Middlesbrough Council

Value for Money Update and Issuance of Recommendations Under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014

21 August 2023

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21 August 2023

Full Council
Middlesbrough Council
Civic Centre
Middlesbrough
TS1 9GA

Dear Elected Members (members) of Middlesbrough Council

In our Draft Audit Results Report for our 2020/21 audit presented to the Corporate Affairs and Audit Committee in July 2022 we reported that we had observed evidence which led us to conclude that the culture and governance arrangements at the Council had not been operating as expected, and that this was undermining the effectiveness of the Council's governance framework. At the same time, we made recommendations to the Council to address our observations and emphasised that the Council needed to address our primary recommendation as an immediate action.

In November 2022, we issued our first update on the Council's response to our recommendations. In it, we noted that the steps taken by the Council were in-line with those we expected to see from the Council in responding to our recommendations and the future actions identified at that point appeared to be appropriate steps towards addressing both the depth and breadth of cultural and governance issues at the Council. We also however noted it was clear that there was significant concern amongst a number of stakeholders over the ability of the Council to deliver on these actions.

This report provides:

i. Our assessment that whilst there are signs of an improvement in the pace with which the Council is addressing the significant cultural and governance weaknesses which we have previously highlighted, the Council has not made the overall progress we would have expected over the period between our previous update in November 2022 and this report; and

ii. Our assessment that three further significant weaknesses in the Council's arrangements to secure value for money in its use of resources have been identified since our previous reporting.

Within this report, we make 11 formal statutory recommendations to the Council under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014:

1. We recommend that the Council ensures the recent progress with development of the next phase of the Corporate Governance Improvement Plan is progressed without further delay, and that appropriate prioritisation is given to actions which address the cultural and governance issues of the Council within the expanded scope of the revised Corporate Governance Improvement Plan.
2. We recommend that the Council develop contingency and succession governance protocols to ensure that delivery of the Corporate Governance Improvement Plan is not further disrupted by any future changes in one or more of the Council's senior leadership positions.

3. We recommend that the Council prioritises the conclusion of its review and updating of the Constitution, drawing upon examples of best practice and ensuring that the refreshed Constitution is clear in its language and requirements. Training on the refreshed Constitution should be provided to all officers and members to ensure that changes are appropriately understood and implemented.

4. We recommend that the Council builds upon the steps already taken to control its expenditure to identify specific deliverable savings over the short term (next 12 months) and protect its limited remaining reserves. Where appropriate, this may need to include the Council changing how it meets its statutory responsibilities and the extent to which it delivers services which are not required to discharge its statutory responsibilities.

5. We recommend that the Council reviews its service delivery models to ensure that they are efficient, represent value for money and achieve the outcomes required for the resources invested. Where opportunities to improve service delivery models are identified, the Council should develop detailed plans for implementation of service delivery transformation and how the up-front transformation costs will be funded.

6. We recommend that the Council review its financial forecasting processes to understand why significant financial pressures, over and above those anticipated and reflected in the Council's annual budget, have emerged within the first half of both the 2022/23 and 2023/24 financial years and ensure future forecasting reflects the lessons learned.

7. We recommend that the Council conclude its review of its Financial and Contract Procedure Rules to ensure that they reflect the needs of the Council and the expectations of members and implement the revised rules without delay. This should include being explicit on how contract modifications should be assessed and managed, as the Financial and Contract Procedure Rules do not currently address contract extensions.

8. We recommend that, once the Financial and Contract Procedure Rules are finalised, training is provided to all officers involved in contracting, procurement or financial decision making to ensure that the requirements of the Financial and Contract Procedure Rules are understood and adhered to.

9. We recommend that the Council complete their review of all ongoing contracts which were initially awarded under an exemption but have been subject to subsequent amendment (including extension) to identify whether they are compliant with The Public Contracts Regulations 2015. If further non-compliance is identified, the Council should evaluate whether any remedial action is necessary.

10. We recommend that the Council review its oversight arrangements for Middlesbrough Development Company for the period up to the demise of the entity, so that it can satisfy itself that Middlesbrough Development Company is delivering value for money with the resources provided to it during this period.

11. We recommend that the Council develop an action plan for the demise of Middlesbrough Development Company which sets out how the Council will realise the value which has been created through the resources provided to Middlesbrough Development Company by the Council.

The Council must consider these recommendations at a public meeting held before the end of the period of one month beginning with the day on which it was sent to the Council. At that public meeting, the Council must decide whether the recommendations are to be accepted and what, if any, action to take in response to these recommendations.

A copy of this report has been sent to the Secretary of State for Levelling-Up, Housing and Communities, and to the directors of Middlesbrough Development Company.

Yours faithfully

Stephen Reid

Partner, for and on behalf of Ernst & Young LLP

Our previous observations

Value for Money

The Council's responsibilities for value for money

The Council is required to maintain an effective system of internal control that supports the achievement of its policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

As part of the material published with its financial statements, the Council is required to bring together commentary on its governance framework and how this has operated during the period in a governance statement. In preparing its governance statement, the Council tailors the content to reflect its own individual circumstances, consistent with the requirements set out in the CIPFA code of practice on local authority accounting. This includes a requirement to provide commentary on its arrangements for securing value for money from their use of resources.

Our observations

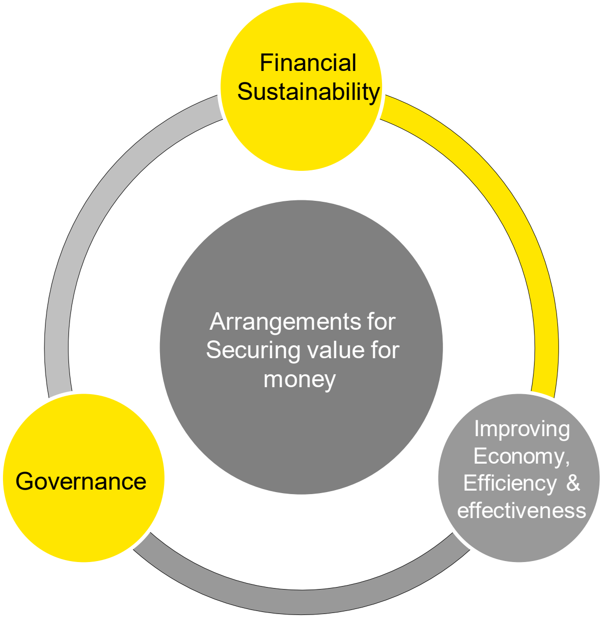
In our Draft Audit Results Report for our 2020/21 audit we reported that we had observed evidence which led us to conclude that the culture and governance arrangements at the Council had not been operating as expected, and that this was undermining the effectiveness of the Council's governance framework.

During the year ended 31 March 2021, we identified multiple instances where significant decisions were taken by the Council without following the Council's established policies and procedures and contrary to the boundaries of the respective roles and responsibilities of officers and members. These included, but were not limited to:

- Significant changes to the design of the Council's largest capital project, Boho X, occurring outside of the Council's Programme and Project Management Framework.
- Purchase of Covid-19 tests, which were not authorised for use in the United Kingdom, outside of the Council's normal procurement processes.
- Engagement of an external individual to provide mayoral assistance activities which are required by The Local Authorities (Elected Mayor and Mayor's Assistant) (England) Regulations 2002 to be performed by an employee of the Authority.

In addition, we reported our observation that there is a pervasive lack of trust within the Council between officers and elected members, and between elected members, which is having a significant impact on the governance of the Council and was a contributing factor to the respective roles and responsibilities of officers and members not being adhered to.

We concluded that these matters constituted a significant weakness in the Council's arrangements to secure value for money, and made recommendations to the Council to address these weaknesses.



Value for Money

Our initial assessment of the Council's response to our recommendation

In November 2022, we provided to the Corporate Affairs and Audit Committee our first assessment of the Council's response to the primary recommendation made in our value for money commentary. We reported that:

> *The Council has taken positive actions to respond to our recommendation, including the commissioning of external work by CIPFA to assist in identifying the root causes of relationship issues at the Council and an action plan to address them, implementation of an Improvement Board with an external chair and strong representation from elected members and senior officers, and reporting of these actions through full council.*
>
> *These steps are in-line with those we expected to see from the Council in responding to our recommendation and the future actions identified to date appear to be appropriate steps towards addressing both the depth and breadth of cultural and governance issues at the Council.*
>
> *It is however clear that there is significant concern amongst a number of stakeholders over the ability of the Council to deliver on these actions, characterised by expressions of a lack of confidence in the acceptance by individuals of the significance of the governance issues identified at the Council and the commitment of all necessary stakeholders towards meaningful change. It will take all of the Council's elected members and senior officers working together to address the issues faced by the Council, however it remains unclear whether this can be achieved.*
>
> *In addition, the Improvement Plan prepared by the Council focuses on actions to be completed over the next 90 days. Whilst these are positive first steps, the Council will not be able to enact the necessary cultural changes within the Council which are required within this timescale, and concerted effort over a much longer period of time will be required.*
>
> *It is clear that significant barriers to implementation of the Improvement Plan exist, however the actions taken to date have been appropriate and given sufficient prominence amongst elected members and senior officers. On this basis, we do not consider that it is either necessary or would be beneficial to escalate our recommendation through the exercise of additional auditor reporting powers (inc. a statutory recommendations) at this time. The Council is currently taking appropriate steps and should be given time to demonstrate whether those steps can have the necessary impact on the Council's culture and governance.*
>
> *We will however continue to monitor the progress of the Council against the Improvement Plan as part of our value for money assessment, where we have recognised the Council's governance as a risk of significant weakness, and report on the Council's progress through our value for money commentary. Should this assessment provide evidence that the Council is not making satisfactory progress against the Improvement Plan or the actions taken are not having the necessary effect on the Council's culture, we will reconsider whether a statutory recommendation or exercise of other auditor reporting powers may be appropriate.*

The following pages provide an update on the Council's response to our recommendation since November 2022.

Progress since November 2022

The Council's response to our recommendation (since November 2022)

'Phase two' of the Corporate Governance Improvement Plan

In November 2022, the Council reported that it had completed the remaining elements of 'phase one' of its Corporate Governance Improvement Plan. This included establishing four task-and-finish working groups focusing on the following (names in brackets are how groups were commonly referred to within the Council):

- How to engage all Members and officers in the improvement conversation (roles and responsibilities);
- Refreshing the approach to Member and officer training and development (training and development);
- Reviewing and refreshing the Constitution, including ensuring that it is user-friendly (the Constitution); and
- Developing supporting materials to improve how Members and officers communicate with each other (culture and communications)

Each of these task-and-finish groups agreed a series of 30-, 60- and 90- day targets, delivery against which was monitored by the Governance Improvement Board.

In February 2023, the Council reported to the Governance Improvement Board that all of the 30- and 60- day actions had been delivered, along with 6 of the 27 90- day actions. It was also reported that 'phase two' of the Corporate Governance Improvement Plan had been substantially completed and that outstanding actions would be incorporated into 'phase three'. The Board agreed to seek finalisation of the actions for phase three of the Corporate Governance Improvement Plan ready for approval by the Board at the end of March 2023.

'Phase three' of the Corporate Governance Improvement Plan

Also in February 2023, 17 of the Council's members wrote to the Council's Chief Executive to express a loss of confidence in their leadership of the Council, citing the assessment of the Council's Children's Services in December 2019 as inadequate, the cultural and governance issues raised in our value for money commentary and a deterioration in the Council's financial position. Further assessment of the Council's financial position is provided on page 18.

The letter sought the immediate resignation of the Chief Executive, and its signatories included the leaders of several of the Council's political groups, several committee chairs and more than half of the Council's Executive. On 10 March 2023, the Corporate Affairs and Audit Committee approved the terms of the Chief Executive's departure from the Council and they formally left the Council on 24 March 2023. We note that external legal advice was sought by the Council as to whether the terms of the Chief Executive's departure represented value for money and were proportionate and appropriate prior to being submitted to the Corporate Affairs and Audit Committee for approval. External legal advice was also sought on the correct committee, under the Council's Constitution, to approve such terms.

Also during March 2023, the Council agreed the early termination of the interim appointment of the Section 151 Officer which had been due to conclude in June 2023. The Interim Section 151 Officer left the Council on 31 March 2023.

Both the Chief Executive and Section 151 Officer posts were subsequently filled by interim appointments in March 2023 and April 2023, respectively. Between the departure of the previous Interim Section 151 Officer and the appointment of the new Interim Section 151 Officer, the Council designated the Head of Financial Planning and Support as the Council's Section 151 Officer.

Further to these changes in the Council's senior officers, the May 2023 election saw a change in both the Mayoral leadership of the Council and the overall political control of the Council. In light of these changes, the Council concluded that a review and reset of the Corporate Governance Improvement Plan would be appropriate prior to detailed development of the next phase of the Corporate Governance Improvement Plan. As a result, development of phase three of the Corporate Governance Improvement Plan remains ongoing as of August 2023.

Value for Money

The Council's response to our recommendation (since November 2022) (continued)

'Phase three' of the Corporate Governance Improvement Plan (continued)

In January 2023, the Council was issued with a Best Value notice by the Department for Levelling Up, Housing and Communities (DLUHC) in relation to the weaknesses in the Council's arrangements reported in our value for money commentary. As part of the follow-up of this notice by the Department, senior officers meet with representatives of the Department on a fortnightly basis to discuss the Council's progress. As these meetings have developed, the Department's interest has expanded beyond the cultural and governance issues which were the focus of the Best Value notice to also include the Council's Children's Services Improvement Plan, the Council's financial position and the high levels of turnover in both officer and member leadership (the latter being a result of the May 2023 election).

In response to the need to provide assurances to the Department over the Council's progress in these areas, the Council intends to expand the scope of phase three of the Corporate Governance Improvement Plan to cover a wider range of issues and reported in July 2023 that phase three would be reshaped around four key themes:

- Financial recovery and resilience
- Cultural transformation
- Social care; and
- Regeneration / Sustainability

The Council also reported that the Governance Improvement Board, which had overseen progress up to February 2023 (no meetings were held after this date) would be replaced with an Improvement Advisory Panel. The Improvement Advisory Panel is intended to include external advisors and experts, including an independent chair. Since May 2023, the Council has made some progress with the development of phase three of the Corporate Governance Improvement Plan and the implementation of the Improvement Advisory Panel and supporting governance structures, however these arrangements are not yet finalised and this remains a work in progress for the Council.

Our assessment

The Council's initial response to our recommendations, as reported in our November 2022 update, was encouraging and the positive actions being taken by the Council continued through to February 2023 with the delivery of the majority of the phase two actions. Since February 2023 however, there has been a loss of momentum in the Council's response to our recommendation due to significant turnover in leadership positions and development of phase three of the Corporate Governance Improvement Plan remains ongoing as of August 2023 despite an initial target date of the end of March 2023.

In addition, we have continued to observe behaviours at the Council over the period between our November 2022 update and this report which are indicative that a lack of trust between individuals remains a significant barrier to effective governance. This includes indicators of increasing strain in the relationships between officers, as well as between officers and members and between members, and concerns being raised to the Council over the manner of communications originating from the Council by other public sector bodies. We are encouraged that both officers and members have reported more positive working relationships in recent months, however it remains to be seen if this is a short-term impact of changes in the senior leadership of the Council or the start of a more fundamental change in the Council's culture.

The Council has described the actions of phases one and two of the Corporate Governance Improvement Plan as providing "*a strong foundation to facilitate ongoing, positive progress and cultural change*" however, in our view, there is a real risk that the loss of momentum with the Corporate Governance Improvement Plan means that the Council is not able to build upon these foundations to achieve the deep-rooted and permanent cultural change which is required for the Council to function effectively and achieve value for money in its use of resources.

Value for Money

The Council's response to our recommendation (since November 2022) (continued)

Our Assessment (continued)

In addition to addressing the cultural and governance issues we have previously highlighted, the Council faces a number of other challenges and currently has separate improvement plans in place in relation to the delivery of children's services and financial sustainability. Whilst integrating these improvement plans into phase three of the Corporate Governance Improvement Plan may provide benefits in offering a single improvement plan for the Council to focus on, it also risks diluting the focus on the cultural change required at the Council which, in our view, is the most significant challenge facing the Council and requires the full attention of officers and members.

Our Conclusion

Whilst there are signs that the pace of change within the Council is now starting to increase again, due to the overall loss of momentum against the Corporate Governance Improvement Plan since February 2023 we are unable to conclude that the Council is making satisfactory progress against our recommendation. In addition, with significant changes proposed to both the scope and governance oversight of the Corporate Governance Improvement Plan there is an increased risk that competing priorities reduce the focus on addressing the cultural and governance issues of the Council.

Accordingly, we consider it necessary to escalate our recommendation into a formal statutory recommendation. Reflecting the progress which the Council has made to date, we make the following recommendation:

1. ***We recommend that the Council ensures the recent progress with development of the next phase of the Corporate Governance Improvement Plan is progressed without further delay, and that appropriate prioritisation is given to actions which address the cultural and governance issues of the Council within the expanded scope of the revised Corporate Governance Improvement Plan.***

We also note that the primary reason for the loss of momentum against the Corporate Governance Improvement Plan has been significant turnover in senior leadership positions. Given that a number of the Council's senior officers, including the Chief Executive and Section 151 Officer, are currently appointed on an interim basis it is likely that there may be further turnover in senior positions before the next phase of the Corporate Governance Improvement Plan is concluded. We therefore also make the following recommendation:

2. ***We recommend that the Council develop contingency and succession governance protocols to ensure that delivery of the Corporate Governance Improvement Plan is not further disrupted by any future changes in one or more of the Council's senior leadership positions.***

We believe these are significant action points. Therefore, we are raising these matters as statutory recommendations to the Council under Section 24, Schedule 7(2) of the Local Accountability and Audit Act 2014.

The Council's Constitution

The phase two actions of the Corporate Governance Improvement Plan were delivered through four task-and-finish groups, which had oversight of discreet areas of focus. One of the task-and-finish groups was focused on the Council's Constitution, which the Council has recognised no longer reflects the current requirements of the Council. In focusing on its Constitution, the Council aims to develop "*A refreshed, fit for purpose, accessible and user-friendly Constitution*".

The majority of actions for this task-and-finish group were 90- day actions and remained ongoing at the conclusion of phase two, and have therefore been impacted by the loss of momentum and delays in commencement of phase three of the Corporate Governance Improvement Plan where they are to be incorporated.

During the course of our assessment of the Council's response to our recommendation and our response to the additional significant value for money risks which we identified, as set out within the rest of this report, we noted several areas of poor practice within the current Constitution and its implementation within the Council including:

- There are multiple references within the Constitution to job titles or grades which are not otherwise used by the Council. We noted differing interpretations within the Council as to how these terms map onto the job titles and grades which are in use within the Council, resulting in a lack of clarity as to how the responsibilities and approval requirements defined within the Constitution in reference to such job titles and grades should be applied;
- Article 17 of the Constitution specifies that the Financial and Contract Procedure Rules (Standing Orders) are part of the Constitution and that "*all financial transactions and contract proceedings must be carried out in accordance with the Middlesbrough Borough Council Financial and Contract Procedure Rules*". The Financial and Contract Procedure Rules should therefore be a key document for the Council, however it is our assessment that there is a limited understanding of the requirements of the Financial and Contract Procedure Rules within the Council. As a result, non-adherence to the requirements of the Financial and Contract Procedure Rules is pervasive within the Council and practices which do not meet the requirements of the Financial and Contract Procedure Rules are well established and widely adopted. Further details in relation to this observation can be found on pages 13 and 14; and
- Prior to submitting the terms of the Chief Executive's departure to the Corporate Affairs and Audit Committee for approval, the Council sought legal advice as to the correct committee under the Council's Constitution to make this decision. This advice relied upon Article 16 of the Constitution which states that the Corporate Affairs and Audit Committee has delegated powers to "*deal with any matter, which is not an Executive function and that has not delegated to any other committee of the Council*". In effect, this Article establishes the Corporate Affairs and Audit Committee as the committee of default or last resort for all non-Executive decisions. In our view, it is not appropriate for the audit committee-equivalent body to take such decisions as it creates a risk of conflicts of interest for the committee between decision making processes and the independent challenge to decisions which such bodies should provide.

The Council has recently concluded a review of its Financial and Contract Procedure Rules with external support from CIPFA, and presented proposed changes to the Council's Corporate Affairs and Audit Committee on 15 August 2023. Officers intend to submit both a revised Constitution and the updated Financial and Contract Procedure Rules to members for approval in September 2023, and provide training to members on the revised versions. In our view, the Council needs to ensure that these changes to its Constitution and supporting rules are swiftly implemented to ensure a solid governance foundation upon which other elements of the Corporate Governance Improvement Plan will build. We therefore make the following recommendation:

3. ***We recommend that the Council prioritises the conclusion of its review and updating of the Constitution, drawing upon examples of best practice and ensuring that the refreshed Constitution is clear in its language and requirements. Training on the refreshed Constitution should be provided to all officers and members to ensure that changes are appropriately understood and implemented.***

We believe this is a significant aspect of the Corporate Governance Improvement Plan and therefore we are raising this matter as a statutory recommendation to the Council under Section 24, Schedule 7(2) of the Local Accountability and Audit Act 2014.

New significant weaknesses in arrangements

Value for Money

New significant weakness in arrangements: Financial sustainability

Financial performance in the financial years ending 31 March 2022 and 31 March 2023

For the year ended 31 March 2022, the Council reported an overspend of £2.5 million against its budgeted outturn and a further net impact of £0.4 million from the direct impacts of the Covid-19 pandemic which the Council reported separately to its main budget. Within the overall overspend of £2.5 million, the Council reported an overspend of £7.9 million by its children's services directorate, equivalent to 19% of the Children's Services budget, which was offset by underspends in other parts of the Council. In October 2021, the Council adopted a Flexible Use of Capital Receipts Strategy under which it released £5 million of capital receipts, against qualifying revenue expenditure intended to transform its services, to its General Fund for the year ended 31 March 2022 to offset the overspends against its budget.

The Council increased the budget of its Children's Services directorate by £6.0 million, 15% of its prior year budget, for the year to 31 March 2023, however by September 2022 it was forecasting a full-year overspend against budget of £7.7 million for Children's Services and £9.4 million for the Council as a whole. The Council attributed the anticipated overspend to a combination of pressures relating to additional inflation, an increased pay award, and increased demand, placement and agency costs within Children's Services.

In October 2022, the Council implemented a Financial Recovery Plan which sought to make additional savings of £6.9 million and generate additional revenue of £0.5 million to mitigate the majority of the anticipated overspend against budget. The Council was able to deliver £4.8 million of the £7.4 million aggregate impact of savings and additional revenues under the Financial Recovery Plan, which contributed to the final overspend for the year to 31 March 2023 being reduced to £3.5 million. Further flexible use of capital receipts was used to release £0.8 million to the General Fund to partially offset the impact of this overspend on reserves.

The final overspend within Children's Services for the year to 31 March 2023 was £10.7 million excluding the impact of flexible use of capital receipts, equivalent to 21% of its revised budget including reallocations from other directorates during the year totalling £5.5 million as well as the increase of £4.3 million from the prior year.

Preparation of the Council's budget for the year ending 31 March 2024

The Council has recognised that the budget baselines for its Children's Services directorate are not deliverable and has sought to 'reset' its budget through a £7.2 million increase to its Children's Services budget for the year to 31 March 2024, applied on top of general increases for inflation and pay growth. In order to afford this increase, the Council's budget for the year to 31 March 2024 also includes £9.4 million of required savings and a requirement for an additional £1.2 million from opportunities for additional income generation. This is a significant change and challenge for the Council, which has not had to include savings targets within its budgets for a number of years prior to this.

In order to provide assurance to its members over the scale of required savings, the Council requested an independent review by CIPFA of its financial position, budget affordability, and financial outlook. This review concluded that "*CIPFA expect that the Council will produce a balanced budget for 2023/24*", however it also concluded that "*It is not possible for CIPFA to have confidence in the delivery against the savings targets identified for Childrens Services*". The review also raised concerns over the low levels of reserves held by the Council, noting "*The Council needs to be very clear that there is no or very limited scope for central funding of overspends*" and "*Failure to deliver the planned savings will place the Council at the risk of having to issue a Section 114 Notice with expenditure likely to exceed financial resources available to the Council*". It is our understanding that circulation of a draft version of the CIPFA report within the Council was a significant factor in the decision by 17 of the Council's members to write to the Council's Chief Executive to request their resignation, as noted earlier in this report.

Performance to-date during the year ending 31 March 2024

The Council has recognised that it commenced the 2023/24 financial year in a challenging financial position and implemented enhanced scrutiny of its financial outturn and forecasts, with additional monthly reporting to its Leadership Management Team (LMT) and additional finance meetings with each directorate head added to the existing quarterly reporting.

New significant weakness in arrangements: Financial sustainability (continued)

Through this enhanced scrutiny of its financial position, the Council identified as early as P2 (May 2023) that it is not on track to deliver against its budget for the year ended 31 March 2024. As of Q1 (June 2023), the Council is forecasting an overspend against its budget of £11.6m. This represents over 9% of the Council's annual budget. The Council only attributes £2.6m of the anticipated overspend to non-achievement of the savings and additional income generation included within its 2023/24 budget, with the majority relating to cost pressures not allowed for within the budget. The most significant of these include a national pay award above the Council's expectations, demand and inflationary pressures within both adult's and children's social care and rising home-to-school transportation costs. These pressures contain a mixture of factors within the Council's control, such as those related to how it delivers it services, and those beyond its control, such as the national pay award.

The Council's financial position

The Council commenced the 2023/24 financial year with a General Fund balance of £12m and unrestricted usable reserves of £2.8m. If the Council is unable to reduce the overspend it anticipates as at the end of Q1, almost 80% of the Council's unrestricted reserves will be utilised by 31 March 2024. Whilst the Council is already taking steps to control expenditure and reduce the forecast overspend, the effectiveness of these steps is unknown and further financial pressures may also emerge during the remainder of the 2023/24 financial year.

The Council has minimal financial headroom available to it to absorb future financial pressures and there is a very real risk that the Council will need to issue a Section 114 Report within the current financial year. A Section 114 Report arises when the Council's Section 151 Officer believes that the expenditure of the Council will exceed the resources available to it for the current financial year, or that the Council is unable to set a balanced budget for the following financial year, and would require the Council to cease all new expenditure other than that supporting functions which are required by statute to be delivered.

Our assessment

The Council is in a strained financial position and faces significant financial challenges, including high levels of demand for its social care services and the impact of inflation. Whilst the Council has taken steps to address these challenges, including a 'reset' of its children's services budget and implementation of both financial recovery and savings plans, these actions have not been able to stabilise the deterioration in the Council's financial position. Without more significant intervention, the Council is highly likely to deplete its limited remaining reserves over the next 12-18 months and, in effect, run out of resources.

We are therefore unable to conclude that the Council has had proper arrangements in place to manage its financial position and conclude that the absence of such arrangements represents a significant weakness in the Council's arrangements to secure value for money. We therefore make the following recommendations:

4. ***We recommend that the Council builds upon the steps already taken to control its expenditure to identify specific deliverable savings over the short term (next 12 months) and protect its limited remaining reserves. Where appropriate, this may need to include the Council changing how it meets its statutory responsibilities and the extent to which it delivers services which are not required to discharge its statutory responsibilities.***
5. ***We recommend that the Council reviews its service delivery models to ensure that they are efficient, represent value for money and achieve the outcomes required for the resources invested. Where opportunities to improve service delivery models are identified, the Council should develop detailed plans for implementation of service delivery transformation and how the up-front transformation costs will be funded.***
6. ***We recommend that the Council review its financial forecasting processes to understand why significant financial pressures, over and above those anticipated and reflected in the Council's annual budget, have emerged within the first half of both the 2022/23 and 2023/24 financial years and ensure future forecasting reflects the lessons learned.***

We consider the financial risks to the Council to be sufficiently serious that we also raise these matters as statutory recommendations to the Council under Section 24, Schedule 7(2) of the Local Accountability and Audit Act 2014.

New significant weakness in arrangements: Contracting and procurement

Commissioning of external social work support

On 24 January 2020, the Office for Standards in Education, Children's Services and Skills (Ofsted) released the results of its inspection of the Council's children's social care services performed between 25 November 2019 and 6 December 2019. The report concluded that the quality of the Council's children's services had deteriorated since the previous inspection in 2015 and were now inadequate in each category of assessment. In response to the Ofsted findings, the Council implemented a Children's Services Improvement Plan.

In February 2020, the Council's Executive approved the commissioning of external social work audit support for children's services as part of the Children's Services Improvement Plan. The Council awarded this contract as a direct award to the preferred supplier under the permitted exemption within the Financial and Contract Procedure Rules for "*social care services under the National Health Services and Community Care Act, 1990 or the Children Act, 1989*". The contracted services were assessed by the Council's procurement team as falling within this definition, however this was not confirmed by the Council's legal team.

In July 2020, the Council directly awarded a second contract to the same supplier to provide an external team of social workers to assist the Council with the ongoing Children's Services Improvement Plan. The documented rationale for direct award of the second contract was a combination of the social care-basis used for the first contract and a further permitted exemption under the Financial and Contract Procedure Rules for "*for work, supplies and services which are patented or of a proprietary or special character and for which it is not possible or desirable to obtain competitive prices*". The Council's Executive gave retrospective approval for the contract on 14 July 2020, and in November 2020 approved a further 24 month extension of the contract.

Also in November 2020, the Council awarded a third contract to the supplier for a second external team of social workers for an intended duration of 6 months. The Council asserts that this contract was approved through the 'Gold Command' process in place during the Covid-19 pandemic, however we have been unable to find reference to it in relevant minutes from that period. We have also been unable to establish the basis on which the contract was deemed exempt and directly awarded to the supplier. This contract was also subsequently extended, however no formal approval for this extension was documented.

In August 2022, the Council awarded a fourth contract to the supplier for a third external team of social workers. No formal approvals or exemptions were sought prior to entering into this contract. Concerns about the awarding of this contract were raised by the Council's procurement team, with a subsequent investigation by the Council confirming that the Council's policies and procedures had not been followed in the awarding of the contract.

Subsequent to the contract awards and extensions documented above, the Council continued to extend the second, third and fourth contracts until April 2023 (second contract) and May 2023 (third and fourth contracts). The Council estimates that total expenditure under these four contracts to May 2023 was £4.3 million. This significantly exceeds the thresholds under which direct award of contracts is permitted under both the Council's Financial and Contract Procedure Rules and The Public Contracts Regulations 2015. Whilst this amount relates to the four contracts in aggregate, three of these contracts individually exceed the £663,540* threshold at which the Council is required undertake a competitive tendering exercise under The Public Contracts Regulations 2015. It is therefore our view that in addition to failing to comply with its own Financial and Contract Procedure Rules, the Council has failed to comply with applicable procurement law in the awarding of these contracts.

Where a contract is awarded under the reduced requirements of The Public Contracts Regulations 2015 (commonly referred to as being under the 'Light Touch Regime'), The Public Contracts Regulations 2015 place restrictions on the subsequent modifications which may be made to the contract whilst remaining within the scope of the reduced requirements. Such modifications may include extension of the original contract or a change in the scope of the contract. The Council has been unable to demonstrate that it has controls in place to monitor and assess whether modifications to its contracts made after the initial award fall within these criteria, therefore we consider there to be an increased risk that the Council may have other contract arrangements which are not in accordance with The Public Contracts Regulations 2015.

** Threshold represents the level effective from January 2022. Lower thresholds applied prior to this date.*

Value for Money

New significant weakness in arrangements: Contracting and procurement (continued)

Wider contracting arrangements

The majority of activity in procuring these contracts occurred within the Council's Children's Services directorate and was unknown to the Council's procurement team. Accordingly, the Council had not recorded any of these contracts on its contracts register. Since the Council's procurement team became aware of these contracts, a control has been implemented to reconcile larger items of expenditure recorded by the Council to known contracts in order to identify any additional unrecorded contract arrangements which may exist. Prior to late 2022 however, the Council had no such control in place and hence is unable to demonstrate that these contracts are an isolated occurrence.

A review of those contracts which the Council had recorded on its contract register as awarded between 1 April 2021 and 31 March 2022 found that of a sample of 12 contracts entered into by multiple directorates, 7 were awarded using some form of exemption. In each case, the application of the exemption had been approved by the Service Head and Head of Commissioning and Procurement however there was no further documented approval. Under the Council's Financial and Contract Procedure Rules, all exemptions require approval by the Section 151 Officer. Other than in a limited number of specified circumstances, the Financial and Contract Procedure Rules also require that exemptions are approved by the Council's Monitoring Officer. There is no requirement under the Financial and Contract Procedure Rules for exemptions to be approved by the Head of Commissioning and Procurement.

Our assessment

It is evident to us that the Council has a well established informal and undocumented practice when it comes to application of procurement exemptions which is neither compliant with the requirements of the Financial and Contract Procedure Rules or as robust. Whilst the procurement of the four social care contracts, or at least aspects of them, appear to have also occurred outside of this informal practice, the widespread non-adherence to the Council's formal policies and procedures is likely to have been a contributory factor as to why this occurred. As noted on page 12, the Council is currently updating its Financial and Contract Procedure Rules.

In our view, non-adherence to the Council's Financial and Contract Procedure Rules is pervasive within the Council and significantly increases the risk that exemptions are applied inappropriately and that the Council is not able to demonstrate that it is securing value for money in its procurements. We consider that this is a significant weakness in the Council's arrangements to secure value for money and therefore make the following recommendations:

7. ***We recommend that the Council conclude its review of its Financial and Contract Procedure Rules to ensure that they reflect the needs of the Council and the expectations of members and implement the revised rules without delay. This should include being explicit on how contract modifications should be assessed and managed, as the Financial and Contract Procedure Rules do not currently address contract extensions;***
8. ***We recommend that, once the Financial and Contract Procedure Rules are finalised, training is provided to all officers involved in contracting, procurement or financial decision making to ensure that the requirements of the Financial and Contract Procedure Rules are understood and adhered to; and***
9. ***We recommend that the Council complete their review of all ongoing contracts which were initially awarded under an exemption but have been subject to subsequent amendment (including extension) to identify whether they are compliant with The Public Contracts Regulations 2015. If further non-compliance is identified, the Council should evaluate whether any remedial action is necessary.***

In our view, these observations and recommendations are closely linked to the overall culture within the Council and should therefore not be seen as isolated from the cultural and governance issues being addressed by the Corporate Governance Improvement Plan. For this reason, we also raise these matters as statutory recommendations to the Council under Section 24, Schedule 7(2) of the Local Accountability and Audit Act 2014.

Value for Money

New significant weakness in arrangements: Middlesbrough Development Company

Role of Middlesbrough Development Company

In February 2019, the Council established MHomes Limited as a subsidiary company with the intention of using it as a housing delivery vehicle. Following a change in political administration in the May 2019 election, the subsidiary was rebranded as Middlesbrough Development Company and the Council changed the proposed focus of the subsidiary away from housing delivery and towards urban regeneration projects. This corresponded with a change by the Council itself towards a more expansive capital programme focusing on redevelopment of Middlesbrough town centre.

Middlesbrough Development Company is currently overseeing two large capital projects on behalf of the Council, the development of Boho Village and the redevelopment of the former Tollesby Shops site, along with a number of smaller scale projects to restore empty homes and 'eyesore sites'. The activities of Middlesbrough Development Company are funded through a combination of loan and grant funding provided by the Council.

Governance of Middlesbrough Development Company

In May 2021, 5 of the 7 members of the Council's Executive resigned citing a number of concerns over the conduct of the Council's Mayor and the Council requested the Council's internal auditor investigate the concerns raised. We reported on the results of these investigations within our previous value for money commentary, however follow-up work by internal audit in relation to the governance of Middlesbrough Development Company was deferred in anticipation of additional good practice guidance being published by CIPFA.

In May 2022, CIPFA published '*Local Authority Owned Companies: A Good Practice Guide*' and the Council requested that internal audit undertake an assessment of the governance of Middlesbrough Development Company against this good practice guidance. The Council's internal auditor undertook this review as an advisory piece of work, and did not therefore seek to offer an overall rating on arrangements, however a draft version of their report shared with senior officers in January 2023 raised some significant concerns over the Council's oversight and governance of the subsidiary. The Council's internal auditor issued the final version of their report at the end of July 2023, in addition within their Annual Head of Internal Audit Report for 2022/23 they noted their review found '*a number of weaknesses*', including in relation to:

- A lack of clarity in respect of roles and responsibilities (including officers and members);
- The composition and training of members of the Board;
- Performance management; and
- Documentation of Board meetings.

As a result of the concerns raised in the draft report the Council's Executive agreed in January 2023 to recommend to the directors of Middlesbrough Development Company that the subsidiary body be wound up. Within the covering report submitted to the Executive to inform this decision, the Council stated:

> *As the activities of the company have turned from theoretical to actual, and the practicalities of taking and implementing board decisions have become more complex, a number of weaknesses have been identified in the board arrangements and the relationship with the Council that would need addressing. Veritau, the Council's internal auditors were asked to provide a view on the overall governance situation, and the improvements that would be required to meet the highest standards of good governance. Early conclusions from this work include:*
>
>> *a. the roles and responsibilities within the company are insufficiently defined for a local authority trading company, with potential conflicts of interest arising through lack of clarity and lack of separation. The role of the shareholder is particularly unclear; and,*
>>
>> *b. some of the operational aspects of the company do not reflect local authority regulations, or frameworks – such as procurement, risk, performance management and project management.*

New significant weakness in arrangements: Middlesbrough Development Company (continued)

> *The relationship with the company would also require further work from the Council's perspective, as there needs to be a suitable governance structure put in place within the Council structures to review performance, or provide the necessary oversight and accountability for it to function effectively. Specifically issues around Information Governance, Data Protection and other legal requirements are not governed by an appropriate agreement with the Council – which could cause unnecessary risks in the future. Additional work is also required to provide improved transparency around Value for Money and alignment of investments with Council priorities.*
>
> *It is clear from the review that revising the arrangements to follow the higher standards of governance set out by Local Partnerships, and CIPFA in their recently published Local Authority Owned Companies – A Good Practice Guide, and to minimise any future risk to the Council would require a significant investment of time and money to achieve. The board of the company would need to be reshaped, the staffing structure bolstered, and the arrangements the Council employs to monitor and support it would need to change.*
>
> *The key gaps identified in issues such as procurement and risk management would require additional staffing to be brought in to manage processes to the standard required by local authorities (and advocated by CIPFA), as would bolstering arrangements around performance management and project management. The current staffing/operation of the company is geared towards commercial expertise and would not therefore have the capacity or experience to adopt the policies and frameworks to align with the Council's approach. Recent examples of issues around Information Governance have highlighted this further, where the company needs to register with the Information Commissioner's Office independently from the Council.*

Whilst the Council has taken the decision to recommend winding-up the subsidiary, this has not yet occurred and the subsidiary remains responsible for the regeneration projects previously assigned to it. Up to the point at which the decision was taken to recommend winding-up the subsidiary, the Council had provided £11.9 million in funding to the subsidiary and the estimated lifetime budget of its projects is £13.3 million.

In July 2023, the Council approved its first Wholly and Partly Owned Council Companies Policy however the principles of this policy have yet to be applied to the governance and oversight of Middlesbrough Development Company. The Council does not currently have any other wholly or partly owned subsidiaries.

Our assessment

In our view, the concerns raised by the Council's internal auditor and the subsequent assessment by the Council that "*a significant investment of time and money*" would be required to meet the standards of governance set out within the CIPFA good practice guidance are indicative that the Council did not have proper arrangements in place to oversee the activities of its subsidiary and ensure that Middlesbrough Development Company delivers value for money with the resources provided to it by the Council.

Given the material levels of funding provided by the Council to Middlesbrough Development Company, we consider that this is a significant weakness in the Council's arrangements to secure value for money and therefore make the following recommendations:

10. ***We recommend that the Council review its oversight arrangements for Middlesbrough Development Company for the period up to the demise of the entity, so that it can satisfy itself that Middlesbrough Development Company is delivering value for money with the resources provided to it during this period; and***
11. ***We recommend that the Council develop an action plan for the demise of Middlesbrough Development Company which sets out how the Council will realise the value which has been created through the resources provided to Middlesbrough Development Company by the Council.***

As the Council's intention is to expand the Corporate Governance Improvement Plan to address wider governance concerns within the Council, these actions should be incorporated into the next phase of this plan and we also raise these matters as statutory recommendations to the Council under Section 24, Schedule 7(2) of the Local Accountability and Audit Act 2014.

Summary of recommendations

Value for Money

Summary of recommendations

Within this report we have highlighted that we are unable to conclude that the Council is making satisfactory progress against our previous value for money recommendations. In addition, we have identified further significant weaknesses in the Council's arrangements to secure value for money in its use of resources where action is required from the Council to address the weaknesses which exist in its arrangements.

Based on these observations, we make 11 formal statutory recommendations to the Council under Section 24 Schedule 7(2) of the Local Audit and Accountability Act 2014:

1. We recommend that the Council ensures the recent progress with development of the next phase of the Corporate Governance Improvement Plan is progressed without further delay, and that appropriate prioritisation is given to actions which address the cultural and governance issues of the Council within the expanded scope of the revised Corporate Governance Improvement Plan.
2. We recommend that the Council develop contingency and succession governance protocols to ensure that delivery of the Corporate Governance Improvement Plan is not further disrupted by any future changes in one or more of the Council's senior leadership positions.
3. We recommend that the Council prioritises the conclusion of its review and updating of the Constitution, drawing upon examples of best practice and ensuring that the refreshed Constitution is clear in its language and requirements. Training on the refreshed Constitution should be provided to all officers and members to ensure that changes are appropriately understood and implemented.
4. We recommend that the Council builds upon the steps already taken to control its expenditure to identify specific deliverable savings over the short term (next 12 months) and protect its limited remaining reserves. Where appropriate, this may need to include the Council changing how it meets its statutory responsibilities and the extent to which it delivers services which are not required to discharge its statutory responsibilities.
5. We recommend that the Council reviews its service delivery models to ensure that they are efficient, represent value for money and achieve the outcomes required for the resources invested. Where opportunities to improve service delivery models are identified, the Council should develop detailed plans for implementation of service delivery transformation and how the up-front transformation costs will be funded.
6. We recommend that the Council review its financial forecasting processes to understand why significant financial pressures, over and above those anticipated and reflected in the Council's annual budget, have emerged within the first half of both the 2022/23 and 2023/24 financial years and ensure future forecasting reflects the lessons learned.
7. We recommend that the Council conclude its review of its Financial and Contract Procedure Rules to ensure that they reflect the needs of the Council and the expectations of members and implement the revised rules without delay. This should include being explicit on how contract modifications should be assessed and managed, as the Financial and Contract Procedure Rules do not currently address contract extensions;

Value for Money

Summary of recommendations

8. We recommend that, once the Financial and Contract Procedure Rules are finalised, training is provided to all officers involved in contracting, procurement or financial decision making to ensure that the requirements of the Financial and Contract Procedure Rules are understood and adhered to.
9. We recommend that the Council complete their review of all ongoing contracts which were initially awarded under an exemption but have been subject to subsequent amendment (including extension) to identify whether they are compliant with The Public Contracts Regulations 2015. If further non-compliance is identified, the Council should evaluate whether any remedial action is necessary.
10. We recommend that the Council review its oversight arrangements for Middlesbrough Development Company for the period up to the demise of the entity, so that it can satisfy itself that Middlesbrough Development Company is delivering value for money with the resources provided to it during this period.
11. We recommend that the Council develop an action plan for the demise of Middlesbrough Development Company which sets out how the Council will realise the value which has been created through the resources provided to Middlesbrough Development Company by the Council.

The Council must consider these recommendations at a public meeting held before the end of the period of one month beginning with the day on which it was sent to the Council. At that public meeting, the Council must decide whether the recommendations are to be accepted and what, if any, action to take in response to these recommendations.

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