

Report to Audit Committee

Update on Financial Administration

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

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8 September 2022

Purpose of the Report

The purpose of this report is to update Members of the Audit Committee on key matters both nationally and locally impacting on Audit and Governance.

Executive Summary

The key matters covered in this report as detailed below are issues of Financial Administration at the following Authorities/ organisations:

- Nottingham City Council
- The London Borough of Croydon
- Slough Borough Council
- Northumberland County Council
- Thurrock Council
- Liverpool City Council
- Sandwell Metropolitan Council
- Luton Borough Council
- Lancashire County Council
- Northwest Community Bank
- Together Energy

The report also advises of a recent communications from the Department for Levelling Up, Housing and Communities (DLUHC) about the future use of capital receipts and the engagement of consultants for the purposes of interpreting Government policy.

It also details other areas of potential interest which could result in further reports which are critical of financial administration for the Authorities detailed above.

Recommendation

The Committee is asked to note the key matters detailed in this report on Audit and Governance.

1 Section 114 Notices Issued by Local Authorities

- 1.1 There have now been four Authorities where the Section 151 Officer has issued a Section 114 Notice since the start of the pandemic. These are the London Borough of Croydon, Slough Borough Council, Nottingham City Council and Northumberland County Council. Two of these Notices (relating to the London Borough of Croydon and Slough) are due to the Councils not having adequate reserves/ general balances to cover day their day to day expenditure. As a result, the two Councils have sought and been granted on-going central Government support via a capitalisation direction (an authority to borrow to meet the costs of revenue expenditure). The other two Notices issued (relating to Nottingham City Council and Northumberland County Council) are more technical in the nature of the breach which has occurred and are covered in more detail in the paragraphs below.

London Borough of Croydon

- 1.2 As previously reported to this Committee, it was necessary for the Section 151 Officer at Croydon to issue a Section 114 Notice (linked into the overall financial resilience of the Council) which was closely followed by the production of a Public Interest report (prepared by the External Auditor) outlining inadequate financial administration including a lack of effective oversight of partnerships which included its wholly owned housing company "Brick by Brick". As further work was undertaken to understand the issues it became apparent that one project delivered on behalf of the Council by this housing company to refurbish the cultural venue "Fairfield Halls" (not detailed in the original Public Interest report) had not gone to plan. This resulted in the production of a second Public Interest report which was critical both of the original procurement (utilising Brick by Brick to procure the contractor) and subsequent project management by Brick by Brick of the works undertaken on the refurbishment which cost more than budgeted with elements of the planned works still not completed. The original business case to finance the cost of refurbishment of Fairfield Halls from the residential development of a large development site of land located next to the venue, proved to be unrealistic and the Council ultimately was required to finance the project from its own capital resources.
- 1.3 Currently there remains one other significant issue at the London Borough of Croydon which is subject to external scrutiny by the External Auditor. This relates to the transfer of assets (a proportion of housing stock) from the Housing Revenue Account to a wholly owned Council Company. This generated a financial benefit to the General Fund. This is a complex issue, and the consideration of the accounting merits of the transaction is ongoing. There remains the potential that the External Auditor decides the past action taken by the London Borough of Croydon is not appropriate. At present there are external Inspectors appointed who are overseeing the response of the Council to the financial predicament it finds itself from previous decisions made. The latest update on the progress made by the Council to improve its financial processes from the Inspection is expected imminently.

Slough Borough Council

- 1.4 The events at Slough Council whereby the Authority accounted for income generated from a joint venture partnership which, after a review by the External Auditor, it was determined that the income levels were not as high as originally expected and resulted in an agreed adjustment to their 2018/19 accounts. This had the impact of reducing their general balances to virtually nil (effectively making them financially insolvent) compared to the financial position originally reported when the draft Statement of Accounts were submitted for External Audit.
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- 1.5 The concerns over the financial administration at the Council resulted in the recruitment of an experienced interim Section 151 Officer. Following a review of the financial position the interim Section 151 Officer issued a Section 114 Notice based on their view of the lack of overall financial resilience of the Council. In subsequently reviewing the finances of the Council, it became apparent that the previously agreed policy for charging Minimum Revenue Provision (MRP) did not follow the professional guidance issued to govern effective Capital Accounting or align to good Treasury Management practices in not setting aside an appropriate budget to facilitate repayments of debt. Slough had undertaken significant borrowing, in part, to fund significant investments in both partnerships and commercial property to generate an ongoing income. This has resulted in further adjustments to its accounts leading to a deterioration in the previously reported financial position covering several financial years. It has also required the Government to underwrite significant levels of capitalisation to support future budgets.
- 1.6 To remain financially solvent, Slough could require capitalisation directions up to £500m. One plan going forward to manage the finances is for Slough to sell off its assets to reduce the overall level of debt.

Nottingham City Council

- 1.7 The losses incurred by Nottingham City Council from setting up and then operating its own energy company (Robin Hood Energy) have previously been reported to this Committee. These significant financial losses led to a review which highlighted poor oversight of all Nottingham City Council partnerships including the Arm's Length Housing Company (Nottingham City Homes). After a period, the Secretary of State for the Department of Levelling Up, Housing and Communities considered that the City Council could not manage the issues under its own direction and has appointed independent Inspectors to continue the work already underway to improve financial administration.
- 1.8 This ongoing work identified an issue whereby between 2014 and 2021 the amount charged to the Housing Revenue Account for services provided within the Council which were then credited to the General Fund were excessive (estimated to be £14.366m). This breach has resulted in the Interim Treasurer of Nottingham City Council issuing a Section 114 Notice. The outcome is that Nottingham City Council will have to repay the £14.366m to the Housing Revenue Account impacting on its overall financial resilience.

Northumberland County Council

- 1.9 The fourth Section 114 Notice was issued by the Interim Treasurer of Northumberland County Council. It was in relation to a partnership developed in conjunction with the NHS. There were several joint roles working across the Council and the NHS which included that of the Chief Executive. The partnership resulted in the two parties (the NHS and the Council) developing a consultancy business which charged for services provided to other countries. The responsibilities in relation to the services to be provided by the consultancy, how it charged for services and payments made to key staff, including the Chief Executive, were not documented and agreed in accordance with the Constitution of the Council. As such the Section 114 Notice was issued based upon this. Ironically it appears that the charges for consultancy made under the partnership did cover the costs incurred. The outcome is that the Chief Executive has now left the Authority.

2 Council Investment Decisions

- 2.1 There are some Council investments whereby losses have either become apparent or there is a risk of future losses not yet recognised in their financial statements. The situation at the London Borough of Croydon around their investment in the wholly owned company
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“Brick by Brick” and the Slough Borough Council investment in partnerships have previously been reported to this Committee so are not repeated in this report.

- 2.2 Issues at Thurrock Council, Warrington Borough Council via their investment in Together Energy and a further issue at the London Borough of Croydon linked into the transfer of Housing Revenue Account assets to a wholly owned company are detailed below. There has also been a proposed joint venture between Liverpool, Wirral and Preston Councils to set up a Community Bank which highlights the risks of setting up partnerships and not concentrating on core business. A recent communication from the Department of Levelling Up, Housing and Communities highlighting the risks to Authorities should they engage consultants to propose innovative approaches to financial transactions is also detailed in this Section of the report. Further detail of this communication can be found at paragraph 2.11 and at Appendix 1.

Thurrock Council

- 2.3 The risks of losses on the green investments made by this Council have been highlighted by the Bureau of Investigative Journalism and subsequently reported in the national press. There are perceived risks with two current investments:
- The Council invested in a bond totalling £30m issued by the Cyprus Stock Exchange in a company called Pure World Energy. There is a risk this company may not be in a financially resilient position to repay this bond in full.
 - The company invested in wind farms originally financed by a company called Rockfire Capital. In a court case (not involving Thurrock) it has become apparent the value of money invested in these wind farms may not be sufficient to recoup the original investment. The reported shortfall as reported in the popular press could amount to £130m.

Warrington Borough Council - Investment in Together Energy

- 2.4 As part of its Treasury Management Strategy to generate income from third party investments, Warrington Borough Council acquired a 50% equity shareholding in the company, Together Energy, paying £17m. At the point Warrington became a shareholder in the company, Together Energy acquired the domestic customers of Bristol Energy (a Local Authority company which had failed).
- 2.5 In addition, over the period of the shareholding the Council has provided guarantees linked into certain matters for the Company which prolonged its operation as a going concern. The company subsequently went into liquidation as Warrington were no longer prepared to provide guarantees to enable the company to continue as a going concern. At the time the company went into liquidation it could not cover certain commitments in relation to Renewable Energy. The expected financial losses from this investment are expected to materialise as the company liquidation is progressed. Recent publications advise that the cost to the Council will not exceed £18m.

London Borough of Croydon

- 2.6 The investment by the London Borough of Croydon in their housing company has resulted in significant financial loss which will impact on the residents. The company is in the process of winding up its operation but the losses to the Council despite land transfers at no cost to the Company are likely to total £100m.
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Northwest Community Bank

- 2.7 This was a planned joint venture between Liverpool City Council, Wirral Metropolitan Borough Council and Preston Borough Council. The aim was for the constituent members to invest between them an amount of £20m to finance a community bank to be constituted as per the regulatory framework overseen by the Financial Conduct Authority (FCA). The work undertaken on this collaborative project obtained the approval of the FCA which would have enabled the entity to operate as a community bank.
- 2.8 As the project moved from the planning stage to the implementation stage the financial resilience at Wirral Council declined and Liverpool City Council was subject to a Best Value Inspection. These events have influenced both these organisations capacity to support the initiative. Observations by the externally appointed inspectors/ advisors at both Liverpool and Wirral indicate the resource utilised on this investment diverted resource from concentrating on more routine financial administration.

Department of Levelling Up, Housing and Communities recent guidance to Local Authorities

- 2.9 Following his appointment as the Secretary of State for the Department of Levelling Up, the new Secretary of State challenged a proposed investment decision from Bournemouth, Poole and Christchurch Council which proposed the transfer of assets including beach huts to a wholly owned Council Company. This was followed by a letter dated 2 August 2022 whereby the use of capital receipts to fund transformational projects is to be limited to schemes which retain in the control of Councils.
- 2.10 The statutory guidance is beginning to reflect a Central Government concern that Councils are not always utilising their flexibilities on investments wisely or in accordance with expected practice.
- 2.11 Furthermore, a letter was issued on 19 August 2022 from the Secretary of State for the Department of Levelling Up, Housing and Communities, expressing concern that some Local Authorities are engaging in high risk commercial practices and are sometimes using external advice to implement risky strategies that “push at the bounds of what is permitted”. Whilst it is acknowledged that external advice is required to assist with operational movements, the Secretary of State is clear that companies should not gain by pushing risky and novel practices using public funds and which the Government will need to intervene to prevent. A copy of this letter can be found at Appendix 1.

3 Potential Improvements in Financial Control requiring Implementation

- 3.1 The situation at Liverpool City Council whereby procurement arrangements required improvement have previously been reported to this Committee. There are two matters recently in the public domain which require reporting which are detailed below relating to Luton Borough Council and Lancashire County Council.

Luton Borough Council

- 3.2 One risk identified in the 2021/22 Annual Governance Statement as previously regularly reported to this Committee is bank mandate fraud. It has been reported that Luton Borough Council in undertaking their role of administering the local enterprise partnership had suffered a fraud totalling £1.1m whereby an e-mail purporting to be legitimately from a third party, resulted in the Council changing the bank details of one of it’s suppliers. This led to the successful fraud. Arising from this development there is an exercise ongoing within Oldham to review systems and processes.
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Lancashire County Council / Liverpool City Council

- 3.3 A long term criminal investigation (code name Operation Sheridan) was launched in 2013 into alleged irregularities in the provision of goods and services by Liverpool Direct Limited and One Connect Lancashire Limited which are both Joint Venture companies set up by Liverpool City Council and Lancashire County Council respectively with British Telecom. On 23 August 2022, a former Council leader and three former senior Council officers were charged with a number of offenses and are due to appear before Magistrates Court on 12 October 2022.

4 Value for Money

- 4.1 The Government intervention at a few Authorities such as Liverpool and Nottingham are linked into a failure of those Authorities to discharge their Best Value duty in securing value for money for their Council taxpayers. The risk of a poor routine value for money opinion is highlighted by Sandwell Metropolitan Borough Council as detailed in the paragraph below.

Sandwell Metropolitan Borough Council

- 4.2 Following the production of a critical value for money review by the External Auditor for the financial year 2020/21 a decision was made by the Secretary of State to appoint Inspectors which included the interim Chief Executive. The Value for Money review identified several projects (Regeneration and ICT) which had been poorly implemented. As such the Council has lost an element of direct control.

5 Options/Alternatives

- 5.1 The Audit Committee considers this report which details issues impacting on certain Local Authorities linked into financial administration.

6 Preferred Option

- 6.1 The preferred option is that the Audit Committee reviews this report in accordance with the recommendation made.

7 Consultation

- 7.1 N/A.

8 Financial Implications

- 8.1 There is no direct financial impact to the Council from the matters detailed in this report as the instances highlighted relate to decisions taken within other Local Authorities. It is important that Members of the Audit Committee understand that some organisations have had a higher appetite for risk than others and that on occasions this can lead to significant financial implications impacting on future financial resilience if matters do not go to plan. The role of the Audit Committee is to provide appropriate challenge on proposals to ensure risks taken are proportionate. (Anne Ryans)

9 Legal Services Comments

- 9.1 N/A.
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10 **Cooperative Agenda**

10.1 N/A.

11 **Human Resources Comments**

11.1 N/A.

12 **Risk Assessments**

12.1 In undertaking its role of governance/ scrutiny on behalf of the Council it is important that Members of this Committee are aware of the issues which have arisen at other Local Authorities. As more detailed investigation has been undertaken into where the governance was less than robust at Local Authorities there has been criticism that the oversight of Regulatory Committees such as the Audit Committee has been less than satisfactory. It is therefore important that individual Members are aware of the risks and provide challenge that such instances could not occur in Oldham. (Mark Stenson).

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.

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: None – the report has utilised public documents from Government and respective Councils' websites

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22 **Appendices**

- 22.1 Appendix 1 – Letter from Secretary of State for the Department of Levelling Up, Housing and Communities



Department for Levelling Up, Housing & Communities

The Rt Hon Greg Clark MP
*Secretary of State for Levelling up
Housing & Communities*

***Department for Levelling Up,
Housing and Communities***
4th Floor, Fry Building
2 Marsham Street
London SW1P 4DF

To: Firms offering councils commercial advice

www.gov.uk/dluhc

19 August 2022

Dear Sir or Madam,

FLEXIBLE USE OF CAPITAL RECEIPTS FOR TRANSFORMATION PROJECTS

I am writing to you as I have concerns that some local authorities are engaging in risky commercial practices, which are putting taxpayers' money at risk. I know that many local authorities engage with consultants and advisors to bring in the necessary expertise and support for a range of reasons, including asset management, financial and accounting advice and to support operational improvements. I recognise the need for local government to draw on expertise and specialist advice, and that this is both necessary and can have significant benefits.

I am concerned, however, that some authorities look for strategies that push at the bounds of what is permitted, and sometimes seek external advice and support to implement novel and risky strategies. I recently closed a loophole in the powers afforded to councils for the flexible use of capital receipts; it concerns me that this was necessary. I would like to be able to trust councils to follow the spirit as well as the letter of the law, and to act prudently with public money. I am, however, concerned that some councils are spending taxpayers' money on external advice to engage in practices that may put public money and service delivery at risk.

I am writing to all councils and those companies who I know work with the sector, to ensure a wide-reaching and consistent message and to ask your support in safeguarding the financial framework. To be clear, I recognise that many councils and advisors will be engaged in sensible, prudent activity. However, I hope that you will agree with me that companies should not seek to gain by helping councils pursue strategies that engage in risky financial practice. This includes where local authorities are taking excessive risks with novel strategies or looking for ways to circumvent the

statutory bounds that are designed to constrain risk. Council officers and Members must also take seriously their responsibilities, and not waste money by pursuing strategies that the government then must intervene to prevent.

I welcome any engagement on this matter and hope that the sector, its advisors, and the government can work cooperatively to make sure public money is used appropriately.

Yours ever,

A handwritten signature in black ink that reads "Greg Clark". The signature is written in a cursive style with a large, sweeping "G" and "C".

RT HON GREG CLARK
Secretary of State for Levelling Up, Housing and Communities