils were qualified. Roughly half of the qualifications in single tier and county councils were given solely on the basis that the children's social care service had been rated 'inadequate' in an Ofsted inspection. Our survey of external auditors indicated that in several cases authorities did not take appropriate steps in response to qualified conclusions. We have said elsewhere that, while levels of qualifications are lower amongst local authorities than some other public sector bodies, the level of qualified conclusions is unacceptably high (paragraphs 2.28 to 2.32 and Figure 13).⁶

⁵ This includes auditors responding 'strongly disagree', 'disagree' and 'neither agree nor disagree'. In our focus groups, a number of which were with survey respondents, it was agreed that where respondents had responded 'neither agree nor disagree', they were not stating that a particular arrangement was dysfunctional, but they were indicating that it was not of an appropriate standard and there was room for improvement. See Appendix Two.

⁶ See footnote 3.

17 Over half of the section 151 officers from single tier and county councils responding to our survey indicated that they wanted changes to be made to external audit. Among section 151 officers from single tier and county councils responding to our survey, 51% indicated that there were aspects of external audit they would like to change. This included requests for a greater focus on the value-for-money element of the audit (26%) and less of a focus on the valuation of capital assets within auditors' work on their financial statements (14%). In our focus groups, heads of paid service, section 151 officers and internal auditors raised concerns that the contribution of external audit to local governance had been reduced recently. Frequently, they linked this to the reduction in the audit fee paid by authorities. Among respondents from single tier and county councils to our section 151 officer survey, 25% thought their audit fees for 2017-18 were 'too low'. However, 68% thought their audit fees for 2017-18 were 'about right', and 3% thought they were 'too high' (paragraphs 2.36 to 2.42 and Figures 17 to 19).

The role of the Department

18 In the Department's view, its responsibility is for the local governance system as a whole. The Department relies on this system to ensure that local authorities are accountable for acting with regularity, propriety, and value for money in the use of all their resources. The accounting officer is clear that she is responsible for ensuring that the local governance system as a whole contains the right checks and balances and is working. The Department told us that its assurance role required it to test and examine the system rather than collecting information about every individual authority. Accordingly, the Department's bi-annual advice to the accounting officer on the robustness of the system is not based on assessments of each individual authority's governance arrangements. In the Department's view, individual local failings do not represent system failure. The Department said that the identification of system failure would involve a judgement based on the nature, scale and circumstances of local failings (paragraphs 3.2 to 3.8).

19 The Department lacks the evidence base to assess rigorously whether governance issues are system-wide and this reduces the level of confidence it can have in the operation of the system. The Department has been clear that it does not collate systemic data on governance following the abolition of the Audit Commission and the associated reduction in reporting requirements on councils. It has increased its consideration of governance at some individual authorities. Using information from its monitoring of financial risk alongside additional information, the Department's reports contain information on governance failings at authorities of concern. This work draws on only one national data set containing governance information. The Department recognises that it could do more to identify systemic concerns and test elements of the system. It has made a risk-based judgement on how to prioritise its efforts and as a result has primarily but not exclusively focused on financial risks to date (paragraphs 3.6 to 3.14).

20 The Department is able to intervene both formally and informally in authorities where it has concerns about governance arrangements, but the process of engagement short of statutory intervention is not transparent.

The Department told us that there was no fixed process for advising the Secretary of State about the use of formal intervention powers, and that while there is internal guidance this does not constitute criteria by which to judge potential interventions. The Department has made high-level public statements about its process of engagement with authorities where it has formally intervened. However, the Department considered there is a need for a 'safe space' for decision-making about whether and how to engage. This includes making decisions about lower-level engagement with individual authorities, or about non-statutory intervention such as independent improvement panels. The Department believes that its approach gives it flexibility, reduces the risk of legal challenge, and that privacy also benefits the local authorities themselves. However, it also means that the scale and effectiveness of its engagement in the sector is not open to public scrutiny or challenge. We cannot fully assess the operation of the system in this context (paragraphs 3.15 to 3.21).

21 There is no clear leader that drives coordinated change across the local governance system. Individual parts of the system are led by other organisations, but the Department's network is fragmented and there is no clear overall system leadership. The Department is engaged with all the actors with responsibilities in the governance framework to differing degrees, from ad hoc meetings to a Memorandum of Understanding in one instance. The Department has set out how the Framework functions via the Accounting Officer System Statement. However, it is not clear how the individual players come together to consider tensions, gaps in the systems, or resolve disputes about roles or sharing information. The Department understands the need for it to be more active in this space to provide leadership to drive coordinated change across the system (paragraphs 3.22 to 3.25 and Figure 20).

Conclusion on value for money

22 Local government has faced considerable funding and demand challenges since 2010-11. This raises questions as to whether the local government governance system remains effective. As demonstrated by Northamptonshire County Council, poor governance can make the difference between coping and not coping with financial and service pressures. The Department places great weight on local arrangements in relation to value for money and financial sustainability, with limited engagement expected from government. For this to be effective, the Department needs to know that the governance arrangements that support local decision-making function as intended. In order to mitigate the growing risks to value for money in the sector the Department needs to improve its system-wide oversight, be more transparent in its engagement with the sector, and adopt a stronger leadership role across the governance network.

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.