

Report of:	Director of Legal and Governance Services and Director of Finance (Section 151 officer)
Submitted to:	Corporate Affairs and Audit Committee, 4 February 2021
Subject:	Lessons learnt – Croydon London Borough Council section 114 notice

Summary

Proposed decision(s)
<p>That the Committee notes the contents of the report and the planned actions to ensure lessons are learnt from events at Croydon London Borough Council (LCBC) are noted and the following planned actions to act on lessons learnt from this exercise are endorsed:</p> <ul style="list-style-type: none"> • to further strengthen visibility it is proposed that the reserves risk assessment is shared with scrutiny during the budget setting process going forward. • review investment plans to ensure the impact of Covid-19 is taken into consideration. • expand the training programme for this committee to include Treasury Management.

Report for:	Key decision:	Confidential:	Is the report urgent?¹
Information	Not applicable	No	Not applicable

Contribution to delivery of the 2020-23 Strategic Plan		
People	Place	Business
Not applicable	Not applicable	The report outlines the steps that will be taken to learn the lessons learnt from LCBC and will impact positively on the Council’s governance arrangements.

Ward(s) affected
Not applicable.

What is the purpose of this report?

1. In October 2020 Croydon London Borough Council’s (CLBC) 151 officer issued a section 114 notice, meaning that in their opinion they were required to trigger section 114 of the Local Government Finance Act 1988 that states ‘the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely

¹ Remove for non-Executive reports

to exceed the resources (including sums borrowed) available to it to meet that expenditure.'

2. This report outlines the key findings from CLBC's auditors on the causes of that notice having to be issued.

Why does this report require a Member decision?

3. The report is necessary to ensure that Corporate Affairs and Audit Committee is provided with sufficient information to ensure it is able to keep the Council's arrangements for Corporate Governance under review, in line with the Committee's terms of reference.
4. Learning lessons from other local authorities is best practice and provides an opportunity for the Council to assess its vulnerabilities.

Report Background

5. On 23 October 2020, CLBC's external auditor, Grant Thornton, issued a public interest report. The Council had experienced deteriorating financial resilience for a number of years with spending pressures within both children's and adult social care and low levels of reserves which created a significant financial challenge in 2020/21. The size of the financial gap in 2020/21 increased due to the additional financial pressures as a result of the Covid-19 pandemic.
6. The Public interest report outlined the key factors including:
 - Significant investment over the last three years in housing and commercial property (£545m of which £200m was loaned to its housing development arm for which no dividend has been returned).
 - Investments in a hotel and retail park both of which failed and were criticised for 'not being grounded in sufficient understanding of the retail and leisure market'.
 - A flawed strategy of attempting to invest its way out of financial challenges rather than controlling internal costs in children's and adult social care which had significant overspends.
 - Incorrect treatment of overspends as 'one off' corporate adjustments.
 - Failure to report a significant identified budget gap to full Council by either scrutiny or CLBC's Cabinet.
7. To put some of the figures into context, CLBC's net budget is almost three times that of Middlesbrough Council's with similar ranges of functions. If the equivalent borrowing figures were translated to this Council there would have been borrowing of circa £182m in housing & commercial property of which £67m would have been loaned for housing development over the last three years. In comparison, Middlesbrough Council has invested in £52m and loaned £7m for these type of investments to date. In addition, Government introduced changes to lending terms in November 2020 that would further restrict a Council from getting into a similar position by borrowing to invest on a commercial basis. Any application must now be accompanied by confirmation from the Section 151 officer that there is no intention to buy investment assets primarily for yield at any point in the next three years.
8. Any business case for investment in these type of projects has an extensive due diligence exercise undertaken by senior officers in both Finance and Regeneration, with

input from specialist experts where required. This evaluation includes a detailed financial appraisal of the cash flows and financing involved in each project, as well as a qualitative assessment of the issues, risks and benefits involved. Approval to proceed can only be given by the S151 Officer, in consultation with the Executive Member for Finance & Governance, on a case-by-case basis. These approvals would be mindful of the cumulative borrowing exposure on similar projects and the impact on the medium term financial plan and beyond.

9. Middlesbrough Council budgeting investments of have always been based on regeneration of the town rather than the need to achieve a significant return in order to achieve a balanced budget. The Council takes the prudent step of not assuming a profit will be achieved for the purpose of setting the budget to ensure that funding for services is protected, sustainable and realistic.
10. Middlesbrough Council have also never reported overspends as one off corporate adjustments.
11. Budget monitoring is reported to Executive and Overview and Scrutiny Board on a quarterly basis. Middlesbrough Council also has year on year evidence of escalating potential future year funding gaps to Council for consideration to be addressed within the budget setting process to ensure full Council were engaged and own the decisions.
12. There is increasing concern nationally around the level of debt being carried by some Councils. In January 2021 the Commons' Public Accounts Committee requested that the Treasury set out how it will manage the risk the levels of debt could have on national finances.

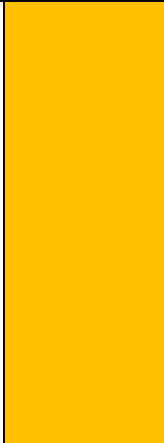
Grant Thornton Recommendations

13. The Public Interest report made a number of specific recommendations that have been set out below, along with an assessment of their applicability to Middlesbrough Council.

CLBC Grant Thornton Recommendation	MBC position	RAG
<p>The Executive Directors need to address the underlying causes of social care overspends: R1a in children's social care and take effective action to manage both the demand and the resulting cost pressures R1b in adults social care and take effective action to manage both the demand and the resulting cost pressures</p>	<p>The comments in relation to an overspend in Adult Social Care (ASC) are not applicable to Middlesbrough Council as there is currently no overspend in ASC.</p> <p>The recommendation in relation to Children's social care however does chime with Middlesbrough Council's history on this matter. On reflection, for a period of time prior to the Ofsted inspection there was limited grip within the services on the underlying causes of year on year overspend. This was reflected in the outcome of the Ofsted inspection. The Council is on an improvement journey and therefore this position should improve going forward, however there is an ongoing overspend in Children's services. The Council policy in the past was to make</p>	<p>Amber</p>

	reserves available to cover this but it is now starting to address underlying causes of the overspend and use performance information to target improvements.	
The Council (including Cabinet and Scrutiny and Overview Committee) should challenge the adequacy of the reserves assessment which should include a risk assessment before approving the budget.	The reserves position is informed by an annual risk assessment for the 151 officer to consider when setting the reserves level (section 25 statement on adequacy of reserves). A summary of this is set out within the annual budget report considered by full Council and reported to Executive. To further strengthen visibility of this it is proposed that the risk assessment is shared with Overview and Scrutiny Board during the budget setting process going forward.	Amber
The Chief Executive should oversee a review of the outcomes achieved from the use of transformation funding to demonstrate that the funding has been applied in accordance with the aim of the scheme.	CLBC specific – MBC has never used transformation funding in this way.	Green
The s151 officer should set out the strategy for applying capital receipts for transformation annually as part of the budget setting process.	CLBC specific – MBC has never used transformation funding in this way.	Green
The General Purposes and Audit Committee should receive reports on the actions being taken to address the DSG deficit and challenge whether sufficient progress is being made.	While MBC also has a DSG deficit – it is one of the smallest in the country – circa £2.8m, compared to £14.5m in CLBC.	Green
The Executive Director (Children's) needs to review the services provided to UASC and to identify options to meet their needs within the grant funding provided by the Home Office.	Unaccompanied asylum seeker children costs for Middlesbrough are very small compared to Croydon.	Green
The Executive Director (Children's) needs to identify the capacity threshold for the numbers of UASC that it has the capacity to deliver safe UASC services to.	Unaccompanied asylum seeker children costs for Middlesbrough are very small compared to Croydon.	Green
The Cabinet reports on the financial position need to improve the transparency of reporting of any remedial action taken to address in year overspends.	There is strong evidence that Middlesbrough Council is open and transparent about remedial action required in year to address budget pressures. This is set out in quarterly reports to Executive and scrutiny and progress against that action is also reported, including non-	Green

	achievement and alternative measures where necessary in line with openness and transparency best practice.	
The Council (including Cabinet and Scrutiny and Overview Committee) need to show greater rigor in challenging underlying assumptions before approving the budget including understanding the track record of savings delivery.	<p>There is a process in place to ensure the underlying budget assumptions are robustly challenged by Executive members as part of the development of proposals. All political groups are invited to sessions to discuss and challenge assumptions prior to the budget being published for consultation.</p> <p>The section151 officer also meets with political groups as and when they request meetings to engage on budget issues.</p> <p>Savings delivery is reported on a quarterly basis to scrutiny and Executive</p>	Green
The General Purposes and Audit Committee must challenge officers on the progress in implementing the Financial Consultant's recommendations to improve the budget setting, monitoring and reporting process and actions to address the Head of Internal Audit's concerns on internal controls.	Not relevant	Green
The s151 officer needs to revisit the Growth Zone assumptions following the pandemic and make recommendations to Cabinet and Council for the continued investment in the scheme.	This will be applicable to every Council. Middlesbrough Council will also need to do this post pandemic as good practice	Amber
The s151 officer should review the financial rationale and associated risks and make recommendations to Cabinet and Council on whether the Revolving Investment Fund should continue.	Not applicable	Green
The s151 officer should review the purchase of Croydon Park Hotel to identify lessons learned to strengthen future due diligence arrangements.	Not applicable. Middlesbrough Council has in place a Programme and Project management Policy, supported by a robust Programme and Project Management Framework which is overseen by the Portfolio Management Office. There is also an Asset Acquisition policy in place which ensures a robust, business case based approach acquisitions.	Green
The Cabinet and Council needs to re-consider the Treasury Management Strategy for ongoing affordability of the	Members of the Corporate Affairs and Audit Committee already receive training on statement of accounts. It is proposed that the programme of training is expanded	Amber

<p>borrowing strategy, the associated risks and identify whether alternative options can reduce the financial burden</p>	<p>to include Treasury Management.</p>	
<p>The Chief Executive should arrange detailed Treasury Management training to assist Members to better understand and challenge the long-term financial implications of matters reported within the Treasury Management Strategy.</p>		
<p>The s151 officer should revisit the Minimum Revenue Provision policy to demonstrate that a prudent approach is being taken.</p>	<p>Not applicable – a prudent approach this matter is in place in Middlesbrough.</p>	<p>Green</p>
<p>The Cabinet and Council should reconsider the financial business case for continuing to invest in Brick by Brick before agreeing any further borrowing.</p>	<p>Middlesbrough Council has in place a Programme and Project management Policy, supported by a robust Programme and Project Management Framework which is overseen by the Portfolio Management Office. There is also an Asset Acquisition policy in place which ensures a robust, business case based approach acquisitions.</p> <p>In Middlesbrough Council, all decisions to lend any money to the Council's development arm are subject to an Executive report and therefore the business case for them is fully assessed during this process.</p>	<p>Green</p>
<p>The Cabinet and Council should review and reconsider the ongoing financial rationale for the Council in the equity investment arrangement with Brick by Brick.</p>	<p>There is a different arrangement in Middlesbrough for its development company which receives loans rather than investment and those loans are much smaller than in CLBC. A business case based approach is also in place to reduce risk.</p> <p>The business plan for the development company is also approved by Executive on an annual basis. Most recently approved in September 2020.</p>	<p>Green</p>
<p>The s151 officer and monitoring officer should monitor compliance with loan covenants with Brick by Brick and report any breaches to Members.</p>	<p>Governance and oversight were considered as part of the work to establish Middlesbrough Council's development company. As a result processes are in place for appropriate financial and governance oversight.</p>	<p>Green</p>
<p>The Cabinet and Council should review its arrangements to govern its interest in subsidiaries, how the subsidiaries are linked, the long-term impact of the</p>	<p>Both the Section 151 officer and the Council's Monitoring officer receive a copy of development company's board papers.</p>	

subsidiaries on the Council's financial position and how the Council's and taxpayers interest is safeguarded.	The Deputy 151 officer attends board meetings and is a director in the company. The 151 officer remains independent to ensure an appropriate distance between the company and the Council.	
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What decision(s) are being asked for?

14. That the Committee notes the contents of the report and the proposed actions to ensure lessons are learnt from events at Croydon London Borough Council (LCBC) are noted and the following planned actions to act on lessons learnt from this exercise are endorsed:

- to further strengthen visibility it is proposed that the reserves risk assessment is shared with scrutiny during the budget setting process going forward;
- review investment plans to ensure the impact of Covid-19 is taken into consideration; and
- expand the training programme for this committee to include Treasury Management.

Why is this being recommended?

15. It is always prudent to take the opportunity to learn lessons from other local authorities and identify where practice can be improved to avoid issues experienced elsewhere. This report fulfils that aim.

Other potential decisions and why these have not been recommended

16. The Council could choose not to reflect on the issues experienced elsewhere, however that is not recommended.

Impact(s) of recommended decision(s)

Legal

17. There are no legal implications from the recommendations. The gap analysis does not identify any significant concerns about local practice in Middlesbrough.

Financial

18. There are no direct financial implications from the planned actions, however the outcome of the review of investment plans may have financial implications that would need to be considered by the Executive.

Policy Framework

19. Not applicable. This report will not alter the policy framework of the organisation.

Equality and Diversity

20. Not applicable.

Risk

21. The issues set out within this report are relevant to the following identified risks within the Council's risk registers:

- Incorrect assumptions in the MTFP (08-059)
- Targeted investment in Middlesbrough is disproportionately affected by low economic growth (e.g. following exit from the EU) (01-005)

22. The report identifies a range of prudent actions that officers will be taken which will impact positively on these known risks.

Actions to be taken to implement the decision(s)

Following this report, officers will take the necessary steps to enact their planned actions to ensure lessons learnt are reflected in local practice.

Appendices

Not applicable.

Background papers

No background papers were used in the preparation of this report.

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