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## Report to Performance Overview Scrutiny Committee

# Update on Financial Administration in Local Authorities

**Portfolio Holder:** Councillor Abdul Jabbar MBE, Deputy Leader and Cabinet Member for Finance and Low Carbon

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### **Purpose of Report**

The purpose of this report is to advise Members of the recent Section 114 notices and associated reports issued by the Chief Finance Officers (Section 151 Officers) at two Local Authorities (the London Borough of Croydon and Slough Borough Council) and provide information on the recent capitalisation directions issued by the Ministry of Housing, Communities and Local Government to support the financial position of several Local Authorities during 2020/21 and 2021/22.

### **Executive Summary**

The detailed information published in the public domain for the London Borough of Croydon has identified that the Scrutiny Committee should have better held the Executive of the Council to account in ensuring operational services spent within their agreed budget allocation and on oversight of Council's partnerships. This report has been prepared to assist the Committee to:

- a) discharge its future Scrutiny function in ensuring there is consideration that the Council effectively manages its budget and oversees partnerships arrangements.
- b) appropriately consider the work programme included elsewhere on the Agenda.

### **Recommendations**

The Committee notes the report and utilises the information provided when considering the work programme elsewhere on the Agenda.

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**Update on Financial Administration in Local Authorities**

**1 Background**

- 1.1 The Performance Overview Scrutiny Committee within the Council has responsibility for scrutinising the deliverability of the Council's agreed budget and providing oversight of key partnerships. The issuing of the Section 114 notice at the London Borough of Croydon has been subject to review by the Ministry of Housing, Communities and Local Government (MHCLG) Select Committee. This alongside the Public Interest report issued by the External Auditor in relation to the London Borough of Croydon has identified the importance of effective Scrutiny to ensure that services deliver within their agreed budget envelope. The view expressed to the MHCLG Select Committee was that if Croydon had brought under control the budget in the overspending areas of Children's and Adults Social Care, the Council would not have needed to engage in high risk commercial investments to generate extra income to balance its budget.
- 1.2 Events have also identified a lack of oversight of partnerships in several authorities resulting in historic losses materialising in the 2020/21 accounts. This has contributed to the issuing of the Section 114 notices at both Slough and Croydon. It has also led to certain Authorities such as Nottingham City Council having to obtain a capitalisation direction from the MHCLG to set a balanced budget for 2021/22.

**2 London Borough of Croydon**

**Section 114 notice**

- 2.1 During 2020, the Section 151 Officer at the London Borough of Croydon issued two Section 114 notices (explanation of such a notice attached as Appendix 1) which limited the spending of the Council to statutory and contractual items. To balance its revenue budget for the financial year 2020/21, the Council relied on a substantial contribution in respect of anticipated loan interest (on money advanced to fund construction) from its wholly owned Housing Company (named Brick by Brick). The company had not achieved the level of construction it anticipated as per its business plan and therefore was not able to repay these loans and the interest due to the Council in the financial year 2020/21.
- 2.2 The information provided to the MHCLG Select Committee to consider the challenges, identified that the system for oversight of the partnerships within the Borough was poor and those Members who had a governance role (both Scrutiny and Audit) to hold the Executive to account, did not discharge their duty effectively. It has been reported, as an example, that when reports were presented to Scrutiny by Brick to Brick, that key information was not made available. With hindsight the Scrutiny Committee should have insisted this information was made available.

**Public Interest Report**

- 2.3 The Public Interest report prepared by the External Auditor identified several instances of poor governance linked into the oversight of the Housing Company, management of other Council owned companies and other commercial investments. In addition, reports in the local press indicate the External Auditor is undertaking a value for money review of a significant refurbishment of a major cultural venue overseen by the Housing Company which has now cost the Council £70m (significantly over the original budget). The original intention was that the refurbishment costs were to be financed from the profits of a housing development on land next to the cultural venue. This housing development has not yet
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taken place and following a recent review by the Council, the development will not now be undertaken by its wholly owned housing company. As such the Council has had to finance the costs of the refurbishment from its own capital resources, with a direct impact on financing costs which are charges against the revenue budget on an annual basis. In addition, the accounting arrangements applied to the 2019/20 Croydon Statement of Accounts (now the Council is funding the scheme) are under consideration. These have the potential to affect the reported level of general balances previously presented by the Council.

### **Capitalisation Direction**

- 2.4 The capitalisation direction (the ability to finance revenue expenditure as if it was capital spending) has now been agreed by the MHCLG for the financial year 2020/21 at a level of £70m, with the principle agreed that there may be a further capitalisation direction totalling £50m for the financial year 2021/22. This has enabled Croydon to set a balanced budget by borrowing money from the Public Works Loan Board (at an enhanced rate of interest) in order to underpin its revenue budget. This money and the associated interest will need to be repaid by the Council in line with its Minimum Revenue Provision (MRP) policy. Indications on the provisional out-turn are that the overspend for the financial year 2020/21 is just below the maximum capitalisation level of £70m although, the unresolved issues on accounting for the costs associated with the cultural venue and previous loan interest to be received from the housing company, could impact on both the 2019/20 and 2020/21 financial position.

### **Government Intervention**

- 2.5 One condition for Croydon receiving the agreed financial support has been the appointment of an Improvement and Assurance Panel, to ensure going forward, that the Council is operated on a sound footing. The Panel has produced two reports for the MHCLG which are made available in the public domain. The second report highlights the financial position remains extremely challenging and will take some time to resolve

## **3 Slough Borough Council**

- 3.1 On the 2 July 2021 the Interim Section 151 Officer at Slough Borough Council issued a Section 114 notice for Slough Borough Council. This followed the External Auditor only considering signing off the accounts for the financial year 2018/19 if an adjustment was processed which reduced the agreed level of general balances to £550k. The adjustment related to the Council overstating the income it expected to receive from a joint venture (set up for commercial purposes). Such an adjustment impacted on the 2019/20 and 2020/21 accounts which are currently undergoing audit and could be subject to an adjustment which further reduces the level of general balances.
- 3.2 The impact on the 2019/20 and 2020/21 accounts is currently being worked through. However, the interim Section 151 Officer was of the view that the Council was effectively bankrupt and issued the Section 114 notice estimating that the level of general balances as of 31 March 2021 would be -£56m (a deficit of £56m). Effectively the interim Section 151 officer has identified that the Council did not set balanced budgets for the financial years 2018/19, 2019/20, 2020/21 and 2021/22. In this officer's report to Council in July when the Section 114 notice was discussed, the officer highlighted that the Council had not charged MRP appropriately to its revenue account since the 2016/17 Statement of Accounts. This therefore meant that the cost of its borrowings, which had increased substantially over the last five years, had been understated in the accounts. Prior to the appointment of the Interim Section 151 Officer, the Council had requested a capitalisation direction of £15.2m. Recent information in the public domain indicates this will now need
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to be increased as this is expected to be insufficient to address the underlying financial position.

#### **4 Capitalisation Directions**

4.1 In addition to the two Authorities who have had Section 114 Notices issued by their Section 151 Officer, the MHCLG has agreed to capitalisation directions at the Authorities detailed below:

- Peterborough City Council
- Eastbourne Borough Council
- The London Borough of Bexley
- Luton Borough Council
- Nottingham City Council
- Wirral Metropolitan Borough Council
- Redcar and Cleveland Unitary Authority
- Copeland District Council

4.2 Whilst the circumstances of each Authority requesting a capitalisation direction are linked into their own unique circumstances, some common themes are emerging as to why such a direction is required. These are:

- a failure to set aside sufficient MRP to cover the cost of borrowing undertaken;
- setting a budget with a very low level of general balances (as such the ability of the authority to absorb a financial shock is minimal); and
- poor partnership governance of wholly owned companies.

4.3 In reviewing its work programme, it is suggested that this Committee liaises with the Audit Committee to ensure adequate oversight of these areas within the Council.

4.4 One condition of this extra Government support is that each Council must commission a review of its financial administration including its financial resilience. The Chartered Institute of Public Finance and Accountancy has been commissioned to undertake each of these reviews. As such, further information on the financial practices of these Authorities is likely to be considered in the public domain once these external reviews have been concluded.

#### **5 Impact on the Committee's Future Work Programme**

5.1 The findings as per the report produced by the MHCLG Select Committee indicate that the primary failure at the London Borough of Croydon was the inability of the Council to deliver a balanced budget with overspendings on certain service areas not being challenged. Whilst not a formal recommendation to the Select Committee, it is considered sensible for this Committee to incorporate the need for effective budget scrutiny into its work programme.

#### **6 Actual Work Programme**

6.1 The suggested work programme is the next item on the Agenda. This report is aimed at ensuring Members of the Committee consider how the work programme is shaped to address all areas deemed appropriate.

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- 7 **Consultation**
  - 7.1 N/A.
  - 8 **Financial Implications**
  - 8.1 N/A
  - 9 **Legal Services Comments**
  - 9.1 N/A.
  - 10 **Cooperative Agenda**
  - 10.1 N/A.
  - 11 **Human Resources Comments**
  - 11.1 N/A.
  - 12 **Risk Assessments**
  - 12.1 N/A
  - 13 **IT Implications**
  - 13.1 N/A.
  - 14 **Property Implications**
  - 14.1 N/A.
  - 15 **Procurement Implications**
  - 15.1 N/A.
  - 16 **Environmental and Health & Safety Implications**
  - 16.1 N/A.
  - 17 **Equality, community cohesion and crime implications**
  - 17.1 N/A.
  - 18 **Equality Impact Assessment Completed?**
  - 18.1 N/A.
  - 19 **Key Decision**
  - 19.1 N/A.
  - 20 **Forward Plan Reference**
  - 20.1 N/A.
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## 21 **Background Papers**

- 21.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref: MHCLG Local authority financial sustainability and the section 114  
<https://publications.parliament.uk>  
Report in the Public Interest concerning the Council's financial position and related governance arrangements – London Borough of Croyden  
<https://www.croydon.gov.uk>

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## 22 **Appendices**

- 22.1 Appendix 1 - A Section 114 Notice
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### What is a S114 Notice?

Within the Local Government Finance Act 1988, Section 114 (3) dictates that:

“The chief finance officer of a relevant authority shall make a report under this section if it appears to him that the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed the resources (including sums borrowed) available to it to meet that expenditure”.

In general terms this means that for Local Government, it is the Chief Finance Officer or Section 151 officer who has the role under law of being the most senior financial advisor to the wider Council's leadership on its financial plans. Uniquely across the public sector however, the CFO also has the power and responsibility to legally suspend spending for a period of time if they judge the council does not have a balanced budget or the imminent prospect of one.

### What happens when a S114 Notice is issued?

It means that no new expenditure is permitted, with the exception of safeguarding vulnerable people and statutory services, however existing commitments and contracts will continue to be honoured.

Council officers must therefore carry out their duties in line with contractual obligations and to acceptable standards, while being aware of the financial situation. Any spending that is not essential or which can be postponed should not take place and essential spend will be monitored.

The only allowable expenditure permitted under an emergency protocol would include the following categories:

- existing staff payroll and pension costs
- expenditure on goods and services which have already been received
- expenditure required to deliver the council's provision of statutory services at a minimum possible level
- urgent expenditure required to safeguard the vulnerable citizens
- expenditure required through existing legal agreements and contracts
- expenditure funded through ring-fenced grants
- expenditure necessary to achieve value for money and / or mitigate additional in year costs

Councillors have 21 days from when a Section 114 notice is issued to discuss the implications at a Full Council meeting.

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