

The guide to

local government finance

2015 edition



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This CIPFA publication is printed on certified FSC mixed sources coated grade stock containing 50% recovered waste and 50% virgin fibre.

Printed on stock sourced from well-managed forests, ISO 14001.

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Published by:

CIPFA \ THE CHARTERED INSTITUTE OF PUBLIC FINANCE AND ACCOUNTANCY

77 Mansell Street, London E1 8AN

020 7543 5600 \ publications@cipfa.org \ www.cipfa.org

© July 2015 CIPFA

ISBN 978 1 84508 438 7

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Designed and typeset by Ministry of Design, Bath

(www.ministryofdesign.co.uk)

Printed by The Complete Product Company, Malmesbury

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Foreword

Following the election of a conservative government in May 2015, the course of financial austerity is set to continue. However, the optimistic conversation is around the increasing call for and delivery of devolution; and the growing numbers of combined authorities that are now emerging. This bottom-up approach brings with it great opportunities, but also the need for strong governance and fiscal transparency.

There are opportunities through business rate growth and new initiatives to grow the resources base, and there are opportunities for new ways of joint working, for example with health services through the Better Care Fund. Challenges remain, however, not least the debates around fiscal devolution and the challenges of ensuring all areas of the country are included in these devolution opportunities. This guide is intended to give readers the background they need about the local government finance system as a whole and about financing for individual services to understand these challenges and to ensure that they can formulate plans that take into account the opportunities and risks inherent in the local government finance system.

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An introduction to local government, revenue income and expenditure

LOCAL GOVERNMENT STRUCTURE

Local government in England is made up of different types of council ranging from large city councils to small district councils. There is a mixture of single-tier areas, in which one council provides all the services for an area, and two-tier areas, in which these services are shared between two councils, known as an upper-tier council and a lower-tier council. In addition, there are police and fire services that also fall within the local government boundary.

In Wales, things are much less complicated as there is only a single tier of local government in addition to police and fire.

The following table illustrates the local government structure for single-tier and two-tier areas in England and Wales.

| England outside London | | London | Wales |
|-------------------------------|--|--------------------------|------------------|
| County councils | Metropolitan councils and unitary councils | Greater London Authority | Unitary councils |
| District and borough councils | | London borough councils | |
| Police and fire authorities* | | | |

* Police services are provided by the Greater London Authority (GLA) in London and fire services are still the responsibility of some upper-tier authorities.

Local authorities in England and Wales are created by act of parliament. The present structure was established by the following:

- **London** – the *London Government Act 1963*, as amended by the *Local Government Act 1985*, the *Education Reform Act 1988* and the *Greater London Authority Act 1999*
- **the metropolitan areas outside London** – the *Local Government Act 1972*, as amended by the *Local Government Act 1985*
- **the shire areas** – the *Local Government Act 1972*, as amended by Orders made under the *Local Government Act 1992*
- **Wales** – the *Local Government (Wales) Act 1994*
- **police** – the *Police and Social Responsibility Act 2011*.

As well as the principal local authorities described above, in many areas of England and Wales there are also third-tier local councils. These may be parish, town or community councils, which provide a much smaller number of services within a small local area.

LOCAL COUNCIL SERVICES

Local councils provide a whole range of services, with responsibility split between upper- and lower-tier councils in two-tier areas. The table below sets out some of the services provided by local government and highlights which tier has responsibility for them in two-tier areas.

| Upper tier | | Lower tier | |
|---|--------------------|--------------------------|-----------------------------|
| Education | Social care | Housing | Planning |
| Highways* | Libraries | Waste collection | Street cleaning |
| Country parks and footpaths | Trading standards | Environmental health | Museums and leisure centres |
| Economic regeneration* | Waste disposal | Parks | Economic regeneration |
| Concessionary fares and public transport* | Planning strategy* | Markets and town centres | Parking |
| | Registrars | | |
| | Public health | | |

** Provided by the GLA in London, which also has responsibility for police and fire services.*

Approach to service provision

Historically, each local authority actually provided the services for which it was responsible, but the approach to service provision has changed significantly in the last 20 years. The concept of the enabling authority has emerged – initially as a response to the pressures of the compulsory competitive tendering legislation, and more recently because of the statutory duty on local authorities to deliver best value and the emphasis on partnership working. Many local authorities are adopting shared services arrangements, which are seen to offer a cost saving while retaining a high standard of service. Shared services are not limited to just two authorities combining to benefit from economies of scale, and examples of multiple shared structures can be seen in areas such as Kent and East Anglia.

The result is that many services are now provided by private sector contractors or voluntary bodies, or through partnership arrangements with a mix of different providers.

Although local authorities usually have the freedom to choose the most appropriate form of service provision, including the option of entering into arrangements with other authorities, one tier of local government may not transfer its legal duties to another tier.

Localism Act 2011

The *Localism Act 2011* brought in an important change – a general power of competence that radically increases the freedoms available to local government. Under the general power of competence local authorities have the legal capacity to do anything that an individual can do that is not specifically banned by other laws. They will not, for example, be able to impose new taxes, as other laws make it clear that they cannot. The general power gives councils more freedom to work in partnership and the confidence to be more innovative in the way services are provided.

Greater London Authority responsibilities

The *Greater London Authority Act 1999* (the GLA Act) gave the mayor responsibility for transport, strategic planning, economic development, the environment and culture, and control over two new executive bodies: Transport for London (TfL) and the London Development Agency (LDA). The GLA Act enabled the mayor to appoint members to the new metropolitan police, fire, and emergency planning authorities. The Act made it clear that the London Assembly should examine the mayor's proposals, decisions and activities, help the mayor to develop policies and approve or amend the mayor's budget.

The mayor has a duty to prepare and keep under review strategies for:

- transport
- the LDA
- spatial development
- biodiversity
- municipal waste management
- air quality
- ambient noise
- culture.

In preparing and revising his strategies, the mayor must take into account the principal purposes of the GLA, the effects of his strategies on the health of people living in Greater London and on the achievement of sustainable development in the UK.

The mayor – rather than central government – has responsibility for London's housing strategy, and for the £1bn per annum regional housing budget. The mayor has powers to 'call in' and determine major planning applications where a borough was failing to follow London Plan policies or where there was unreasonable delay in making decisions.

Boroughs remain in charge of planning decisions, so long as they are taking proper account of the need for affordable homes and other London Plan policies. The mayor will only intervene if these are being ignored. The mayor also has powers to insist that boroughs' local development plans are consistent with his London Plan.

Since 16 January 2012, the mayor of London has also been directly responsible for policing, with the creation of the Mayor's Office for Policing and Crime.

Devolution in England

The Coalition document *Our Programme for Government* supported the devolution of power away from Westminster to local councils and communities. Rather than instigating a top-down organisation change, the government approach has been to introduce policies that reduce the barriers that have prevented this type of locally driven change in the past.

The *Localism Act 2011* strengthens the ability of local authorities to make decisions that support local growth and reflect individual local requirements. City Deals, Growth Deals and New Development Deals are intended to support this policy intention.

In November 2014, the government supported legislation to enable the creation of the Greater Manchester Combined Authority, which represents a new era for local government. It will have powers to support business growth and join up budgets in health and social care and include electing a metro mayor.

Many other local authorities have expressed a desire to restructure in this way and this will shape the design and delivery of local government in the future.

Funding

Local councils receive funding for the services they provide from local residents and businesses through council tax and business rates, and from central government through grants for specific purposes and general revenue support grant. Central government also sets out the rules and regulations that local councils have to comply with, which includes controls over how they raise and spend money and over the services they provide. These are described in more detail in the following sections.

The financial year for all local authorities is 1 April to 31 March.

GOVERNMENT FUNDING OF LOCAL GOVERNMENT

Central government funds part of local government spending for a number of reasons, including:

- to support local government services, such as education, which are of importance to the nation as a whole
- to enable local authorities to provide a similar range and level of service at broadly the same cost to local taxpayers across the whole country
- to provide a subsidy to local taxpayers
- to influence (or control) local government spending on some services
- to encourage local authorities to implement central government's policy initiatives
- to act as a pump primer for development works
- to redistribute resources from one part of the country to another.

Central government also has an interest in the total expenditure of local government as it forms part of overall public spending and local government borrowing counts against public sector net borrowing.

The public expenditure planning process

Following the 1997 general election, the government introduced a new public expenditure planning system based on periodic reviews of all public spending. The new public spending plans covered a three-year period, but not a rolling three-year period.

The public spending regime is concerned with public expenditure for government as a whole – total managed expenditure (TME).

TME includes:

- central government expenditure for which three-year plans have been set and included within departmental expenditure limits (DEL)
- annually managed expenditure (AME), which includes spending that is influenced by the economic cycle, such as welfare payments, local authority self-financed expenditure (LASFE), the common agricultural policy, net public service pensions, gross central government debt interest, and spending financed by the National Lottery.

The budget preceding a spending review sets an overall envelope for public spending that is consistent with the fiscal rules for the period covered by the spending review. The results of the first review were published in July 1998 with the results of the three subsequent reviews published in July 2000, July 2002 and July 2004.

It was announced in 2005 that there would be no 2006 spending review. Instead, a second comprehensive spending review would be undertaken in 2007. The 2007 comprehensive spending review was announced on 9 October 2007 at the same time as the 2007 pre-budget report and covered three years from 2008/09 to 2010/11. The next spending review should have been in 2009 but was deferred until October 2010 and covered the period 2011/12 to 2014/15.

Spending review 2010

On 20 October 2010, the Chancellor George Osborne set out the government's spending plans for the next four years. The announcement heralded a prolonged period of austerity for everyone associated with public services.

After the 2008 financial crisis, recession and subsequent collapse in government revenues, the UK's public deficit reached levels not seen since the Second World War. Public spending increased from around 41% of gross domestic product to 48% between 2006/07 and 2009/10, while receipts fell to 37%. This meant that the government was running a deficit of 11% and had to borrow one pound for every four it spent.

Before the 2010 election, all of the major parties agreed that tackling the deficit was a priority, and that spending reductions would have to play a major part in this, although they did not agree over the timing and depth of these cuts. Shortly afterwards, the emergency budget gave an indication of what was to come, but not the full picture; the spending review was presented as being the moment when the government would publish substantive details on its aims to reduce the deficit over the next four years.

To put the figures into context, public expenditure in the 2004–07 spending review period grew by just over 4% per annum in real terms, while it had increased by around 2% per annum in real terms between 2007 and 2010. The chancellor announced that departmental spending would fall by 19% over the next four years, in order to save £81bn. This was in keeping with the government's policy to eliminate the structural deficit by 2014/15, and to do so primarily by cutting spending, rather than by increasing taxes.

Spending review 2013

The 2013 announced a further 10% cut to council funding in 2015/16; this is on top of the 33% reductions already made since 2010. As a result, local authority core funding from the

Department for Communities and Local Government (DCLG) will fall by £2.1bn in 2015/16. Acknowledging concern over adult social care, the government made available an additional £2bn funding in this area. Spending review 2013 announced that the government will reduce total spending in 2015/16, 2016/17 and 2017/18 in real terms at the same rate as during the spending review 2010 (SR 2010) period.

Local government finance settlement

Each year in November/December, the government announces the provisional local government finance settlement that sets out central government support for local government for the following year. These allocations are confirmed in the final local government finance settlement early in the new year.

Prior to 2013/14, a complicated system of formulae worked out the level of formula grant (which included a share of business rates). The formulae were based on a large number of demographic and other factors for each individual local authority.

In line with the intentions set out in spending review 2010, the government started to provide provisional resource figures for years 2 and 3 of the settlement to local government. The 2013/14 settlement included provisional figures for 2014/15 but was unable to give indications beyond year 2 in advance of spending review 2013. The 2014/15 settlement included provisional figures for 2015/16.

Capping

The previous system of universal capping of local authorities' budgets, which was a feature of local government finance over the period from 1991/92 to 1998/99, was abolished by the *Local Government Act 1999*. Under universal capping each local council had a limit on the level of budget requirement it could set in any year. Under the 1999 Act, the government retains reserve powers which enable the secretary of state:

- to regulate increases in the council tax
- to adopt such criteria as he thinks fit, but to focus on increases in local authorities' budget requirements, with powers to look at changes in budgets over a number of years
- to apply different criteria to different categories of local authority, or indeed different authorities.

Capping was not used in the intermediate years following its introduction but, due to increasing public concern about rising council tax levels, the secretary of state used the reserve powers in 2004/05. Fourteen authorities faced capping in 2004/05, and the government limited the budgets of six of these. In the following years a further 10 local authorities were capped and had notional budgets set to limit future years' increases.

In the October 2010 spending review, the government announced funding for a new council tax freeze grant, to compensate local authorities for freezing council tax. The grant was equivalent to a 2.5% rise in council tax for those authorities that froze their council tax. The government announced on 23 March 2011 that all authorities in England had decided to freeze or reduce their council tax in 2011/12.

The *Localism Act 2011* introduced a new system of local referendums for England. Each year the secretary of state will pre-announce council tax 'principles' for the following financial year. If a local authority sets a council tax outside these pre-announced principles, a local referendum will be triggered. Local people will be able to vote to accept the council tax increase, in which case the budget decision and council tax will stand, or vote to reject the increase, which means that the authority will need to set a new budget and council tax and send out replacement council tax bills.

The government offered a Council Tax Freeze Grant to those authorities that freeze their council tax in 2015/16. Local authorities raising their council tax by 2% or more will have to hold a local referendum on the proposal.

The referendum limit includes levies within local authority expenditure (eg amounts charged by passenger transport authorities or joint waste authorities for their services). Parish and town councils remain excluded from the referendum requirements, although the *Local Audit and Accountability Act 2014* does allow them to be subject to referendums in the future.

Lyons Inquiry 2007

There have been several attempts to initiate a comprehensive review of local government finance but wholesale reform faces political difficulties. In 2004, Sir Michael Lyons was appointed to undertake an independent inquiry into local government funding in England and to report to the deputy prime minister and the chancellor of the exchequer by the end of 2005. The inquiry was asked to:

- make recommendations on how best to reform council tax, taking into account the forthcoming revaluation of domestic property
- assess the case both for providing local authorities with increased flexibility to raise additional revenue and for making a significant shift in the current balance of funding
- conduct a thorough analysis of options other than council tax for local authorities to raise supplementary revenue, including local income tax, reform of business rates and other possible local taxes and charges, as well as the possible combination of such options.

Sir Michael's final report was published in March 2007.

It was concluded that council tax was not broken and should be retained, but that the government should take action in the short term to ensure a more sustainable finance system, including:

- bringing forward a package of measures on business rates to promote economic prosperity, provide local flexibility and support improved relationships between local authorities and businesses
- a range of initiatives to make council tax fairer through changes to council tax benefit
- ceasing to use, and then abolishing, its capping powers as pressures on council tax reduce
- conducting a revaluation of properties, introducing a process of regular revaluation at intervals of no more than five years, introducing new bands at the top and bottom of the distribution and giving consideration to the introduction of separate bands for inner London

- more radical, longer-term, changes to taxation were considered to require much greater consensus than was in place; those recommended for consideration included linking council tax liability more closely to the actual value of a property.

Other important reviews include:

City Finance Commission 2011

The City Finance Commission was set up by Birmingham, Manchester and Westminster City Councils and chaired by Sir Stuart Lipton. It proposed ways to promote growth in UK cities, in the context of continuing recession. Its recommendations centred on growth and included:

- proposals for pooled budgets to deliver integrated local services
- further financial and regulatory freedoms for cities
- a business rate retention scheme and tax increment financing (TIF) powers.

London Finance Commission 2013

The London Finance Commission was initiated by the mayor and supported by the boroughs to consider the weaknesses of the existing system and to propose improvements. Key recommendations from the commission included:

Capital investment

- London should have more freedom to invest in its own infrastructure through relaxing restrictions on borrowing for capital investment within prudential rules and devolving revenue streams.
- The government should distinguish between borrowing that will be used to promote growth or reduce public expenditure and thus be repaid, and other kinds of debt.
- TIF projects should be supported by government where they demonstrate net gains to the public finances.
- Borrowing limits for housing purposes for boroughs should be relaxed or removed. Prudential borrowing rules would still apply, as would the rigour of long-term Housing Revenue Account business plans.

Taxation

- The devolution of housing benefit (or a related share of Universal Credit) to London should be considered.
- The full suite of property taxes (council tax, business rates, stamp duty land tax, annual tax on enveloped dwellings and capital gains property development tax) should be devolved to London government, which should have devolved responsibility for setting the tax rates and authority over all matters including revaluation, banding and discounts.
- Council tax should be retained as a local tax but London government should be given the power and be required to hold periodic revaluations (undertaken by the Valuation Office, according to national practice), to determine the number of bands, to set the ratio of tax from band to band and to set the tax rate.
- 100% of business rates should be devolved to London government, through an appropriate governance mechanism, including the responsibility for the timing of revaluations. London government should be free to determine such issues as discounts

and tax breaks, and should have the freedom to use business rates to undertake enterprise zone style interventions.

The Independent Commission for Local Government Finance

Published in March 2015, its recommendations included a call for independent scrutiny of local government funding, a call for self-sufficiency within local government and support from government for pioneer authorities that wanted to pursue the new agenda.

REVENUE EXPENDITURE

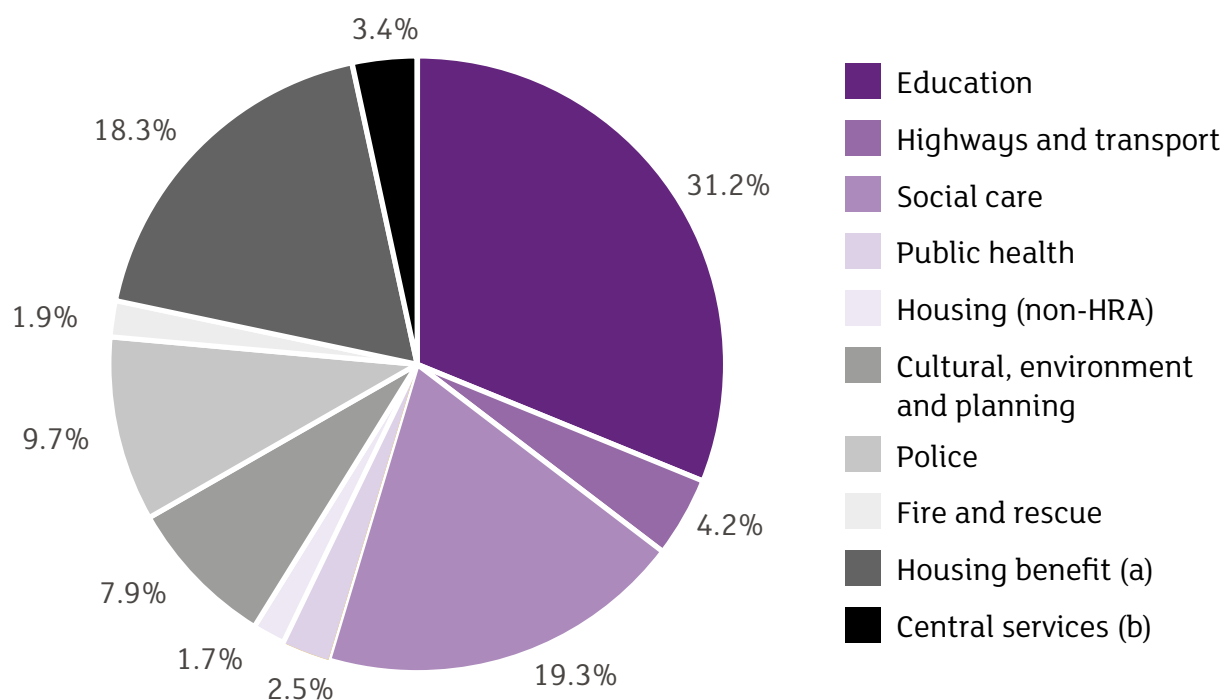
Revenue budget

The revenue budget is the term used to describe the amount that a local council spends on its day-to-day running of services. This includes wages and salaries, property and transport running costs and payments to suppliers. The money a council spends on investing in new buildings, infrastructure and expensive pieces of equipment is known as the capital budget.

Revenue expenditure was budgeted to be £98.8bn in England in 2014/15, a decrease from £102.2bn in 2013/14. Most of this decrease was due to a decrease in education expenditure, from £38.8bn in 2013/14 to £35.8bn in 2014/15.

The graphs below show how this expenditure is split between the main services that local government provides.

Total service expenditure 2014/15 – England



(a) Housing benefit includes mandatory rent allowances and rent rebates.

(b) Central services include courts and other services relating to administration costs for council and non-domestic rates collection.

Note: the housing figure is shown net of rental income.

Budget requirement

In addition to the running costs of services, councils have to fund the costs of borrowing money to pay for their capital assets and meet the costs of certain other local service providers, such as the Environment Agency for flood prevention work, through what are known as levies. Once all these things are taken into account, along with specific grants, a figure known as net revenue expenditure is reached. From this figure, any use of council reserves is subtracted to get to a budget requirement figure that is then funded from general government grant or council tax.

Specific grants

Local councils receive a number of specific grants from central government to support its priorities. The tables below sets out some of the key specific grants payable in 2013/14.

Main specific grants – England

| Grant | Description |
|-------------------------------------|---|
| Dedicated Schools Grant | Grant to fund schools that can only be used for that purpose. |
| Pupil Premium | Additional funding for disadvantaged pupils that can only be used for that purpose. |
| Housing Benefit Subsidy Admin Grant | Paid to billing authorities to support their costs of administering support for council tax. |
| New Homes Bonus | Paid to councils to encourage them to build new homes. New homes bonus gives local councils grant equivalent to their increase in council tax income for a period of six years for each new home. There is an additional amount payable if any of these new homes are affordable housing. |
| Local Sustainable Transport Fund | Funding to promote sustainable transport schemes. |
| Weekly Collection Support Scheme | Paid to authorities who bring back weekly refuse collection. |
| Council Tax Freeze Grant | Paid to councils to allow them to freeze their council tax. |
| PFI | Paid to councils with PFI schemes to support the costs of the investment in new assets. |

Main specific grants – Wales

Wales continues to support a much larger range of services through the use of specific grants compared to England, where many former specific grants have now been built into base funding. This table lists the highest value specific grants.

| Grant | Description |
|---|--|
| Concessionary Fares Reimbursement Grant | Grant to support the cost of concessionary fares for the disabled and the elderly. |
| Families First | Funding for promoting integrated support for families. |
| Flying Start Revenue Grant | Targeted support for very young children in the most deprived areas of Wales. |
| Foundation Phase Revenue Grant | Support to improve education for three- to seven-year-olds. |
| Post-16 Provision in Schools | Funding for post-16 education in Welsh schools. |
| Supporting People | Grant to help vulnerable people live as independently as possible. |
| Sustainable Waste Management Grant | Grant to help local councils improve waste reduction, re-use and recycling. |

Funding

In 2012/13, the budget requirement was funded from a mixture of formula grant and council tax, where formula grant was an amount distributed to local government by central government to support general expenditure. From 2013/14, local authorities have been funded by three separate sources:

- **Council tax** – the amount collected from local residents based upon the value of the property in which they live.
- **Business rates** – local authorities are allowed to keep a proportion of the income they receive from businesses based upon the value of the premises from which they operate.
- **Revenue support grant** – local authorities receive general grant from government to support the services they provide.

These different sources of income are covered in detail in the following sections.

It should be noted that police and crime commissioners are funded differently to other local authorities as they do not receive any income from business rates but instead receive police grant.

COUNCIL TAX

Council tax is collected from residents within a council's area based on the value of the property they live in. Council tax was introduced in 1993 to replace the community charge (or poll tax). For the purpose of council tax, each property is assigned to one of eight bands, A to H, based on its value in 1991. The value of each property is assessed by the Valuation Office Agency, an agency of central government. For properties built after 1991, their value is

assessed as if it had been in existence in 1991. Residents who do not agree with the council tax band their property has been placed in have a right of appeal.

In Wales, the property values relating to each band were reassessed and updated in 2005 based upon 2003 property values. This process is known as council tax revaluation. There has been no revaluation in England.

The band a property is placed in determines how much council tax will be paid relative to other properties in the same council area. For example, a band A property will pay two thirds of the amount of council tax paid by a property in band D, while a property in band H will pay double. The table below sets out the property values that relate to each of the council tax bands and the relative amounts of council tax that will be paid.

| Band | English values | Welsh values before 2005 | Welsh values from 2005 | Relative council tax |
|------|----------------------|--------------------------|------------------------|----------------------|
| A | Less than £40,000 | Less than £30,000 | Less than £44,000 | $\frac{2}{3}$ |
| B | £40,001 to £52,000 | £30,001 to £39,000 | £44,001 to £65,000 | $\frac{7}{9}$ |
| C | £52,001 to £68,000 | £39,001 to £51,000 | £65,001 to £91,000 | $\frac{8}{9}$ |
| D | £68,001 to £88,000 | £51,001 to £66,000 | £91,001 to £123,000 | 1 |
| E | £88,001 to £120,000 | £66,001 to £90,000 | £123,001 to £162,000 | $\frac{11}{9}$ |
| F | £120,001 to £160,000 | £90,001 to £120,000 | £162,001 to £223,000 | $\frac{13}{9}$ |
| G | £160,001 to £320,000 | £120,001 to £240,000 | £223,001 to £324,000 | $\frac{5}{3}$ |
| H | Over £320,000 | Over £240,000 | Over £324,000 | 2 |

The level of council tax can be reduced in certain circumstances, described in the following sections.

Liability

The person liable to pay the council tax is normally the resident, but where no one is resident, the owner of the property is liable. Where more than one person is resident, the person liable to pay is determined according to a hierarchy of ownership and tenancy determined by the government. For example, if two people are resident and one is the owner of the dwelling and the other a lodger, the owner is liable to pay the tax.

Where more than one person is liable, for example where the dwelling is occupied by joint tenants and the landlord is not resident, these persons are jointly and severally liable. However, if the dwelling is occupied by a number of people, some of whom are severely mentally impaired and others who are not, only those who are not severely mentally impaired can be held liable to pay the tax. Section 74 of the *Local Government Act 2003* makes full-time students exempt from joint and several liability.

Spouses – married couples, civil partners or a couple living together as if married – are usually jointly and severally liable.

The Department for Communities and Local Government (DCLG) has made regulations to ensure that the owner of a care home is liable for council tax, and to ensure that the liability cannot be disaggregated to transfer the liability to the residents. However, if a care home

contains a self-contained unit provided as accommodation for the owner of the care home, the unit will be treated as a separate dwelling.

Discounts, exemptions and reductions in valuations

Tax bills for single-person households are discounted by 25%. The bills are also discounted by 25% where all but one of the residents in a property are:

- detained in prison or detained under the mental health acts
- severely mentally impaired
- students
- young people who have reached the age of 18, but in respect of whom child benefit is payable
- patients in hospitals and homes
- care workers in certain circumstances.

Some properties are exempted from the tax, including:

- properties occupied only by students
- Crown properties
- properties that are unoccupied because the residents are in prison, in hospital or receiving care.

From 1 April 2013, billing authorities in England took on additional powers over certain council tax discounts. 'Unoccupied and substantially unfurnished' properties may receive a discount of between 0% and 100% of their council tax. Properties that are vacant and are undergoing 'major repair work' or 'structural alteration' can attract a discount of between 0% and 50%, for a maximum of 12 months.

From 1 April 2013, local authorities in England may also set an 'empty homes premium' for long-term empty properties. Properties that have been unoccupied and substantially unfurnished for over two years may be charged up to 150% of the normal liability. In Scotland, the premium may be applied after one year and the total charge may be up to 200% of the normal liability. This is not yet in force in Wales. Where a property has been specially adapted for a person with physical disabilities, the council tax valuation is reduced by one band, ie a property valued as a band D property would be taxed as a band C property if it has been adapted for a person with physical disabilities.

Section 76 of the 2003 Act gave English billing authorities the power to reduce the council tax liability for any chargeable dwelling or any class of property. The cost of these local discounts has to be funded by the billing authority, and DCLG has made directions under section 98 of the *Local Government Finance Act 1988* to ensure that this happens. It is worth noting that the power to determine local discounts rests with the billing authority. In the shire county areas, this will always be the district or borough council, so county councils do not have the power to grant discounts to council taxpayers.

Council tax benefit

Council tax benefit no longer exists under legislation and has been replaced with council tax support.

Council tax support

From 2012/13, council tax benefit has been replaced by a localised system of discounts designed and administered by individual local authorities. The government provided funding for the cost of discounts within the local government finance settlement; however, in calculating the resources to be transferred to local government, the government assumed a 10% cut in funding. This meant that local authorities had to either design schemes that were less generous or find additional resources to make up the deficit. Because the council tax discount is converted to a percentage reduction in the council tax base, it automatically impacts on major and local preceptors.

Within the legislation framework setting up council tax support, there is a requirement that government will review its implementation. To date no timetable has been set.

Billing and precepting authorities

The Corporation of London, London boroughs, metropolitan districts, shire districts and unitary councils are responsible for billing and collecting council tax.

Billing authorities calculate the amount to be raised through the council tax after taking into account the precepts of major precepting authorities, ie county councils, police authorities, combined fire authorities, joint authorities and national park authorities, and of minor precepting authorities, ie parish, community and town councils.

Billing

Local authorities are able to serve council tax demands electronically. DCLG has made regulations – the *Council Tax and Non-Domestic Rating (Electronic Communications) (England) Order 2003* – which make it possible for English billing authorities to serve both council tax and business rate demands either as an attachment to an email or via a secure website. The regulations came into force on 5 November 2003.

Collection and recovery

The regulations governing demands for council tax and the recovery of unpaid sums are set out in the *Council Tax (Administration and Enforcement) Regulations 1992* as amended.

In April 2013, the *Taking Control of Goods Regulations 2013* was brought into force. This regulates activities around the collection of debt where an individual has a liability order that has been passed to a debt enforcement agency.

Collection rates

The collection rate for the council tax is better than that for the community charge.

According to DCLG figures in July 2014, local authorities in England achieved a national average in-year collection rate for council tax of 97% in 2013/14, which is a decrease of 0.4 percentage points over 2012/13.

The collection rate in all types of authority fell. The biggest falls were in metropolitan areas, which fell by 0.8 percentage points, and unitary authority areas, which fell by 0.6 percentage points. Local authorities in England collected £23.4bn in council taxes by the end of March 2014 out of a total of £24.1bn collectable.

There are concerns that the introduction of local council tax support will impact on collection rates as it will result in households that were previously exempt having to pay council tax for the first time and this may account for some of the changes in the figures.

Calculating the council tax

The council tax is calculated by subtracting the amount of business rates and revenue support grant that a council expects to receive from its budget requirement. The balance is left to be funded by the council tax and the actual council tax is calculated by dividing this amount by the council tax base.

The council tax base is calculated by converting the number of dwellings into each band to band D equivalents; for example, each house in band H is equivalent to two band D houses and each band A house is equivalent to two thirds of a band D house. From this amount, the value of any discounts is subtracted, for example if a single person's tax discount (equivalent to 25%) is awarded to four houses in the same band, this would reduce the tax base for that band by 1. The following example shows a very simplified version of how this works.

| Band | Number of properties | Reduction due to discounts | Adjusted number of properties | Ratio | Band D equivalent |
|--------------|----------------------|----------------------------|-------------------------------|----------------|-------------------|
| A | 3,000 | 1,200 | 1,800 | $\frac{2}{3}$ | 1,200 |
| B | 4,000 | 1,300 | 2,700 | $\frac{7}{9}$ | 2,100 |
| C | 6,000 | 1,500 | 4,500 | $\frac{8}{9}$ | 4,000 |
| D | 4,500 | 1,000 | 3,500 | 1 | 3,500 |
| E | 3,200 | 500 | 2,700 | $\frac{11}{9}$ | 3,300 |
| F | 1,950 | 150 | 1,800 | $\frac{13}{9}$ | 2,600 |
| G | 1,850 | 50 | 1,800 | $\frac{15}{9}$ | 3,000 |
| H | 920 | 20 | 900 | 2 | 1,800 |
| Total | | | | | 21,500 |

In the example above, the tax base for the area is 21,500 band D equivalents. The band D council tax is calculated by dividing the amount to be raised from council tax by the council tax base. The council tax for other bands is then calculated by multiplying the band D council tax by the relative ratio for each band; for example, if the band D council tax is £900, the band A council tax will be two thirds of this amount or £600.

The example below shows the calculation for an area with a police and crime commissioner, a county council, a district council and a parish council. The council tax base is higher for

the police and county councils as these cover several district council areas and lower for the parish council as there will be several within the district area.

| Council | Precept/amount to be collected from council tax | Tax base | Band D council tax |
|--|---|----------|--------------------|
| County council | 225,000,000 | 250,000 | 900 |
| Police and crime commissioner | 30,000,000 | 250,000 | 120 |
| District council | 4,300,000 | 21,500 | 200 |
| Parish council | 75,000 | 1,500 | 50 |
| Total to be paid by council taxpayers | | | 1,270 |

Council tax can either be paid in a lump sum or in instalments, usually by direct debit. From 2013/14 all residents will have the option to pay their council tax over 12 instalments under new legislation introduced by the government. Previously, most councils offered the option to pay over 10 instalments to give some flexibility to minimise council tax arrears. Billing authorities are responsible for collecting council tax and paying over the major and local preceptors' shares. They are also responsible for dealing with any arrears and taking action against non-payers, and they are able to make discretionary hardship payments to those genuinely struggling to pay their bills.

Council tax increases

Consecutive governments have been concerned about the level of increases in council tax and have sought to limit the amount by which council tax is allowed to increase. Initially this was done through capping, under which local authorities were given specific limits on the amount their budgets could increase. This system of 'crude and universal' capping was abolished in 1999 but the secretary of state retained reserve powers.

Since 2012/13, council tax referendum rules have been in place. Under these rules, if a council increases its council tax above a pre-announced percentage, that council will have to organise a referendum of council taxpayers to approve the increase. Councils are unlikely to risk going to referendum because it would take place after the budget setting and council tax billing processes have finished and councils would risk having to meet the cost of re-billing if taxpayers vote no. For 2012/13, the referendum limit was set at 3.5%; for the 2014/15 financial year, the 'principles of excessiveness' stated that all local authorities, police and crime commissioners and fire and rescue authorities could not raise council tax by more than 2% without a referendum.

The government has also made grant available to those authorities who would have set a very low increase in council tax to implement a council tax freeze. The table below shows the impact this grant has had over the last couple of years, with virtually no increase in council tax.

Average band D council tax percentage change 2005/06 to 2014/15

| | Band D | |
|---------|--------|----------|
| | £ | % change |
| 2005/06 | 1,214 | 4.1 |
| 2006/07 | 1,268 | 4.5 |
| 2007/08 | 1,321 | 4.2 |
| 2008/09 | 1,373 | 3.9 |
| 2009/10 | 1,414 | 3.0 |
| 2010/11 | 1,439 | 1.8 |
| 2011/12 | 1,439 | 0.1 |
| 2012/13 | 1,444 | 0.3 |
| 2013/14 | 1,456 | 0.8 |
| 2014/15 | 1,468 | 0.9 |

Figures include parish precepts.

Sources: BR (to 2011/12) and CTR (from 2012/13) forms, DCLG.

The collection fund

Because billing authorities collect council tax on behalf of all the authorities in its area, there is a need to avoid mixing up the true income due to the billing authority with income that is merely passed straight on to its preceptors. The collection fund is the way this is done. All local council income is paid into the collection fund and payments are made from the fund into billing authorities' individual accounts and to the major preceptors. The government does not want the income local authorities receive during the year to vary too significantly as this may cause problems for budgeting purposes and so has made regulations to achieve this through the collection fund.

The amount that individual authorities receive from the collection fund is fixed at the level of the precept or the amount that is projected when the council tax is set. This amount is paid out of the collection fund regardless of how much council tax is collected during the year. If more council tax is collected than expected, this creates a surplus on the collection fund; if less is collected, it creates a deficit. The surplus/deficit on the collection fund is shared out among the individual authorities in the following year(s) and taken into account in the budget calculations for that year(s).

The collection fund is also used to collect and pay out business rates.

BUSINESS RATES

Business rates are payable by businesses based on the rateable value of the premises they occupy, which is calculated according to how much rent they would achieve if rented out. Valuations are carried out by the Valuation Office Agency on a five-year cycle; the last valuation list applied from 2010 and listed the rateable value of all business properties. The

rateable value broadly represents the annual rent the property could have been let for on the open market on a particular date, on full repairing and insuring terms. For the current rating lists, this date was set as 1 April 2008. The arrangements for the setting, billing and collection of the tax are set out in Part III of the *Local Government Finance Act 1988* (the 1988 Act).

Local councils are responsible for calculating actual rates bills and for collecting rates and will use the rateable value in working out how much businesses have to pay. The actual rate bill is calculated by applying the rate multiplier (a rate in the pound) to the rateable value and then deducting any reliefs that are applicable. In England the multiplier is set by DCLG and in Wales the multiplier is set by the Welsh Government. The multiplier for 2015/16 was:

- England = 49.3p in the pound
- Small businesses in England* = 48.0p in the pound
- All businesses in Wales = 0.482

* For England a small business is one where the total rateable value is under £18,000 (or under £25,500 in London). For example, a property with a rateable value of £12,000 in England would have an annual rates bill of:

- £12,000 x 0.45 = £5,400

Some businesses may be eligible for small business relief or charitable discounts which can affect the amount of rates they pay. In addition, billing authorities are able to grant discretionary relief to individual businesses, for example to promote town centre regeneration.

Until 2013/14, local councils merely collected business rates on behalf of the government. The business rates were then passed back to local councils as part of their overall funding, that is, they were allocated through the funding formula, so some individual authorities received back less in funding than they had collected in business rates. From 2013/14 local councils, other than police and crime commissioners, keep a portion of the business rates raised in their areas. This is the business rate retention scheme.

Valuation and rating lists

The 1988 Act defined the rateable value of a property – referred to in the legislation as a ‘hereditament’ – as *‘an amount equal to the rent at which it is estimated the hereditament might reasonably be expected to be let from year to year if the tenant undertook to pay all usual tenant’s rates and taxes and to bear the cost of repairs and insurance and the other expenses (if any) necessary to maintain the hereditament in a state to command that rent’*.

The *Rating (Valuation) Act 1999* amended the 1988 Act and says that valuations for rating purposes are to be carried out on the assumption that the property concerned is in a reasonable state of repair, except where any repairs would be uneconomic to carry out.

The 1988 Act says that properties must be revalued every five years. The 1990 rating list was based on rental values in 1988. The 1995 rating list was based on rental values in 1993, and the 2000 rating list was based on rental values as at April 1998. The current rating list that came into force on 1 April 2010 is based on rental values as at April 2008.

The Valuation Office Agency (VOA) is responsible for valuing non-domestic properties. Most properties appear on the local rating list, which is maintained by the VOA’s valuation officer for each billing authority area. A copy of the local rating list is held by the authority. The

central valuation officer also maintains a central rating list, which includes the valuations for properties prescribed by the secretary of state in England and the National Assembly for Wales, such as those relating to utilities (eg gas and electricity). The billing authority must put the local rating list on public display.

2010 revaluation

In July 2009, the government published the results of the 2010 revaluation, which took effect from 1 April 2010:

- The majority (60%) of businesses saw a fall in their 2010 bill as a result of the revaluation.
- Overall, as a result of revaluation and the relief arrangements, a million businesses saw an average decrease of £770 in 2010/11.
- High-street retailers were largely unaffected, with sectors such as shops seeing cuts in rates bills – figures showed an average 1% reduction.
- Large supermarkets saw increases given their growth in property value since the last revaluation in 2005.
- The industry and manufacturing sector, from large factories down to small workshops and start-up units, saw falls of 3% or £175m.

All regions saw average rate bills fall or stay the same as a result of revaluation and the relief scheme, except London and the South West, which on average saw respective increases of 3% and 1% after transitional relief. London had seen the highest economic growth of any region, had the highest concentration of businesses, and made a proportionate contribution through business rates.

The high property market of April 2008, upon which 2010 rateable values are based, did not affect overall bills as there were parallel falls in the multiplier.

Details are summarised in the following tables.

Sector effect of the 2010 revaluation – percentage change in bills 2010/11 before inflation and other reliefs

| | Total | | Offices | | Retail | | Industry | | Others | |
|-----------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
| | Before transition | After transition | Before transition | After transition | Before transition | After transition | Before transition | After transition | Before transition | After transition |
| East Midlands | -10% | -4% | -18% | -7% | -8% | -3% | -16% | -6% | -2% | -1% |
| West Midlands | -7% | -3% | -8% | -3% | -4% | -1% | -13% | -5% | -1% | -1% |
| South East | -5% | -2% | -13% | -4% | 0% | 1% | -12% | -4% | 0% | 0% |
| East of England | -3% | -1% | -7% | -2% | 1% | 1% | -9% | -3% | 2% | 0% |
| North West | -2% | -1% | -3% | -1% | -1% | 0% | -9% | -3% | 2% | 0% |

| | Total | | Offices | | Retail | | Industry | | Others | |
|--------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|-------------------|------------------|
| | Before transition | After transition | Before transition | After transition | Before transition | After transition | Before transition | After transition | Before transition | After transition |
| North East | -1% | 0% | -6% | -2% | -1% | 0% | -7% | -2% | 6% | 3% |
| Yorkshire & Humber | -1% | 0% | -1% | 0% | 1% | 1% | -9% | -4% | 3% | 1% |
| South West | 3% | 1% | -3% | -1% | 5% | 3% | -3% | -2% | 7% | 3% |
| Central list | 3% | 2% | n/a | n/a | n/a | n/a | n/a | n/a | n/a | n/a |
| London | 10% | 3% | 19% | 5% | 4% | 1% | 0% | 0% | 4% | 2% |
| Total | 0% | 0% | 5% | 1% | 1% | 1% | -9% | -3% | 2% | 1% |

Effect of the 2010 revaluation on 2010/11 bills before inflation and other reliefs – retail sector by type

| | Hereditaments | Before transition % change | After transition % change |
|-------------------|---------------|----------------------------|---------------------------|
| Shops | 407,700 | -1% | -1% |
| Retail warehouses | 7,800 | -4% | 0% |
| Supermarkets | 3,900 | 12% | 9% |
| Department stores | 200 | -6% | -2% |
| High street banks | 10,400 | -2% | 0% |
| Large shops | 2,300 | -2% | 0% |
| Other retail | 43,400 | 2% | -1% |

2015 revaluation

The revaluation due in 2015 has been delayed until 2017 by the government.

Appeals

Ratepayers may seek an alteration to the rateable value of a property on a number of different grounds; for example, if:

- they object to the valuation that has been determined by the valuation officer
- they believe that the factors taken into account in the valuation of the property are factually incorrect
- the physical circumstances of the property have changed due to the property being split, merged with another property, partially demolished, or extended
- the basis of the valuation has altered due to external factors that were not present at the valuation date.

A ratepayer seeks an alteration by making a proposal to the valuation officer to have the valuation altered. After three months, proposals are automatically referred to the local valuation tribunal, at which point they become appeals.

Proposals about the 2005 rateable value could be made until 31 March 2010. Proposals about the 2010 rateable value could only be made until March 2015. Because of the delay in revaluation, any proposal made after 31 March 2015 will only be backdated to 31 March 2015, not 2010. Before making a proposal, ratepayers can contact their local VOA to discuss why they want to appeal. Reasons need to be provided for the proposal.

Transitional relief

The 1990 revaluation was the first revaluation of non-domestic properties since 1973. The combination of the rating revaluation and the move from a locally set to a nationally set tax rate would have produced big changes in rate bills – large increases for some ratepayers and large cuts for others. The government introduced transitional arrangements that limited the year-on-year increases and decreases in the bills paid by individual ratepayers. The initial legislation was set out in the 1988 Act, and was amended by the *Local Government Housing Act 1989* and the *Non-Domestic Rating Act 1992*.

Transitional arrangements – 2010 rating list

In July 2009, DCLG published a consultation paper on the transitional arrangements for the 2010 revaluation. The government’s response to consultees’ comments on the proposed transitional arrangements for the non-domestic rating revaluation 2010 was published in November 2009.

The consultation sought views on how much transitional relief should be provided for small and large properties, over what time period, and how this relief should be financed. Sixty-two consultation responses were received. They showed broad support for the government’s preferred option, with a majority agreeing that the same caps on increases in rate liabilities should be applied as those adopted at the last revaluation, that the transitional scheme should last five years, and that it should be funded through caps on reductions in rate liabilities.

In light of the responses received, the government proposed introducing a £2bn transitional relief scheme to limit and phase in increases in rate liabilities. The scheme would provide relief for the full five years of the revaluation period by applying caps to increases in bills, funded by caps on reductions to bills. This would ensure that no business would see its 2010/11 rates liability rise by more than 12.5% before inflation (11% after inflation) as a result of revaluation, with no small business seeing increases resulting from revaluation of more than 5% before inflation (3.5% in real terms).

Transitional arrangements – 2010 rating list, England

| Caps on increases and reductions before inflation | | | | |
|---|--|--|---|---|
| | Cap on increases (small properties) | Cap on increases (large properties) | Cap on reductions (small properties) | Cap on reductions (large properties) |
| 2010/11 | 5% | 12.5% | 20% | 4.6% |
| 2011/12 | 7.5% | 17.5% | 30% | 6.7% |
| 2012/13 | 10% | 20% | 35% | 7% |
| 2013/14 | 15% | 25% | 55% | 13% |
| 2014/15 | 15% | 25% | 55% | 13% |

Exemption from business rates

Many properties are wholly exempt from rates. By definition, all domestic properties are exempt, but so are:

- fish farms
- fishing rights
- places of religious worship
- Trinity House properties which are lighthouses, buoys and beacons
- sewers
- drainage authority properties
- parks
- property used for the disabled
- air-raid protection works
- swinging moorings for boats or ships.

The secretary of state and the National Assembly for Wales may add to the list of exempt properties by issuing regulations under the 1988 Act.

Relief granted to charitable bodies

Charities and community amateur sports clubs are entitled to:

- an 80% reduction on occupied properties
- after the initial three-month exemption, an 80% reduction of the tax on empty properties which, when next used, are likely to be used for charitable purposes, and where the ratepayer is a charity or its trustees.

These are mandatory discounts. The cost of these discounts is taken into account by the government in determining the level of each authority's contribution. Billing authorities have the discretion to waive the remaining 20% on occupied and unoccupied properties.

Small business rates relief

Section 61 of the *Local Government Act 2003* gives the secretary of state and the Welsh Government the power to give discounts to small businesses. The relief came into operation on 1 April 2005.

Section 62 of the 2003 Act provides for DCLG to set two business rate multipliers for England from 1 April 2005:

- a small business rating multiplier
- a business rating multiplier.

The business rating multiplier will be set at such a level as to produce an increase in the tax yield from properties that do not qualify for small business relief that will be sufficient to meet the cost of the relief given to small businesses.

Mandatory relief is only available to ratepayers with either:

- one property with a rateable value below the appropriate threshold – ie £18,000 outside London and £25,500 inside London, or
- one main property and other additional properties, providing each of those additional properties have rateable values of less than £2,600 and the total value all the properties remains under the appropriate threshold.

Ratepayers who satisfy these conditions will have the bill for their sole or main property calculated using the small business rating multiplier rather than the national multiplier that is used to calculate the liability of other businesses.

In addition, if the sole or main property is shown on the rating list with a rateable value which does not exceed £12,000, the ratepayer will receive a percentage reduction in their rates bill for this property. The mandatory relief will be 50% of the bill for properties with rateable values below £6,000. Relief will decrease on a sliding scale of 1% for every £100 of rateable value, up to £12,000. The rate bills for single, eligible properties outside London with rateable values between £12,000 and £18,000 – and inside London with rateable values between £12,000 and £25,500 – will be calculated on the basis of the small business rating multiplier, but these will not qualify for any further relief.

Discretionary rate relief

In addition to charity relief, billing authorities may grant relief up to 100% to other non-profit-making bodies. This discretionary relief could be given to properties used for recreational, charitable, philanthropic or religious purposes or in connection with education, social welfare, science, literature or the fine arts, provided that the organisations involved are not run for profit.

There are no rules on this because it is a matter for local discretion, but government practice notes on discretionary rate relief suggest that authorities may want to set down criteria to help them decide how, if at all, to grant discretionary reliefs. Those criteria include:

- the extent to which the facilities are available to the public and to special groups such as older people, people with disabilities, young people and people from ethnic minorities
- whether the facilities provided include education and/or training for club members as a whole or for special groups
- the extent to which the facilities provided reduce the demand for local authority services
- the way in which the facilities are provided, ie does the organisation raise its own funds, rely on grant aid, or use a combination of self-help and grant aid? The practice note suggests that self-help bodies might be treated more favourably than grant-aided bodies
- whether the organisation is affiliated to other local or national groups and actively involved locally or nationally in the development of its area of interest.

Section 69 of the *Localism Act 2011* provides a power for the local authority to reduce the business rates of any ratepayer locally. This localism discount can be awarded where the authority considers it to be in the interests of the taxpayer and allows the authority greater discretion.

Discretion can also be exercised under section 49 of the *Local Government Act 1988* to provide either partial or full relief for business rate payments in cases of hardship. Each case must be considered on its merits. It is necessary for the authority to obtain details of the hardship (most likely to be financial) and take into account the impact of the loss of the ratepayer to the area.

Business rate localisation – England only

From April 2013, local councils have been allowed to keep a proportion of the business rates they collect from businesses in their area. In all areas, half of business rates will have to be paid over to central government. Billing authorities will continue to collect all of the business rates in their area on behalf of the major precepting authorities, which are the same as for council tax, and central government. The shares of total business rates each type of local authority is allowed to keep is set out in the table below:

Proportion of business rates each type of authority may keep

| | |
|---|-----|
| District councils | 40% |
| County councils (with responsibility for fire) | 10% |
| County councils (where there is a separate combined fire authority) | 9% |
| Unitary and metropolitan authorities (with responsibility for fire) | 50% |
| Unitary and metropolitan councils (where there is a separate combined fire authority) | 49% |
| Combined fire authorities | 1% |
| London boroughs | 30% |
| Greater London Authority | 20% |

Because the amount of business rates an individual authority is able to collect will vary enormously depending upon location and the characteristics of the authority, the government has introduced a system of top-ups and tariffs to re-distribute business rates around the country. Local councils with a relatively high level of business rates pay a tariff into a national pot which is used to pay top-ups to those local authorities with relatively low levels of business rates. The level of these top-ups and tariffs was set by the 2013/14 local government finance settlement, and is set for a period of at least seven years, although both top-ups and tariffs will increase by inflation over that time.

In order to prevent local councils having to drastically cut services as a result of a significant fall in business rate income and to provide some protection against major economic shocks, the government has also introduced a safety net mechanism to ensure that no local council will experience a fall in business rate income of more than 7.5% in any one year. This safety net is paid for by a levy on what the government deems to be 'excessive growth'. Any local council whose business rates increase by more than inflation will have to pay over a greater proportion of business rates to government, with the result that their locally retained business rates do not increase by more than the equivalent percentage growth above inflation.

For example, if we take a unitary authority with business rates of £400m per year (excluding the impact of any discretionary discounts) and a tariff of £50m per year:

- retained business rate income would be 50% of £400m less the tariff of £50m, ie £150m.

Assuming its business rates increase by £40m or 10% above inflation:

- without the levy it would keep £20m, or 50% of this growth
- under the levy arrangement, the council's increase in income would be limited to 10% of its retained business rate income, ie £15m
- the council would be required to pay £5m into the central pot
- this gives a levy rate of 0.25 (£5m/£20m), requiring this council to pay 25% of any growth in its local share of business rates above inflation into the national pot.

The levy rate for each local council is set as part of the local government finance settlement, in order to achieve this balance of 1% growth in local resources for each 1% growth in business rates above inflation. To ensure that an incentive for growth is retained, the levy rate is capped at 0.5, ie all local councils are able to keep at least half of the growth in their local share of business rate income.

The amount of business rates a local authority will take into account when setting its budget each year is decided when the billing authority completes its estimate of business rate income for the following year in January and completes a return to government (called NNDR1) setting out this amount. This also fixes the amount that the council will pay over to government. Business rate income is paid into the collection fund, administered by the billing authority, as it is collected from businesses. The collection then makes payments out to the billing authority general fund, the major preceptors and government based on the NNDR1 estimate. If more income is received than estimated, this creates a surplus on the collection fund; if less is collected, it creates a deficit, and this is paid over to the individual councils and government the following year.

Where a council's estimate is so low that the safety net becomes payable, payments are made on account by government during the year. Any levy payments and the difference between estimated and actual safety net payments become payable at the end of the financial year, although the actual cash is paid over in the following financial year.

THE LOCAL GOVERNMENT FINANCE SETTLEMENT – ENGLAND

The local government finance settlement is announced annually and sets out the amount of funding local government will receive for the following year from central government. It also provides provisional figures for future years. A provisional settlement announcement is made in December and the final settlement is announced following consultation in January. There is usually little change between the provisional and the final settlement figures.

Local government control total

Before the government works out how much each individual local authority will receive, it sets the local government spending control total. This is the amount of the overall public spending envelope it decides should be spent by local government. The government then makes a

number of adjustments to this total for central funding that needs to be met from within the local government control total.

A number of further adjustments are then made to this revised total for specific grants that are transferring into core funding or for any grants being transferred out of the local government spending control total to get to a figure known as the aggregate start-up funding assessment, which was £26.1bn in 2013/14 and £23.9bn in 2014/15.

Estimated business rates aggregate

To get to a starting position for the new system, the government made an estimate of the business rates that will be collected in 2013/14, known as the estimated business rates aggregate, which was set at £21.8bn for 2013/14. The estimated business rates aggregate includes a reduction in estimated business rate income of approximately 8% to reflect the amount of business rate income that is likely to be lost nationally as a result of successful business rate appeals. The local share of business rates is 50% so the amount of local business rate funding local authorities will be expected to receive is £10.9bn.

The value of revenue support grant (RSG) in 2013/14 was then calculated by subtracting the amount of locally retained business rates from the aggregate start-up funding assessment:

- aggregate start-up funding assessment £26.1bn, less
- local share of estimated business rates aggregate £10.9bn, gives
- RSG £15.2bn.

From the local share of estimated business rates aggregate and the total of RSG, the ratio of local share:RSG is calculated. In order to calculate this ratio, the estimated business rates aggregate is reduced by £0.8m for two items that relate to London only to give a final ratio of 10.1:15.2.

Local government funding formula

After calculating the start-up funding assessment at an aggregate level, the government then allocated this assessment between local authorities to get to each local council's start-up funding assessment. The government uses a mechanism known as formula funding to allocate funding between local authorities. The formula uses a number of local indicators, including population figures and measures of deprivation, known as the four-block model. The four-block model consists of:

- relative needs amount
- relative resource amount
- central allocation
- floor damping.

Calculation of revenue support grant

RSG is a grant paid by government to support local councils' general expenditure. There are no restrictions on how it is to be used (within a council's legal powers) and the amount each local authority will receive is set out in the local government finance settlement.

Once a local council's start-up funding assessment has been calculated, the local share:RSG ratio is used to work out how much RSG a council will receive and what its baseline funding level for business rates is. If we take a local council that has a start-up funding assessment of £500m:

- RSG would be $\frac{£500m \times 15.2}{(10.1+15.2)} = £300.4m$
- Baseline funding would be $\frac{£500m \times 10.1}{(10.1+15.2)} = £199.6m$

The RSG figure is the amount of grant that the council will actually receive. The baseline funding figure, however, now needs to be compared to the amount of business rates the council is projected to collect to work out whether the authority is a top-up or a tariff authority.

Billing authority business rates baselines are calculated by distributing the local share of the estimated business rates aggregate between local authorities. This is done on the basis of proportionate shares. An individual billing authority's proportionate share is calculated by comparing how much business rate income it has collected over the last two years to the total amount collected. Where necessary these business rate baselines are then split between the major preceptors and the billing authority according to the fixed shares. The business rate baseline is then compared to the baseline funding to work out the top-up/tariff.

In the example above, if we assume the authority with the start-up funding assessment of £500m is a county council (with responsibility for fire), and the billing authority has a business rate baseline for its area of £400m:

- The council's business rate baseline would be $£400m \times 10 / (40+10) = £80m$
- The council's baseline funding level for business rates is £199.6m
- The council is a top-up council with the top-up for 2013/14 set at $£199.6m - £80m = £119.6m$.

The local government finance settlement sets out the figures for individual authorities.

THE LOCAL GOVERNMENT FINANCE SETTLEMENT – WALES

The Welsh Government operates a completely different system to the one in England. Wales uses a system of standard spending assessments to work out each local council's share of total local government expenditure. The calculation is based on a mathematical formula that makes use of information reflecting the demographic, physical, economic and social characteristics of each area.

Standard spending assessments

Standard spending assessments (SSAs) are intended to reflect variations in the need to spend which might be expected if all authorities responded in a similar way to the demand for services in their area. This is the mechanism for distributing RSG to local authorities to enable them to charge the same council tax for the provision of a similar standard of service.

The total of SSAs is the same as the total of assumed budgets for Welsh authorities. This means that the overall amount is influenced by decisions on the underlying increase in funding from central government and the actual amount assumed raised through council tax. Actual budgets may vary above or below the SSA for an authority as decisions on the level of service provided varies from authority to authority.

For the purpose of calculating individual SSA allocations, local government revenue spending is broken down into 49 notional service areas. A separate method of distribution exists for each of these elements in order to distribute the total across the authorities. The distribution methods fall into two categories:

- formula based on indicators of need
- distribution based on actual expenditure or estimates of expenditure.

Authorities' elements of the individual service areas are 'unhypothecated' – they are notional figures which serve as building blocks for the overall SSA; they do not represent spending targets for individual services, nor are they in any way meant to be prescriptive.

The majority of service allocations are distributed on the basis of a formula containing indicators of need. Indicators of need are used as opposed to direct measures of service utilisation so that authorities are not able to directly influence their SSAs and hence the amount of grant that they receive. The indicators used in the formulae can be placed in three categories:

- **Main client group:** the main factor influencing cost, eg population, pupil numbers or road lengths.
- **Deprivation:** indicators to reflect the additional cost of providing services to populations with higher levels of deprivation, eg income support recipients, people with long-term illness.
- **Population dispersion:** indicators to reflect the additional cost of providing services to populations in rural areas. Measures of population dispersion were developed specifically for use in the Welsh local government settlement, based on the pattern of settlements in Wales.

The formulae for all services were reviewed prior to the 2001/02 settlement following recommendations made in an independent review undertaken by Swansea University and Pion Economics. A major review of the main personal social services formulae was carried out in 2004, with the new formulae for the children and young persons and older adults services incorporated in the 2005/06 settlement, and younger adults in the 2007/08 settlement.

Business rates

Business rates in Wales are collected by billing authorities as in England but are paid over to the Welsh Government in their entirety. The Welsh Government then redistributes these based on each local council's share of the total Welsh population – a simple per capita distribution. For 2014/15, the distributable amount of business rates available is £ 1.041bn. This is reduced by 7% to be retained for police funding, giving a figure to be distributed to councils of £968.1m. Taking Swansea as an example, its population is 192,893 compared to a total Welsh population of 2,443,161, so the amount of NDR it will receive is:

- $£968.1\text{m} / 2,443,161 \times 192,893 = £76.4\text{m}$

Revenue support grant

RSG is a grant paid by the Welsh Government to support local councils' general expenditure. There are no restrictions on how it is to be used (within a council's legal powers).

In order to calculate the amount of revenue support grant due, a council tax yield is calculated based on a notional standard council tax figure, £997.79 for 2013/14, multiplied by the council's estimate of its council tax base supplied to the Welsh Government. In Swansea's example, its tax base is 90,633, so its council tax yield at the notional council tax would be:

- $£997.79 \times 90,633 = £90.4\text{m}$

RSG is calculated by subtracting from the standard spending assessment the figure for redistributed business rates and council tax yield at standard council tax. In Swansea's case, its standard spending assessment is £414.7m, so its unadjusted RSG would be:

- $£409.0\text{m} - £76.4\text{m} - £90.4\text{m} = £242.2\text{m}$

Because of the use of 'floors' in the 2014/15 settlement, whereby the greatest amount RSG can fall by is limited to 4.79%, Swansea's actual RSG is £241.8m as the amount of RSG is scaled back to pay for the 'floor'.

LOCAL GOVERNMENT CUTS AND THE FUTURE

Current economic projections suggest that austerity and public expenditure cuts will continue until 2020 with no return to previous expenditure levels. It is likely that public services at the end of this period will look very different to those prior to the start of the government's austerity programme.

In 2009, CIPFA and SOLACE published *After the Downturn*, which was updated in 2010 by *The Long Downturn*. In these two documents, CIPFA outlined three specific strategic options:

- Option 1: Redefining the relationship between the state and the individual.
- Option 2: A significant delayering of the public sector with many more decisions taken locally with minimal oversight.
- Option 3: A major initiative to maximise economies by much more effective collaboration between public bodies.

In its 2014 manifesto, CIPFA continues to campaign and work with Local authorities. Most recently it has called for an independent grants commission, the introduction of longer-term financial settlements and the devolution of financial power.

In the subsequent period, the coalition government and individual public bodies have been taking action in all three of these categories with a range of different results. There has also been concerted action to restrain public sector pay and to reform public sector pensions, as well as a relentless emphasis on measures to ensure the tightest possible stewardship of resources and the elimination of waste.

FURTHER READING

After the Downturn: Managing a Significant and Sustained Adjustment in Public Sector Funding, CIPFA, 2009

Business Rates Retention and the Local Government Finance Settlement: A Practitioner's Guide (Version 3), DCLG, 2012

The Coalition: Our Programme for Government, HM Government, 2010

Guide to Local Government Reform and the Collection Fund, CIPFA, 2012

An Introductory Guide to Local Government Finance (2014 Edition), CIPFA, 2014

The Local Government Finance Report (England) 2013/2014, DCLG, 2013

The Long Downturn: Implications for Public Service Organisations, CIPFA, 2010

Place-shaping: A Shared Ambition for the Future of Local Government – Final Report (Lyons Inquiry into Local Government), Crown Copyright, 2007

Raising the Capital: The Report of the London Finance Commission, London Finance Commission, 2013

Setting Cities Free – Releasing the Potential of Cities to Drive Growth, Final Report of the City Finance Commission, 2011

Capital finance

INTRODUCTION

The prudential framework for capital finance was introduced on 1 April 2004 and provides the framework for council capital investment. Capital expenditure generally relates to spending on physical assets that have a useful life of more than one year. This can range from the buying of new assets, additions to existing assets, or loans to third parties for a capital purpose. It can also, with the express permission of the secretary of state, cover expenditure on items such as equal pay claims or statutory redundancy costs. This module explains in more detail what constitutes capital expenditure, outlines the nature of the government's controls, sets out the statutory framework for the capital finance system and provides an overview of how the new system operates.

This module also provides trend data on capital expenditure over the last five years in England and Wales. It explores the key methods of financing capital expenditure, including borrowing, grants, capital receipts, revenue, bonds, PFI and tax increment financing.

CHALLENGES FOR CAPITAL

For councils, capital investment plays an important role in improving economic opportunities within a locality and so will usually form a key part of an authority's overarching corporate strategy. Capital investment typically directly contributes to economic regeneration or has indirect economic impact, for example, by providing a much-needed stimulus to the economy, employment opportunities and supporting skills development or contributing to confidence.

In the current climate of austerity, pressures have been placed on councils' capacity to finance capital investment. Revenue budget pressures have reduced their ability to finance the revenue implications of investment and directly finance capital investment. The current market conditions have led to reduced estimates for capital receipts for the sale of assets. This, coupled with reduced central government support for borrowing, has led to many authorities reviewing and subsequently reducing their capital programmes. The main challenge is therefore to continue to finance the necessary capital investment.

WHAT IS CAPITAL EXPENDITURE?

Expenditure which falls outside the capital framework must be charged to revenue in the year, whereas capital expenditure can be financed from other means, such as capital receipts, or spread over future years via borrowing.

In England and Wales, the *Local Government Act 2003* defines three routes by which expenditure can qualify as capital under the framework:

- Expenditure which results in the acquisition of, construction of, or subsequent expenditure on non-current assets in accordance with '*proper practice*'.
- Expenditure for which the secretary of state has made a direction that the expenditure can be treated as capital, known as a capitalisation direction.
- Expenditure which meets one of the definitions specified in regulations prescribed by the secretary of state.

Proper practice

Proper practice across England and Wales includes the *Code of Practice on Local Authority Accounting in the United Kingdom*, which is updated annually. Its provisions relating to capital definition are based on International Accounting Standard 16 *Property, Plant and Equipment*. Costs associated with property, plant and equipment shall only be capitalised (and hence appear on the balance sheet) if it is probable that there are future economic benefits or service potential associated with the item and that the cost can be reliably measured.

Initial costs will include:

- the purchase price
- any costs associated with bringing the asset to the location and the condition necessary
- the initial cost of dismantling and removing the item and restoring the site on which it is located.

Assets that are in the process of being constructed are included on the balance sheet at historical cost, ie the costs which have been spent on them. Also currently included on this basis are infrastructure assets, such as roads, footways and bridges, and community assets, such as open spaces or allotments.

Many authorities set a *de minimis* limit for capital expenditure. This means that any expenditure which is below the limit, often in the region of £10,000, must be classed as revenue even if it meets one of the definitions for capital.

Capitalisation direction

A capitalisation direction from the secretary of state is the means by which DCLG or the Welsh Government, exceptionally, permits councils to treat revenue costs as capital costs. This means that these costs can be funded from capital, including by borrowing or use of capital receipts, and enables authorities to meet these costs over a number of years.

In recent years, guidance notes have been published annually detailing the procedures and timescales for the issue of capitalisation directions, although there are indications that this process is unlikely to continue. Historically, a key part of the assessment process was the consideration of the level of reserves (excluding schools), including general and earmarked reserves.

A capitalisation direction is generally only appropriate for one-off payments (such as statutory redundancy costs), rather than indefinitely continuing payments (such as ongoing salaries) as it would be most imprudent for an authority to keep borrowing to meet the latter.

A capitalisation direction is only likely to be granted where a council is placed in an unavoidable situation. Applications for the funding of planned schemes other than organisational restructuring are likely to be refused because councils should not embark on projects without budgeting appropriately. It should also be noted that applications should only be submitted for the financial year in which the expenditure is to be incurred.

Revenue expenditure funded by capital under statute (REFCUS)

The third route for an item of expenditure to be classified as capital is through regulations made by the secretary of state. This includes items such as:

- the cost of buying or preparing a computer program
- the giving of a loan or grant towards costs which, if borne by the authority, would have been classified as capital
- the acquisition of share capital (and loan capital in Wales)
- the cost of buying, producing or constructing assets which are not owned by the authority, but which would be classed as capital expenditure if they were owed by the authority.

SPENDING LEVELS

Local government capital expenditure for England and Wales was over £20bn in 2013/14 but this was still 1% lower in cash terms than the total for 2008/09.

The following tables show the analysis of gross capital expenditure, by service, for the period 2008/09 to 2013/14 for England and for Wales.

England

The figures for England show an increase in expenditure the period 2008/09 to 2010/11, a reduction in expenditure in 2011/12 and 2012/13, followed by an increase in 2013/14. In aggregate, capital expenditure increased by 17% between 2008/09 and 2010/11, and fell by 13% in 2011/12 and by a further 5% in 2012/13, and then increased by 4% in 2013/14.

Composition of gross capital expenditure – England 2008/09 to 2013/14

| Service | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|--|---------------|---------------|---------------|---------------|---------------|---------------|
| | £m | £m | £m | £m | £m | £m |
| Education | 4,542 | 5,392 | 6,107 | 5,495 | 4,528 | 3,741 |
| Highways and transport | 4,735 | 5,851 | 7,943 | 6,574 | 6,046 | 6,615 |
| Housing | 4,901 | 4,514 | 4,063 | 3,274 | 3,731 | 3,964 |
| Other | 5,623 | 5,605 | 5,033 | 4,689 | 4,626 | 5,341 |
| Of which: | | | | | | |
| <i>Cultural and Related Services</i> | | 1,056 | 1,245 | 1,147 | 1,102 | 877 |
| <i>Planning and Development services</i> | 1,081 | 924 | 833 | 653 | 879 | 1,131 |
| <i>Social services</i> | 300 | 288 | 312 | 253 | 207 | 343 |
| <i>Environmental Services</i> | 604 | 571 | 531 | 488 | 526 | 581 |
| <i>Police</i> | 794 | 704 | 602 | 538 | 500 | 481 |
| <i>Other</i> | 1,788 | 1,873 | 1,608 | 1,655 | 1,637 | 2,805 |
| Total | 19,801 | 21,362 | 23,146 | 20,032 | 18,931 | 19,661 |

Source: Local Government Finance Statistical Release Capital Expenditure and Receipts 2013-14, October 2014.

Wales

The figures for Wales show that in aggregate:

- Overall gross capital expenditure in Wales reduced by 17% in 2009/10 compared with 2008/09. Since then, expenditure has recovered its general upward trend, although it has yet to reach its 2008/09 level. In 2013/14 it was still 8% less in cash terms than in 2008/09.
- Of all the areas of capital expenditure, only that on education has risen consistently over the period.

Composition of gross capital expenditure – Wales 2008/09 to 2013/14

| Service | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|------------------------------------|----------------|--------------|--------------|----------------|----------------|----------------|
| | £m | £m | £m | £m | £m | £m |
| Education | 203.6 | 215.5 | 233.3 | 260.6 | 267.4 | 274.0 |
| Social services | 22.1 | 21.9 | 22.3 | 18.8 | 22.9 | 17.7 |
| Transport | 231.4 | 204.0 | 210.9 | 206.9 | 231.5 | 175.1 |
| Housing | 238.2 | 217.4 | 210.1 | 230.1 | 216.4 | 223.6 |
| Planning and development | 95.6 | 56.5 | 73.9 | 94.7 | 109.2 | 123.7 |
| Law, order and protective services | 61.6 | 44.6 | 53.2 | 37.9 | 33.9 | 53.7 |
| Other transactions | 276.0 | 174.2 | 193.9 | 187.3 | 206.8 | 172.8 |
| All capital expenditure | 1,128.4 | 934.1 | 997.7 | 1,036.3 | 1,088.1 | 1,040.6 |

Source: Welsh Local Authority Capital Expenditure 2013-14 Statistical Release, October 2014.

FUTURE SPENDING PLANS

In England, the government's policy is to equip the local government sector with the tools that it needs to reconfigure and redesign its vital service areas, to benefit local people and to maximise efficiency savings within local government.

In 2014, DCLG announced its Transformation Challenge Award; a package of incentives intended to reward authorities that cut duplication and build services around the needs of local people. £90m was made available in 2013/14, with further funding in 2014/15 and 2015/16 to areas with ambitious plans for improving services that could include integrating health and social care; getting the unemployed back to work; or early intervention to get children ready for school. At the heart of all these plans will be a renewed drive to redesign public services in a way that works for users, as well as efforts to reduce long-term costs to the taxpayer by making public bodies both more efficient and more effective.

The £15m in 2014/15 was aimed principally at smaller district councils re-engineering their business, rapidly moving to a single senior management team, or a single work force, unified IT, and a sharing of other assets; and for authorities that have 'ready to go' projects.

The £120m in 2015/16 is to enable councils to deliver scaled-up transformation projects, working in partnership to redesign their services around the user.

The £200m capital receipt flexibility in 2015/16 is to enable councils to use up to £200m from asset sales for transformation; receipts from assets sales can usually only be used for capital but this means £200m of expenditure from capital receipts can be allowed for use on transformation projects.

In 2014, the chief secretary to the Treasury and the secretary of state for communities and local government commissioned an independent service transformation challenge panel to recommend how public services could significantly achieve better outcomes for people in more places, and at a faster pace. The panel made a number of recommendations, but called for three fundamental changes:

- A new person-centred approach to help specific groups and individuals with multiple and complex needs.
- More easily accessible and flexible funding available to invest in the upfront costs of transformation.
- Radical improvements in how data and technology are used to provide smarter services.

The panel's report was welcomed by ministers. Transformation agenda initiatives and the public service transformation network are helping to drive better outcomes from whole-systems reforms in a number of places.

The government also has a key initiative to invest in enterprise zones, which have enabled councils to channel hundreds of millions of pounds into crucial infrastructure projects by allowing them to take advantage of top-class investment incentives that are driving forward the economy. More than £410m will be spent by local partners on major projects across the country, unlocking development and paving the way for tens of thousands of new jobs as well as providing a significant boost to the UK's construction sector. This significant investment has been possible since the government gave councils powers to retain all business rate

growth from their local enterprise zone and to use the revenue generated to secure borrowing for infrastructure projects.

In July 2014, the government announced the first instalment of plans to invest at least £12bn in local economies in a series of 'Growth Deals'. The money will go towards providing support for local businesses to train young people, create thousands of new jobs, build thousands of new homes and start hundreds of infrastructure projects; including transport improvements and superfast broadband networks. Projects beginning in 2015/16 are expected to be matched by local investments worth around twice the contribution from central government. Across the country they are expected to lead to work on more than 150 roads, 150 housing developments and 20 stations, as well as:

- providing small business support services in every part of England and significant investment in skills training
- working to improve educational attainment
- getting more people from welfare to work.

The table below, extracted from the Autumn Statement 2014, shows public sector gross investment.

Total managed expenditure

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|--------------|--------------|--------------|--------------|--------------|--------------|
| | £bn | £bn | £bn | £bn | £bn | £bn |
| Current expenditure | | | | | | |
| Resource annually managed expenditure | 319.6 | 334.3 | 341.4 | 358.9 | 373.5 | 389.7 |
| Resource departmental expenditure limits | 316.9 | 316.8 | 316.8 | | | |
| Ringfenced depreciation | 22.1 | 20.6 | 22.3 | | | |
| <i>Implied resource departmental expenditure limits, including depreciation</i> | | | | 321.8 | 310.6 | 305.6 |
| Public sector current expenditure | 658.5 | 671.7 | 680.4 | 680.6 | 684.1 | 695.3 |
| Capital expenditure | | | | | | |
| Capital annually managed expenditure | 19.3 | 19.1 | 17.9 | 19.0 | 20.0 | 18.2 |
| Capital departmental expenditure limits | 42.0 | 46.3 | 47.9 | | | |
| <i>Implied capital departmental expenditure limits</i> | | | | 47.0 | 47.2 | 51.8 |

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| | £bn | £bn | £bn | £bn | £bn | £bn |
| Public sector gross investment | 61.4 | 65.4 | 65.8 | 66.0 | 67.2 | 70.0 |
| Total managed expenditure | 719.9 | 737.1 | 746.2 | 746.7 | 751.3 | 765.3 |
| Total managed expenditure (% GDP) | 41.5% | 40.5% | 39.5% | 38.2% | 36.9% | 36.0% |

THE PRUDENTIAL FRAMEWORK

CIPFA's *Prudential Code* provides the framework for councils' capital investments. The key feature of the prudential system is that councils should determine the level of their capital investment – and how much they borrow to finance that investment – based on their own assessment of what they can afford, not just for the current year but also for future years.

The statutory basis for the prudential system is set out in Part I of the *Local Government Act 2003*. The 2003 Act:

- confirms councils' power to borrow – which in the medium term must only be for capital purposes, while short-term borrowing can be for cash flow purposes
- makes it clear that, as previously, councils may not mortgage assets
- places a duty on councils not to exceed their prudential borrowing limits, or any national limits imposed by central government
- places a duty on councils to determine – and review – their own borrowing limits in accordance with the CIPFA *Prudential Code*
- gives the government and National Assembly for Wales a reserve power to impose borrowing limits that would override councils' own borrowing limits for national economic reasons
- makes it clear that credit arrangements should be treated as borrowing under the prudential system
- makes it clear that councils may invest both for the prudential management of their financial affairs and for purposes relevant to their functions.

The CIPFA *Prudential Code* requires each council to produce a three-year forecast of its capital expenditure.

When setting its capital programme, each authority must have regard to:

- the council's service objectives – the capital spending plans should be consistent with the council's strategic plan for the authority
- the stewardship of the council's assets – as demonstrated by the council's asset management planning
- the value for money offered by the plans – as demonstrated by the appraisal of the options considered by the council
- the prudence and sustainability of its plans – eg their implications for external borrowing

- the affordability of its plans – eg the implications for the council tax
- the practicality of the capital expenditure plan – eg whether the forward plan is achievable.

The prudential framework is underpinned by the requirement for councils to produce balanced budgets. All the revenue implications of a capital programme should be included in the revenue budget. In addition, if the government considers that an individual council's budget or council tax increase is too high, a council tax referendum would be triggered.

The framework uses a series of prudential indicators to monitor compliance with the *Prudential Code*. Within each authority the body that approves the budget must set its own indicators prior to the start of the financial year. During the year these indicators should be monitored, reported against and if necessary new indicators approved or action agreed to ensure that indicators are not breached.

In assessing the 'affordability' of their capital expenditure plans, councils need to consider:

- for the three-year period:
 - the estimates of the ratio of the capital financing costs to the authority's net revenue stream
 - the estimates of the incremental impact of the capital investment decisions on the council tax for three years, or longer if required, to capture the full-year effect of capital investment decisions
- and after the year-end:
 - the actual ratio of the capital financing costs to the authority's net revenue stream.

Councils should also consider:

- for the three-year period:
 - the estimates of capital expenditure
 - the estimates of the capital financing requirement
 - the authorised limit for external debt
 - the operational boundary for external debt
- after the year-end:
 - the actual level of capital expenditure for the previous financial year
 - the actual capital financing requirement
 - the actual external debt.

In assessing the prudence of its plans, each council should:

- consider the affordability of its plans
- ensure that over the medium term the council's debt is only for a capital purpose
- ensure that its treasury management:
 - complies with the CIPFA *Treasury Management in the Public Services: Code of Practice*
 - sets upper limits for fixed interest rate and variable interest rate exposures
 - sets upper and lower limits for maturity structure of borrowings
 - sets an upper limit on the level of investments for longer than 364 days.

The indicators include figures for:

- capital expenditure
- capital financing requirement – a measure that reflects an authority’s underlying need to borrow
- external debt – gross borrowing and other long-term liabilities
- operational boundary for external debt – based on an authority’s working estimate of most likely, ie prudent, but not worst-case scenarios
- authorised limit for external debt – the intended absolute limit that has to be set by the full council.

Central controls

Although the actual and estimated capital expenditure, by service, for English councils are shown in the government’s public spending plans, the government does not control the level of capital expenditure on individual services.

The prudential framework is designed to ensure that capital plans are prudent, affordable and sustainable without the need for external control.

The secretary of state does, however, have powers through the *Local Government Act 2003* to impose either a national limit or a limit on individual authorities, although to date these powers have not been used. Similar powers exist in Wales, although, as in England, they have yet to be used.

RICS ASSET MANAGEMENT PRACTICE GUIDELINES

The Royal Institution of Chartered Surveyors (RICS) has produced a series of industry-approved guidelines that will assist those involved in property asset management across the public sector. There are three documents on the subject of property asset management. The main work is entitled the *RICS Public Sector Property Asset Management Guidelines*.

The guidelines provide guidance for managers in the complex challenge of property asset management. They explain how to reduce operating costs and to obtain better quality accommodation, more productive staff and satisfied customers. RICS has also produced the *RICS Public Sector Property Asset Management Quick Start Guide*, which provides step-by-step guidance on starting and continuing the asset management process. The third publication in this series, aimed at senior decision makers, is the *RICS Public Sector Property Asset Management Senior Decision Makers’ Guide*. It stresses the importance of strategic asset management planning and provides the background, practical benefits and policy reasons for implementation along with the identification of roles and responsibilities and suggestions for the monitoring of performance.

The guidance is supplemented by a series of seven best practice leaflets covering a range of topics such as disposal of land at less than best consideration to improving customer experience and measuring performance.

A FRAMEWORK FOR LOCAL AUTHORITY ASSET MANAGEMENT

The government recognises that councils face different challenges and that there cannot be a 'one-size-fits-all' asset management strategy for local government. DCLG therefore published *Building on Strong Foundations: A Framework for Local Authority Asset Management* in February 2008, to bring together key policies and influences that shape council asset management.

It is aimed at council decision makers and sets out a framework for asset management that shows how local government assets can be used to develop a sense of place, deliver better outcomes for citizens, and generate efficiency savings. It is a combination of case studies, summaries of relevant policy initiatives such as the Quirk review of community ownership of assets, and practical advice set out in a framework.

CAPITAL AND ASSETS PATHFINDERS

The capital and assets pathfinder programme in England started in December 2010. The programme seeks to remove the hindrances faced by local public bodies adopting a 'one public estate' approach. One example is the attempt to join together the various streams of top-down funding for public buildings. The aim of this is to make it easier for public bodies to connect asset rationalisation and development programmes at a local level. Waves 1 and 2 have shown projected savings of £4bn across a total asset base of £20bn and are projected to deliver improved efficiencies over the next ten years. Pathfinders showed a wide range of outcomes through the innovative use of buildings, ranging from public sector hubs accommodating a wide range of public sector services, to the 'polishing' and disposal of assets to create an investment fund for housing and other regenerative schemes.

HIGHWAYS INFRASTRUCTURE ASSETS

The *Code of Practice on Transport Infrastructure Assets* (the Transport Code) was published in 2010 and has since been used to provide information for the whole of government accounts (WGA) and to support asset management. It is based on the principle that the same data should be used for asset management, financial management and financial reporting, with the more effective management of assets being the key driver.

The Transport Code was updated in 2013 to incorporate the lessons of experience and also to reinforce links with the *Code of Practice on Local Authority Accounting in the United Kingdom* and to provide more clarity on financial reporting practicalities.

From the financial reporting perspective, the difference between the current value accounting approach adopted by central government and the historic cost approach adopted for the local roads network has become a more visible issue since the publication of WGA in 2011. The inconsistent accounting policies and the size of the potential difference between the valuation bases (£200bn) is one of the main WGA qualification issues.

CIPFA/LASAAC has agreed that the measurement requirements of the Transport Code, ie a move to a depreciated replacement cost (DRC) basis, will be adopted for 2016/17 council statements of accounts, with retrospective restatement for 2015/16.

The sector has been working hard to demonstrate that highways are a valuable asset and vital to the economic and social wellbeing of communities. Asset management supports business decisions and provides longer-term financial benefits. It helps us to understand the asset we have, describe how it performs and determine the funding needed to meet the requirements placed upon it. Much progress has been made in the way asset management is developed and implemented in the UK; it has already been adopted by many highway authorities and is well proven in other sectors, but much more is still to be done.

The *Highways Infrastructure Asset Management Guidance Document*, which was developed through the Highways Maintenance Efficiency Programme, builds on existing good practice and offers a flexible framework that is suitable for all councils, wherever they are in terms of implementing asset management. It consolidates existing documents and moves the focus away from developing transport asset management plans and towards implementing asset management effectively. The guidance will help all those delivering highways services to embed asset management principles in their organisations and to make the case for funding highway maintenance.

FINANCING CAPITAL EXPENDITURE

There are a number of options for authorities to finance capital expenditure. These include the methods described in this section.

Borrowing

The prudential framework allows for two types of borrowing – supported and unsupported. When the government determines its revenue grant allocation, it makes assumptions about the anticipated level of capital expenditure and includes the funding in its allocation. This is known as supported borrowing. Unsupported borrowing is that which can be undertaken in addition to the supported element under the prudential framework.

In the October 2010 spending review the government announced that from 2011/12 it would no longer be providing for new supported borrowing through the settlement in England. It indicated this funding would come via capital grant in order to make the process more transparent.

Public bodies generally borrow from the National Loans Fund via the Public Works Loans Board (PWLB), a statutory body operating within the United Kingdom Debt Management Office, an executive agency of HM Treasury. A council can only borrow in sterling, unless consent is sought from the Treasury.

Grants or contributions

Grants or contributions from third parties such as developers are often given for specific projects and must be used for the intended purpose. Occasionally they will be given as a general grant whose use is not restricted.

Contributions can be from many different sources, but include developers' contributions where these are made as part of the planning permission for a scheme, with the developer contributing to community costs such as the building of a community centre.

Capital receipts

Capital expenditure can be financed by capital receipts, which are the proceeds from the sale of an asset, usually a property. There are some restrictions on the use of capital receipts from the sale of housing stock.

In a difficult economic climate, public bodies may find that they are unable to achieve the levels of capital receipts that they had planned for in their budgets. If they are able to sell assets, they may get less for them than they had estimated and may have to consider delaying sales until the economy has recovered. The implications of this must then be built into the budget.

Directly from revenue

Capital expenditure can be financed directly from revenue. There are no limitations on this, other than one of affordability. Given the current restrictions on councils' spending, generally authorities will only be able to afford to fund a small proportion of expenditure from revenue.

Bonds

Councils have the power to raise bonds to fund capital expenditure, though this power has not been widely used. The most recent council example was in 2011 when the Greater London Authority issued a £600m bond to raise funds for the Crossrail project. Transport for London has also successfully issued a number of bonds, including four in 2012 as part of the financing for its £10bn five-year investment programme; the most recent was in 2013.

The increase in the PWLB rate in the 2010 spending review led to a renewed interest in the bond market, but the announcement in the 2012 budget of a future reduction in PWLB rates has led to a falling off in this interest. The Local Government Association announced in late 2014 that its collective agency was moving into its launch phase following a successful raising of equity. The agency plans to issue bonds and then to on-lend to councils.

Public–private partnership/private finance initiative

Public–private partnership (PPP) is an umbrella term for government schemes involving the private business sector in public sector projects.

Private finance initiative (PFI) was a form of PPP developed by the government in which the public and the private sectors join to design, build or refurbish, finance and operate (DBFO) new or improved facilities and services to the public. Under the most common form of PFI, a private sector provider will, through a special purpose company (SPC), hold a DBFO contract for facilities such as hospitals, schools and roads according to specifications provided by public sector departments. Over a typical period of 25–30 years, the private sector provider is paid an agreed monthly (or unitary) fee by the relevant public body (such as a local council or a health trust) for the use of the asset(s), which at that time are owned by the PFI provider.

In November 2011, the Chancellor announced a review of PFI. The objective of the review, led by the Treasury, was to create a new model for delivering public assets and services that takes advantage of private sector expertise, but at a lower cost to the taxpayer. Following the review, the government launched its new approach to PPP in December 2012 – PF2.

The government announced that it will *'look to act as a minority co-investor in future PF2*

projects, promoting better partnerships with industry, a stronger public voice on projects and greater transparency about the performance of PF2 projects.

The privately financed element of the Priority Schools Building Programme is to be the first to implement the reforms. Forty-six schools in five batches will be rebuilt using PF2, with a total funding requirement of approximately £700m. Procurement for the first batch of schools was launched by the Education Funding Authority in June 2013 with the remaining batches to follow over the next 12 months.

In each case the government will invest alongside the private sector in a 'joint venture company'. Each company will be majority owned by the private sector and the government will invest on the same terms as the private sector. The draft shareholders' agreement is the subject of consultation during the summer of 2013, together with other legal documentation, which sets out the proposed terms of the government's investment. It includes details of the voting arrangements, the government's right to appoint a director to each company and increased information other shareholders will be required to disclose to provide greater transparency to the public.

The programme will see 261 schools rebuilt or have their condition needs met by the Education Funding Agency (EFA). All schools within the programme will be delivered by the end of 2017. There are 215 schools being delivered via capital grant funding and 46 schools being delivered via private finance funding.

Tax increment financing

Tax increment financing is very popular in the US, but is still at the early stages of development in the UK. It is based on the theory that future business rates growth as a result of a new development are retained by the council in order to fund the development.

The first schemes of this type included Newcastle City Council's city deal, which allows the creation of an accelerated development zone in the city centre. This creates an opportunity for working with the private sector to create high-quality business space, an outstanding urban environment, a lower carbon footprint, modern infrastructure and good connectivity. The government has agreed that the city council and Gateshead Council can retain all growth in business rate income on four sites within this zone for the next 25 years, rather than send this income into central government. If the sites are successfully developed and attract new business, this arrangement could see at least £300m in additional business rate income, to support investment in infrastructure. Where sound business cases can be established, the two councils will invest at least £90m in the four sites and associated infrastructure. This represents a major opportunity for the city to secure a strong economic recovery from the recession.

Financing capital expenditure – England

DCLG's latest summary of the financing of council capital expenditure in England is shown in the following table.

Financing council capital expenditure in England 2008/09 to 2013/14

| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|---|---------------|---------------|---------------|---------------|---------------|---------------|
| | £m | £m | £m | £m | £m | £m |
| Central government grants | 5,733 (a) | 7,494 | 8,063 | 7,170 (e) | 8,481 | 7,484 |
| EU structural funds grants | 156 | 43 | 38 | 77 | 55 | 57 |
| Grants and contributions from private developers and from leaseholders etc | 1,176 | 502 | 634 | 747 | 693 | 749 |
| Grants and contributions from NDPBs (a) | 540 | 602 | 753 | 522 | 442 | 443 |
| National lottery grants | 106 | 119 | 104 | 121 | 67 | 49 |
| Use of capital receipts | 2,040 | 1,603 | 1,409 | 1,647 | 1,294 | 1,516 |
| Revenue financing of capital expenditure | 3,241 | 3,532 | 3,984 | 4,504 (e) | 3,167 | 4,909 |
| Housing revenue account (CERA) | 228 | 247 | 235 | 324 | 466 | 572 |
| Major repairs reserve | 1,224 | 1,377 | 1,069 | 1,160 | 1,259 | 1,488 |
| General fund (CERA) | 1,789 | 1,908 | 2,680 | 3,020 | 1,442 | 2,849 |
| Capital expenditure financed by borrowing/credit | 7,241 | 7,931 | 8,399 | 18,819 | 4,842 | 4,464 |
| SCE(R) single capital pot (b) | 2,257 | 2,181 | 1,581 | 338 | 88 | 70 |
| SCE(R) separate programme element (b) | 760 | 748 | 484 | 74 | 30 | 8 |
| Other borrowing and credit arrangements not supported by central government (c) | 4,224 | 5,002 | 6,335 | 18,406 (d) | 4,724 | 4,386 |
| Total | 20,233 | 21,826 | 23,385 | 33,606 | 19,042 | 19,671 |

- (a) *Non-departmental public bodies, organisations that are not government departments but which have a role in the processes of national government, such as Sport England, English Heritage and the Natural England.*
- (b) *Supported capital expenditure (SCE) financed by borrowing that is attracting central government support has been discontinued as of March 31 2011. This may have a bearing on the financing of capital expenditure. A residue of schemes will continue to be financed in reliance of supported borrowing from earlier years.*
- (c) *The prudential system, which came into effect on 1 April 2004, allows local authorities to raise finance for capital expenditure – without government consent – where they can afford to service the debt without extra government support.*
- (d) *It is estimated that approximately £13bn is associated with the financing of the HRA self-financing determination payment.*
- (e) *There is a discontinuity from 2010/11 owing to a change in the treatment of expenditure by GLA. Previously this was recorded as 'Central government grant' but for 2011/12 it has been recorded as CERA to align with figures received on the Revenue Outturn.*

Source: Local Government Finance Statistical Release Capital Expenditure and Receipts 2013-14, October 2014.

Financing capital expenditure – Wales

Details of capital financing in Wales from 2008/09 to 2013/14 are shown in the following table.

Financing council capital expenditure in Wales 2008/09 to 2013/14

| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|--|----------------|--------------|--------------|----------------|----------------|----------------|
| | £m | £m | £m | £m | £m | £m |
| Capital grants | 538.6 | 470.0 | 515.7 | 477.2 | 507.4 | 464.1 |
| Major repairs allowance (a) | 85.8 | 79.7 | 67.6 | 60.4 | 57.8 | 63.0 |
| Supported borrowing (b) | 156.2 | 161.1 | 145.8 | 122.0 | 118.3 | 88.7 |
| Unsupported borrowing | 125.0 | 106.1 | 144.4 | 175.8 | 205.1 | 213.0 |
| Use of capital receipts | 102.5 | 47.5 | 45.4 | 70.7 | 46.0 | 37.6 |
| Capital expenditure charged to a revenue account (non-HRA) | 120.3 | 69.6 | 78.7 | 130.1 | 153.5 | 174.3 |
| Total capital expenditure | 1,128.4 | 934.1 | 997.7 | 1,036.3 | 1,088.1 | 1,040.6 |

(a) Capital grant for the improvement of council housing stock.

(b) The level of borrowing that the Welsh Government supports via revenue support.

Source: Welsh Local Authority Capital Expenditure 2013-14 Statistical Release, October 2014.

FURTHER READING

Budget 2014, HM Treasury, 2014

Building on Strong Foundations: A Framework for Local Authority Asset Management, DCLG, 2008

Capital Success: Good Practice in the Implementation of the Prudential Code, CIPFA, 2007

Code of Practice on Transport Infrastructure Assets (2013 Edition), CIPFA, 2013

Highways Infrastructure Asset Management Guidance Document, Highways Maintenance Efficiency Programme, 2013

Local Government Act 2003

Local Government Finance Statistical Release Capital Expenditure and Receipts 2013-14, October 2014

Practitioners' Guide to Capital Finance in Local Government (2012 Edition), CIPFA, 2012

The Prudential Code for Capital Finance in Local Authorities (2011 Edition), CIPFA, 2011

The Prudential Code for Capital Finance in Local Authorities: Guidance Notes for Practitioners (2013 Edition), CIPFA, 2013

RICS Public Sector Property Asset Management Guidelines, RICS, 2013

RICS Public Sector Property Asset Management Quick Start Guide, RICS 2011

RICS Public Sector Property Asset Management Senior Decision Makers' Guide, RICS, 2009

Spending Review 2014, HM Treasury 2014

Welsh Local Authority Capital Expenditure 2013-14 Statistical Release, October 2014

Budgeting and financial reporting

INTRODUCTION

Budgeting and financial planning have never been more important in councils as expenditure cuts bite even more deeply and service and organisational transformation becomes the key to long-term survival. This module looks at the budget process and the importance of setting the annual budget in the context of more long-term financial planning.

Setting the budget is only the first part of effective financial management and this module also looks at budget management and financial reporting, finishing with a look at how the statement of accounts under IFRS can be tied back to the original budget set by the council.

SETTING AND MANAGING BUDGETS

Setting and managing budgets has come into sharp focus in the last few years, with the severe cuts in public sector expenditure. This section considers the requirements for authorities to set and manage budgets. It covers financial planning and the financial cycle; the annual budget, including reserves and balances; setting the council tax; budgetary control and devolved budgets; and virement.

Statutory context

Budget setting is at the core of the financial processes within a council. It is complex, with many aspects, and must be fully integrated with the authority's strategic planning, service planning and best value planning processes.

CIPFA's *Standards of Professional Practice* set out the key principles that should underpin each aspect of the budget planning and control process and provide guidance on each of them. The key principles and guidance cover:

- the relationship between the budgets and the organisation of the authority
- the consistency, transparency, prudence and accuracy of the council's budgets
- the effective control and implementation of the council's budgets
- the measurement and monitoring of performance against the council's budgets and objectives.

The principles remain unchanged, but Part 2 of the *Local Government Act 2003* provides a legislative framework for the process:

- Sections 25 to 29 places new duties on local authorities – and their chief finance officers – in relation to the setting and monitoring their budgets.
- Section 25 requires each local authority's chief finance officer to make a report to the authority when it is considering its budget and council tax. The report must deal with:
 - the robustness of the estimates
 - the adequacy (or otherwise) of the council's reserves.
- Sections 26 and 27:
 - enable the secretary of state, or the National Assembly for Wales, to specify, by regulation, the minimum levels of reserves to be held by local authorities
 - require each local authority's chief finance officer to report to the authority if it appears likely that the authority's reserves will fall below the prescribed minimum level, and to explain why this is likely to happen and what action should be taken.
- Sections 28 and 29 require local authorities to monitor their budgets during the financial year, and to take remedial action if this is necessary because of potential overspendings and/or potential shortfalls in income.

Financial planning

A council must have a sound financial planning system. This has always been the case, but:

- the changes in the age structure and lifestyle of the population – and in particular the ageing of the population in many parts of the country and the increase in the number and proportion of single adult households – mean that councils need to plan for the effects of these changes on council services and spending levels
- the capital finance system means that each council must – at least – produce robust, medium-term financial plans.

Each council's plans must be monitored and reviewed regularly if they are to be of real value.

Financial planning is a part of the corporate planning process and is not just a matter for the chief finance officer. CIPFA's *Standards of Professional Practice* make it clear that the chief finance officer '*should take all reasonable steps to ensure that budgets are planned as an integral part of the strategic and operational management of the organisation and are aligned with its structure of managerial responsibilities*'. The objectives of the financial planning system are:

- to help elected members to determine priorities and their timing
- to forecast the changes in demand for services
- to show the likely implications of changes in legislation on spending
- to show the future costs of alternative policies
- to match demand with likely resources
- to provide a framework for programming activities by individual services.

The most important short-term planning activity is the preparation of the annual budget, but the annual budget is of limited value as a policy document if it looks only one year ahead. The implementation of significant policy initiatives often takes longer than one financial year. This is most obvious where the policy involves major capital works. Longer-term

forecasting is therefore essential. It is particularly important to plan over a longer timescale – at least three to five years ahead – for the likely effects of demographic and/or economic change, and the medium-term consequences of legislative changes. This is made clear in the *CIPFA Standards of Professional Practice*.

The financial cycle

No two councils have precisely the same financial arrangements, but they usually follow a similar pattern. The following table sets out a typical budget cycle – spread over about 30 months – that could apply to many councils. A county council's budget cycle would need to run slightly ahead of that shown because of the legal requirement to set precepts before 1 March for the financial year beginning one month later. The financial year runs from 1 April to 31 March for all authorities.

In the table, year 0 is taken up with policy planning and finalising the budget. Year 1 is the year in which money is spent to implement the agreed policies. During year 1, the implementation of policy decisions should be reviewed regularly and there should be a procedure for monitoring actual expenditure and income against the budget. The preparation of final accounts for year 1 must be completed and approved by committee within six months of that year-end, ie during the first half of year 2.

In practice, the tasks of planning the budget for the following year, monitoring the budget for the current year and closing the accounts for the previous year must all take place simultaneously. It is the responsibility of the chief finance officer to ensure that sufficient attention is given to each of these tasks.

The provisional details of the local government finance settlement are usually announced about three months before councils take their final decisions on the budget and local tax level for the next financial year – that is, in the November or December of the preceding financial year. The final decisions on the local government finance settlement are usually taken in January or February for the year beginning on the following 1 April.

Financial planning and control timetable

| | Planning | Implementation and monitoring | Completion of accounts |
|------------------|---|--|--|
| | Year 0 | Year 1 | Year 2 |
| April/June | Financial guidelines set for preparation of policy options | | Preparation of accounts |
| July | Prioritisation of options | Review of performance against budget | |
| August/September | Options analysed and strategy determined | | Publication of annual reports and accounts |
| October | Assessment of relative priorities and agreement of priorities | Detailed work on revised estimate for current year and any necessary amendments to years 2 and 3 | |

| | Planning | Implementation and monitoring | Completion of accounts |
|-----------------------|---|--|------------------------|
| | Year 0 | Year 1 | Year 2 |
| November/ December | Detailed work on estimates for the following year with indicative figures for years 2 and 3 | | |
| December | Priorities finalised in light of provisional local government finance settlement | | |
| January | Estimates considered for following year and ideally years 2 and 3 | Revised estimates for current year and any necessary amendments to years 2 and 3 | |
| February | Budget recommendation finalised for year 1 with indicative figures for years 2 and 3 | Information on likely outcome fed into discussion of new budget | |
| March | Council sets council tax for year 1 with indicative figures for years 2 and 3 | | |

Improving the budgeting, monitoring and reporting cycle

In many public sector organisations, setting the budget can consume significant board and senior management time and energy. There is also a danger that the budget can dominate as the financial target for managers to hit for in-year monitoring, rather than being the expression of the organisation’s delivery plan.

At the end of the financial year actual financial results, and the operational performance that they reflect, often receive scant scrutiny and examination other than at headline level.

In recent years, CIPFA has taken a long and hard look at the budgeting, forecasting, monitoring and reporting cycle arrangements in place in most public bodies to assess whether they are working well. The evidence suggests that improvements are needed. All financial processes need to be fundamentally reviewed from time to time and the budget cycle is no exception.

The financial environment has now moved towards medium-term three-year settlements for public services, with pressure for faster accounts closure, and a greater emphasis on efficiency, performance outcomes and value for money. The budget and reporting cycle needs to adapt as a tool to support these developments.

Improving Budgeting: Modernising the Cycle, published in February 2008, describes practical ways to improve this process. Existing good practice and fresh approaches to budgeting are explained along with sensible steps that organisations can take. The CIPFA website says of the publication:

Rolling forecasts that are formally reviewed and updated each quarter are potentially a powerful tool. Looking ahead 18 months and integrating known financial outcomes with performance metrics, taken together with frequent re-forecasts and the analysis of underlying performance and financial trends ... allows organisations to see into the future as a rounded whole. Resources can be redirected at frequent intervals. Because known financial results are prepared each quarter the closure of the accounts for the current financial year is streamlined.

Among the potential benefits of this approach are better skilled managers who remain engaged with planning what the future will look like. They can gain a deeper understanding of the prime cost drivers and variables for their business area. For the organisation's leaders, the forecasts act as a tool for relating funds with the outcomes they purchase and the organisation is much better able to assess value for money.

Preparing the annual budget

The annual budget is the financial representation of the council's policies. Its preparation is one of the most extensive and visible products of the authority's financial management system. The annual budget process is one part of the medium- and longer-term planning process.

This section outlines the way in which the annual budget is typically completed.

Stage 1 (April to October)

The first step is for the chief finance officer to issue detailed guidelines to the various spending departments explaining the basis on which they, rather than the chief finance officer, should compile the basic budget figures and the date by which they should return these figures to the chief finance officer. The objective is to ensure that the underlying pressures to spend on each service are assessed by the appropriate managers. The chief finance officer's task is to provide advice and assistance to spending departments, to draw together the departmental estimates, to test out the assumptions lying behind them, and to ensure that the established principles have been followed.

The chief finance officer's setting of the detailed guidelines is an important part of the exercise. The guidelines must take account of the council's service delivery policies as well as prevailing economic conditions. For example, they should indicate the council's policies for expansion or contraction in relation to individual services as well as the likely effects of inflation, for example on energy costs and other goods and services. With the move to three-year capital and revenue settlements, consideration needs to be given to the provision of figures for years 2 and 3 as well as the first year of each spending review period.

CIPFA's *Standards of Professional Practice* list the factors that should be taken into account in the framing of the budget.

Stage 2 (October to November)

After the chief finance officer has collected and scrutinised the various budget returns from spending departments, the budget for each service will be submitted to the appropriate elected members of the council for consideration. The chief finance officer may report at the

same time to the finance or policy committee, setting out the initial trends and outlining the possible effects on services and local tax levels of changes to spending levels.

Stage 3 (December to January)

Elected members usually carry out their final scrutiny of budgets at this stage. Each authority should receive the final notification of its grant entitlement for the forthcoming year, with indicative figures for years 2 and 3, by late January (or early February).

Stage 4 (February to March)

The final stage in the process is the collection of the service figures with any final adjustments for contingencies, planned use of reserves, etc, by the chief finance officer for presentation to council, which then agrees and publishes the precept or council tax for its own services. If the authority is a billing authority, it will add precepting authorities' precepts to its own budgetary requirement before determining the council tax level for the coming year, with indicative figures for years 2 and 3. Only the full council can make a precept or set the council tax.

In recent years, councils have had to take account of expenditure limitation – or capping – when framing their budgets. The government decided to abandon the universal capping of councils' budgets from 1999/2000. Accordingly, councils no longer needed to test their budget plans against the government's capping criteria. However, the secretary of state retained reserve capping powers – and the minister for local government made it clear that the government would continue to use those powers, and did so.

Since the 2012/13 budget round, the council tax referendum arrangements require council tax increases above a pre-announced level to be subject to a local referendum, so councils still need to be satisfied that their budget increases will not be considered excessive and fall foul of the referendum criteria.

The budget in detail

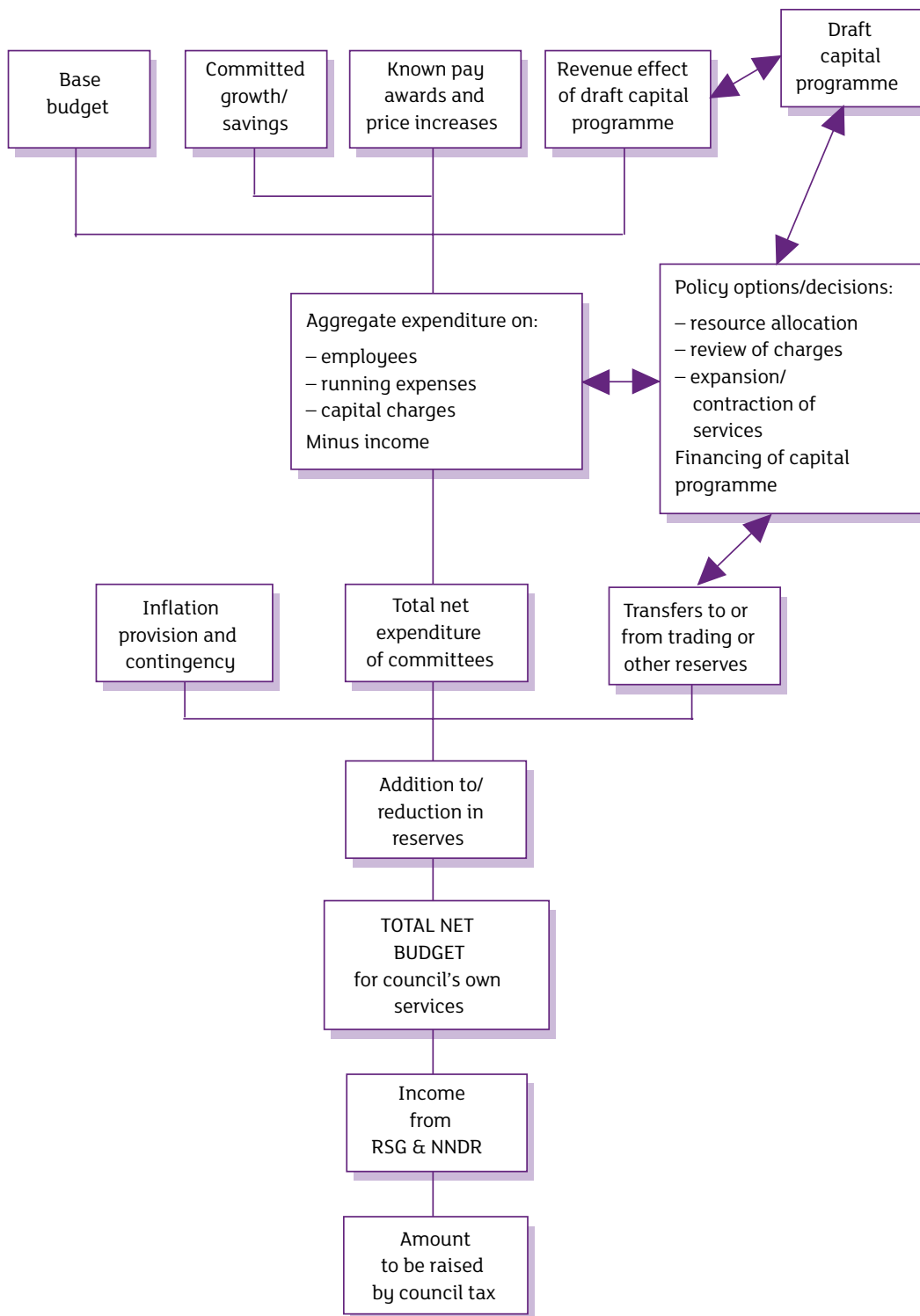
The lowest level of detail at which budgets are usually produced by officers is the individual line item (also known as the detail head or vote). For example:

- planning department – printing and stationery
- social services department – caretakers' wages.

However, working papers should contain more detail, showing exactly how the figures have been compiled. Budgets presented to elected members for approval, certainly at council level, will show less detail than this. Exactly how much detail is shown depends upon the traditions of the authority and the wishes of its members. Too much detail can divert the attention of members from their policy-making role and prevent officers from giving attention to critical areas where decisions are required; too little may prevent members from exercising adequate scrutiny.

The figure below illustrates the components of a typical council budget. The paragraphs that follow explain the key terms used.

Local authority budget building



Base budget

The previous year's budget is often the starting point for the budget exercise, but this does not mean that the base budget cannot be changed. Too ready an acceptance of the previous year's budget as the base, ie incremental budgeting, could mean that the current level of service and the means of providing it, such as the staffing structure, are accepted by default. Elected members need to re-examine the policies that are implicit in the existing budget, as well as focusing attention on new initiatives.

An alternative approach to the budget process is to start from zero and build up the figures for each year from scratch; this is called zero-based budgeting (ZBB). This approach does not take existing policies and service levels for granted; instead, it examines them afresh and rebuilds the budget each year. It demands greater input to the budget process from officers and members, so it is often used where substantial changes in service provision are envisaged, or where expenditure or income is of an ad hoc nature. In addition, it may be used to carry out a zero-based review of each budget, from time to time, perhaps on a rolling programme, to make sure that spending plans remain consistent with agreed priorities and reflect:

- service levels
- volume changes
- price changes.

CIPFA issued a briefing paper on ZBB in January 2006. There was renewed interest in ZBB, springing partly from the fact that the 2007 comprehensive spending review included a set of zero-based reviews of baseline expenditure in government departments, aimed at assessing their effectiveness in delivering the government's long-term objectives, and contributing further to the efficiency programme.

ZBB aligns closely to current initiatives, including the efficiency agenda, and to performance measurement. Successful use of ZBB relies upon the effective involvement of all executive managers. Like all good budgeting processes, it requires that the organisation's objectives are determined and clearly stated. Where it differs from the traditional route and adds value to the budget process is in the next stage, where different ways of achieving those objectives are explored and assessed, so that the resources associated with the preferred option can be actively justified.

Committed growth and savings

It is necessary to add to the base budget existing (and generally inescapable) commitments and to deduct known reductions or savings. There is no universally agreed definition of what constitutes a commitment, although it is generally taken to mean a contractual or statutory obligation. Elected members should satisfy themselves that what is claimed as committed expenditure is confirmed by their own judgement. Some authorities may regard increasing or decreasing numbers of clients as committed growth or savings respectively; others will not. Commitments will normally include the following:

- full-year impact of previous policy decisions not wholly included in the previous budget, often known as the full-year effect (for example, additional costs where new buildings were opened during the course of the previous year or savings arising where buildings were closed down part-way through a year)
- full-year effect of financing the current year's capital spending as well as savings in debt charges resulting from debt repayment
- annual salary increments for those staff continuing in post, although this can be offset by an allowance for new staff replacing staff leaving with the new staff on a lower incremental point
- full-year effects of pay awards

- changes in prices or charges (such as national insurance contributions)
- superannuation fund deficiency payments.

Inflation

Most authorities incorporate a provision for inflation in each budget head. Detailed budgets are therefore prepared at outturn prices, ie those expected to occur during the forthcoming year. The inclusion of the inflation allowance in the detailed budget heads gives service managers a clear cash budget within which to work. However, the actual effect of inflation may be different from the budgeted amount. If it is higher than budgeted, the purchasing power of the cash budget will be less than intended in real terms. If this happens, departments may well have to reduce the volume of goods and services they consume – and the volume of service they provide to clients – in order to keep within budget, or renegotiate prices.

Apart from the desire to reduce bureaucracy, many councils have moved towards setting budgets at outturn prices because housing rents and trading account charges need to be fixed in advance, after taking into account likely levels of inflation.

Councils need to take account of inflation when setting fees and charges for the year ahead in order to maintain the level of income in real terms.

Councils may choose to set charges for some services by reference to what the market will bear rather than the cost of provision in order to hold down the council tax or pay for the development of other services.

The chief finance officer should include information on the inflation factors to be used in the preparation of the budget in the budget guidelines. In calculating the inflation factors, the chief finance officer will usually take a view on the likely level of:

- pay awards for different categories of employee
- price increases for supplies and services
- trends in interest rates.

Councils need to make adequate provision for the effects of inflation, particularly when inflation rates are high. If an authority seriously underestimates inflation when setting its budget, it might have to make unplanned cuts in services during the year. In extreme circumstances, the chief finance officer might have to issue a report under section 114 of the *Local Government Finance Act 1988*.

Non-domestic rates and central government support

A factor in preparing an acceptable authority-wide budget is the level of the authority's non-domestic rates and revenue support grant. With the localisation of business rates, the level of resources available to the general fund is set by the finalisation of the NNDR1 form by the end of January preceding the start of the financial year. NNDR1 is a statutory form that has to be completed by billing authorities and submitted to the Department for Communities and Local Government which sets out the projections for the amount of non-domestic rates to be collected the following year. The estimate will take into account any projected increases in the tax base along with any projected losses due to appeals and collection rates.

Final decisions on the level of RSG are usually taken late in the January or early in the February preceding the start of the new financial year as part of the final local government finance settlement following the provisional settlement in December.

More details about the funding of local government can be found in module one.

Other policy decisions for the authority

Councils have to make a number of major policy decisions on the financing of the authority as a whole. These are dealt with differently by individual authorities, but are likely to involve the leader or the appropriate members of the council's cabinet. Sometimes these decisions are preceded by informal discussions within the council's majority political group.

The capital programme

The CIPFA *Prudential Code* requires each council to produce a three-year forecast of its capital expenditure, and have regard to, inter alia:

- the affordability of its plans, including the implications for the council tax
- the prudence and sustainability of the plans and their implications for external borrowing
- the council's service objectives; for example, the capital spending plans should be consistent with the council's strategic plan for the authority
- the practicality of the capital expenditure plan, and that the forward plan is capable of being achieved.

Put simply, each council must consider the consequences of its capital programme, and the way in which that capital programme is to be financed, as part of its financial planning process.

Contingency provisions

Councils may choose to make a central contingency provision for inflation in excess of the budget provision and/or for unforeseen events, such as for increased expenditure on highways maintenance due to an exceptionally severe winter. Alternatively, these risks could be covered by the retention of general reserves, in which case no contingency provision would appear in the budget.

Deficit or surplus on trading undertakings

Councils must decide how far deficits or surpluses should be allowed to develop on trading undertakings and, in the case of surpluses, how these should be used.

Reserves and balances

A council must decide the level of general reserves it wishes to maintain before it can decide the level of the council tax – and has a statutory duty to do so.

CIPFA takes the view that there is no theoretically right level of reserves because the factors that affect the need for reserves – such as inflation rates and the certainty about councils'

spending plans – vary over time. But, CIPFA believes that elected members should agree on the appropriate level of reserves in the light of the advice given by the chief finance officer.

The chief finance officer has a fiduciary duty to local taxpayers, and must be satisfied that the decisions taken on balances and reserves represent proper stewardship of public funds.

CIPFA's views on reserves and balances are set out in LAAP Bulletin 99 *Local Authority Reserves and Balances*, published in July 2014. The bulletin:

- describes the different types of reserves held
- makes it clear that it was the responsibility of the finance director to advise councils about the appropriate levels of reserves and to ensure that clear protocols were in place, setting out the purpose of the reserves, how and when they could be used, how they should be managed, and how – and when – they should be reviewed
- sets out the factors, in addition to the authority's cash flow requirements, that should be taken into account in determining the appropriate level of reserves.

The bulletin makes it clear that the factors to be taken into account in setting reserves can only be properly assessed at local level, and stressed that decisions on the level of reserves should be set in the context of each council's medium-term financial plan, not based on short-term considerations.

Authorities will need to consider various factors when assessing an appropriate level of reserves. The bulletin reflects the lessons learned from recent events, including the collapse of Icelandic banks and the ensuing threat to council deposits with the banks. External factors such as the flooding in 2007 and 2008, and the problems experienced by the global financial markets in 2008, have highlighted the importance for authorities of maintaining appropriate levels of reserves. LAAP Bulletin 99 provides guidance to council chief finance officers in England, Northern Ireland, Scotland and Wales. The general principles set out in the guidance apply to an authority's general fund and, where appropriate, to the housing revenue account. The advice relates to reserves, not provisions. Definitions of provisions and reserves are given below.

Reserves and provisions in the balance sheet

A council's balance sheet summarises its financial position at 31 March each year. The top half of the balance sheet contains the assets that it holds and liabilities (including **provisions**) that it has accrued with other parties. As councils do not have equity, the bottom half is comprised of **reserves** that show the disposition of a council's net worth falling into two categories, usable and unusable. In order for the balance sheet to balance, the sum of the reserves must equal the council's total assets less liabilities.

Reserves

Amounts set aside for purposes falling outside the definition of provisions should be considered as reserves, and transfers to and from them should be distinguished from expenditure disclosed in the income and expenditure account. Expenditure should not be charged directly to any reserve. For each reserve established, the purpose, usage and the basis of transactions should be clearly identified. Reserves include earmarked reserves

set aside for specific policy purposes and balances which represent resources set aside for purposes such as general contingencies and cash flow management.

Provisions

Provisions are required for any liabilities of uncertain timing or amount that have been incurred. Provisions are required to be recognised when:

- the council has a present obligation (legal or constructive) as a result of a past event
- it is probable that a transfer of economic benefits will be required to settle the obligation
- a reliable estimate can be made of the amount of the obligation.

A transfer of economic benefits or other event is regarded as probable if the event is more likely than not to occur. If these conditions are not met, no provision should be recognised.

A provision should be recognised when the council has a contract that is onerous, ie the unavoidable costs of meeting the obligations under the contract exceed the economic benefit or service potential expected to be received under it.

The costs of internal and external restructuring should only be recognised as a provision when the council has a constructive obligation to restructure, ie there is an approved and detailed formal plan and the authority has raised a valid expectation in those affected that it will carry out the restructuring either by starting to implement the plan or by announcing its main features to those affected by it. A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:

- necessarily entailed by the restructuring, and
- not associated with the ongoing activities of the entity, for example retraining or relocating continuing staff.

Provisions should not be recognised for future operating losses.

Provisions should be charged to the appropriate revenue account; when payments for expenditure are incurred to which the provision relates they should be charged directly to the provision. The amount recognised as a provision should be the best estimate, taking into account the risks and uncertainties surrounding the events.

Provisions should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that a transfer of economic benefits will be required to settle the obligation, the provision should be reversed.

Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised only when it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

In the appropriate revenue account the expense relating to a provision may be presented net of the amount recognised for a reimbursement.

Types of reserve

When reviewing their medium-term financial plans and preparing their annual budgets, councils should consider the establishment and maintenance of reserves. These can be held for three main purposes:

- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves
- a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves
- a means of building up funds, often referred to as earmarked reserves (or earmarked portion of the general fund in Scotland – see below), to meet known or predicted requirements; earmarked reserves are accounted for separately but remain legally part of the general fund.

Reserves can be established in Scotland only where there are explicit statutory powers. Schedule 3 of the *Local Government (Scotland) Act 1973* (as amended) permits certain Scottish local authorities to establish a renewal and repair fund, an insurance fund and a capital fund (including capital receipts). Scottish local authorities may earmark specific parts of the general fund reserve. Some common examples of established earmarked reserves (earmarked portions of the general fund in Scotland) are listed in the table below (the list is not exhaustive).

Common types of reserve

| Category of earmarked reserve | Rationale |
|---|--|
| Sums set aside for major schemes, such as capital developments or asset purchases, or to fund major reorganisations | Where expenditure is planned in future accounting periods, it is prudent to set aside resources in advance. |
| Insurance reserves (note that the insurance fund is a statutory fund in Scotland) | Self-insurance is a mechanism used by a number of councils. In the absence of any statutory basis (other than in Scotland), sums held to meet potential and contingent liabilities are reported as earmarked reserves where these liabilities do not meet the requirements of IAS 37. |
| Reserves of trading and business units | Surpluses arising from in-house trading may be retained to cover potential losses in future years, or to finance capital expenditure. |
| Reserves retained for service departmental use | Authorities may have internal protocols that permit year-end underspendings at departmental level to be carried forward. |
| Reserves for unspent revenue grants | Where revenue grants are received by the council with no conditions or where the conditions are met and expenditure has yet to take place. The Code Guidance Notes recommend that these sums are held in earmarked reserves. (For further information on grant conditions please refer to module 2, section C of the 2014/15 Code Guidance Notes.) |
| School balances | These are unspent balances of budgets delegated to individual schools. |

Councils also hold other reserves that arise out of the interaction of legislation and proper accounting practice. These reserves, which are not resource-backed and cannot be used for any other purpose, are described below.

The **pensions reserve** is a specific accounting mechanism used to reconcile the payments made for the year to various statutory pension schemes in accordance with those schemes' requirements and the net change in the authority's recognised liability under the Code's adoption of IAS 19 *Employee Benefits* for the same period. A transfer is made to or from the pensions reserve to ensure that the charge to the general fund reflects the amount to be raised in taxation.

The **revaluation reserve** records unrealised gains in the value of property, plant and equipment. The reserve increases when assets are revalued upwards, and decreases as assets are depreciated or when assets are revalued downwards or disposed of. The **capital adjustment account** is a specific accounting mechanism used to reconcile the different rates at which assets are depreciated under proper accounting practice and are financed through the capital controls system. Statute requires that the charge to the general fund is determined by the capital controls system. The **available-for-sale financial instruments reserve** records unrealised revaluation gains arising from holding available-for-sale investments, plus any unrealised losses that have not arisen from impairment of the assets. The **financial instruments adjustment account** is a specific accounting mechanism used to reconcile the different rates at which gains and losses (such as premiums on the early repayment of debt) are recognised under proper accounting practice and are required by statute to be met from the general fund. The **unequal pay back pay account** is a specific accounting mechanism used to reconcile the different rates at which payments in relation to compensation for previous unequal pay are recognised under proper accounting practice and are required by statute to be met from the general fund. This account is not applicable to Scotland.

The **collection fund adjustment account** is a specific accounting mechanism used to reconcile the differences arising from the recognition of council tax and non-domestic rates income under proper accounting practice to those amounts required to be charged by statute to the general fund.

The **major repairs reserve** records the unspent amount of HRA balances for capital financing purposes in accordance with statutory requirements for the reserve. In Wales, this represents the amounts unspent from the major repairs allowance capital grant.

Other such reserves may be created in future where developments in local authority accounting result in timing differences between the recognition of income and expenditure under proper accounting practice and under statute or regulation.

In addition, authorities will hold a **capital receipts reserve**. This reserve holds the proceeds from the sale of assets, and can only be used for capital purposes in accordance with regulations.

For each earmarked reserve (earmarked portion of the general fund in Scotland) held by a council, there should be a clear protocol setting out:

- the reason for/purpose of the reserve (required by the Code)

- how and when the reserve can be used (required by the Code)
- procedures for the reserve's management and control
- a process and timescale for review of the reserve to ensure continuing relevance and adequacy.

When establishing reserves, councils need to ensure that they are complying with the *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code) and in particular the need to distinguish between reserves and provisions.

In LAAP Bulletin 99, CIPFA and the Local Authority Accounting Panel make it clear that they do not accept that there is a case for introducing a generally applicable minimum level of reserves. Councils, on the advice of their chief finance officers, should make their own judgements on such matters taking into account all the relevant local circumstances. Such circumstances vary. A well-managed authority, for example, with a prudent approach to budgeting, should be able to operate with a level of general reserves appropriate for the risks (both internal and external) to which it is exposed. In assessing the appropriate level of reserves, a well-managed authority will ensure that the reserves are not only adequate but also necessary. There is a broad range within which authorities might reasonably operate depending on their particular circumstances.

Imposing a generally applicable minimum level would also run counter to the promotion of local autonomy and would conflict with the financial freedoms introduced for English and Welsh local authorities in the *Local Government Act 2003* and for Scottish authorities in the *Local Government in Scotland Act 2003*. Nor is it considered appropriate or practical for CIPFA, or other external agencies, to give prescriptive guidance on the minimum (or maximum) level of reserves required, either as an absolute amount or as a percentage of budget.

Section 26 of the *Local Government Act 2003* gives ministers in England and Wales a general power to set a minimum level of reserves for local authorities. However, the government has undertaken to apply this only to individual authorities in circumstances where an authority does not act prudently, disregards the advice of its chief finance officer and is heading for serious financial difficulty. This accords with CIPFA's view that a generally applicable minimum level is inappropriate, as a minimum level of reserve will only be imposed where an authority is not following best financial practice (including the guidance in LAAP Bulletin 99).

Principles to assess the adequacy of reserves

In order to assess the adequacy of unallocated general reserves when setting the budget, a chief finance officer should take account of the strategic, operational and financial risks facing the authority. Where authorities are being reorganised, this assessment should be conducted on the basis that the services will continue to be provided, and adequate reserves will therefore be required by successor authorities. The assessment of risks should include external risks, such as flooding, as well as internal risks.

In England and Wales, statutory provisions require an authority to conduct a review at least once in a year of the effectiveness of its system of internal control, which will include risk management. The CIPFA/SOLACE framework *Delivering Good Governance in Local Government* details an approach to giving assurance that risk, control and governance matters are being addressed in accordance with best practice.

The *Codes of Audit Practice* in England, Wales, Scotland and Northern Ireland make it clear that it is the responsibility of the audited body to identify and address its operational and financial risks, and to develop and implement proper arrangements to manage them, including adequate and effective systems of internal control. The financial risks should be assessed in the context of the authority's overall approach to risk management.

Setting the level of general reserves is just one of several related decisions in the formulation of the medium-term financial strategy and the budget for a particular year. Account should be taken of the key financial assumptions underpinning the budget and financial strategy alongside a consideration of the authority's financial management arrangements. In addition to the cash flow requirements of the authority, the following factors should be considered:

- The treatment of inflation and interest rates – the overall financial standing of the authority (level of borrowing, debt outstanding, council tax collection rates, etc). The significant increases in the prices of some commodities, such as fuel, highlighted the relevance of using a number of inflation rates in the budget and financial strategy, and considering whether general reserves are adequate to deal with unexpected increases. Recent volatility in the financial markets also points to the need to consider investment and borrowing risks and their impact on income.
- Estimates of the level and timing of capital receipts – the authority's track record in budget and financial management, including the robustness of the medium-term plans. Authorities will also need to take into account changes in the property market and adjust estimates and assumptions for reserves accordingly.
- The treatment of demand-led pressures – the authority's capacity to manage in-year budget pressures, and its strategy for managing both demand and service delivery in the longer term.
- The treatment of planned efficiency savings and productivity gains – the strength of the financial information and reporting arrangements. The authority should also be in a position to activate contingency plans should the reporting arrangements identify that planned savings or gains will either not be achieved or be delayed.
- The financial risks inherent in any significant new funding partnerships, major outsourcing arrangements or major capital developments – the authority's virement and end-of-year procedures in relation to budget under/overspends at authority and departmental level. Risk management measures in relation to partnerships, including consideration of risk allocation. Contract provisions designed to safeguard the authority's position in the event of problems arising from outsourcing arrangements.
- The availability of reserves, government grants and other funds to deal with major contingencies and the adequacy of provisions – the adequacy of the authority's insurance arrangements to cover major unforeseen risks. When considering insurance cover, the structure of the cover as well as the overall level of risk should be taken into account. Risk assessments should be used when balancing the levels of insurance premiums and reserves.
- The general financial climate to which the authority is subject – external factors, such as future funding levels expected to be included in national spending reviews and expected capping criteria, will influence an authority's ability to replenish reserves once they have

been used. Any plans for using reserves will need to consider the need and ability of the authority to replenish the reserves, and the risks to which the authority will be exposed while doing so.

While many of these factors relate to setting the annual budget, the level of risk and uncertainty associated with them will be relevant in determining an appropriate level of reserves.

Events such as large-scale flooding have emphasised the need for authorities to be prepared for major unforeseen events. Adequate insurance cover combined with appropriate levels of reserves will enable authorities to manage the demands placed on them in such circumstances. However, these arrangements need to take account of all possible scenarios. An example quoted in the Audit Commission report *Staying Afloat* is that the total cost of the flooding was reduced where authorities had specifically considered the impact of a wide-scale, serious event affecting many assets, and had taken appropriate action, such as negotiating insurance policies that capped the total excesses linked to one event.

Emergency financial assistance from central government may be available to assist authorities in dealing with the immediate consequences of major unforeseen events, normally under the 'emergency financial assistance to local authorities' scheme (commonly known as the Bellwin scheme). However, there is no automatic entitlement to financial assistance, and where financial assistance is given, it will not cover all of the costs even in exceptional circumstances.

Authorities should plan to have access to sufficient resources (through reserves, insurance or a combination) to cover the costs of recovering from events that are likely to be unavoidable. Alternative arrangements, such as mutual aid agreements, may help to reduce the reliance on reserves or insurance.

Part of the risk management process involves taking appropriate action to mitigate or remove risks, where this is possible. This in turn may lead to a lower level of reserves being required, and it would be appropriate to consider reducing the level of balances held where appropriate action to mitigate or remove risks has been successfully undertaken. A balance will need to be found between maintaining adequate levels of reserves and investing in risk reduction measures. This balance should form part of the risk management process and be considered as part of the annual budget process.

The many factors involved when considering appropriate levels of reserves can only be assessed properly at a local level. A considerable degree of professional judgement is required. The chief finance officer may choose to express advice on the level of balances in cash and/or as percentage of budget (to aid understanding) so long as that advice is tailored to the circumstances of the authority.

The advice should be set in the context of the authority's risk register and medium-term plans and should not focus exclusively on short-term considerations. Balancing the annual budget by drawing on general reserves may be viewed as a legitimate short-term option. However, it is not normally prudent for reserves to be deployed to finance recurrent expenditure. Where such action is to be taken, this should be made explicit, and an explanation given as to how such expenditure will be funded in the medium to long term. Advice should be given on the

adequacy of reserves over the lifetime of the medium-term financial plan, and should also take account of the expected need for reserves in the longer term.

The *Code of Practice on Local Authority Accounting in the United Kingdom* requires the purpose, usage and basis of transactions of earmarked reserves to be identified clearly. It is recommended that a review of the level of earmarked reserves be undertaken as part of annual budget preparation.

It is worth stressing that it is illegal for an authority to budget for a deficit.

The external auditor can and does comment on the level of reserves, in the context of good financial management practice. The auditor is likely to comment if, in his or her opinion, an authority's reserves are considered too high or too low. However, it is not the responsibility of auditors to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.

Reserves can only be used once. If they are used to keep the council tax down in the current year, that will put pressure on the next year's tax. The council tax or budget will be even greater if the authority has to raise additional money in order to restore reserves to a reasonable level.

Setting the council tax

The council tax is set by billing authorities – London boroughs, metropolitan districts, non-metropolitan districts, unitary authorities and the City of London Corporation. Each billing authority adds the amounts required by major precepting authorities (including county councils, police authorities and joint authorities) to its own tax requirement. It translates the required tax yield into the tax rate for band D properties; other bands can be calculated on the basis set out in the *Local Government Finance Act 1992*.

The precepts for local precepting authorities, such as parish councils, must be calculated separately for each local precepting authority area.

Precepting authorities must issue precepts before 1 March and billing authorities must set the council tax by 11 March for the financial year starting on the following 1 April.

Budgetary control

The responsibility for budgetary control usually lies with service chief officers, and through them with their line managers. These line managers should monitor actual expenditure and income against the budget provisions regularly, usually monthly.

Elected members will consider budget monitoring reports regularly throughout the year. These reports should provide comparisons of actual and estimated income and expenditure, usually at the same level of detail as the budget approved by the committee. If the monitoring process reveals adverse trends, ie if expenditure is too high or income is too low, councillors may need to reconsider their policies at some level, for example:

- at detailed budget level if, say, income is considerably below the estimated level, or
- at authority level if, say, events occur that cannot be covered by the contingency provision or general reserves.

Devolved budgets

Councils usually devolve responsibilities for operational decision-making and budgeting to individual service managers. Responsibility has been devolved first from central departments, like the finance department, to service departments and then within departments down to area offices, divisions and some sections within divisions.

In many councils, managers have been given more flexibility to make changes within their budgets. The flexibility can extend to allowing managers to fund improvements in the services they manage from the income raised by new initiatives. In other cases, managers have been given the flexibility to negotiate the cost of support services provided by central departments, often through service level agreements. In some cases managers purchase support services from outside the authority, if this alternative is cheaper or more convenient.

One advantage of devolution is that service managers may feel more responsible for their budgets than they did when large elements were beyond their control. However, with greater devolution there is greater risk if staff are inadequately trained. It remains the responsibility of the chief finance officer to ensure proper financial control is maintained. This could include providing detailed guidelines to departments on budget setting, budget monitoring and internal controls and ensuring that managers in service departments receive appropriate financial training.

Elected members are ultimately responsible for determining a scheme of delegation to enable the authority to operate effectively. Not all decisions can be taken by members and chief officers, so the scheme of delegation needs to specify the responsibilities delegated to different levels of management within the authority. The scheme of delegation should cover the delegation of budgetary responsibility. Financial limits should be set on the financial decisions that can be taken by the various committees and post holders.

Strategic partnerships

There has been an increasing emphasis in recent years on authorities working in partnership with other authorities and organisations. This may well have budget implications, especially where funding streams or budgets are pooled, and concerns have been expressed, for example by the Audit Commission, about financial management in relation to partnerships.

Virement

Under virement, a service manager may spend more than originally planned on one budget head provided that this is matched by a corresponding reduction on some other budget head, ie a switch of resources between budget heads. Practice varies: a few authorities allow no virement at all; some allow almost unlimited virement; many prohibit transfers that would give rise to a continuing commitment, such as a transfer of resources from the equipment budget to the salaries budget in order to finance the cost of a new permanent member of staff. Virement should be encouraged where it allows managers to obtain better value for money, provided that it does not result in poor financial management.

Performance indicators

In the past, budget information tended to relate solely to financial information. This was unsatisfactory. If value for money is to be obtained, then money spent has to be related, as far as possible, to the outputs it achieves. The use of performance indicators to establish the relationship between financial and non-financial data leads to better management of council services – provided that the number of indicators is not excessive and the indicators are not contradictory.

CIPFA guidance

Balance sheet management

Balance Sheet Management in the Public Services: A Framework for Good Practice (2006) looks at balance sheet management in the context of an authority's overall financial management framework.

The message from the publication is that the finance function is increasingly involved in supporting operational service delivery and performance. Balance sheet management has a key role to play in generating real savings and delivering assets where they are needed, to enable effective front-line service delivery.

The framework provides an assessment tool that organisations can use to develop a much closer knowledge of their balance sheets. It also includes a powerful analysis tool to identify the areas where greatest focus is required for improvement. Finally, the framework provides practical ideas on how organisations can improve and supplies links to other sources of guidance.

Integrated planning

Public sector organisations are expected to have corporate and business plans – sometimes several different plans, each with a different focus, meeting the needs of a range of stakeholders, including central government and regulatory authorities. Yet, in many public sector bodies, the annual financial planning process is often only loosely connected to the strategic and service planning process.

Planning is an important activity, but is not an end in itself. Plans must join up and have both an operational and a financial dimension. Despite this, the gulf between financial and operational plans is familiar to many organisations.

Integrated Planning: An Overview of Approaches (2006) recommends practical steps that can be taken to bridge the gap, covering people, processes and tools – starting with strategy and planning, working through performance management, and feedback through the review process.

This guide is intended to provide an overview of how an integrated planning process can be approached and made to work more effectively for planners, finance and operational staff who play a part in it.

The first section examines the overall process and includes a summary for senior management and board members about their part in setting the direction and deciding on alternative options when finalising the overall plan.

The second section looks at elements of the cycle and suggests techniques and approaches for better planning outcomes.

The guide also offers brief summaries of the techniques and approaches involved in planning and links to further sources of details and advice.

Developing a financial strategy

The annual budget secures the stewardship of public money and is an important source of information with which to build more ambitious strategies. In the medium-term view, attention switches to the management of performance against demanding efficiency targets that can only be realised over a period of several years. Within this medium-term planning horizon, most public service organisations have become adept at financial forecasting – often with the appropriate sensitivity testing against a range of assumptions.

The distinctive feature of *Thinking Ahead: Developing a Financial Strategy* (2012) is its emphasis on longer-term planning and on the limitations of using forecasting for such strategies. It advocates instead the more widespread use of scenario planning. Scenarios are plausible and coherent possible states of the future world that may become a reality. Some methodologies for developing credible scenarios are sketched out, as well as some techniques for developing a reasonable response to the challenges they pose. Such approaches force organisations to consider the distinctly different futures that they may face and as a consequence become more agile in developing their responses.

Public financial management

The CIPFA FM Model: Assessment of Financial Management in Public Service Organisations (2010) was launched in 2004 and is now in its third version. The principles of good financial management are unchanged, namely that it is the business of the whole organisation, that it requires a tone set from the top, sound processes, competent and motivated people and attention to the needs of stakeholders.

The model is structured around three styles of financial management:

- **Securing stewardship** – an emphasis on control, probity, meeting regulatory requirements and accountability.
- **Supporting performance** – responsive to customers, efficient and effective, and with a commitment to improving performance.
- **Enabling transformation** – strategic and customer led, future orientated, proactive in managing change and risk, outcome focused and receptive to new ideas.

The styles of financial management are intended to be progressive and it is expected that all three styles will be present in an organisation exhibiting best practice financial management characteristics. For example, stewardship alone is not sufficient to enable an organisation to drive performance and to develop its transformational capacity and, conversely, performance

or transformation programmes that are not founded in a robust approach to controlling and accounting for resources are unlikely to succeed.

The model is also organised by four management dimensions. These cover both hard-edge attributes that can be costed and measured and softer features such as communications, motivation, behaviour and cultural change. The dimensions are:

- **Leadership** – focuses on strategic direction and business management, and the impact on financial management of the vision and involvement of the organisation’s board members and management team. The tone set from the top will be critical.
- **People** – includes both the competencies and the engagement of staff, within and throughout the organisation.
- **Processes** – examines the organisation’s ability to design, manage, control and improve its financial processes to support its policy and strategy.
- **Stakeholders** – acknowledges the relationships between the organisation and those with an interest in its financial health. Public service organisations interact with a web of stakeholders from government, inspectors, taxpayers, partners, suppliers, customers and clients. External stakeholders have legitimate expectations about the finances of the organisations. This is enveloped by the public interest.

A matrix approach is used in the model, combining the styles of financial management and the management dimensions. The assessment matrix that is formed shows the high-level issues that an organisation faces. The evidence that underpins the scores enables organisations to identify the key issues that need to be addressed in order to raise scores and most importantly improve financial management.

Audit Commission guidance

In *Financial Management in a Glacial Age* (2009), the Audit Commission comments on the uncertain financial future facing authorities, with increasing demand for services and decreasing income. The publication aims to help councils learn lessons from past financial failure and secure their financial stability. It is based on real-life examples of:

- possible causes of financial failure to watch out for
- key changes to take to help with recovery
- steps management can take to improve financial standing.

It highlights that the financial management arrangements in failing bodies often included:

- a reliance on short-term fixes, such as asset sales to raise cash
- the use of reserves and investment income to balance budgets
- a reluctance to commit to key financial decisions, such as budget setting
- insufficient budget monitoring, especially at the start of the year
- misleading budget information, particularly information to audit committees
- a disconnect between financial planning and other key functions, such as human resources
- a lack of understanding of costs and their relationship with activities.

In addition, the Audit Commission carried out detailed fieldwork into strategic financial management between July and November 2009. It defines strategic financial management as councils' abilities to allocate resources to achieve their objectives, choose between competing priorities, and manage and monitor implementation of their plans. The study should help councils assess the advantages of a strategic approach to financial management and prepare for, and respond to, the challenges of the current financial and fiscal climate.

The Commission commented that:

There are still situations where the board assumes it's the finance director's responsibility to sort out problems: this attitude has contributed to wider corporate failures. Substitute 'council' for 'board' and we have a real risk. Financial planning must link to corporate and business planning and embrace not just income and expenditure, but also balance sheet items including cash flow and asset management.

The Audit Commission continued its work on how councils were affected by and responding to recession and public expenditure cuts in *Tough Times* (2011, 2012 and 2013).

LOCAL AUTHORITY ACCOUNTING AND REPORTING

This section of the guide outlines some of the key accounting principles and looks at the annual statement of accounts that all councils are required to produce. This is a simplified overview that is aimed at giving the reader a general understanding of councils' accounts.

Local authority accounting differs from private sector accounting in a number of important ways. Although local authority accounting is based on the same accounting standards, these are mainly designed for the private sector and so need to be adapted for councils. In addition, the government makes specific rules known as statutory requirements that local councils must follow when they prepare their financial statements limiting the amount that can be charged to council taxpayers and avoiding significant changes in expenditure from one year to the next. As a result, local authority accounting is a combination of the accounting standards that dictate how all organisations should account and legislation.

Accounting standards are set by the International Federation of Accountants (IFAC) and are known as International Financial Reporting Standards (IFRS). These set out how accountants should present items in the annual statement of accounts. Legislation is set out through a mixture of regulations and accounting directions that are issued by the Department for Communities and Local Government, requiring councils to treat certain items in the accounts differently to the way specified in the accounting standards.

All the accounting requirements for councils are brought together in CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom*.

International Financial Reporting Standards

International Financial Reporting Standards (IFRS) are a suite of accounting standards used across the world. IFRS is the international equivalent of the Financial Reporting Standards (FRSs) that were previously used in the UK, and are still used for smaller companies.

In the 2007 budget, the then chancellor announced that the UK public sector would adopt IFRS, as this was seen as best practice and allowed for international comparisons to be

made. It was also a question of timing. The UK Accounting Standards Board (ASB) has been reviewing the future of UK GAAP and in the short to medium term all but the smallest organisations will be producing accounts based on IFRS.

As a result, CIPFA/LASAAC now produces the IFRS-based *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code), overseen by the Financial Reporting Advisory Board (FRAB), the independent body that advises the government on accounting issues, rather than the Statement of Recommended Practice (the SORP), which was overseen by the Accounting Standards Board.

IFRS were developed for the private sector, but the impact of the vast majority of transactions is the same whatever sector you are in. In developing proper accounting practices, the Code is based on European Union adopted IFRS. Therefore, where appropriate, the Code adapts IFRS and sets out the required accounting treatment based on the approach in the Memorandum of Understanding (MoU) between Relevant Authorities.¹ In the unusual event that a local authority enters into a transaction not covered by the Code but which is covered by an extant IAS, IFRS, SIC Interpretation or IFRIC Interpretation, IPSAS or other reporting standards relevant to the public sector, the requirements of the relevant standard or interpretation should be followed. It is not stated explicitly, but authorities would be expected to search for an appropriate standard or interpretation.

International Public Sector Accounting Standards (IPSAS) are accounting standards developed specifically for the public sector by the International Public Sector Accounting Standards Board (IPSASB). The 'rules of the road' followed by the IPSASB when developing IFRS-based standards mean that the requirements of IPSAS will be the same as those under IFRS, except where there is a pressing public sector reason to adopt a different treatment. This makes them the natural first port of call for CIPFA/LASAAC when IFRS is not appropriate. There are also some IPSAS that deal with exclusively public sector issues, and for which there is no IFRS equivalent, such as taxation. When HM Treasury took the decision to follow IFRS, IPSAS were not as up to date as IFRS and were still under development in key areas. So the decision was taken to adopt IFRS rather than IPSAS. That has now changed and governments around the world are increasingly adopting IPSAS directly.

There are arguments that IFRS make the accounts too long and complex. Councils have a complex story to tell and IFRS introduce more disclosures, but notes only need to be produced if they are material. For example, the accounts need to reflect the pensions deficit which, although it does not have to be funded from this year's budget, is still a true cost – it represents the amount that will need to be found from future budgets to pay for pension entitlements already incurred in delivering services. So it is a real call on future funding. Not showing this would hide the liability that the authority has incurred.

This also applies to other reserves. Like the pension reserve, the capital adjustment account, the unequal pay back pay account and similar reserves all do one thing: they hold expenditure that the authority has incurred but not yet financed.

1. The use of adaptations in the Code is determined by reference to the guidance in Annex A of the Memorandum of Understanding.

Annual statement of accounts

Each local council is required to produce an annual statement of accounts by the 30 June immediately following the end of the financial year. The accounts contain detailed information on the financial position of the council. They show not just the income and expenditure of the council, but also the assets and liabilities it holds. The statement of accounts is a key way that local councils are able demonstrate that they are using public money properly, known as financial stewardship. The format of the statement of accounts is set out in the *Code of Practice on Local Authority Accounting in the United Kingdom* and contains the following key statements:

| | |
|--|---|
| Movement in reserves statement | This statement shows the impact of the financial year on the council's reserves. It also includes all of the income and expenditure that is recognised under accounting rules but then removed from the accounts by legislation to give the amount of expenditure that has been funded by the local taxpayer. |
| Comprehensive income and expenditure statement | This is where all the income and expenditure of the council is recorded in line with accounting rules. This statement is similar to the one you would find in a private company. |
| Balance sheet | This statement summarises a council's financial position at each year-end and reports the assets, liabilities and reserves of the council. Some of the reserves are specific to councils, such as the pensions reserve and the capital adjustment account, and exist to allow accounting entries required by legislation. |
| Cash flow statement | This summarises the cash flows that have been made into and out of the council's bank account during the financial year. |

Accruals

The principle of accruals is a key one for accounting and it describes when income and expenditure is recognised (included) in the accounts. The simplest form of accounting is cash basis, where transactions are recognised in the accounts when the actual cash is received or paid out. This would not, however, accurately reflect the true position of the council as it would not show how much the council owes or was owed.

Under the accruals basis of accounting, revenues and expenses are recorded when earned and incurred, regardless of when cash is exchanged (ie received or paid). Revenue is recognised either when it is earned (ie services are provided) and realised (ie cash is received) or realisable (ie it is reasonable to expect that cash will be collected in the future). Expenses are recognised when costs have been incurred (ie goods or services are provided) and payment is made or becomes payable (ie it is reasonable to expect that payment will have to be made in the future).

Taking a simple example, if a council is providing home care that it charges for, it would recognise the costs of the home care as it was provided, even if it has yet to be invoiced or paid for. It would then recognise the income due from the client as soon as the service is provided and cash is received or it was reasonable to expect that payment would be received (for example, if payment was due following receipt of an invoice by the client). Revenue and

expenses included in a council's accounts that has not yet been settled (ie cash has not been received or paid) will give rise to debtor and creditor balances in the council's balance sheet.

Debtors come into existence where income has been recognised but consideration has not yet been received by the council. Put simply, debtors are individuals or organisations that owe the council money.

Creditors come into existence where expenditure has been recognised but payment has yet to be made by the council. Put simply, creditors are individuals or organisations to whom the council owes money.

Taking the home care example, the debtor would be created and the income recognised even where the income is payable many years in the future following the eventual sale of the client's home.

Capital accounting

Capital accounting is the term used to describe the entries in a council's accounts that are made in relation to its fixed assets; mainly buildings, infrastructure and expensive pieces of equipment. There are two key elements to capital accounting:

- To ensure that the value of the council's assets are correctly reflected in its balance sheet so that the balance sheet gives an accurate view of the council's overall financial position.
- To reflect the cost of using assets as an expense of the council so that the cost of service provision shows the total cost.

Asset valuation

When the council invests in new assets it includes these in the balance sheet at the cost of the investment plus any directly related expenses. In order to ensure that the balance sheet is kept up to date, assets need to be regularly revalued – every five years, or yearly for the most valuable assets. If council assets are not regularly updated, the balance sheet will very soon become out of date. For example, if a Victorian school building were left on the balance sheet at the amount it cost to build, it may be undervalued by several hundred thousand pounds. The table below sets out the main categories of assets and how they are valued.*

| Category of asset | Description | Valuation | Description |
|-------------------------------|--|--|--|
| Land and buildings | Land and buildings used to provide services | Fair value based on existing use or depreciated replacement cost | A valuation based on how much the assets could be sold for if they were sold for the same purpose they are currently used for, eg a school is valued if sold for use as a school rather than for housing. Revalued every five years, or more frequently, if necessary, for those assets where there are material changes in value. |
| Vehicles, plant and equipment | Vehicles, plant and equipment used to provide services | Cost | The cost of acquiring the asset or work carried out to date.** |
| Infrastructure | For example roads, footpaths, bridges and tunnels | Cost | The cost of acquiring the asset or work carried out to date.** |
| Assets under construction | New buildings that are in the process of being built | | |
| Housing – dwellings | Houses used to provide social housing | Existing use value – social housing | The current value of the houses if they were to be sold to be used for letting for social rents. |
| Heritage assets | Assets with special qualities that are held and maintained principally for their contribution to knowledge and culture | Valuation, or cost where a value is not available | Value does not have to be professional valuation but could be an insurance valuation (for museum or art gallery exhibits for example). For some assets a value may not be available (for example, an archaeological site) and cost can be used where this is available. |
| Community assets | Assets that the council intends to hold in perpetuity, for example a park | Cost, or as per heritage assets | Councils can choose to use cost or the same basis as for heritage assets. |
| Investment assets | Assets held for income-generation purposes rather than service provision | Value as at balance sheet date | These are valued at market value as if they could be sold on 31 March with no special restrictions on their use. |

** This table is only relevant to the 2014/15 year (and previous years) as the 2015/16 Code adopts IFRS 13 Fair Value Measurement, which will apply prospectively from 1 April 2015. However, the 2015/16 Code adapts the measurement requirements for property, plant and equipment and has introduced the concept of current value. This new definition of current value means that the measurement requirements for property, plant and equipment providing service potential for an authority has not changed from the 2014/15 Code, ie they are measured for their service potential either at existing use value, existing use value – social housing or depreciated replacement cost, and not at fair value. The 2015/16 Code has, however, changed the measurement requirements for assets classified as surplus assets. These assets are now to be measured at fair value (as a current value measurement base) in accordance with the definition in IFRS 13 and without any adaptations to that definition. Where applicable, all other assets are measured at fair value.*

*** As part of its Code of Practice on Transport Infrastructure Assets, CIPFA has produced guidance for valuing infrastructure assets on a depreciated replacement cost basis (which is the estimated cost of replacing the asset in current value terms). The Code of Practice on Local Authority Accounting in the United Kingdom has confirmed that this measurement basis will be introduced in 2016/17. Further information in this area is provided in appendix D to the 2014/15 Code. This is a substantial change to measurement practice and CIPFA is considering the guidance necessary to support authorities in their implementation of these requirements. See CIPFA's Code of Practice on Transport Infrastructure Assets: Guidance Notes. LAAP Bulletin 100 Project Plan for Implementation of the Measurement Requirements for Transport Infrastructure Assets by 2016/17 provides useful guidance to help authorities identify the key areas and milestones they should take into consideration in developing their implementation plans.*

Where a council is in the process of selling an asset or has made the decision to sell an asset, it is classified as an asset held for sale (if it meets certain criteria in the Code) and included in current assets on the council's balance sheet. This reflects the fact that the council does not intend to hold the asset for the long term. Where the criteria are not met the asset is classified as a surplus asset.

When an asset is revalued, this creates a difference between its previous value and its current value. A change in valuation is generally reflected in the revaluation reserve. When an asset's value falls (ie a revaluation loss or it is impaired), the revaluation reserve can be reduced by this fall in value provided that the value of the asset in question has previously increased by at least as much (accumulated revaluation). If the accumulated revaluation figure for an asset is not enough, any balance between the fall in value and the accumulated depreciation has to be charged to the comprehensive income and expenditure statement.

Depreciation

Depreciation is the term used to describe the charge that is made to the comprehensive income and expenditure statement to reflect the council's use of its assets. The argument is that, in using an asset to provide services, its value is diminished. This is most simply illustrated by taking a vehicle as an example. Suppose a council buys a new minibus for £20,000 which it intends to use for 10 years, at which point it expects to sell it for £10,000. If it included just the cash value in its comprehensive income and expenditure statement, it would have expenditure of £20,000 in the first year and income of £10,000 in year 11. In years 2 to 10 it would still be using the minibus but would show no cost in its comprehensive income and expenditure statement of doing so. If, instead, it includes the £20,000 in the balance sheet (in property, plant and equipment) and spread the £10,000 cost of owning the asset (the purchase cost of £20,000 less its final value of £10,000) over the 10 years of expected use, it would charge £1,000 per year to its comprehensive income and expenditure statement.

The actual calculation of depreciation is slightly more complicated in practice but the principle remains the same, with an asset's value, less any final value on disposal, being spread over the expected life of the asset. Because the value of land, provided it is not being used for landfill or mineral extraction, does not change as a result of using it, land is not depreciated – only the buildings upon it.

Capital accounting in the movement in reserves statement

The comprehensive income and expenditure statement for a council will include the costs of depreciation, charges for impairment and revaluation losses and gains and losses on the disposal of fixed assets. Depreciation, impairment and revaluation losses have been described above. Gains and losses on the disposal of fixed assets reflect the difference between the balance sheet value of an asset and the amount it is sold for. Because of the way councils are financed and the fact that money received for the sale of fixed assets is tied up in capital receipts, the government does not want these items to hit the bottom line, and so has made regulations to take these items out in the Movement in Reserves Statement. Depreciation is replaced with a minimum revenue provision, which makes a charge to the accounts for the repayment of borrowing associated with capital expenditure. These adjustments are made against the capital adjustment account, which is an unusable reserve and is one of the reserves that are specific to councils.

Reserves and provisions

Reserves

Reserves are split into usable reserves and unusable reserves on the balance sheet. Usable reserves include general and earmarked reserves, ie those reserves that can be spent on future services. Unusable reserves include all those accounting reserves that cannot be used for expenditure on services.

General and earmarked reserves

When reviewing their medium-term financial plans and preparing their annual budgets, councils should consider the establishment and maintenance of reserves. These can be held for three main purposes:

- a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – this forms part of general reserves
- a contingency to cushion the impact of unexpected events or emergencies – this also forms part of general reserves
- a means of building up funds, often referred to as earmarked reserves, to meet known or predicted requirements, but where the requirements or amounts are not certain enough to create a provision.

Earmarked reserves formally remain part of the general fund of the council. The general fund of a council represents the money available to local taxpayers that can be used for expenditure on services. Key categories of earmarked reserves are as follows.

| Category of earmarked reserve | Rationale |
|--|--|
| Sums set aside for major schemes, or to fund major reorganisations | Where major expenditure is planned in future years, it is prudent to set aside resources in advance. |
| Insurance reserves | Reserves held to fund repairs or replacement of assets where the council chooses not to buy insurance against these costs with external insurance companies. |
| Reserves of trading and business units | Surpluses arising from trading or business units may be held back to cover potential losses in future years, or to finance capital expenditure. |
| Reserves retained for service departmental use | Councils may let departments keep all or some of any underspends to use for future projects. |
| Reserves for unspent revenue grants | Where revenue grants are received by the council with no conditions or where the conditions are met and expenditure has yet to take place. The Code Guidance Notes recommend that these sums are held in earmarked reserves. (For further information on grant conditions please refer to module 2, section C of the 2014/15 Code Guidance Notes.) |
| Schools balances | These are the unspent balances of individual schools' budgets that can only be used by those schools. |

Unusable reserves

Councils also include a number of unusable reserves on the balance sheet. These are not backed by cash so cannot be spent on council services but arise because of entries in the accounts specific to councils. Examples of these accounts are as follows.

| Category of unusable reserve | Rationale |
|---|---|
| Pensions reserve | This reflects the difference between the amount charged for pensions in the accounts under accounting rules and the actual payments made to various statutory pension schemes for the year. |
| Revaluation reserve | The accumulated balance of changes in the value of fixed assets. |
| Capital adjustment account | The difference between depreciation and the charges made to the accounts under capital accounting rules. |
| Available-for-sale financial instruments reserve and financial instruments adjustment account | The difference between the amounts charged to the accounts for council borrowings and investments under accounting rules and the amounts charged under legislation. |
| Unequal pay back pay account | The difference between the amounts charged to the accounts for compensation for unequal pay under accounting rules and the amounts charged under legislation. |
| Collection fund adjustment account | The difference the amounts recognised in the accounts for council tax and non-domestic rates income (England) and the amounts charged under legislation. |

Other reserves

Councils will hold the following two usable reserves:

- **Capital receipts reserve** – this reserve holds the proceeds from the sale of assets, and can only be used to fund capital expenditure or to repay debt.
- **Major repairs reserve** (housing authorities in England and Wales) – in England, this reserve records the unspent amount of HRA balances for capital financing purposes in accordance with statutory requirements for the reserve. In Wales, this represents the amounts unspent from the major repairs allowance capital grant.

Provisions

A council may set up a provision when it knows that it is highly likely that it will have to pay out money or transfer assets in the future; for example, the council may be involved in a court case that could eventually result in the payment of compensation. Provisions are charged to the appropriate service line in the comprehensive income and expenditure statement when the council becomes aware of the need for them. When payments are eventually made, they are charged to the provision carried in the balance sheet. Provisions should be regularly reviewed to ensure they reflect the most accurate estimate of future cost.

Pensions

IAS 19 *Employee Benefits* is probably one of the best-known financial reporting standards as it has been frequently mentioned in news items about final salary pension schemes. The standard requires the balance sheet to give a snapshot of a pension fund's assets and liabilities at the end of the financial year and the associated costs to be reflected in the comprehensive income and expenditure statement.

The standard applies to all employee benefits but has a particular impact on defined benefit schemes where the pension paid is based on the salary of the recipient, not the amount they have paid into their pension pot. Police and fire schemes are excluded from the accounting standard as they are 'unfunded' schemes where contributions are used to pay existing pensions with the difference underwritten by government.

The difference between the cost of pensions under accounting rules (IAS 19) and the actual payments made is reversed out of the accounts in the movement in reserves statement against the pension reserve.

Other accounts

Councils may use other accounts, formally known as memorandum accounts, to record income and expenditure relating to certain services they provide or functions they carry out. Key accounts include the following.

| | |
|------------------|--|
| Trading accounts | Used where a council has set up a trading arm to record income and expenditure to assess whether or not the trading arm is creating a surplus of income over expenditure. The word 'surplus' is used instead of 'profit' in not-for-profit organisations such as councils. |
|------------------|--|

| | |
|-------------------------|---|
| Housing revenue account | Used to record the income and expenditure related to a council's housing function and required by legislation. |
| Collection fund | Used to record income and expenditure related to council tax and non-domestic rates collected by billing authorities. |

Local authority reporting

The statement of accounts is a key way that councils are able show they are using public money properly and forms the core of local authority reporting. In addition, councils have to comply with some other key aspects of financial reporting.

Narrative reporting

The financial statements on their own can be difficult for a lay person to understand and interpret, so explanations and commentary are needed to help the reader make sense of the financial statements and to help demonstrate the extent to which the objectives of the council have been achieved.

In 2009, CIPFA published *Narrative Reporting: A Public Services Perspective*. The report provides a guide to narrative reporting in theory and in practice and applies to public services in England, Wales, Scotland and Northern Ireland. The report highlights the need to improve reporting to ensure that it is open and honest, clear and understandable, and sufficiently relevant to stakeholders to be interesting and worth reading.

Remuneration of senior officials

Since 31 March 2010, councils have been required to include detailed remuneration information for their senior employees in their annual statement of accounts. Remuneration includes all monetary and non-monetary payments made to an employee as part of their employment. It does not include employer pension contributions. However, for the purposes of disclosing senior officer remuneration in England and Wales, employers' pension contributions must be reported in addition to the remuneration.

The transparency agenda

Councils are required to publish all expenditure over £500 to encourage 'armchair auditors', members of the public with an interest in council finances who are prepared to question councils over what they spend. In February 2015, DCLG published its latest version of *The Local Government Transparency Code*, which councils are required to follow.

The code requires councils to publish the following data:

- expenditure over £500
- government procurement card transactions
- procurement information about tenders for contracts; and contracts, commissioned activity, purchase orders, framework agreements and any other legally enforceable agreement in relation to the provision of goods and/or services with a value that exceeds £5,000
- information on public land and buildings

- information on social housing asset value (details on the value of social housing assets within local authorities' Housing Revenue Account)
- grants to voluntary, community and social enterprise organisations
- an organisational chart of the staff structure of the council including salary bands and details of currently vacant posts
- information on trade union facility time including the number of staff who are union representatives, the number of staff who devote at least 50% of their time to union duties and the names of the trade unions represented
- income and expenditure on the authority's parking account including details of revenue collected from on-street parking, off-street parking and penalty charge notices and an analysis of how any surplus on the parking account has been spent
- information on parking spaces including the number of marked-out controlled on- and off-street parking spaces within their area
- information on senior employee salaries,
- information on the council's constitution
- the 'pay multiple' – the ratio between the highest paid salary and the median average salary of the whole of the council's workforce
- information about the council's counter-fraud work and the measures in place to combat fraud.

This data should be published on the council's website and in a format that is as widely usable as possible.

Effective reporting

There are a number of reasons why reporting should take place. They include:

- to explain the ambitions of the organisation for its citizens and how it is committed to their delivery
- to indicate how well management employs and safeguards resources in the achievement of its objectives
- to hold those charged with governance of the authority to account for the performance of the authority
- to inform stakeholders of the activities of the authority and encourage them to push for the information they require
- to provide sufficient comfort to regulators that authorities are acting within their boundaries.

Concerns about the increasing complexity and decreasing relevance of financial reports have been growing in recent years. Many people point to their increasing length and detail, and the regulations that govern them, as evidence that we have a problem. Others are more worried that reports no longer reflect the reality of the underlying businesses, with key messages lost in the clutter of lengthy disclosures and regulatory jargon.

These concerns have been raised by those not just within the public services but also in the corporate sector and led to the FRC's *Reducing Complexity* project. This project has led to

the development of eight proposed principles for reducing complexity, four for regulators in developing new standards and the following four related to effective communication.

To be effective financial reporting should be:

1 Focused

Highlight important messages, transactions and policies and avoid distracting readers with immaterial clutter.

2 Open and honest

Provide a balanced explanation of the results – the good news and the bad.

3 Clear and understandable

Use plain language, only well-defined technical terms, consistent terminology and an easy-to-follow structure.

4 Interesting and engaging

Get the point across with a report that holds the reader's attention.

Focused reporting highlights important messages and transactions and avoids distracting readers with immaterial clutter. Focus is not merely about removing superfluous information; it is also about ensuring that reporting provides the information that readers need to understand both the financial figures themselves and the context within which the organisation is operating.

The level of information provided will depend on the audience and the type of report. An annual report aimed at the public will need far greater contextual information than an in-year monitoring report to the board. The key to achieving focus is to concentrate on the information that the user needs to get a proper picture of the organisation and its financial position while avoiding unnecessary clutter and superfluous information.

Open and honest reporting should provide a balanced explanation of performance – the good news and the bad. Users want a balanced commentary that provides a fair discussion of strengths and weaknesses. Where strengths and weaknesses are reported, they should be supported by an open discussion of the factors influencing them and their impact on future performance. The presentation of reports should give equal weight to both and not attempt to hide weaknesses within the text.

Clear and understandable reporting recognises that to provide an effective channel of communication, the user must be able to appreciate the message that the organisation intends to convey. While this may seem self-evident, in framing reports organisations should consider how readily their meaning will be appreciated by potential users. This will be especially relevant where they contain technical content or use terms that are not in everyday use. Clear and understandable reporting is particularly challenging for public service organisations where there is such a wide range of stakeholders and a requirement to communicate with all, both internally and externally. Public sector organisations may need to consider whether they need to provide additional education and support to users,

particularly to elected representatives/boards and citizens, to help them understand financial reporting.

Interesting and engaging reporting should get the point across with a report that holds the reader’s attention. It can be easy to forget that users of reports are people too: the more interesting and engaging the report, the better it will communicate important messages to users. There is currently a significant debate under way about the future of electronic-based reporting (such as via the internet). There is a distinct argument that, in looking to the future, public service organisations should be moving to an environment when reporting can provide a snapshot in time at whatever point the user requires it and in a format and level of detail geared to their needs. However, regular key published reports (whether paper-based or electronic) still have an important role in providing a comprehensive summary of all activity and a prompt to stakeholders to consider the information they require and how that can be sourced. In effect, the published reports can be a gateway into the new forms of continuous reporting as these develop.

Comparisons with budgets

For councillors and members of the public, probably the most important issue will be whether the authority has a surplus or a deficit compared to its budget (and council tax) for the year. Because the financial statements follow accounting standards rather than local government legislation, prior to the introduction of IFRS, this was not easy to identify. However, the movement in reserves statement under IFRS gives this information.

The table below shows how this can be done for the general fund. For housing authorities, there is a separate column in the movement in reserves statement showing the equivalent HRA figures; other columns show earmarked reserves, etc.

| | |
|--|--|
| Surplus (or deficit) on the provision of services | General fund share of the surplus or deficit. The housing revenue account share is in a separate column. |
| Adjustments between accounting basis and funding basis under legislation | Statutory adjustments such as replacing depreciation with the minimum revenue provision, pension liabilities under IAS 19 with actual contribution costs, etc. |
| Net increase/(decrease) before transfers to earmarked reserves | Surplus/(deficit) for the year. |
| Transfers to/from earmarked reserves | Offset by any transfers to or from earmarked reserves. |
| Increase/decrease in year | Gives the change in the general fund balance over the year. |

A loss shown in the comprehensive income and expenditure statement is an indication that the costs of providing this year’s services have not been covered by income, which will need to be funded by taxpayers in future years. An overall increase in usable reserves despite a loss being shown in the comprehensive income and expenditure statement normally means that there is a corresponding change in unusable reserves as, for example, statutory charges to revenue expenditure for use of capital assets replace depreciation and impairment charges with the difference reflected in the capital adjustment account. Unusable reserves such as the capital adjustment account and the pensions reserve will need to be funded in the future, even if it is over a long period, so increases in these balances show an increasing burden on future taxpayers.

FURTHER READING

Balance Sheet Management in the Public Services: A Framework for Good Practice, CIPFA/PwC, 2006

The CIPFA FM Model: Assessment of Financial Management in Public Service Organisations – Statements of Good Practice, CIPFA, 2010

Code of Practice on Local Authority Accounting in the United Kingdom, CIPFA, annual

Code of Practice on Local Authority Accounting in the United Kingdom: Guidance Notes, CIPFA, annual

Code of Practice on Transport Infrastructure Assets (2013 Edition), CIPFA, 2013

Code of Practice on Transport Infrastructure Assets: Guidance Notes, CIPFA, 2015

Delivering Good Governance in Local Government: Framework, CIPFA, 2007 (a range of supporting and sector-specific publications are available – see the CIPFA website)

Financial Management in a Glacial Age, Audit Commission, 2009

Guide to Local Government Reform and the Collection Fund, CIPFA, 2012

Improving Budgeting: Modernising the Cycle, CIPFA, 2008

Integrated Planning: An Overview of Approaches, CIPFA, 2006

LAAP Bulletin 99: Local Authority Reserves and Balances, CIPFA, 2014

LAAP Bulletin 100: Project Plan for Implementation of the Measurement Requirements for Transport Infrastructure Assets by 2016/17, CIPFA, 2014

The Local Government Transparency Code, DCLG, 2015

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Treasury management

INTRODUCTION

Treasury management activities are defined in CIPFA's *Treasury Management in the Public Services: Code of Practice* (the Treasury Management Code) as:

*The management of the **organisation's investments and cash flows**, its banking, money market and capital market transactions; **the effective control of the risks** associated with those activities; and the **pursuit of optimum performance consistent with those risks**.*

As the bold elements demonstrate, treasury management is really all about cash flows, the risks associated with them, and optimising performance within those risks. Essentially, it is the term used to describe the way a council manages the cash to meet both its day-to-day running costs and its borrowing for capital expenditure.

The scale is significant, with English councils having almost £30bn in investments and nearly £70bn of borrowing at the end of March 2014. This module explores how this has changed over recent years since the collapse of the Icelandic banks.

This module also covers the key elements of the regulatory framework including the CIPFA *Standards of Professional Practice*, the CIPFA *Treasury Management Code* and government guidance on council investments. It covers the basics of day-to-day cash management and cash flow forecasting, identifying the key cash flows, and considers the role of the auditor.

TREASURY MANAGEMENT CHALLENGES

Council investments were placed under the national spotlight following the collapse of the Icelandic banks, with almost £1bn invested with the affected banks. The Audit Commission published their *Risk and Return* report in March 2009. The Department for Communities and Local Government (DCLG) Select Committee also reviewed council investments and produced a report with a number of recommendations.

The main challenges for treasury management are broadly the same as they were at the time of the Icelandic banks collapse and centre around the effective management of risk and the balancing of security, liquidity and yield. That said, the banking crisis has significantly reduced the number of banks councils are prepared to invest with and the lower interest rates for investments have been challenging for budget setting. On the borrowing side, the review of many capital programmes has reduced some of the demand for borrowing with many authorities utilising internal balances and delaying their actual borrowing.

PROVISIONS OF THE LOCAL GOVERNMENT ACT 2003

Councils in England and Wales are given a general power to borrow by section 1 of the *Local Government Act 2003* (the 2003 Act):

A local authority may borrow money:

- *for any purpose relevant to its functions under any enactment, or*
- *for the purpose of the prudent management of its financial affairs.*

These provisions give authorities wide scope to borrow. Basically, if an authority is lawfully carrying out its functions in such a way that a cash deficit is produced, it is entitled to borrow to make good that deficit. However, the powers go wider in that borrowing can take place without a justification of this sort, provided it will reasonably assist with the prudent management of the authority's financial affairs. Fundamentally, this means that an authority can borrow short term for cash flow purposes and in the medium term for capital purposes.

The 2003 Act also gives similar powers to invest:

A local authority may invest:

- *for any purpose relevant to its functions under any enactment, or*
- *for the purpose of the prudent management of its financial affairs.*

These provisions give authorities the freedom to determine how to invest their surplus cash balances, subject to prudent consideration of such things as the credit rating of the institution taking the deposit, the access the authority will have to the principal sum on giving notice and the returns being offered.

The Act also requires councils to determine and keep under review how much money they can afford to borrow and states that borrowing must only be in sterling, unless the Treasury has granted permission otherwise. It also states that authorities are not able to secure borrowings against their property, ie mortgage their property. Instead, borrowings are secured equally against an authority's future revenues. The Act gives the secretary of state the power to impose borrowing restrictions on authorities, but at the time of writing this power has not been used.

STANDARDS OF PROFESSIONAL PRACTICE

The International Federation of Accountants (IFAC) is developing and enhancing coordinated worldwide standards for the accountancy profession. CIPFA, as a member of IFAC, is committed to supporting the Federation's broad objectives. One way in which CIPFA supports this is by producing *Standards of Professional Practice* (SoPPs) for the guidance of its members. For these purposes, members are defined as Institute members, students and diplomates.

In recognition of the importance of such standards, CIPFA requires all members to comply with each SoPP that regulates an area of their work. Failure to comply with any relevant SoPP may be regarded as grounds for disciplinary action under the Institute's byelaws.

There is a specific SoPP which covers treasury management. This applies to individual CIPFA members as defined above, whichever sector they work in. The SoPP covers the following key areas:

- treasury management within the wider business and service objectives
- treasury management budgeting and accounting
- treasury management decision making and analysis
- treasury management reporting and review.

CIPFA TREASURY MANAGEMENT CODE

The CIPFA *Treasury Management Code*, which was last updated in 2011, covers all public sector organisations, although councils in England and Wales are statutorily required to 'have regard' to it. CIPFA also produces sector-specific guidance notes for local, police and fire authorities, also revised in 2011. In 2014, the *Guidance for Smaller Public Service Organisations on the Application of the CIPFA Code of Practice for Treasury Management in the Public Services* was updated.

The *Treasury Management Code* has three key principles:

- That public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- That their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risk, and should ensure that priority is given to security and liquidity when investing funds.
- That they should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

The *Treasury Management Code* recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses:

- 1 *This organisation will create and maintain, as the cornerstones for effective treasury management:*
 - *a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities*
 - *suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.*
- 2 *This organisation (ie full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan*

in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

- 3 *This organisation delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to [name of responsible body or nominated group of individuals], and for the execution and administration of treasury management decisions to [title of responsible officer], who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.*
- 4 *This organisation nominates [name of responsible body or committee] to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.*

INVESTMENT STRATEGY

The DCLG produces *Guidance on Local Government Investments*, which councils in England are required to have regard to. Guidance produced by the Welsh Government mirrors the English guidance and Welsh authorities are required to 'have regard' to it. The guidance requires authorities to produce an investment strategy, which must be approved by the same body that approves the budget prior to the start of the financial year. It may be revised during the year, but must be approved again. Typically this forms part of an authority's overall treasury management strategy.

The guidance makes explicit the requirement to consider the investment policy in terms of '**Security – Liquidity – Yield... in that order!**'

The guidance defines a prudent investment policy as achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). Only when these two elements are satisfied should yield (the amount of return received) be considered.

An authority's investment strategy must define its approach to the use of both 'specified' and 'non-specified' investments. Specified investments are those which offer high security and liquidity and include investments with the UK government and other councils, and must be for less than one year and made in sterling. The strategy should deal in more detail with non-specified investments: identify the types of such investments, set a limit to the amounts held in them at any time in the year, and have guidelines for making decisions on such investments.

The strategy should be published and should also include the following:

- the use of credit ratings and of any additional sources of information on credit risk
- the use of treasury management advisers
- the investment of money borrowed in advance of spending needs
- the procedures for reviewing and addressing the needs of the authority's treasury management staff for training in investment management.

TREASURY MANAGEMENT STRATEGY

The scale of borrowing by councils, the interrelationship of capital and revenue cash management, and the fact that authorities may have surplus funds for investment require authorities to develop sound borrowing and investment strategies. It is a requirement of the *Treasury Management Code* that an organisation's full board or council receive an annual strategy prior to the start of the financial year. This usually incorporates government's investment strategy. This must be approved by the body that approves the budget.

The treasury management strategy will usually include an authority's policy statement in relation to treasury management. The *Treasury Management Code* recommends that an organisation's policy statement should include the following:

- the definition of treasury management as detailed in the Code
- that the successful management of risk is the prime criteria to measure the effectiveness of treasury management activities
- the acknowledgement that treasury management supports the business and service objectives and is hence committed to achieving value for money within effective risk management.

Authorities must have a treasury management strategy that encompasses all of these activities in a safe, efficient and consistent manner. The treasury management strategy needs to take into account:

- future capital and revenue cash flows
- the profile of the existing loan debt and the size and timing of debt repayments
- the availability of internal sources of finance, such as revenue reserves and capital receipts unapplied
- the extent to which any available monies should be invested
- alternative financing options, including borrowing and credit arrangements, and costs and benefits of each of these
- economic indicators and interest rate trends
- the risks associated with different investment and borrowing options
- the authority's policy on borrowing in advance of need
- the risk appetite of the organisation.

The strategy should also be scrutinised by the body or committee responsible for the scrutiny of treasury management.

TREASURY MANAGEMENT INDICATORS

There are four specific treasury management prudential indicators contained within the Treasury Management Guidance Notes for Local Authorities. Councils must set these annually and they must be approved by the body that approves the budget prior to the start of the financial year. Their purpose is to restrict the activity of the treasury function to within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. They are:

■ Interest rate exposure

This is set by the council for the forthcoming financial year and the following two financial years and sets upper limits to its exposures to the effects of changes in interest rates. The indicators relate to both fixed interest rates and variable interest rates and are referred to respectively as the upper limits on fixed interest rate and variable interest rate exposures. They may be expressed either as absolute amounts or as percentages and may be related to the authority's net interest or its net principal sum outstanding on its borrowing/investments.

The effect of setting these upper limits is to provide ranges within which the authority will manage its exposures to fixed and variable rates of interest. It is expected that for most authorities the interest rate exposure calculations will result in a positive figure. However, for councils that do not have borrowings, and for some other authorities with substantial cash investments, these calculations will result in a negative figure.

■ Maturity structures of borrowing

The council will set for the forthcoming financial year both upper and lower limits for the maturity structure of its borrowing.

■ Total principal funds invested for greater than 364 days

Where a council invests, or plans to invest, for periods longer than 364 days, it will set an upper limit for each forward financial year period for the maturing of such investments.

TREASURY MANAGEMENT INDICATORS WITHIN THE PRUDENTIAL CODE

In addition to the treasury management indicators within the Treasury Management Code, there are a number of external debt and treasury management indicators in CIPFA's *The Prudential Code for Capital Finance in Local Authorities*. They are:

■ Adoption of the CIPFA Treasury Management Code

The first treasury management indicator is that the council has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes*.

■ Authorised limit

This limit is set by the council for the forthcoming financial year and the following two financial years and is the maximum it can borrow. It is split between borrowing and other long-term liabilities such as finance leases or PFI liabilities.

■ Operational boundary

The operational boundary is set by the council for the forthcoming financial year and the following two financial years and is based on the authority's estimate of most likely, ie prudent, but not worst-case scenario. Risk analysis and risk management strategies should be taken into account. The operational boundary should equate to the maximum level of external debt projected by this estimate. Thus, the operational boundary links directly to the authority's plans for capital expenditure; its estimates of capital financing requirement; and its estimate of cash flow requirements for the year for all purposes. The operational boundary is a key management tool for in-year monitoring, although it will probably not be significant if the operational boundary is breached temporarily on occasions due to variations

in cash flow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate.

The authority will need to assure itself that these plans are affordable and prudent. The authorised limit will in addition need to provide headroom over and above the operational boundary sufficient, for example, for unusual cash movements.

■ **Actual external debt**

After the year-end, the closing balance for actual gross borrowing plus (separately) other long-term liabilities will be obtained directly from the council's balance sheet. This prudential indicator for actual external debt considers a single point in time and hence is only directly comparable to the authorised limit and the operational boundary at that point in time, although actual external debt during the year can be compared.

TREASURY MANAGEMENT PRACTICES

All public service organisations should have their own treasury management practices (TMPs). These detail the operational processes and procedures that the organisation has developed to ensure effective and efficient treasury practices.

There are 12 TMPs specified in the *Treasury Management Code* and all public sector organisations are expected to include those that are relevant to their treasury management powers and the scope of their activities as part of their detailed operational procedures. They cover the following:

■ **TMP1 Risk management**

This details how the following risks will be identified, monitored and controlled: credit and counterparty, liquidity, interest rate, exchange rate, refinancing, legal and regulatory, fraud, error and corruption, and contingency management and finally market risk management.

This is a key area for those charged with governance and for senior finance officers to be familiar with, and a particularly important area to scrutinise. It is essential that each public body is fully aware of the risks that it may be taking and the possible consequences.

■ **TMP2 Performance measurement**

This practice is to ascertain how performance will be measured and value for money ensured within an effective risk management framework.

■ **TMP3 Decision-making and analysis**

This details the processes to be undertaken when making treasury management decisions to ensure that the necessary checks and safeguards are in place.

■ **TMP4 Approved instruments, methods and techniques**

This provides clarity on which treasury management instruments, methods and techniques can be used.

■ **TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements**

This provides a clear statement of responsibilities for all involved in treasury management to ensure that appropriate controls such as the segregation of duties are in place.

■ TMP6 Reporting requirements and management information arrangements

This specifies the organisation's reporting including the minimum reports required to the body that approves the budget along with any additional internal reporting. Consideration should be given to the frequency of reporting, the level of detail and the level within the organisation.

■ TMP7 Budgeting, accounting and audit arrangements

In order to enhance accountability all the costs and revenues for treasury management should be brought together.

■ TMP8 Cash and cash flow management

The preparation of cash flow projections on a regular and timely basis provides a solid framework for effective cash management.

■ TMP9 Money laundering

This provides details of the processes an organisation has in place to identify and report potential money laundering.

■ TMP10 Training and qualifications

This details the arrangements in place to ensure that those responsible for treasury management (for both officers and those charged with governance) have the appropriate skills and knowledge to carry out their role effectively. The responsible finance officer should ensure that training is made available for those charged with governance.

■ TMP11 Use of external service providers

This covers the use of external providers and the services provided by them. How they are reviewed and monitored should be comprehensively documented.

■ TMP12 Corporate governance

This details how an organisation ensures that treasury management activities are undertaken with openness and transparency, honesty, integrity and accountability.

DAY-TO-DAY TREASURY MANAGEMENT

The responsibility for day-to-day management of the authority's cash flow, including both capital and revenue monies, rests with the chief finance officer. This responsibility cannot be held outside the authority. The chief finance officer's objective will be to perform that task at minimum cost to the authority while ensuring that any cash invested is secure against risk of loss and earning the optimum return achievable at minimum risk levels.

The chief finance officer's responsibilities in relation to the treasury management function are set out in CIPFA's *Standards of Professional Practice*.

The broad principles of revenue cash flow management are that:

- income should be collected as promptly as possible
- arrears should be monitored and action taken to recover outstanding amounts promptly
- payments to creditors should be managed within an agreed policy on payment periods
- surplus cash should be invested for an appropriate period to earn interest

- any borrowing that becomes necessary through unforeseen factors should be at minimum cost to the authority
- the funding transactions must be in accordance with the law and the authority's treasury management policy statement
- a proper assessment should be made of the risks associated with all of the activities.

CASH FLOW FORECASTS

The chief finance officer will need to forecast the authority's cash flow for at least 12 months ahead, having regard to:

- the dates on which salaries, wages and payments to contractors are due and the likely size of each payment
- the dates when major capital expenditure payments fall due
- the pattern of other spending throughout the year (including regular payments to contractors)
- the dates on which any loans are due for repayment and the amounts involved
- the dates on which major items of income are receivable, such as specific grants, housing subsidy, revenue support grant or instalments from the NDR pool
- the pattern of other income receipts throughout the year.

This gives the chief finance officer a broad picture of when the authority is likely to be borrowing from or lending to the money markets throughout the year. That broad picture needs to be monitored and fine-tuned every day.

At the start of the day, the authority's bank balance as at the close of the previous day's business should be ascertained. Many authorities have direct computer links to their bank and can look at their accounts on screen at all times. The chief finance officer or delegated officer will then estimate:

- the value of the payments that the authority will make during the day
- the income it is likely to receive during the day
- and then take a decision on the amount to be borrowed or lent on that day.

ROLE OF THE AUDITOR

Given the scale of council borrowing, both internal and external auditors have roles in relation to treasury management. In particular, they will want to ensure that:

- the authority has set down proper arrangements for its treasury management policy and for developing its treasury management strategy in accordance with the CIPFA TM Code
- proper checks are applied to all transactions
- cash management systems ensure security of the authority's monies
- cash management systems achieve cost effectiveness
- the authority complies with the law and proper accounting practices.

RISK MANAGEMENT

Risk management is the key element of treasury management. CIPFA's *Treasury Management Code* identifies nine treasury management risks which include interest rate risk; credit and counterparty risk (in terms of losing one's capital); refinancing risk; fraud and error; and market risk. The management of these risks is the key element of a council's treasury management activities.

The overall quantum of risks facing council treasury management had never been identified and the CIPFA Treasury Management Network decided to address this. Supported by the Treasury Management Panel, for a number of years they undertook an annual risk study to seek to identify the key risks facing councils.

On the investment side, the study revealed that councils were investing the majority of their funds on a short term basis. This short term nature brings a low risk of default and low liquidity risk, but reduces the likely income from the investment. This is consistent with the recommendations in both the CIPFA *Treasury Management Code* and the DCLG *Guidance on Local Government Investments* that priority should be given to security and liquidity and only once these are satisfied, yield.

The study showed that much of the existing borrowing by councils is long term and at fixed rates. This means that the costs of this borrowing are known, providing comfort for the section 151 officer when budget setting. There were a large number of authorities that had not borrowed up to their capital financing requirement (CFR), which is their underlying requirement to borrow or that amount of capital expenditure which is to be financed by borrowing or credit.

After the Icelandic banks crisis, concerns were raised that councils were borrowing significant sums in advance of when they needed the finance and in the meantime these sums were being invested, increasing the credit risk faced. The study shows that this is not currently the case, but more the opposite, meaning that temporarily surplus internal resources are being used initially to finance capital expenditure before borrowing externally.

This approach brings with it a different set of risks. There is a refinancing risk, ie that there may be insufficient finance available when an authority needs to borrow. There is also interest rate risk – that is, when the authority does come to borrow, there is a risk that interest rates may have risen, leading to an additional cost. Such a strategy is thus most appropriate when interest rates are expected to fall or at least remain static.

The refinancing risk is reduced by the availability of PWLB funding as the lender of last resort for councils. Historically PWLB funding was at attractive rates for councils; however the October 2010 spending review increased the PWLB rate in order to create a downward pressure on council borrowing and to make councils more market facing. This meant that those authorities that had delayed their borrowing would be paying more than they would have done had they borrowed pre-budget.

Some authorities have used market loans called 'lender option borrower option' (LOBOs). For these on certain dates the lender has the option to change the interest rate. The borrower then has the option to either pay the new rate or repay the loan. The associated interest rate risks are that the lender will increase the rates when general rates are high and then the

borrower will either be left with a high interest rate when rates fall, or have to refinance at a time when general interest rates are high. The study showed that there is a relatively small risk of these LOBOs being called and that interest rates would have to move significantly for this to be a major risk. This is because the option is of value to the lender. Typically LOBOs are considered a relatively inefficient form of long term borrowing and consideration should always be given to these longer term issues when planning treasury management strategies.

In 2012, CIPFA's Treasury and Capital Management Panel produced a *Treasury Risk Management Toolkit for Local Authorities*. Its aim is to provide a toolkit of techniques and reports that councils can use to identify, benchmark and manage their treasury risks. The toolkit proposes the following risk management methodology for treasury decision making:

- 1 establish the organisation's risk appetite
- 2 establish quantified risk benchmarks which represent the agreed risk appetite, against which to measure the level of risk in the portfolio
- 3 take treasury decisions and manage the portfolio, relative to the agreed risk benchmarks
- 4 review outcomes and performance relative to the risk benchmarks.

Unless an acceptable level of risk is defined and benchmarked in this way, authorities cannot know clearly what level of risk they are trying to manage to. The publication encourages authorities to develop their own liability benchmark as a means of managing debt risks. In this context, 'risk benchmarks' refers to the organisation setting its own measures or standards for risk monitoring and management; it does not mean benchmarks in the sense of comparative statements with other organisations.

The techniques and analysis in the publication aim to be practical and accessible, so that organisations can produce risk management reports in-house.

Organisations need to understand the treasury management risks they are exposed to and to be clear about the actions they can take to manage those risks. Some risks can be managed by using specific financial instruments known as derivatives. The corporate sector and some public sector organisations have used derivatives as a tool to manage treasury risks for many years, although this has not always been trouble-free.

Specific financial instruments can be effective tools to manage risk, but they are complex and introduce new and less obvious risks. So it is essential that any public sector organisation considering entering into such a transaction is able to demonstrate that it has made an informed decision. In 2013, CIPFA's Treasury and Capital Management Panel produced *Practical Considerations in Using Financial Instruments to Manage Risk in the Public Sector*. The purpose of this publication is to provide an introduction to the practical issues that a public sector organisation may face when considering using specific financial instruments to manage risk. It is intended to raise awareness of factors that will require further consideration and is not intended to be a definitive guidance document. While the publication does explore some of the legal issues, it is anticipated that organisations considering such instruments will seek appropriate legal and professional advice prior to deciding on whether they are an appropriate risk management tool.

FURTHER READING

Guidance for Smaller Public Service Organisations on the Application of the CIPFA Code of Practice for Treasury Management in the Public Services (2014 Edition), CIPFA, 2014

Guidance on Local Government Investments, DCLG, 2010

Guidance on Local Government Investments, Welsh Government, 2010

Local Authority Investments in Icelandic Banks as at 31 December 2008 (Revised), DCLG, 2009

Local Authority Investments Seventh Report of Session 2008-09, DCLG Select Committee, 2009

Local Authority Investments: The Role of the Financial Services Authority (Second Report of Session 2009-10), DCLG Select Committee, 2010

Local Government Act 2003

Practical Considerations in Using Financial Instruments to Manage Risk in the Public Sector, CIPFA, 2013

The Prudential Code for Capital Finance in Local Authorities (2011 Edition), CIPFA, 2011

Risk and Return: English Local Authorities and the Icelandic Banks, Audit Commission, 2009

Standards of Professional Practice, CIPFA, 2002

Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition), CIPFA, 2011

Treasury Risk Management Toolkit for Local Authorities, CIPFA, 2012

MODULE 5

Auditing

INTRODUCTION

There have been significant developments in recent years around the audit of local councils. Within external audit, the audit practice part of the Audit Commission has been outsourced and the government has abolished the Audit Commission. Local councils will have the ability to appoint their own auditors either from the 2017/18 or the 2020/21 financial year via 'auditor panels' that can be set up individually by councils or jointly between more than one authority.

Within internal audit, in 2013 the Relevant Internal Audit Standards Setters, of which CIPFA is the standard setter for local government, issued the first *Public Sector Internal Audit Standards*, which apply across the public sector and are based on the standards set by the global Institute of Internal Auditors. These are supplemented by CIPFA's own *Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards*, which is mandatory for the local government sector.

THE ROLE OF AUDIT

The role of audit is to provide an objective and independent review of the records, processes or functions of an organisation. The UN provides the following definition:

The overall purpose of an audit function is to provide for verification of records, processes or functions in a sufficiently independent manner from the institution or subject being audited in order to add its value and improve its operations. Specifically, its objectives are:

- *To independently identify information which is essential to develop an overall picture of the institution/local authority.*
- *To identify any weaknesses or administrative flows which otherwise would not be identified due to unwillingness or inability by insiders of the institutions.*
- *To identify strengths and weaknesses of the administrative structures in order to inform decisions on overall strengthening of the institution.*
- *To provide baselines on which reforms can be assessed.*
- *To provide the government (other governing bodies) and general public with credible information that result in public faith or trust of the institution and/or pressure for any reforms to address problems identified.*

Source: United Nations Anti-Corruption Toolkit, UNODC, 2002

Local councils have a framework of external and internal audit whose function is to provide assurance both to the public and to central government but also to the organisation itself that its management of resources is robust.

INTERNAL AUDIT

A professional, independent and objective internal audit service is one of the key elements of good governance in local government.

An effective internal audit service should:

- understand the whole organisation, its needs and objectives
- understand its position with respect to the organisation's other sources of assurance and plan its work accordingly
- be seen as a catalyst for improvement at the heart of the organisation
- add value and assist the organisation in achieving its objectives
- be forward looking – knowing where the organisation wishes to be and aware of the national agenda and its impact.

The foundation of an effective internal audit service is compliance with standards and proper practices.

Statutory requirements

In England, section 5(1) of the *Accounts and Audit Regulations 2015* states that '*a relevant body must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance*'.

In Scotland, section 7(1) of the *Local Authority Accounts (Scotland) Regulations 2014* set for the first time a statutory requirement for internal audit that '*a local authority must operate a professional and objective internal auditing service in accordance with recognised standards and practices in relation to internal auditing*'.

In Wales, section 7(1) of the *Accounts and Audit (Wales) Regulations 2014* state that '*a relevant body must maintain an adequate and effective system of internal audit of its accounting records and of its system of internal control*', although the regulations do not require the body to maintain an internal audit department.

While there is no specific statutory requirement for internal audit within local authorities in Northern Ireland, it is widely recognised that effective internal audit cover is good practice.

Public sector internal auditing standards

The UK Public Sector Internal Audit Standards

Across the UK public sector there are several groups who decide what standards the internal auditors should follow. These groups, collectively known as the Relevant Internal Audit Standard Setters,² have adopted a common set of *Public Sector Internal Audit Standards*

2. The Relevant Internal Audit Standard Setters are HM Treasury in respect of central government; the Scottish Government, the Department of Finance and Personnel Northern Ireland and the Welsh Government in respect of central government and the health sector in their administrations; the Department of Health in respect of the health sector in England (excluding foundation trusts); and CIPFA in respect of local government across the UK.

(PSIAS) from 1 April 2013. In doing so, they have adopted international standards for internal auditing because the PSIAS encompass the mandatory elements of the *International Professional Practices Framework* (IPPF) of the Global Institute of Internal Auditors (IIA Global). These are:

- Definition of Internal Auditing
- Code of Ethics
- International Standards for the Professional Practice of Internal Auditing (including interpretations and glossary).

The PSIAS apply to all public sector internal audit service providers, whether in-house, shared services or outsourced.

Definition of internal auditing

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

Source: The Institute of Internal Auditors

Code of Ethics

The Code of Ethics promotes an ethical, professional culture. It contains four principles: integrity, objectivity, confidentiality and competency, with rules of conduct relating to each.

The PSIAS also requires internal auditors to have regard to the Committee on Standards in Public Life's Seven Principles of Public Life – Selflessness, Integrity, Objectivity, Accountability, Openness, Honesty and Leadership.

The Code does not supersede or replace internal auditors' own professional bodies' codes of ethics or those of employing organisations.

International Standards for the Professional Practice of Internal Auditing

The PSIAS includes all of the standards as well as additional requirements and interpretations for the UK public sector.

There are two types of standard: attribute standards that set out the requirements for internal auditors and for the internal audit service; and performance standards that cover the work of internal audit and how it must be done. The main headings are:

- 1000 Purpose, Authority and Responsibility
- 1100 Independence and Objectivity
- 1200 Proficiency and Due Professional Care
- 1300 Quality Assurance and Improvement Programme
- 2000 Managing the Internal Audit Activity
- 2100 Nature of Work
- 2200 Engagement Planning
- 2300 Performing the Engagement

- 2400 Communicating Results
- 2500 Monitoring Progress
- 2600 Communicating the Acceptance of Risks

Local Government Application Note (LGAN) for the United Kingdom Public Sector Internal Audit Standards

CIPFA, in its role as the Relevant Internal Audit Standard Setter for local government, adopted the PSIAS and considered if there were any further requirements in the local government context. The *Local Government Application Note* sets out these further requirements and explains how some of the requirements of the PSIAS should be applied in practice.

For example, the PSIAS use certain terms to capture key concepts: board, senior management and chief audit executive among them. The LGAN gives further advice on how these terms should be used within local government:

As a result of the range of organisational options across local government, it is not possible to specify how individual local authorities should define 'board' or 'senior management'. It is expected that the audit committee, where one exists, will fulfil the role of the board in the majority of instances, but it is still the responsibility of each individual organisation to consider every occurrence of the term 'board' and 'senior management' within the PSIAS and decide which committee or other such group best fits the role in that situation, bearing in mind the need to preserve the independence and objectivity of the internal audit function.

The original IIA Standards use the term 'chief audit executive' throughout, and this has been fully adopted by the PSIAS, as well as in the Application Note. However, it is important to note that the term only describes a role and the PSIAS glossary states that the specific job title may vary across organisations. It is not the intention that organisations amend the job titles of all heads of internal audit (or other such titles) to 'chief audit executive'.

The LGAN also provides a tool to help a user assess an organisation's internal audit arrangements for the conformance with the PSIAS and the LGAN.

Leading an effective internal audit service

In recent years, CIPFA has issued two statements, one on the role of the chief financial officer (CFO) and one on the role of the head of internal audit (HIA) in local government. They each have something useful to say on the topic of leading internal audit.

The first states that the CFO must:

- ensure an effective internal audit function is resourced and maintained
- ensure that the authority has put in place effective arrangements for internal audit of the control environment
- support the authority's internal audit arrangements
- ensure that the audit committee receives the necessary advice and information, so that both functions can operate effectively.

Therefore, the role of the CFO in creating the right context for internal auditing is clearly of particular importance in local government. The CFO has a responsibility to establish

arrangements that are mature and robust enough to provide credible and constructive challenge to, amongst others, the CFO.

The second CIPFA statement, on the role of the HIA, adopts the following key principles:

The head of internal audit in a public service organisation plays a critical role in delivering the organisation's strategic objectives by:

- 1 *championing best practice in governance, objectively assessing the adequacy of governance and management of existing risks, commenting on responses to emerging risks and proposed developments; and*
- 2 *giving an objective and evidence based opinion on all aspects of governance, risk management and internal control.*

To perform this role the head of internal audit:

- 3 *must be a senior manager with regular and open engagement across the organisation, particularly with the leadership team and with the audit committee*
- 4 *must lead and direct an internal audit service that is resourced to be fit for purpose; and*
- 5 *must be professionally qualified and suitably experienced.*

Some of the key issues addressed in the statement are summarised below.

Coverage of internal audit

Internal auditing covers governance, management of risk and internal control, although it is not responsible for these areas. Its purpose is to help the organisation to achieve its objectives by evaluating and helping to improve these areas.

Good governance is fundamental to establishing confidence in public services. All managers have a responsibility for good governance but the HIA has a role in promoting this and spreading good practice. The leadership team collectively needs to set the tone that good governance is core to achieving strategic aims and demonstrating that public money is used well. The HIA is not responsible for good governance but they do have a role in helping to raise standards. This can be done by promoting the benefits of good governance as well as reporting on system failures. There are also benefits for the HIA in taking such an approach as this helps staff and others see the wider purpose of internal audit's work and the support that they can provide.

HIAs must review and make a judgement on the whole range of controls including those relating to achieving value for money and the prevention and detection of fraud and corruption. In reaching the judgement, the HIA might want to look at corporate arrangements, for example those regarding data quality and performance management arrangements. They may also want to test how these arrangements work by examining specific topics, for example major projects, decision making and implementation of programmes. Overall, internal audit's objectives must be aligned to the organisation's and should help improve the effectiveness of public service delivery.

There can often be many agencies reviewing controls within organisations. Internally there may be management consultants reviewing operational management. Externally there is a range of inspectors and other review agencies and service delivery partners. The HIA must understand the governance arrangements and assess the strengths of each of the parts.

They then need to set out what reliance has been placed on the different elements and why they believe the reliance to be well placed. Setting out this framework should also help in explaining to others how internal audit fits into the wider governance picture.

The HIA needs to give the organisation a range of assurances, including reports on specific systems or work areas, new or developing systems (and the risks in areas being considered), partnerships and the overall annual opinion.

The annual HIA opinion is the most important output from the HIA. This is one of the main sources of objective assurance that chief executives have for their annual governance report. This opinion must reflect the work done during the year and it must summarise the main findings and conclusions together with any specific concerns the HIA has. Audit planning must be comprehensive and consider the whole control environment, so that the opinion is based on a picture of the whole organisation. The audit work should address key risk areas and draw attention to significant concerns and what needs to be done. The HIA must express concerns where they exist.

Role and resources available to internal audit

HIAs face increasing challenges and higher expectations from stakeholders, especially in helping organisations look forward. The HIA must be at the heart of the organisation, challenging and supporting the leadership team with authority and credibility. He or she should also be seen as a leader, promoting improvement and good governance. To do this effectively, making an impact and adding value, the HIA position must be a senior manager.

The PSIAS requires that the HIA must report to a level within the organisation that allows internal audit to fulfil its responsibilities, which includes having a functional reporting line to the board. This demonstrates how important it is to decide who or what body will fulfil the role of 'board' for the different standards. What is paramount is that the reporting line must leave the HIA free from interference in setting the scope of internal audit's work, in coming to conclusions and in reporting the results. They must also have unfettered access across the organisation, especially to the chief executive, the board and the audit committee chair. In practice this is most likely to be achieved by the HIA reporting to the chief executive or to the chief financial officer.

The HIA role must be filled by a nominated individual so that all are clear about lines of responsibility. Where the service is provided in-house this should be straightforward. Where the service is contracted out or shared with others, then the organisation must decide whether the HIA should come from within the organisation or from the supplier of the audit service. In the latter case the relationship between the HIA and the organisation, including the audit committee, must be clearly set out as part of the organisation's governance framework. In practice it is likely that the HIA should be the person who is responsible for drawing up the internal audit charter and plan and for issuing the HIA annual internal audit opinion.

The leadership team in public service organisations takes many forms, with different mixes of executive and non-executive members, as well as elected representatives. Collectively the leadership team is responsible for setting the strategic direction for the organisation, its implementation and the delivery of public services. The HIA must also have a right of

access to individual members of the leadership team and as a minimum, it is vital that the HIA attends key meetings where they consider it necessary. The HIA should be well placed to support the leadership team in understanding the governance, risk management and control arrangements. Examples of this might include presenting the internal audit plan or the annual internal audit opinion or taking part in discussions about the annual governance report or planned major policies, projects or system changes.

The HIA's relationship with the audit committee, especially the chair, is crucial. They should be mutually supportive in their aim to be objective and to provide challenge and support across the organisation and improve governance, risk management and internal control. The HIA must work closely with the audit committee chair so that they are clear about their respective roles and make best use of the available resources. For some areas of the public services it may be appropriate for the audit committee chair to have a role in the appointment and performance appraisal of the HIA.

The internal audit resources available must be proportionate to the size, complexity and risk profile of the organisation and must be enough for the HIA to give a reliable opinion on the organisation's control environment. Responsibility for ensuring that an effective and appropriately resourced internal audit service is in place rests with the organisation. The organisation needs independent assurance over the quality of internal audit's work and should ensure that a regular external assessment is carried out. The PSIAS and LGAN require a comprehensive quality assurance and improvement programme that includes regular self-assessments of quality and an external assessment at least every five years.

A great deal of reliance is placed on the work of internal audit and the HIA must ensure that all the work, including planning and individual assignments, is consistently of a high quality and in line with professional standards. The HIA must also ensure that all staff demonstrate the highest ethical standards. The HIA therefore has a responsibility to ensure that internal audit staff have appropriate qualifications, knowledge, skills and competencies and are continuously developed. The HIA must assess the staffing needed to make sound judgements on the whole range of the organisation's governance arrangements and is required by the PSIAS to inform the board if he or she believes that the level of agreed resources will be insufficient to carry out the work needed to support the annual internal audit opinion.

STEWARDSHIP AND EXTERNAL REPORTING

Information is more readily available now than ever before and the ways in which we access it have also changed significantly, given developments in such areas as real-time news reporting, the internet, mobile phones, mobile broadband and instant messaging. As a result, authorities face increased expectations on the part of residents and taxpayers.

This section describes the key legislative requirements in respect of authorities' stewardship and external reporting responsibilities, including access to information. It also covers how authorities communicate with residents in the 21st century.

The current government on coming to office made it clear that transparency was to be a key feature of its policies toward local government. We have had the requirement to publish all spending data above £500, increased disclosures on senior officer pay and the promotion of the idea of the 'armchair auditor', whereby local residents are to be encouraged to challenge

the spending of local authorities. The *Open Public Services* White Paper continued this theme although many of its proposals are yet to be brought to fruition.

Formal requirements

Elected members and the local press have traditionally made sure that news of a local authority's activities reaches a wide audience, and this has been reinforced by statutory requirements on a local authority to publish information.

The *Local Government Act 1982* requires the publication of annual accounts. The *Accounts and Audit Regulations* made under the Act specify their contents and procedures for notifying the public, and this is described in further detail below.

Prescribed information, showing how the council tax bill is calculated, must be published with the accounts, and figures showing how much services are expected to cost have to be included.

The *Freedom of Information Act 2000* gives the public a general right of access to information held by public bodies – subject to exemptions primarily to protect confidential information.

The *Local Government Act 2000* makes it clear that local authority executives and/or their committees may decide which of their meetings should be open to the public and which should be held in private, but:

- If meetings are held in private, written records must be kept of the decisions taken at these meetings – and the reasons for those decisions. With the exception of prescribed information, the records must be open to the public.
- Background papers which support reports made to a principal council must also be available for inspection.

Accounts of a local authority

The principal legislation relating to the keeping of local authority accounts is contained in Part III of the *Local Government Finance Act 1982* and Part IV of the *Local Government and Housing Act 1989*.

The SORP recommended the form and content of local authority accounts and constituted a '*proper accounting practice*' under the terms of the *Local Government and Housing Act 1989*. The code of practice was endorsed as a statement of recommended practice by the independent Accounting Standards Board, and was an essential reference point for local authorities when preparing their final accounts, as well as for the external auditors. In 2010 the SORP was replaced by a new *Code of Practice on Local Authority Accounting in the United Kingdom* (the Code), the first to be based on IFRS rather than UK GAAP, which was a significant development in local authority accounting. The new Code had effect for financial years commencing on or after 1 April 2010.

The Code specifies the principles and practices of accounting required to prepare a statement of accounts which gives a true and fair view of the financial position and transactions of a local authority.

At the same time as the introduction of the Code, CIPFA's *Best Value Accounting Code of Practice*, which provided the guidance on financial reporting to stakeholders required by the

Local Government Act 1999, was replaced by the *Service Reporting Code of Practice for Local Authorities (SeRCOP)*.

Accounts and audit regulations

These regulations, made under the 1982 Act, include specific requirements for the content of an authority's published financial statements, the necessary accounting records and control systems, the signing, approval and amendment of accounts and provisions for public inspection. The current regulations, in England, are the *Accounts and Audit Regulations 2015*, which came into effect from 31 March 2015, and in Wales, the *Accounts and Audit (Wales) Regulations 2014*. They apply to most local government organisations, including local authorities, joint authorities, police authorities, parish and community councils, combined fire authorities, national parks authorities, probation committees and port health authorities.

The regulations place particular responsibilities on the officer responsible for the administration of financial affairs, which reinforce those imposed by section 151 of the *Local Government Act 1972* and section 114 of the *Local Government Finance Act 1988*.

The detailed regulations are slightly different for some types of authority. Accordingly, this section concentrates on the more stringent main provisions applying to local authorities, joint authorities, police authorities, combined fire authorities and national parks authorities. The requirements for parish and town councils are dealt with in the National Association of Local Councils/Audit Commission publication *Governance and Accountability in Local Councils in England and Wales: A Practitioners' Guide*, last updated in March 2014.

Publication of the financial statements

The chief finance officer must prepare, sign, date and certify that the accounts present a true and fair view of the financial position of the authority at the end of the period and activities during the period covered. The certified statement of accounts then has to be approved by a meeting of the authority, or one of its committees.

A larger authority must publish the statement of accounts together with any certificate or opinion, the approved annual governance statement and narrative statement no later than by 31 July following the end of the financial year to which the accounts relate.

Where the annual external audit has not been completed by 31 July, the authority must publish a notice (which must include publication on the authority's website) as soon as reasonably possible on or after that date stating that it has not been able to publish the statement of accounts and its reasons for this; and then publish the required documents as soon as reasonably practicable after receiving the auditor's report.

A smaller authority (as defined in the *Local Audit and Accountability Act 2014*) must publish the statement of accounts together with any certificate or opinion and the annual governance statement by 30 September following the end of the financial year to which the accounts relate.

Non-compliance with the requirements for publication constitutes an offence.

Public inspection

In addition to the information that has to be published in connection with an authority's accounts, electors have the right to inspect the accounts of their authority and to question the external auditor. The auditor has to appoint a date on or after which those rights may be exercised. The accounts and other relevant documents are to be available for public inspection for 20 working days before the date appointed (previously it was 15 days).

The right of access extends to most local authority documents, although access to information that would give the enquirer some unfair commercial advantage or would disclose information collected on a confidential basis is restricted. Cases of difficulty are resolved by application to the courts.

The Audit Commission has prepared a note of guidance for those who wish to inspect the accounts of an authority. The note explains that an auditor's powers do not extend to questioning the policy of the local authority, provided that the policy is within the law.

The authority must publish a notice advertising the availability of accounts for inspection, which should specify:

- the period during which documents are available for inspection
- the place and times that documents will be available
- the name and address of the auditor
- the rights of the public to inspect and challenge the accounts
- the date from which electors may approach the auditor to query the accounts.

The authority must then formally notify the auditor that the notice has been advertised. No alteration may be made to the accounts from the date that they go on public inspection without the auditor's consent. If the authority does not make the accounts and supporting documents available for inspection, does not comply with the provisions for notifying electors, fails to notify the auditor or makes alterations without the auditor's consent, it commits an offence.

On conclusion of the audit, the authority must give a notice advertising the fact, and notifying electors that the final statement of accounts is available for inspection. If the auditor has required amendment to the accounts since the earlier period of inspection, the authority can choose to represent these as a statement of the amendments required, or place a revised version of the accounts for public inspection. If it chooses the latter option, the accounts must be accompanied by:

- an explanation of the material alterations that have been made
- a statement that the accounts have been prepared as at the original date of the document
- a statement of electors' rights to inspect the statement of accounts and auditor's report
- the place and times that the accounts and auditor's report are available for inspection.

It must then notify the auditor that this has been done. Joint committees, joint boards and combined authorities must also ensure that a copy of the auditor's report is deposited with constituent authorities within 14 days of conclusion of the audit.

As soon as reasonably possible after it is received, authorities must publish the annual audit letter received from the auditor, and make copies available for purchase by any person.

An auditor may, under schedule 7 of the *Local Audit and Accountability Act 2014*, make a report in the public interest on any matters coming to their notice during an audit which they consider should be brought to the attention of the public. A report may be made at the conclusion of an audit, or where the auditor considers it appropriate the matter may be made the subject of an immediate report.

An auditor must notify an authority's auditor panel (see below) as soon as is '*reasonably practicable*' after making a public interest report relating to the authority. The authority must consider public interest reports and any recommendations at a meeting within one month of the report or recommendation being sent to it and decide at that meeting what action needs to be taken.

Where an audited body receives an immediate report, any member of the public may inspect the report, make copies or require the body to supply a copy of the report, or any part of it, on payment of a reasonable fee. The auditor may also notify any person that he or she has made a report and supply a copy or any part of it to any person he or she thinks fit.

Freedom of Information Act 2000

The *Freedom of Information Act 2000* fundamentally changed the way in which councils provide information to the public, and the extent of the information that individuals can rightfully expect. Councils must treat every written request for information, whether it mentions the *Freedom of Information Act 2000* or not, as a request made under the Act, and process these requests in accordance with the requirements of the legislation.

The provisions in the *Freedom of Information Act 2000* specify that nothing in the Act limits the existing powers of public authorities to disclose information held by them. Therefore local authorities must continue to publish information that they are otherwise required by law to publish.

Under freedom of information, the essential approach is that any person will have a general right to see any information that is held by the council. Local authorities can decide to withhold certain types of information, for example if it relates to information provided in confidence or personal information about a third party. However, in most of these cases, the council will not be able automatically to withhold information – if they want to do so, they have to be able to prove that it is in the public interest to do so. They will need to be able to justify such a decision to the independent information commissioner.

The access to information regulations signified the following changes in the access to information regime:

- applying the regime to the executive decision-making process
- creating a general principle that the public should have access to meetings, documents and decisions where the decision to be taken is a key decision
- key decisions are defined as executive decisions that are likely to result in the local authority incurring expenditure or making a saving which is significant when having regard to the local authority's budget for the service or function to which the decision

relates; or to be significant in terms of its effects on communities within two or more wards

- requiring local authorities to produce a forward plan laying out the key decisions to be taken in the following four months, and for this to be regularly updated.

Both officers and members will be the first point of contact for members of the public seeking information. There will therefore be an imperative need for both members and staff in local authorities involved with the provision of information to be aware of the Act, its scope and the processes which they need to follow.

The general right of access to information came into force with regard to all public authorities, including local authorities, in January 2005.

Information Commissioner's Office

The Information Commissioner's Office (ICO) is the UK's independent public body set up to promote access to official information and to protect personal information. It regulates and enforces the *Data Protection Act 1998*, the *Freedom of Information Act 2000*, the *Privacy and Electronic Communications Regulations (EC Directive)* (amended 2004 and 2011), the *Environmental Information Regulations 2004* and the *INSPIRE Regulations 2009*.

The ICO provides guidance to organisations and individuals and rules on eligible complaints and can take action when the law is broken. Reporting directly to parliament, the commissioner's powers include the ability to order compliance, using enforcement and decision notices and prosecution.

The ICO approves publication schemes, which are guides to the information a public authority publishes routinely or intends to publish routinely. It is a schedule of commitments to make information available in accordance with what the publication scheme says. Under the *Freedom of Information Act 2000* every local authority has a statutory duty to:

- adopt and maintain a scheme which relates to the publication of information by the authority and to have that scheme approved by the commissioner
- publish information in accordance with the scheme
- from time to time, review the scheme.

Where a large number of public authorities all perform very similar functions, the *Freedom of Information Act 2000* allows for model schemes to be developed. The model schemes contain predefined classes of information with fairly general titles, as well as standard information about charging and manner of publication. Once a model scheme has been approved by the information commissioner, it may be adopted by the public authorities it was designed for. There is no need for those adopting the model scheme to submit their scheme for approval from the information commissioner, as long as they do not make changes to the model.

Model publication schemes that have been approved by the information commissioner are listed below. Each model scheme has been designed for a particular group of public authorities and may be adopted by the authorities from that group. When necessary, the model schemes are accompanied by explanatory notes. The approved model schemes are:

- District Drainage Commissioners Model Scheme

- Fire Authorities Model Scheme
- Internal Drainage Boards Model Scheme
- Parish & Town and Community Councils Model Scheme
- Parish Meetings Model Scheme
- Passenger Transport Authorities Model Scheme
- Port Health Authorities Model Scheme.

The ICO has published a number of guidance documents on publication schemes which can be found on its website.

Local authorities operating executive arrangements under the *Local Government Act 2000* are required under the *Access to Information Regulations* to produce a forward plan setting out key decisions to be taken in the following four months. Local authorities will want to think carefully about the relationship between their forward plan and their publication scheme, bearing in mind the different purposes and legal basis of each, and ensuring consistency between them.

Records management

A successful records management strategy will be crucial for local authorities to deliver access rights and generally to be successful in the implementation of the *Freedom of Information Act 2000*. Section 46 of the Act requires the Lord Chancellor to issue a code of practice on the management of records. The Code was published in 2002 but fully revised and reissued in 2009. The National Archives have also produced guidance specific to local government for developing records management compliant with the Code. This is a step-by-step guide to what local authorities should be doing in order to ensure compliance.

Improving financial literacy in public service organisations

Board members and business managers carry big responsibilities for the health and effectiveness of the organisations they lead and manage. Squeezing out the maximum quantity and quality of public services from the finance they have at their disposal is what value for money is all about. Successful organisations acknowledge the need for good financial management and recognise its fundamental importance to maximising performance.

However, it is not always clear what is expected from the people on the board or heading service units, or what financial management competencies they need to do their jobs. The *CIPFA FM Model* sets out some core principles: that financial management is the business of the whole organisation, not just finance staff, and that it requires a tone set from the top, sound processes, competent and motivated people and attention to the needs of stakeholders. Financial responsibilities can often be widely diffused. Board members are the focus of public accountability but they need managers to be financially literate and they need finance professionals to contribute challenge, interpretation and advice. Good financial management is therefore an organisational discipline, a key to value for money, and an enabler for service improvement.

This is also the message of the Audit Commission's 2005 discussion document *World Class Financial Management*, which describes the three key groups with responsibility for financial management as:

- Top management – the board or its equivalent. *'All members of the top management team, both executive and non-executive, need to accept individual and collective responsibility for the stewardship and use of resources and for financial accountability to external stakeholders.'*
- Managers – non-financial business managers. *'Managers remain accountable for the financial performance of their own service area – basic financial literacy and competencies are essential if managers are to understand the financial consequences of any decision they take.'*
- Finance teams – finance professionals. *'An excellent finance team is essential – the finance team has a role in supporting and advising managers on financial matters and robust quality assurance arrangements should cover all aspects of the work of the finance function.'*

CIPFA's *Improving Financial Literacy in Public Service Organisations: A Good Practice Resource Pack* (2008) has been developed to support excellence in financial management for two of these groups: the board, or its equivalent, and managers. There are two elements for each group:

- a briefing, so that individuals can test their understanding of their role in financial management and can identify development areas
- a competency framework for financial management skills and knowledge for the organisation to use as one element of its overall competency suite.

The transparency agenda

Councils are required to publish all expenditure over £500 to encourage 'armchair auditors', members of the public with an interest in council finances who are prepared to question councils over what they spend. In February 2015, DCLG published its latest version of *The Local Government Transparency Code*, which councils are required to follow.

The code requires councils to publish the following data:

- expenditure over £500
- government procurement card transactions
- procurement information about tenders for contracts; and contracts, commissioned activity, purchase orders, framework agreements and any other legally enforceable agreement in relation to the provision of goods and/or services with a value that exceeds £5,000
- information on public land and buildings
- information on social housing asset value (details on the value of social housing assets within local authorities' Housing Revenue Account)
- grants to voluntary, community and social enterprise organisations

- an organisational chart of the staff structure of the council including salary bands and details of currently vacant posts
- information on trade union facility time including the number of staff who are union representatives, the number of staff who devote at least 50% of their time to union duties and the names of the trade unions represented
- income and expenditure on the authority's parking account including details of revenue collected from on-street parking, off-street parking and penalty charge notices and an analysis of how any surplus on the parking account has been spent
- information on parking spaces including the number of marked-out controlled on- and off-street parking spaces within their area
- information on senior employee salaries,
- information on the council's constitution
- the 'pay multiple' – the ratio between the highest paid salary and the median average salary of the whole of the council's workforce
- information about the council's counter-fraud work and the measures in place to combat fraud.

This data should be published on the council's website and in a format that is as widely usable as possible.

Audit committees

Guidance from CIPFA in 2013, *Audit Committees: Practical Guidance for Local Authorities and Police*, encouraged local authorities to put in place an audit committee where they did not have one and helped those with established committees to make them more effective.

Audit committees are a key aspect of good corporate governance; they help raise the profile of internal control, risk management and financial reporting issues within an organisation, as well as providing a forum for the discussion of issues raised by internal and external auditors. They help to support the internal auditor so that they are able to be as effective as possible. They have a role in reviewing the annual governance statement and ensuring that it is an accurate assessment of the authority's governance framework and control systems and that action plans address all the problem areas that have been identified. An effective audit committee can enhance public trust and confidence in the financial governance of an organisation.

Ideally, audit committees should be separate from executive and scrutiny arrangements, and chaired independently from both these functions. Local authorities may organise their committee functions differently, but what is important is that the functions of an audit committee are delivered efficiently and effectively.

Status and independence are important, but being effective also means having well informed people able to confirm to the council that the right processes are in place to give confidence that the local authority's financial stewardship and overall governance arrangements can be relied upon. CIPFA's guidance provides valuable advice on the skills required by members, their selection and training, and how committees should be supported.

Audit committees are not just the concern of auditors; they are about the governance, financial reporting and performance of the whole organisation.

EXTERNAL SCRUTINY

This section describes the current legislative requirements in relation to the external scrutiny of authorities. The main focus is on external audit and the requirements of the NAO's 2015 *Code of Audit Practice*.³ This section also covers recent changes to the audit of local authorities for England. Brief summaries are also provided on the role of the ombudsman and the freedom of information legislation.

External audit

The *Local Government Finance Act 1982*, as amended by the *Local Government Finance Act 1988*, the *Audit Commission Act 1998*, the *Local Government Act 1999*, the *Local Government Act 2000* and the *Local Government Act 2003*, set out the legislative framework for the audit of local authorities in England and Wales. The 1982 Act set up the Audit Commission for England and Wales, which was responsible for appointing auditors to each local authority and other public bodies.

Because of the special accountabilities attached to public money and the conduct of public business, external audit in local government and the NHS was historically characterised by three distinct features:

- auditors are appointed independently from the bodies being audited
- the scope of auditors' work is extended to cover not only the audit of financial statements, but also the financial aspects of corporate governance, and aspects of performance management
- auditors may report aspects of their work widely to the public and other key stakeholders.

These features were consistent with the principles of public audit as defined by the Public Audit Forum, which comprises all the national audit agencies in the UK.

Local audit in England

On 13 August 2010, the secretary of state for communities and local government announced plans to disband the Audit Commission and refocus the audit of local public bodies on helping residents to hold those bodies to account for local spending decisions. The *Local Audit and Accountability Act 2014* formally abolished the Audit Commission and established new arrangements for the audit and accountability of local government bodies in England.

The Act sets out a statutory framework for maintaining audit quality, overseen by the National Audit Office and the accountancy profession and, importantly, it requires local audit bodies to establish auditor panels to appoint their external auditor. This replaces the

3. The Comptroller and Auditor General (C&AG) has legal responsibility for the production and maintenance of the *Code of Audit Practice*. The NAO undertakes operational work in respect of the Code on behalf of the C&AG and is the body that readers of this guide should engage with on Code-related matters. This guide refers to 'the NAO's *Code of Audit Practice*' throughout.

independent process of commissioning of external auditors that was previously carried out by the Audit Commission.

Appointment of auditors

Local public bodies include not only those bodies in the local government sector (for example local authorities, police and crime commissioners, and chief constables) but also includes parts of the NHS (for example clinical commissioning groups and special trustees for hospitals).

When existing audit contracts come to an end, these local public bodies will be responsible for appointing their own local auditors. The first of these new contracts are expected to start in 2017, so the procurement process will need to take place in 2016 and CIPFA and DCLG will be issuing guidance for local government bodies later in 2015.

This appointment must be made taking into account the advice of the authority's auditor panel.

Auditor panels

When the government consulted on the future of local audit, a number of responses (CIPFA's included) suggested that it would be more appropriate to strengthen the current audit committee arrangements than to introduce new auditor panels. However, DCLG has not wavered from its intention to introduce new, independent panels, and this requirement is included in the Act.

For local authorities, the Act requires the majority (or all) of the auditor panel members – including the chair – to be independent. 'Independence' is further defined in the *Local Audit (Auditor Panel Independence) Regulations 2014*, summarised as follows:

The main areas through which independence may be impaired are where the panel member has:

- previous experience within the last five years as a member or officer with the authority or another, connected authority or an officer or employee of a connected entity
- a relationship (familial or friendship) with a member or officer of the authority or a connected authority or with an officer or employee of a connected entity
- a contractual (commercial) relationship with the authority – either as an individual or via a body in which the panel member has a 'beneficial interest'
- a possible conflict of interest through being a prospective or current auditor of the authority or, within the previous five years, is or has been:
 - an employee of such a person
 - partner in a firm, or
 - director of a body corporate

that is a prospective or current auditor of the authority at the given time.

The Act and regulations do not have any requirements for the skills or experience needed by auditor panel members. More guidance on this area will be included in the CIPFA/DCLG auditor panel guidance that will be published in 2015, if authorities are required to appoint

their own auditors for the 2017/18 financial year, or 2018 if the existing audit contracts are extended to 2020.

The Act permits existing audit committees to take on the role of an auditor panel, providing the independence criteria are met. The auditor panel could also be a sub-committee of the audit committee, which might address some authorities' concerns over having a local authority committee made up of mostly independent members. Other options include sharing an auditor panel with one or more other authorities.

Auditor panels have a duty to advise authorities on the selection and appointment of local auditors, although authorities are not bound to accept that advice. Where they do not follow the advice of their auditor panel, they will need to publish their reasons for choosing a different auditor.

The future of local audit – Wales

On 12 July 2011, the first minister made a statement on the Welsh Government's legislative programme in which he announced its intention to introduce a Bill in the 2011/12 session of the National Assembly for Wales to establish arrangements for more effective accountability, governance and oversight of the Auditor General for Wales (AGW) and the AGW's Office.

In July 2012, the draft Bill was introduced, setting out the proposed new arrangements for the Wales Audit Office. The Bill was passed into law in April 2013. The overall intention of the Act is to strengthen and improve the accountability and governance arrangements relating to the AGW and the Wales Audit Office (WAO).

The Act transfers employer, financial and other administrative functions from the current AGW and vests them in the new WAO, which will report to and be scrutinised by the Public Accounts Committee (PAC), which in turn will report to the Assembly. The Act retains the AGW's independence from the Assembly and the Welsh Government and provides, as now, for the new AGW to be appointed by Her Majesty on the recommendation of the Assembly and for the new AGW to continue as a corporation sole.

The main provisions in the Act include the establishment of the new WAO as a body corporate with seven members. Most are non-executive members appointed by the Assembly's PAC on merit through open and fair competition. The new AGW is automatically the chief executive officer and a member of the new WAO, and one employee member is appointed by the non-executive members.

The new WAO is responsible for all the corporate-type functions currently vested in the AGW, the intention being to ensure that such powers would no longer rest solely in the hands of one individual. The new WAO has a duty to monitor and a power to advise the new AGW; employs staff; secures the provision of services; and holds property for the purposes of carrying out its functions and those of the new AGW.

Duties of the external auditor

The basic duties of the external auditor are set out in section 20 of the *Local Audit and Accountability Act 2014*, under which auditors need to satisfy themselves that:

- (a) the accounts comply with the requirements of the legislation that apply to them

- (b) proper practices have been observed in the preparation of the accounts and that the statement presents a 'true and fair view'
- (c) the body whose accounts are being audited has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

In performing these functions the auditor shall comply with the *Code of Audit Practice* published and maintained by the Audit Commission, which applies until the end of the 2014/15 financial year. The Code specifies in further detail the external auditor's objectives when conducting an independent assessment of an authority. These objectives include assessment of:

- whether or not the statement of accounts presents a true and fair view of the financial position of the authority and its income and expenditure for the year in question and complies with the legal requirements
- the authority's arrangements for achieving value for money from its resources
- the general financial standing of the authority
- the council's financial systems
- fraud prevention and detection arrangements ensuring the legality of transactions
- arrangements for collecting, recording and publishing information on performance required by statute.

Code of Audit Practice

The responsibilities of auditors are derived from statute, principally the *Local Audit and Accountability Act 2014* and from the NAO *Code of Audit Practice*. All auditors appointed under the Act are obliged to comply with the National Audit Office's Code, which came into force on 1 April 2015, when conducting audits. The Code, which requires Parliament's approval, prescribes the way in which auditors are to fulfil their functions under the Act and embodies what, in the NAO's view, is the best professional practice with respect to the standards, procedures and techniques to be adopted by auditors.

The *Code of Audit Practice* defines the scope, nature and extent of local audit work. The NAO has a statutory duty to prepare, and keep under review, a code of audit practice prescribing the way in which auditors must carry out their functions under the *Local Audit and Accountability Act 2014*. The Code embodies what the NAO considers to be the best professional practice with respect to the standards, procedures and techniques to be adopted by auditors.

The Code has to be approved by both Houses of Parliament at five-yearly intervals and auditors have a statutory duty to comply with it. As such, it constitutes secondary legislation, and the way it is drafted and the process for reviewing and revising it reflects this.

The Code:

- sets out the general principles that should underpin the conduct and work of the auditor in discharging their statutory duties
- outlines auditors' responsibilities regarding the audit of financial statements and value for money work

- sets out auditors' statutory duties with respect to the range of outputs for reporting the results of their work.

The Code also outlines how auditors should carry out their additional powers and duties, which include:

- to give electors the opportunity to raise questions about the accounts and consider and decide upon objections received in relation to the accounts
- to apply to the court for a declaration that an item of account is contrary to law
- to consider whether to issue and, if appropriate, to issue an advisory notice or to make an application for judicial review.

The NAO will produce advice to explain the powers of the auditor, help members of the public understand their rights to inspect, and help local objectors to question and object to local government bodies' accounts.

A schedule to the Code outlines the distinct approach to the audit of smaller authorities, such as small parish councils, to which it is inappropriate to apply the same level of audit scrutiny as principal bodies because of the relatively small amounts of public money controlled by the bodies in question.

The results of audit work are communicated in a range of reports:

- The audit planning document, which sets out how auditors intend to carry out their responsibilities, in accordance with auditing standards and other relevant guidance.
- Reports to those charged with governance on the completion of audit fieldwork on the following areas:
 - the results of their audit of the financial statements, consistent with the requirements of auditing standards
 - the results of their work in respect of the audited body's arrangements to secure value for money through the economic, efficient and effective use of its resources
 - the results of any additional work undertaken in accordance with their statutory powers and duties.
- At the conclusion of the financial statement audit, the auditor must also publish:
- An audit report, which should cover:
 - the results of their audit of the financial statements,
 - the results of their work in respect of the audited body's arrangements to secure value for money
 - the results of any additional work undertaken in accordance with their statutory powers and duties.
- An audit completion certificate, the effect of which is to close the audit.
- An annual audit letter, which should provide a clear, readily understandable commentary on the results of the auditor's work and highlight any issues that the auditor wishes to draw to the attention of the public.
- A statement on consolidation schedules, which sets out whether any schedules or returns the audited body is required to produce for the purposes of preparing consolidated accounts are consistent with the audited body's financial statements.

Other reports may be issued at any point during the audit process, where appropriate.

Schedule 7, section 1 of the *Local Audit and Accountability Act 2014* requires auditors to consider whether, in the public interest, they should report on any matter that comes to their attention in the course of the audit so that it may be considered by the body concerned or brought to the attention of the public.

Under section 2 of the same schedule, auditors of local government bodies may make written recommendations that need to be considered and responded to publicly. Where the auditor considers it necessary to make such recommendations, these can be included, where relevant, within other written outputs from the audit or they may be the subject of a specific report to the audited body.

The Code explicitly recognises that local authorities increasingly operate, commission and deliver services in a range of partnerships and other forms of joint working or contracts with other public, private or third sector bodies. It states that auditors should therefore consider how best to obtain assurance over such arrangements, working effectively with other auditors where appropriate.

Legality

The external auditor has particular duties in relation to questions of legality, losses due to misconduct and rights of challenge to the accounts. To fulfil these duties, the auditor has access to all documents as appear necessary for the purposes of the audit.

The *Local Government Act 2000* made important changes to the external auditor's powers.

Where it appears that any item of account is contrary to law, the auditor may still apply to the court for a declaration that the item is contrary to law. However, under section 90 of the 2000 Act, the Adjudication Panel, rather than the auditor, will determine whether there has been misconduct – and any issue would then be pursued under the provisions of Part III of the 2000 Act.

With regard to questions of legality, auditors may decide:

- that the audited body should consider formally, and respond to in public, recommendations made in an audit report
- to issue an advisory notice or to apply to the court for a declaration that an item of account is unlawful, if they have reason to believe that unlawful expenditure has been or is about to be incurred by an audited body
- to apply for judicial review with respect to a decision of an audited body or a failure of an audited body to act, which it is reasonable to believe would have an effect on the accounts of that body.

The auditor must send a copy of any advisory note to the authority or the officer concerned – and the body or officer must give the external auditor the number of days' notice (required by the auditor) of the intention to proceed with the decision or action which led to the issue of the advisory notice. The notice period may not exceed 21 days.

The issue of the advisory notice gives the external auditor time to seek the courts' opinion on the legality of the proposed decision or course of action.

The Act requires an authority which receives an advisory notice to consider that notice. If the authority nevertheless wishes to proceed with the decision or course of action, it may not do so within the notice period. The authority may only proceed with the decision or course of action if:

- the court decides that the decision/action would be lawful, or
- the auditor does not seek the court's opinion on the legality of the proposed decision or action within the notice period.

Report in the public interest

The auditor must also consider whether, in the public interest, to make a report on any matter arising in the course of the audit in order that it may be considered by the body concerned or brought to the attention of the public.

Schedule 7 of the *Local Audit and Accountability Act 2014* requires the external auditor to make a report in the public interest if matters arise during the course of the audit which warrant it. Such a report is a public document issued for the information of the local taxpayers and will usually draw attention to things that have gone wrong. The report will, therefore, be of particular interest and concern to elected members. Typical matters which, if of substance, would merit a report in the public interest might include:

- failure to comply with statutory requirements
- deficiencies in general or county funds or on the housing revenue account
- the fact that the auditor's opinion on the statement of accounts has been qualified
- lack of, or weakness in, the arrangements for securing economy, efficiency and effectiveness in the use of resources
- failure to exercise adequate control over the specification or performance of services contracted out
- unnecessary expenditure, or loss of income due to waste, extravagance, inefficient financial administration, poor value for money, mistake or other cause
- failure to properly discharge trustee responsibilities, and
- misconduct or frauds.

The auditor must consider whether the public interest requires any such matter to be made the subject of an immediate report rather than of a report to be made at the conclusion of the audit.

Public inspection of accounts

At each audit of accounts, the accounting records and documents must be available for public inspection; any person interested may inspect those accounts and '*all books, deeds, contracts, bills, vouchers, receipts and other documents relating to those records*' and may make copies of all or any part of those records or documents.

Any local government elector for any area to which those accounts relate, or any representative of such an elector, may have an opportunity to question the external auditor about the accounting records.

Any local government elector may also make an objection to the auditor as to any alleged illegality or any other matter on which the auditor might report in the public interest. The requirements for making such an objection are that the objection is in writing and that a copy of the objection is sent to the authority whose accounts are being audited.

The ombudsman

On matters where maladministration may have occurred, another course of action by an aggrieved person is to appeal either through their councillor or directly to the ombudsman. The Commission for Local Administration (CLA), also known as the Local Government Ombudsman (LGO), in England was created by Part III of the *Local Government Act 1974*. The CLA comprises three local government ombudsmen and the parliamentary ombudsman. The CLA provides independent, impartial and prompt investigation and resolution of complaints of injustice caused through maladministration by local authorities. Each ombudsman enjoys wide rights of access to documents and is also able to question officials. The ombudsman publishes the results of enquiries and a conclusion on whether maladministration has occurred or not.

Freedom of Information Act 2000

The *Freedom of Information Act 2000* fundamentally changed the way in which councils provide information to the public, and the extent of the information that individuals can rightfully expect. Councils must treat every written request for information, whether it mentions the *Freedom of Information Act 2000* or not, as a request made under the Act, and process these requests in accordance with the requirements of the legislation.

The *Freedom of Information Act 2000* reinforces local authorities' duties to make papers available, gives statutory rights of access to a wide range of information held by public authorities, and requires them to adopt publication schemes. An independent commissioner enforces the legislation.

Section 97 of the *Local Government Act 2000* extends the public's access to information by requiring local authorities to make available for inspection copies of background papers which support reports considered by principal local authorities.

Limitation on scrutiny

The *Data Protection Act 1998* applies to local authorities. The purpose of the Act is to protect individuals against the misuse or disclosure of data about them held principally on computers and equipment capable of 'automatic processing', such as electric typewriters and word processors.

The Act requires data users to:

- register with the data protection registrar the personal data they hold, the purposes for which it is used, their sources of information, those to whom they may disclose information and any countries outside the UK to which they transfer information
- be open about their use of personal data and to follow good practice in collecting and using the data.

The Act gives individuals rights of access to data about themselves, but there are exceptions to this requirement. The main instances where local authorities do not have to allow individuals to inspect data about themselves are those where that information is held in connection with:

- the prevention or detection of crime, the apprehension or prosecution of offenders, and the assessment and collection of tax or duty if access to the data would prejudice these activities
- the discharge of any statutory function
- statistical or research purposes – provided that the data is not used or disclosed for any other purpose and that any published results of the research do not reveal the identity of the individual
- the payment of salaries, wages, pensions or accounts for sales and purchases.

Payroll data must not be disclosed except:

- to the person responsible for making the payments
- in order to obtain insurance advice
- for research into occupational diseases
- for audit purposes
- to provide information about the data user's financial affairs, or
- where the subject of the data has asked for, or consented to, the disclosure.

Accounts data may only be disclosed for audit purposes or to provide information about the data user's financial affairs.

Local authorities have to balance their duties to publish information with the requirements of the *Data Protection Act 1998*.

FURTHER READING

Accounting and Auditing Standards: A Public Services Perspective (2013 Edition), CIPFA, 2013

Accounts and Audit (England) Regulations 2015

Accounts and Audit (Wales) Regulations 2014

Audit Committees: Practical Guidance for Local Authorities and Police (2013 Edition), CIPFA, 2013

The CIPFA FM Model: Assessment of Financial Management in Public Service Organisations – Statements of Good Practice, CIPFA, 2010

CIPFA Statement on the Role of the Chief Financial Officer in Local Government, CIPFA, 2010

CIPFA Statement on the Role of the Head of Internal Audit in Public Service Organisations, CIPFA, 2010

Code of Audit Practice, National Audit Office, 2015

Code of Data Matching Practice, Audit Commission, 2008

Code of Practice on Local Authority Accounting in the United Kingdom, CIPFA, annual

The Code of Recommended Practice for Local Authorities on Data Transparency, DCLG, 2011

The Excellent Internal Auditor: A Good Practice Guide to Skills and Competencies, CIPFA, 2011

Improving Financial Literacy in Public Service Organisations: A Good Practice Resource Pack, CIPFA, 2008

Local Audit and Accountability Act 2014

Local Audit (Auditor Panel Independence) Regulations 2014

Local Authority Accounts (Scotland) Regulations 2014

Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards, CIPFA, 2013

The Local Government Transparency Code, DCLG, 2015

Public Audit (Wales) Act 2013

Public Sector Internal Audit Standards, the Relevant Internal Audit Standard Setters, 2013

Service Reporting Code of Practice for Local Authorities, CIPFA, annual

World Class Financial Management, Audit Commission, 2005

MODULE 6

Governance

INTRODUCTION

Governance in public sector organisations is increasingly under the spotlight. High profile failures in governance such as the MPs' expenses and cash for questions scandals have focused public attention on the way public sector bodies make decisions and how we can trust them to work in a proper and ethical manner. In addition, the decisions councils make are increasingly being subject to judicial review and challenge through the courts.

Given the service cuts that many councils are implementing, it is vital that decision-making processes are transparent and that decisions are taken with a full understanding of the facts and knowledge of the potential implications.

DEFINING CORPORATE GOVERNANCE

The Cadbury Report

The Report of the Committee on the Financial Aspects of Corporate Governance (the Cadbury Report, 1992) identified three fundamental principles of corporate governance as:

- **Openness** – an open approach is required to ensure all interested parties are confident in the organisation itself. Being open in the disclosure of information leads to effective and timely action and lends itself to necessary scrutiny.
- **Integrity** – this is described as both straightforward dealing and completeness. It should be reflected in the honesty of an organisation's annual report and its portrayal of a balanced view. The integrity of reports depends on the integrity of those who prepare and present them which, in turn, is a reflection of the professional standards within the organisation.
- **Accountability** – this is the process whereby individuals are responsible for their actions. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure.

The Cadbury Report defined these three principles in the context of the private sector, and, more specifically, of public companies, but they are as relevant to public service bodies as they are to private sector entities.

The Committee on Standards in Public Life

Aspects of corporate governance in the public services have been addressed by the Committee on Standards in Public Life (the Nolan Committee, today chaired by Lord Paul Bew) which was established in 1994 to examine concerns about standards of conduct by

holders of public office. Standards of conduct are regarded as one of the key dimensions of good governance. The first report, published in May 1995, identified and defined seven general principles of conduct which should underpin public life, and recommended that all public service bodies draw up codes of conduct incorporating these principles. In 2013, the committee issued a report – *Standards Matter: A Review of Best Practice in Promoting Behaviour in Public Life*. The seven principles of public life have been given revised descriptions:

- **Selflessness** – holders of public office should act solely in terms of the public interest.
- **Integrity** – holders of public office must avoid placing themselves under any obligation to people or organisations that might try inappropriately to influence them in their work. They should not act or take decisions in order to gain financial or other material benefits for themselves, their family, or their friends. They must declare and resolve any interests and relationships.
- **Objectivity** – holders of public office must act and take decisions impartially, fairly and on merit, using the best evidence and without discrimination or bias.
- **Accountability** – holders of public office are accountable to the public for their decisions and actions and must submit themselves to the scrutiny necessary to ensure this.
- **Openness** – holders of public office should act and take decisions in an open and transparent manner. Information should not be withheld from the public unless there are clear and lawful reasons for doing so.
- **Honesty** – holders of public office should be truthful.
- **Leadership** – holders of public office should exhibit these principles in their own behaviour. They should actively promote and robustly support these principles and be willing to challenge poor behaviour wherever it occurs.

The CIPFA/SOLACE Framework

CIPFA has worked to widen the debate on corporate governance arrangements in public service bodies, not least in its various submissions to the Committee on Standards in Public Life.

In May 2001, CIPFA and SOLACE published jointly a corporate governance framework for councils across the UK – *Corporate Governance in Local Government – A Keystone for Community Governance: The Framework*, and an accompanying guidance note.

The first CIPFA/SOLACE Framework was based on the Cadbury definition of corporate governance. It reflected Cadbury's three principles as set out below, adapted to reflect the public sector context, and in particular, Nolan's seven principles of public life.

Openness and inclusivity are required to ensure that stakeholders can have confidence in the decision-making and management processes of councils, and in the approach of the individuals within them. Being open through genuine consultation with stakeholders and providing access to full, accurate and clear information leads to effective and timely action and lends itself to necessary scrutiny. Openness also requires an inclusive approach, which seeks to ensure that all stakeholders and potential stakeholders have the opportunity to engage effectively with the decision-making processes and actions of councils. It requires an

outward focus and a commitment to partnership working. It calls for innovative approaches to consultation and to service provision.

Integrity comprises both straightforward dealing and completeness. It is based upon honesty, selflessness and objectivity, and high standards of propriety and probity in the stewardship of public funds and the management of an authority's affairs. It is dependent on the effectiveness of the control framework and on the personal standards and professionalism of the members and staff within the authority. It is reflected in the authority's decision-making procedures, in its service delivery and in the quality of its financial and performance reporting.

Accountability is the process whereby councils, and the members and staff within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. It is achieved by all parties having a clear understanding of those responsibilities, and having clearly defined roles through a robust structure.

The first CIPFA/SOLACE Framework made it clear that the concept of leadership overarches these three principles; the principles could only be adhered to if leadership is exercised through the local authority providing vision for its community – and leading by example with members and managers demonstrating high standards of conduct.

Good Governance Standard for Public Services

In 2004, the Independent Commission on Good Governance in Public Services published a set of common principles that it wanted all public sector organisations to adopt. The commission, set up by CIPFA in conjunction with the Office for Public Management, said there should be a common governance standard for public services similar to the private sector's *UK Corporate Governance Code* (formerly the Combined Code).

The *Good Governance Standard for Public Services* builds on the Nolan principles for the conduct of individuals in public life by setting out six core principles that it says should underpin the governance arrangements of all bodies: a clear definition of the body's purpose and desired outcomes; well-defined functions and responsibilities; an appropriate corporate culture; transparent decision-making; a strong governance team; and real accountability to stakeholders.

Delivering Good Governance in Local Government: Framework and Guidance Notes

The main concept underpinning the development of the original CIPFA/SOLACE Framework, published in 2001, was that local government was shaping its own approach to good governance. This concept has remained key to the revised Framework. The revised Framework, published in 2007, builds on governance work in both the public and private sectors and in particular *The Good Governance Standard for Public Services*.

The six core principles from *The Good Governance Standard* have been adapted for the local government context. The principle of leadership has been expanded to emphasise the role of authorities in 'leading' their communities and therefore that this concept 'overarches' the other principles. Greater emphasis has been placed on scrutiny and overview. Also, the

principles have been developed to take greater account of the political regime in which councils operate.

The Framework comprises best practice objectives that should provide the basis for each council to develop and maintain a local code of governance reflecting its type, size, functions and nature.

The Framework comprises six core principles with supporting principles, each of which in turn translates into a range of specific requirements that should be reflected in authorities' local codes. The principles and supporting principles are set out below.

- ***Focusing on the purpose of the authority and on outcomes for the community and creating and implementing a vision for the local area***
 - *exercising strategic leadership by developing and clearly communicating the authority's purpose and vision and its intended outcomes for citizens and service users*
 - *ensuring that users receive a high quality of service whether directly, or in partnership or by commissioning*
 - *ensuring that the authority makes best use of resources and that tax payers and service users receive excellent value for money.*
- ***Members and officers working together to achieve a common purpose with clearly defined functions and roles***
 - *ensuring effective leadership throughout the authority and being clear about executive and non-executive functions and of the roles and responsibilities of the scrutiny function*
 - *ensuring that a constructive working relationship exists between authority members and officers and that the responsibilities of authority members and officers are carried out to a high standard*
 - *ensuring relationships between the authority and the public are clear so that each know what to expect of the other.*
- ***Promoting values for the authority and demonstrating the values of good governance through upholding high standards of conduct and behaviour***
 - *ensuring authority members and officers exercise leadership by behaving in ways that exemplify high standards of conduct and effective governance*
 - *ensuring that organisational values are put into practice and are effective.*
- ***Taking informed and transparent decisions which are subject to effective scrutiny and managing risk***
 - *being rigorous and transparent about how decisions are taken and listening and acting on the outcome of constructive scrutiny*
 - *having good quality information, advice and support to ensure that services are delivered effectively and are what the community wants/needs*
 - *ensuring that an effective risk management system is in place*
 - *using their legal powers to the full benefit of the citizens and communities in their area.*

- ***Developing the capacity and capability of members and officers to be effective***
 - *making sure that members and officers have the skills, knowledge, experience and resources they need to perform well in their roles*
 - *developing the capability of people with governance responsibilities and evaluating their performance, as individuals and as a group*
 - *encouraging new talent for membership of the authority so that best use can be made of individuals' skills and resources in balancing continuity and renewal.*
- ***Engaging with local people and other stakeholders to ensure robust public accountability***
 - *exercising leadership through a robust scrutiny function which effectively engages local people and all local institutional stakeholders including partnerships, and develops constructive accountability relationships*
 - *taking an active and planned approach to dialogue with and accountability to the public to ensure effective and appropriate service delivery whether directly by the authority or in partnership or by commissioning*
 - *making best use of human resources by taking an active and planned approach to meet responsibility to staff.*

The Framework is intended to be followed as best practice for developing and maintaining a local code of governance and making adopted practices open and explicit. It urges councils to test their structures against the principles contained in the Framework by:

- reviewing their existing governance arrangements against the Framework
- developing and maintaining an up-to-date local code of governance, including arrangements for ensuring its ongoing application and effectiveness
- preparing a governance statement in order to report publicly on the extent to which they comply with their own code on an annual basis, including how they have monitored the effectiveness of their governance arrangements in the year, and on any planned changes in the coming period.

The *Code of Practice on Local Authority Accounting in the United Kingdom* requires that local authorities prepare an annual governance statement in accordance with the Framework.

Good governance is important to all involved in local government. However it is a key responsibility for the leader of the council (or equivalent) and the chief executive (or equivalent). It is intended that the Framework be used by:

- county councils
- district councils
- multi-purpose authorities
- Greater London Authority and functional bodies
- city regions
- the Corporation of London
- fire authorities
- joint authorities (including passenger transport authorities, waste disposal authorities and combined fire authorities)

- police authorities
- national park authorities.

Delivering Good Governance and the Role of the Chief Financial Officer

In June 2009, CIPFA launched its *Statement on the Role of the Chief Financial Officer in Public Service Organisations*. The statement sets out five principles and the governance requirements needed to support them. CIPFA recommends that organisations use the statement to benchmark their existing arrangements, and report publicly on compliance.

The *Statement on the Role of the Chief Financial Officer in Local Government*, published in April 2010, sets out the five principles that define the core activities and behaviours for the CFO and the organisational arrangements needed to support them. For each principle, the statement sets out the governance arrangements required within an organisation to ensure that CFOs are able to operate effectively and perform their core duties. The five principles are:

- **principle 1: chief financial officer as a key member of the leadership team**
- **principle 2: actively involved in and able to influence financial strategy**
- **principle 3: safeguard public money**
- **principle 4: lead a suitably resourced finance function**
- **principle 5: professionally qualified and suitably experienced – governance requirements.**

In July 2014, CIPFA issued a consultation document on the statement to look at how it is working in practice and whether any additional guidance is required. A revised version is to be published in 2015.

More detail on these principles can be found later in this module (see the ‘Role of the Chief Financial Officer’ section).

Delivering Good Governance in Local Government: Framework – Addendum

To ensure the Framework remained ‘fit for purpose’ the CIPFA/SOLACE Joint Working Group reviewed *Delivering Good Governance in Local Government: Framework* in 2012 and issued an addendum. The working group also developed a revised guidance note for local authorities in England.

The addendum includes an example annual governance statement. For the purpose of the addendum, the example was updated to give an increased emphasis on a strategic approach. The example was also updated to reflect Regulation 4(3) of the *Accounts and Audit Regulations 2011*, which requires all relevant bodies to prepare an annual governance statement rather than a statement on internal control. It also reflects other key changes including conformance with the *CIPFA Statement on the Role of the Chief Financial Officer in Local Government*.

The addendum replaced the *Application Note to Delivering Good Governance in Local Government: Framework* issued in 2010 to reflect the recommendations of the CIPFA Statement. The tables from the Application Note have been incorporated into the revised guidance note.

International Framework: Good Governance in the Public Sector

In July 2014, CIPFA, in association with the International Federation of Accountants (IFAC), published the *International Framework: Good Governance in the Public Sector* (the International Framework). This represents a major piece of international thought leadership, and is important in terms of both CIPFA's global reputation and the potential opportunities to encourage better governance across the UK public services. In the UK it supersedes the 2005 CIPFA/OPM *Good Governance Standard for the Public Services*, which is the basis for all current governance guidance, including the CIPFA/SOLACE Framework *Delivering Good Governance in Local Government*.

The project involved several key stages including the publication of a consultation draft of the document in June 2013. This was developed with input from an International Reference Group (IRG) established for the project. The IRG included senior representatives from the IMF, OECD, INTOSAI, former politicians, and governance experts. Owing to the level of overall support for the consultation draft, it was decided that there was no need to elongate the process by developing an exposure draft and consulting on this before finalisation.

Definition and function of governance

Governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved. The fundamental function of good governance in the public sector is to ensure that entities achieve their intended outcomes while acting in the public interest at all times.

Purpose of the International Framework

The aim of the International Framework is to encourage better service delivery and improved accountability by establishing a benchmark for aspects of good governance in the public sector. It is intended to apply to all entities that comprise the public sector.

The International Framework is not intended to replace national and sectoral governance codes. Instead, it is anticipated that those who develop and set governance codes for the public sector will refer to the International Framework in updating and reviewing their own codes. Where codes and a national framework do not exist, the International Framework will provide a powerful stimulus for positive action.

To deliver good governance in the public sector, both governing bodies and individuals working for public sector entities must try to achieve their entity's objectives while acting in the public interest at all times, consistent with the requirements of legislation and government policies, avoiding self-interest and, if necessary, overriding a perceived organisational interest. Acting in the public interest implies primary consideration of the benefits for society, which should result in positive outcomes for service users and other stakeholders. It therefore requires:

| | |
|--|---|
| <p>A Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law</p> | <p><i>Public sector entities are accountable not only for how much they spend, but also for how they use the resources under their stewardship. This includes accountability for outputs, both positive and negative, and for the outcomes they have achieved. Public sector entities are accountable to legislative bodies for the exercise of legitimate authority in society. This makes it essential that each entity as a whole can demonstrate the appropriateness of all of its actions and has mechanisms in place to encourage and enforce adherence to ethical values and to respect the rule of law.</i></p> |
| <p>B Ensuring openness and comprehensive stakeholder engagement</p> | <p><i>As public sector entities are established and run for the public good, their governing bodies should ensure openness in their activities. Clear, trusted channels of communication and consultation should be used to engage effectively with all groups of stakeholders, such as individual citizens and service users, as well as institutional stakeholders.</i></p> |

In addition to the overarching requirements for acting in the public interest in principles A and B, achieving good governance in the public sector also requires effective arrangements for:

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| <p>C Defining outcomes in terms of sustainable economic, social, and environmental benefits</p> | <p><i>The long-term nature and impact of many of the public sector’s responsibilities mean that it should define and plan outcomes and that these should be sustainable. The governing body should ensure that its decisions further the entity’s purpose, contribute to intended benefits and outcomes, and remain within the limits of authority and resources. Input from all groups of stakeholders, including citizens, service users, and institutional stakeholders, is vital to the success of this process and in balancing competing demands when determining priorities for the finite resources available.</i></p> |
| <p>D Determining the interventions necessary to optimize the achievement of the intended outcomes</p> | <p><i>The public sector achieves its intended outcomes by providing a mixture of legal, regulatory, and practical interventions. Determining the right mix of interventions is a critically important strategic choice that governing bodies of public sector entities have to make to ensure they achieve their intended outcomes. Public sector entities need robust decision-making mechanisms to ensure that their defined outcomes can be achieved in a way that provides the best trade-off between the various types of resource inputs while still enabling effective and efficient operations. Decisions made need to be reviewed continually to ensure that achievement of outcomes is optimized.</i></p> |

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| E Developing the entity's capacity, including the capability of its leadership and the individuals within it | <i>Public sector entities need appropriate structures and leadership, as well as people with the right skills, appropriate qualifications and mindset, to operate efficiently and effectively and achieve their intended outcomes within the specified periods. The governing body must ensure that it has both the capacity to fulfill its own mandate and to make certain that there are policies in place to guarantee that an entity's management has the operational capacity for the entity as a whole. Because both individuals and the environment in which an entity operates will change over time, there will be a continuous need to develop the entity's capacity as well as the skills and experience of the leadership of individual staff members.</i> |
| F Managing risks and performance through robust internal control and strong public financial management | <i>The governing bodies of public sector entities need to ensure that the entities they oversee have implemented – and can sustain – an effective performance management system that facilitates effective and efficient delivery of planned services. Risk management and internal control are important and integral parts of a performance management system and crucial to the achievement of outcomes. They consist of an ongoing process designed to identify and address significant risks involved in achieving an entity's outcomes. A strong system of financial management is essential for the implementation of public sector policies and the achievement of intended outcomes, as it will enforce financial discipline, strategic allocation of resources, efficient service delivery, and accountability.</i> |
| G Implementing good practices in transparency, reporting, and audit to deliver effective accountability | <i>Accountability is about ensuring that those making decisions and delivering services are answerable for them, although the range and strength of different accountability relationships varies for different types of governing bodies. Effective accountability is concerned not only with reporting on actions completed, but also ensuring that stakeholders are able to understand and respond as the entity plans and carries out its activities in a transparent manner. Both external and internal audit contribute to effective accountability.</i> |

Source: *International Framework: Good Governance in the Public Sector*, CIPFA/IFAC, 2014.

The CIPFA/SOLACE Framework *Delivering Good Governance in Local Government* and related guidance are to be reviewed in 2015 and the International Framework will form the basis for this review.

Delivering Good Governance in Local Government Pension Funds

In 2009, CIPFA published *Delivering Good Governance in Local Government Pension Funds: A Guide to the Application of the CIPFA/SOLACE Code of Corporate Governance in Local Authorities to their Management of LGPS Funds*. The governance compliance statement that LGPS funds are required to produce forms part of the governance structure in local government. This guide aims to place this requirement in the context of the CIPFA/SOLACE publication *Delivering Good Governance in Local Government: Framework*.

The Role of the Head of Internal Audit in Public Service Organisations

In December 2010, CIPFA issued a *Statement on the Role of the Head of Internal Audit in Public Service Organisations*. The statement highlights the key role heads of internal audit (HIAs) can play in relation to good governance. It emphasises that HIAs need to review the whole system of control, both financial and non-financial, and focus on the areas where assurance is most needed. The HIA provides an annual opinion on the organisation's governance arrangements, which is used by chief executives as a primary source of evidence for their annual governance report.

GOVERNANCE STRUCTURES OF LOCAL AUTHORITIES

This section looks in detail at the decision-making structures in local government. It covers the framework introduced by the *Local Government Act 2000* and provides the context surrounding the current changes to the governance structures in local government. It looks at the *Localism Act 2011* and how it is affecting the way in which local government operates.

Context

The government believes that it is time for a fundamental shift of power from Westminster to people. We will promote decentralisation and democratic engagement, and we will end the era of top-down government by giving new powers to local councils, communities, neighbourhoods and individuals.

Source: *The Coalition: Our Programme for Government*, May 2010

The *Localism Act 2011* is intended to shift power from central government to individuals, communities and councils. The Act devolves greater powers to councils and neighbourhoods and gives local communities more control over housing and planning decisions. The *Localism Act 2011* includes a number of important packages including decentralisation and strengthening local democracy.

Key areas

The provisions relating to councils' governance include:

- The 'general power of competence' gives local authorities the legal capacity to do anything an individual can that is not specifically prohibited. This new general power will give local authorities greater freedom to work in partnership and develop more innovative ways of providing services.
- The government has abolished the Standards Board regime but has introduced a new duty to promote and maintain high standards of conduct. Local authorities are required to draw up their own codes of conduct.
- The government is encouraging greater use of the directly elected mayor model of governance.
- The Act permits local authorities and their citizens to change their form of governance structures and to move away from an executive form of governance to a committee structure if they wish.

A number of governance provisions apply to both England and Wales. These include:

- ensuring that councillors are not prevented from taking part in decisions where they have expressed a view on related issues (predetermination)
- requiring local authorities to publish senior pay policy statements
- repealing duties for local authorities to promote understanding of local democracy and develop schemes for handling petitions.

Local Government Act 2000

Prior to the *Local Government Act 2000*, local authorities could either take all decisions in full council or could delegate decision making to committees, subcommittees, other local authorities or officers. This governance model was commonly known as the committee system. In practice, the bulk of decisions were taken by committees or subcommittees which then reported them periodically to the full council, but some matters were always reserved to the full council to decide.

The *Local Government Act 2000* introduced new governing structures for local councils in England and Wales, intended to clarify responsibility for making decisions and establishing a role for scrutiny. Councils with populations above 85,000 were required to have 'executive arrangements' whereby the executive comprised elected members. Councils with populations below 85,000 were able to have a modified committee system together with arrangements for overview and scrutiny. The Act set out three broad types of political structure, or model, and required most councils to develop their own proposals within one of those structures.

The three models specified in the Act were:

- the mayor and cabinet executive model – a directly elected mayor who appoints two or more councillors to the executive
- the leader and cabinet executive model – a council leader, elected by the full council, who appoints two or more other councillors to the cabinet executive
- the mayor and council manager executive model – a directly elected mayor who works with a council officer, appointed by the council as council manager.

The mayor and council manager model was subsequently abolished by the *Local Government and Public Involvement in Health Act 2007*.

In governance terms, the full council's responsibilities include:

- agreeing the council's constitution comprising the key governance documents including the executive arrangements and making major changes to reflect best practice
- agreeing the policy framework and key strategies
- agreeing the budget.

The executive is responsible for:

- proposing the policy framework and key strategies
- proposing the budget
- implementing the policy framework and key strategies.

The Act required councils to set up **overview and scrutiny committees** to hold the executive to account. It also made clear that members of the executive could not sit on an overview and scrutiny committee.

Another key element of the 2000 Act included introducing a **standards regime** by:

- placing a duty on councils to adopt the mandatory elements of a model code of conduct into their own codes
- placing a duty on all councils other than town, parish and community councils to set up a standards committee
- providing for the creation of a body (the Standards Board for England) to regulate the conduct of councillors.

These issues are examined in more detail below.

Overview and scrutiny committees

The *Local Government Act 2000* brought in new arrangements that clearly defined a scrutiny role for elected members in holding executives of councils to account, and in scrutinising the work of other agencies providing local services. There was to be a clear distinction between the executive's role in proposing and implementing policies and the non-executive members' role in reviewing policy and scrutinising executive decisions. A local authority overview and scrutiny committee had the power to summon members of the executive and officers of the authority before it to answer questions, and was able to invite other persons to attend meetings to give their views or submit evidence. Local authority overview and scrutiny committees would, in certain circumstances, have the power to ask other partner bodies for information and those partner bodies would be required to have regard to recommendations made by the overview and scrutiny committee.

The role of scrutiny is to review policy and challenge whether the executive has made the right decisions to deliver policy goals. This is different from the role of the audit committee, which exists to provide independent assurance that there are adequate controls in place to mitigate key risks and to provide assurance that the authority, including the scrutiny function, is operating effectively. That said, an audit committee's judgements may well be informed by the results of scrutiny within the authority.

The scrutiny function had four key legislative roles:

- holding the executive to account
- policy development and review
- best value reviews
- external scrutiny – scrutiny committees have the power to consider matters that are not the responsibility of the council, but which affect the authority's area or its inhabitants.

Overview and scrutiny committees might also:

- provide satisfying and meaningful roles for non-executive members
- consider the improvement agenda, general performance, management and review
- ensure corporate priorities are met
- monitor and revise the constitution

- engage partner organisations, the public and the press.

The *Local Government and Public Involvement in Health Act 2007* empowered councillors to refer local government matters and local crime and disorder matters for consideration by the relevant overview and scrutiny committee of their council. The committee is required then to put the matter on its agenda, and discuss it at a meeting. It is not required to take any further action, but all the powers it has – to mount inquiries, to require information, and to make reports and recommendations – are to be available to it, if it decides to take the matter up.

The power to refer a matter is available only where it is of direct concern to the ward or division that the councillor represents. A councillor can refer a matter even if no citizen has asked him or her to consider it. There is no requirement for councillors in multi-member wards to agree – any of them can refer a matter.

The *Local Democracy, Economic Development and Construction Act 2009* included a requirement for councils to designate a scrutiny officer and broadened the scope of overview and scrutiny committees. More detail on this Act can be found later in this module.

Today, local authorities have specific powers exist to scrutinise health bodies, crime and disorder partnerships, police and crime commissioners and flood risk management authorities.

Legislative provisions for overview and scrutiny committees for England can be now be found in the *Localism Act 2011*.

The standards regime

The *Local Government Act 2000* established a new ethical framework for local government which:

- gave the secretary of state and the National Assembly for Wales power to develop a set of general principles of conduct
- provided for the development of a model code of conduct covering the behaviour of elected members and placed a duty on councils to adopt the mandatory elements of that model code into their own codes of practice
- placed a duty on all councils, other than town, parish and community councils, to set up a standards committee
- put in place arrangements for the functions of a standards committee for town, parish and community councils to be carried out on their behalf by the appropriate district council or unitary authority (England) and the appropriate county borough or county council (Wales)
- precluded a directly elected mayor or executive leader from membership of the standards committee, and members of the executive from chairing the standards committee
- set out the functions of the standards committee
- provided for the creation of a Standards Board for England (SBE) to investigate breaches of local codes of practice

- conferred new functions on the Commission for Local Administration in Wales.

Model codes of conduct for members

The former ODPM issued four *Model Codes of Conduct for Members* in 2001. The four national codes apply respectively to councils, parish councils, park authorities and police authorities.

The National Assembly for Wales published a model code in March 2001.

The model codes developed by the former ODPM cover:

- general principles in relation to equality of treatment for all people irrespective of race, age, religion, gender, sexual orientation and disability
- the safeguarding of the impartiality of councils' employees
- confidentiality and openness – the treatment of confidential information and access to information
- criminal offences and bringing an authority into serious disrepute
- the use of an authority's resources – the prohibition of members from using their office or position to obtain advantage or from using council resources for the benefit of political parties
- decision-making – the requirement for members to act reasonably
- personal interest – restrictions on participation in meetings by members with a personal interest in matters under consideration
- the registration of members' interest – and gifts and/or hospitality received.

The model codes were subsequently amended to cover such issues as bullying and intimidation.

Each authority was required to make its own code of conduct available for inspection and send a copy of its code to the Standards Board for England.

Standards committees

The functions of the standards committee were determined by statute and resolutions.

Part III of the *Local Government Act 2000* required standards committees to undertake the following functions:

- give the council advice on adopting a local code of conduct
- monitor the effectiveness of the code
- train members on the code, or arrange such training
- promote and maintain high standards of conduct for members
- help members to follow the code of conduct.

Regulation of standards

The *Local Government Act 2000* led to the creation of the Standards Board for England (SBE) in 2001 as the regulator of conduct of local authority members. The scheme of regulation was criticised, particularly by local government, as overly bureaucratic. As a result, a remodelled local standards framework was introduced from May 2008 by the *Local Government and*

Public Involvement in Health Act 2007. Most complaints about members' behaviour were then dealt with at a local level by standards committees with only those complaints that were unsuitable for local investigation being dealt with by the SBE.

Standards committees are responsible for assessing complaints, initiating investigations and, where appropriate, deciding whether a member had breached the code of conduct. At the same time, the SBE became the strategic regulator with overall responsibility for the effectiveness of the new system in promoting high standards of conduct. Since July 2009, the SBE had operated under the new name, Standards for England, in order to emphasise its role under the new devolved arrangements. It ceased to function on 31 January 2012, as a result of the government's review of non-departmental public bodies, and was formally abolished on 31 March 2012.

In Wales, the public services ombudsman for Wales considers complaints that local authority members have broken their authority's code of conduct. He considers such complaints under the provisions of Part III of the *Local Government Act 2000* and relevant orders made by the National Assembly for Wales under that Act. His role and powers are defined by the *Public Services Ombudsman (Wales) Act 2005*.

Abolition of the Standards Board regime in England

The commitment to abolish the Standards Board regime was published in *The Coalition: Our Programme for Government* in May 2010.

The *Localism Act 2011*:

- removed the statutory requirement on authorities in England to adopt a centrally prescribed code of conduct and to maintain standards committees with an independent chair to oversee standards
- abolished the Standards Board for England
- placed a new duty on councils to promote and maintain high standards of conduct
- continued to require councillors to register their personal interests on a publicly available register, enabling the electorate to hold them to account. A new criminal offence for failure to comply with this requirement acts as a deterrent for councillors who seek to put their personal or financial interests above those of the people they were elected to serve
- ensured that councillors are no longer prevented from speaking and voting on issues they may have an expressed opinion about.

Individuals who feel they have been personally disadvantaged by something a council or a councillor has done can complain to the local government ombudsman.

Duty to promote and maintain high standards of conduct

The duty introduced in the *Localism Act* links with the third principle of the CIPFA/SOLACE Framework – promoting values for the authority and demonstrating the values of good governance through upholding high standards of conduct – and its supporting principles. In CIPFA's view, codes of conduct for members and for employees are an essential component of good governance for all public service bodies as they define the values and standards expected of individuals. Although the *Localism Act* has enabled councils to put in place

locally drawn-up codes of conduct for their elected members, DCLG has published an illustrative text that councils can, if they choose, use as a basis for their local code of conduct.

The LGA, with support from SOLACE and Lawyers in Local Government (LLG, formerly ACSeS), has published a template for a code of conduct together with guidance.

The committee system of governance

The *Localism Act 2011* allows councils in England to implement a committee system, should they wish. The key elements of the framework are as follows:

- Previous restrictions that were set out in the *Local Government Act 2000* requiring all councils in England with a population of 85,000 or more to operate executive arrangements, either the leader and cabinet or mayor and cabinet model, have been removed.
- Councils in England have the freedom to decide what governance model to adopt, including the committee system.
- Councils opting to operate the committee system are able to decide how to discharge their functions, subject to the requirement to have certain statutory committees, such as a licensing committee.

Subject to the above, and any regulations made by the secretary of state specifying that certain functions (such as decisions on the council's budget) should be for full council, councils operating the committee system are able to decide to take all decisions in full council or delegate functions to committees, subcommittees or officers of the council. There is also scope for such councils to decide that certain of their functions should be discharged jointly with any other council or by another council entirely.

Councils choosing to operate the committee system are not required to have an overview and scrutiny committee, under section 21 of the 2000 Act. It is entirely open to such councils to decide what, if any, scrutiny arrangements to put in place. This could range from choosing to have an overview and scrutiny committee under the 2000 Act, to putting in place informal scrutiny arrangements, to having no internal overview and scrutiny.

As is currently the case, where a governance model (for example the mayor and cabinet model) has been adopted following a referendum, councils are only be able to change it as a result of a further referendum supporting that change. Local people can also continue to be able to instigate a binding referendum on changing their council's governance arrangements by presenting a petition signed by 5% of the local electorate to the council.

Councils are also able to choose to hold a referendum on proposals to change the governance arrangements, should they wish, save for the above requirements; they are not required by statute to do so. Once a referendum has been held (no matter how it was instigated), however, a council is prohibited from holding a further referendum for ten years.

Creation of directly elected mayors in the 12 largest cities

The 2010 Coalition agreement made a commitment to holding mayoral referendums in the 12 largest cities (by population) in England. Both Leicester and Liverpool subsequently established mayors following resolutions by their respective city councils. A third city, Bristol,

voted 'yes' in a referendum held in May 2012 and elected its first mayor in November. The remaining nine cities rejected the mayoral system.

Mayors do not have powers over and above those available to non-mayoral local authorities. Proposals have also been made for 'metro mayors', covering areas wider than single local authorities.

Power to instigate local referendums

The government has repealed the legislation included in the *Local Democracy, Economic Development and Construction Act 2009*, setting out requirements for principal local authorities to set up and maintain a petitions scheme that meets centrally determined requirements for dealing with all petitions from local people. Apart from those petitions calling for a referendum, and to which particular arrangements apply, it is for councils to decide how to respond to all other petitions from local people.

The *Localism Act 2011* placed a duty on councils to hold a local referendum when it is triggered by a local petition or by certain other means. The clauses of the Act set out the grounds for determining whether a petition is valid, what actions a council must take upon receiving a petition, how a local referendum will be held and what issues need to be taken into account.

London

The *Localism Act 2011* passed on increased powers regarding housing and regeneration to elected representatives in London. It empowers the mayor to carry out housing investment activities and economic development work previously undertaken by the Homes & Communities Agency and the London Development Agency respectively.

The transparency agenda

The government is committed to increasing transparency across Whitehall and local authorities in order to make data more readily available to the citizen and allow them to hold service providers to account.

DCLG has issued a *Local Government Transparency Code* which sets out the minimum data that local authorities should be publishing, the frequency it should be published and how it should be published. The Code is regularly updated.

The Code requires local authorities in England to publish information related to the following themes:

- expenditure over £500
- government procurement card transactions
- contract and tender information
- grants to voluntary, community and social enterprise organisations
- organisation chart
- senior salaries
- the pay multiple

- trade union facility time
- local authority land and building assets
- parking accounts and parking spaces
- fraud
- the constitution.

Partnership working and shared services

Commissioning and partnerships with other sectors are increasingly used as vehicles for delivering public services by local government in England and Wales. Local authorities often work with and through a range of organisations in order to deliver services. Partnerships and the cross-cutting issues with which they often deal create some special challenges for clear accountability and good governance. Each partner organisation may have its own governance and accountability structure, its own code of conduct and risk management arrangements. Demonstrating clear lines of accountability for stakeholders and customers may be difficult and needs to be carefully thought through by those involved, but is essential for good governance. Shared services between organisations can bring about substantial benefits for the parties involved. At the same time, there can be distinct issues surrounding what happens if something goes wrong. Questions that should be raised should focus on what could have been done to prevent the problem, how quickly the problem was identified and agreement reached on remedial action and any potential financial liabilities shared appropriately between the participating organisations.

Other issues

Other key areas that councillors need to focus on in relation to the governance of their authority include risks associated with:

- Health and safety – the consequences of a tragic event that is given news coverage will be enormous for an authority in terms of reputational damage. Councillors will also need to be aware of the governance implications of corporate manslaughter liability associated with the *Corporate Manslaughter and Corporate Homicide Act 2007*.
- Personal data – safeguarding personal data is essential. The reputational damage and potential fines associated with loss or misuse of personal data are significant.
- Fraud and corruption.

Councillors will need to ensure that the authority has appropriate policies, strategies and plans in place to deal with the above.

Audit committees

In 2013, CIPFA updated and published *Audit Committees: Practical Guidance for Local Authorities and Police Bodies*. This publication sets out CIPFA's guidance on the function and operation of audit committees in local authorities and police bodies. It incorporates CIPFA's 2013 Position Statement *Audit Committees in Local Authorities* and replaces the *Position Statement on Audit Committees in Local Government* issued in 2005.

While not a statutory requirement, audit committees in local authorities are necessary to satisfy the wider requirements for sound financial management. In England, for instance, local authorities are responsible *'for ensuring that the financial management of the body is adequate and effective and that the body has a sound system of internal control which facilitates the effective exercise of that body's functions and which includes arrangements for the management of risk'* (the *Accounts and Audit (England) Regulations 2011*). Again, in England, section 151 of the *Local Government Act 1972* requires every local authority to *'make arrangements for the proper administration of its financial affairs'*.

Regardless of the specific legislative or regulatory framework, the chief finance officer is key to discharging the requirement for sound financial management. To be truly effective, the chief finance officer requires an effective audit committee to provide support and challenge, as well, of course, as adequate and effective internal audit. Both these elements are now enshrined in the *Public Sector Internal Audit Standards* and the supporting *Local Government Application Note*.

There have been a number of significant developments in governance and audit practice since 2005 which have required audit committees to adapt their remit – notably the introduction of annual governance statements. The aim of this publication is to reflect these changes and to support local authority audit committees in performing effectively.

Best practice dictates that governance, risk management and strong financial controls be embedded in the daily and regular business of an organisation. The existence of an audit committee does not remove responsibility from senior managers, members and leaders, but provides an opportunity and a resource to focus on these issues. No single model of audit committee is prescribed; instead, organisations should apply the principle of 'what works' alongside the need to demonstrate good governance principles and independence from the executive and other political allegiances.

CIPFA's guidance is applicable to all principal local authorities in the UK, and to the new independent audit committees established to support police and crime commissioners and chief constables.

Audit committees are not just the concern of auditors; they are about the governance, financial reporting and performance of the whole organisation.

Where authorities return to a committee system of governance, they will no longer be required to have an overview and scrutiny committee. In such circumstances the audit committee will be able to play an important role.

Local government elections

Council members are elected for four-year terms using the first-past-the-post system. The pattern of elections to councils varies across England and Wales. Elections to councils are held on the first Thursday in May in any given year. Parliament can change the day of local government elections in England so that they are held on the same date as European parliamentary elections when the two take place in the same year.

There are three different methods of holding elections to local councils:

- the whole council being elected once every four years
- half of the councillors being elected every other year
- one third of the councillors being elected each year for three out of four years.

From 1 April 2010, the number of councillors for each council has been decided by the independent Local Government Boundary Commission for England. In Wales, the Local Government Boundary Commission for Wales keeps under review all local government areas including council size.

Community governance reviews

Since February 2008, principal councils (district councils or unitary councils) in England have had the power to carry out community governance reviews and put in place or make changes to local community (parish) governance arrangements.

The Local Government Boundary Commission for England (LGBCE) retains responsibility for making any related alterations to district ward or county division boundaries following a parish boundary change. Community governance reviews replaced the parish reviews that principal authorities undertook under the *Local Government and Rating Act 1997*.

A review can consider a number of issues, including:

- whether to create a new parish
- whether to alter the boundary of an existing parish
- whether to group a number of parishes together in a grouped parish council.

Local people can petition a principal council to undertake a community governance review. A principal council must undertake a review if the relevant conditions in relation to the petition are met. The principal authority is responsible for setting the terms of reference of any review and must also undertake consultation when considering what changes to make.

The LGBCE has responsibility for changing the ward or division boundaries following a community governance review. These are called 'consequential changes'. Proposals for consequential changes should be consulted on as part of a review and the recommendation made to the LGBCE. The LGBCE is then responsible for making the changes to the wards or divisions.

Councils conducting, or considering conducting, a review should refer to the joint guidance issued by the LGBCE and the Department for Communities and Local Government *Guidance on Community Governance Reviews* (March 2010).

In Wales, the Local Democracy and Boundary Commission for Wales or a principal council may conduct reviews of community areas. A report of such a review carried out by a principal council is submitted to the commission. The commission may then submit proposals to the Welsh Government. Following the publication of the commission's report there is a period of six weeks when representations may be made to the Welsh Government. Further guidance can be found on the commission's website.

RELATIONSHIPS BETWEEN COUNCILLORS AND OFFICERS

This section focuses on relationships between councillors and officers under the current political management structures, and the importance of the independence and impartiality of officers. It looks at the impact of the *Local Government Act 2000* and the *Local Democracy, Economic Development and Construction Act 2009*.

The role of officers

CIPFA believes that effective local government is dependent on there being a strong working relationship between councillors and officers that is based on mutual trust and respect, and that the authority's code of conduct should support this relationship. In addition, CIPFA believes that one of the fundamental principles that must be embedded in the codes is that officers should undertake their roles in a manner that is sensitive to the political environment, but give advice in a politically impartial way. Officers must work for the authority as a whole, and that it is a matter of local choice as to how officer support is organised for the different roles.

CIPFA believes it is essential also that all decision making is supported by sound professional advice and that this requirement is enshrined clearly in the protocols that form part of the written constitution of each council. This in turn means that it is important that:

- there is a clear distinction between the roles of officers and members
- officers are free to give their professional advice to the council – without fear.

CIPFA has drawn attention to the importance of:

- distinguishing between the strategic, representational and policy roles of members and the operational roles of officers
- the extension of statutory protection against dismissal to the monitoring officer and the chief financial officer, and other chief officers such as directors of education and social services.

CIPFA considers that:

- clarity about the respective roles of councillors and officers has always been important, but the introduction of the new political models makes this even more important
- the greater power and freedom of action that the new executives have need to be balanced by strong scrutiny arrangements
- councils will need to consider the extent to which the officers who work closely with the executive could also work with the scrutiny committees – or whether the scrutiny committees, like parliamentary select committees, will need their own staff.

CIPFA believes that a single finance officer should be able to support both the executive and the scrutiny functions with impartial, professional, financial advice.

Following the *Local Government Act 2000*, the principles to be followed in England were described in *The Local Government Act 2000 New Council Constitutions – Guidance Pack*, issued by the ODPM.

Key points made in the guidance included the following. In recognition of their enhanced roles under executive arrangements and the ethical framework, the secretary of state

amended the *Local Authorities (Standing Orders) Regulations 1993* to provide that the statutory protections in those regulations also applied to the monitoring officer and the chief finance officer. This means that the head of paid service (except where that person is also the council manager), monitoring officer and chief finance officer may not be suspended for more than two months for the purposes of investigating misconduct unless it is in accordance with a recommendation in a report made by an independent person whose appointment has been agreed between the officer in question and the local authority (this is also referred to in the section 'Relationship with elected members').

The core roles of the chief executive, who should be the statutory head of paid service, are underpinned by the fundamental principles of political neutrality and service to the whole council.

With the introduction of the ethical framework, there were significant changes to the role of the monitoring officer. The monitoring officer has a key role in promoting and maintaining high standards of conduct within a local authority, in particular through provision of support to the local authority's standards committee. The monitoring officer cannot, therefore, be the head of paid service (and therefore chief executive) or the council manager.

In addition to their traditional role of advising all members and officers about vices, maladministration, financial impropriety and probity, under executive arrangements the monitoring officer and the chief finance officer also have a role in advising where particular decisions were, or are likely to be, contrary to the policy framework or contrary to the budget.

The monitoring officer should also be the proper officer for the purposes of ensuring that executive decisions, together with the reasons for those decisions and relevant officer reports and background papers, are made publicly available.

The local authority needs to ensure that the monitoring officer and chief finance officer have access as necessary to meetings and papers and that members consult with them regularly.

It is a matter for local choice how councils choose to organise officer support for the different roles within the council, but they should do so in accordance with the following broad key principles:

- all officers are employed by, and accountable to, the council as a whole
- support from officers is needed for all the council's functions and the roles of the full council, overview and scrutiny, committees, the executive, individual members representing their communities, etc
- overview and scrutiny in particular will need to be properly resourced and effectively supported by officers
- day-to-day managerial and operational decisions should remain the responsibility of the chief executive and other officers
- councils should seek to avoid potential conflicts of interest for officers arising from the separation of the executive and the overview and scrutiny role
- all officers will need access to training and development to help them support the various member roles effectively and to understand the structures.

In organising support for the executive, councils need to take into account the potential for tension between chief officers and cabinet members with portfolios. It may be helpful to arrange the officer and member responsibilities so that they are not exactly coincident.

Councils should develop appropriate conventions setting out the roles, responsibilities and rights of officers and members and establishing the key principles governing officer/member relationships.

The principles to be followed in Wales were set out in *New Council Constitutions: Modular Constitutions for County and County Borough Councils in Wales* (National Assembly for Wales, December 2001).

Ethical standards

There is a personal responsibility on all professionally qualified accountants in carrying out their duties to comply with the professional – ie ethical and technical – standards laid down by their professional body.

CIPFA Council passed its *Ethics Statement* on 7 December 2000. This set out the overall standards of professional conduct for CIPFA members. In particular, it required CIPFA members to observe six fundamental principles:

- integrity
- objectivity
- competence and due care
- confidentiality
- proper conduct
- the maintenance of technical and professional standards.

In addition, CIPFA Council approved revised *Standards of Professional Practice* (SoPP) on 12 September 2002.

Under the SoPP, CIPFA members were required to ensure that they:

- conducted business lawfully, fairly and responsibly
- did not use any information for personal benefit or gain
- maintained the confidentiality of information except where there is an overriding legal or professional duty to disclose
- provided timely advice with due care and diligence
- adhered to the financial regulations of their employing organisations
- recognised and acted on the need for effective internal controls to provide accountability
- kept records which meet legal and audit requirements
- dealt promptly and impartially with complaints.

Where members use professional advisors, the final responsibility for discharging professional responsibilities rests with the member.

There are also separate standards covering the following:

- auditing

- budgetary planning and control
- financial transactions management
- financial reporting
- suspected fraud and corruption
- tax management
- treasury management.

CIPFA adopted its new *Standard of Professional Practice on Ethics* in May 2006 with a further update in 2011. The SoPP applies to all CIPFA members and students. While it marked no fundamental change in the ethical and behavioural expectations of professional accountants, it is a significantly different document, with important new conceptual underpinning, in the context of a greatly raised profile for ethics.

The SoPP is based on the International Federation of Accountants (IFAC) *Code of Ethics*. CIPFA has adopted the IFAC code in full.

The SoPP is based on five principles. They are:

- integrity
- objectivity
- professional competence and due care
- confidentiality
- professional behaviour.

The SoPP is split into three sections:

- **Part A** – applies to all CIPFA members.
- **Part B** – applies to accountants employed in practice; for CIPFA members this includes members who are employed in the national audit agencies and framework contract firms.
- **Part C** – applies to accountants in business, which includes members employed in public sector organisations, charities and in industry.

The full version of the SoPP, updated in 2011, is available on the CIPFA website.

CIPFA acknowledges that the IFAC code is a large document. In order to make it more accessible and relevant to CIPFA members in the public sector, it has prepared a short guidance document, *Ethics and You*.

Ethics and You includes public sector information that is relevant to the code, to assist CIPFA members in understanding how the code applies to them in the workplace. It also includes ten case studies which are based in different sectors and cover CIPFA members at different stages of their careers.

Good governance in local government

In June 2007, CIPFA and SOLACE published *Delivering Good Governance in Local Government: Framework and Guidance Note* (see the section on the CIPFA/SOLACE Framework earlier in this module). The *Framework* was reviewed in 2012 and an Addendum was issued. A revised

guidance note for authorities in England was also published. The *Framework* defines the principles that should underpin the governance of each local government body. It provides a structure to help individual authorities with their own approach to governance.

The guidance note provides detail on how the principles can work in practice. The second principle, '*Members and officers working together to achieve a common purpose with clearly defined functions and roles*', addresses how an authority's governance structure can facilitate effective working between members and officers.

The Framework and guidance are to be reviewed in 2015.

Local Democracy, Economic Development and Construction Act 2009

The *Local Democracy, Economic Development and Construction Act 2009* received royal assent in November 2009. At the heart of the Act were new rights for local people to have more information and influence over local decisions, new powers to hold politicians to account and, where they choose, more opportunity to get directly involved in managing and shaping how local services are delivered.

As far as officers are concerned, a key feature of the Act is the provision that certain senior officers of a principal local authority can be called to account at a public meeting. It is up to principal authorities to determine which of their officers are liable to be called to account, but their petition schemes must ensure that as a minimum the head of paid service, often known as the chief executive of the authority, and the most senior officers responsible for the delivery of services can be required to attend meetings of overview and scrutiny committees when requested to do so by a petition with a number of signatures above the threshold in the authority's scheme. The reasons for the request must relate to the officer's job functions.

Scrutiny officers

Each council operating executive arrangements is required by the *Local Government Act 2000* to have at least one overview and scrutiny committee. The *Local Democracy, Economic Development and Construction Act 2009* inserted a new section into the *Local Government Act 2000* requiring local authorities, with the exception of district councils in areas where there is a county council, to designate one of their officers as a scrutiny officer to support the work of the authority's overview and scrutiny committee.

Typically, a scrutiny officer will promote the scrutiny function generally within the authority and local government partners more widely, and provide advice and support to members of the authority's committee in undertaking their work. This may include the provision, or management, of committee secretariat services, research, analysis of data and report preparation.

A council may not designate any of the following as scrutiny officer:

- the head of the authority's paid service
- the authority's monitoring officer
- the authority's chief finance officer.

Politically restricted posts

Certain council employees in positions of seniority or influence, such as the chief executive, are restricted from undertaking certain political activities, such as standing for election or speaking publicly in support of a particular political party.

Prior to the *Local Democracy, Economic Development and Construction Act 2009*, employees with a salary of £36,730 or above were deemed to hold a politically restricted post. These political restrictions were introduced to address concerns about political impartiality and conflicts of interest. These so-called 'Widdicombe rules' sought to ensure that authority members were confident that the advice they received from senior staff was impartial. The 2009 Act removed this restriction.

Local leadership and public trust

In February 2009, CIPFA made a submission to the Committee on Standards in Public Life, 12th Inquiry – *Local Leadership and Public Trust: Openness and Accountability in Local and London Government*. Key points from the submission which are still relevant are summarised below. The full response is on the CIPFA website.

Local government leadership and decision making

There are both strengths and weaknesses associated with executive arrangements in local government. Where they are working well, arrangements have made the exercise of power more transparent. Where the new arrangements are not working so well, there are instances of cabinet decisions effectively being made 'behind closed doors' prior to the public cabinet meeting.

By splitting the executive and the scrutiny function, many members of the controlling parties in councils have felt excluded from the decision-making process. In addition, they may not engage in the scrutiny process since they may perceive that to do so would endanger their prospects within the ruling party. Effective scrutiny may therefore only come from the opposition.

It is essential that the leader and the chief executive lead by example through the development of a successful working relationship with each other based on mutual understanding and respect. The authority should also take a lead in establishing and promoting values for the organisation and its staff.

Once a culture of shared values has been successfully established, it is important that it is maintained. This can be a challenge for councils as terms of office come to an end or the political agenda changes, but continuity is essential.

Local government openness and accountability

It is essential that the council is clear, and communicates to staff, to whom it is accountable and for what, and how it can engage effectively.

Collective responsibility is essential in considering the accountability framework for local government. In recent years, the concept of executive responsibility has been undermined

by 'point accountability' whereby a huge burden of responsibility is placed upon individual members and officers for specific service areas.

Members need the skills and knowledge to do their job well and these skills include the ability to scrutinise and to challenge information received from the executive and the ability to recognise when outside advice is needed.

The current arrangements for scrutiny in local government do not take account of the political dimension.

Local government officers' roles and accountability

Attempts to oversimplify the distinctive roles of members and officers – for example, politicians do policy/strategy, officers do implementation – can be unhelpful. In practice the leadership of councils is a partnership between members and officers in which each group brings different knowledge, skills and perspectives.

The leader's role will usually emphasise effective strategic direction. The chief executive is likely to emphasise leading the organisation in implementing strategy and managing the delivery of services. A good working relationship between the two is fundamentally important for the effective governance of the organisation as a whole. Their roles should be clearly explained to the organisation as a whole.

Good working relationships and communications within the leadership team – members and officers – together with a degree of formality and rigour in decision making are also key ingredients in the chemistry of a successful, well governed council.

CIPFA is concerned about political appointees and special advisors who do not fit into the current accountability framework. In central government such appointees are able to act as 'gatekeepers' and restrict access to ministers. If such a scenario were to be repeated in local government, senior officers might find themselves unable to carry out their statutory duties. The introduction of political appointees and special advisers adds an important new component to the top team but this needs to be explicitly recognised and considered carefully in the design of effective governance arrangements.

Chief financial officers in local government have a unique accountability to the local taxpayer. Legislation places particular responsibilities on them and this is reinforced by the other statutory officers.

Local government accountability and partnerships

Partnerships and the cross-cutting issues with which they often deal create some special challenges for clear accountability and good governance.

ROLE OF THE CHIEF FINANCIAL OFFICER

This section describes the legislative and other requirements relating to the role of the chief financial officer (CFO). It covers the main statutory responsibilities of the CFO and relationships with members and other officers.

CIPFA Statement

In June 2009, CIPFA launched its *Statement on the Role of the Chief Financial Officer in Public Service Organisations* at its annual conference. The statement sets out five principles that define the core activities and behaviours of the role of the chief financial officer in public service organisations and the organisational arrangements needed to support these. Summaries of personal skills and professional standards detail the technical expertise and leadership qualities that an organisation can expect in the CFO.

Following this, CIPFA updated its earlier 2003 statement on the role of the finance director in local government. The approach adopted was to follow closely the format and principles of the statement on the CFO in public sector organisations more generally, but to add in, as necessary, additional content relating to the unique statutory position of the role in local government.

The statement recognises that the global financial crisis and economic downturn have made the role of the CFO even more challenging, but they have also underlined the fundamental importance of the role.

To support CFOs in the fulfilment of their duties, and to ensure that councils have access to effective financial advice at the highest level, CIPFA introduced a 'comply or explain' requirement in the annual statement of accounts. Detailed guidance on how this requirement should be complied with was published in *Application Note to Delivering Good Governance in Local Government: Framework* (CIPFA/SOLACE, March 2010) as an interim measure. The Application Note has now been withdrawn and replaced with an Addendum to the Framework issued in 2012. The tables from the application note were built into CIPFA's update of *Delivering Good Governance in Local Government: Guidance Notes for English Authorities* in December 2012.

The local government CFO statement was published for consultation in December 2009 and a final version was then issued in April 2010. The statement sets out the five principles that define the core activities and behaviours that belong to the role of the CFO and the organisational arrangements needed to support them. Successful implementation of each of the principles requires the right ingredients in terms of the organisation, the role and the individual.

For each principle, the statement sets out the governance arrangements required within an organisation to ensure that CFOs are able to operate effectively and perform their core duties. The statement also sets out the core responsibilities of the CFO role within the organisation. Many of the day-to-day responsibilities may in practice be delegated or even outsourced, but the CFO should maintain oversight and control.

The statement also summarises the personal skills, professional standards, leadership skills and technical expertise organisations can expect from their CFO. These include the key requirements of CIPFA and the other professional accountancy bodies' codes of ethics and professional standards.

The principles underpinning the statement are that the CFO in a local authority:

- 1 must be a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest

- 2 must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer-term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy
- 3 must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities, the CFO:

- 4 must lead and direct a finance function that is resourced to be fit for purpose
- 5 must be professionally qualified and suitably experienced.

The core CFO responsibilities under each of these five principles are summarised below.

Principle 1: key member of the leadership team – core CFO responsibilities

- Contributing to the effective leadership of the authority, maintaining focus on its purpose and vision through rigorous analysis and challenge.
- Contributing to the effective corporate management of the authority, including strategy implementation, cross-organisational issues, integrated business and resource planning, risk management and performance management.
- Supporting the effective governance of the authority through development of corporate governance arrangements, risk management and reporting framework; and corporate decision-making arrangements.
- Leading or promoting change programmes within the authority.
- Leading development of a medium-term financial strategy and the annual budgeting process to ensure financial balance and a monitoring process to ensure its delivery.

Principle 2: actively involved in and able to influence financial strategy – core CFO responsibilities

Responsibility for financial strategy

- Agreeing the financial framework with sponsoring organisations and planning delivery against the defined strategic and operational criteria.
- Maintaining a long-term financial strategy to underpin the authority's financial viability within the agreed performance framework.
- Implementing financial management policies to underpin sustainable long-term financial health and reviewing performance against them.
- Appraising and advising on commercial opportunities and financial targets.
- Developing and maintaining an effective resource allocation model to deliver business priorities.
- Leading on asset and balance sheet management.
- Co-ordinating the planning and budgeting processes.

Influencing decision making

- Ensuring that opportunities and risks are fully considered and that decisions are aligned with the overall financial strategy.
- Providing professional advice and objective financial analysis enabling decision makers to take timely and informed business decisions.
- Ensuring that efficient arrangements are in place and sufficient resources available to provide accurate, complete and timely advice to support councillors' strategy development.
- Ensuring that clear, timely, accurate advice is provided to the executive in setting the funding plan/budget.
- Ensuring that advice is provided to the scrutiny function in considering the funding plan/ budget.
- Ensuring that the authority's capital projects are chosen after appropriate value for money analysis and evaluation using relevant professional guidance.
- Checking, at an early stage, that innovative financial approaches comply with regulatory requirements.

Financial information for decision makers

- Monitoring and reporting on financial performance that is linked to related performance information and strategic objectives that identifies any necessary corrective decisions.
- Preparing timely management accounts.
- Ensuring the reporting envelope reflects partnerships and other arrangements to give an overall picture.

Principle 3: safeguard public money – core CFO responsibilities

Promotion of financial management

- Assessing the authority's financial management style and the improvements needed to ensure it aligns with the authority's strategic direction.
- Actively promoting financial literacy throughout the authority.
- Assisting the development of a protocol which clearly sets out the roles and responsibilities of both democratically elected councillors, whether acting in executive or scrutiny roles, and officers for financial management, including delegated authority/ powers.

Value for money

- Challenging and supporting decision makers, especially on affordability and value for money, by ensuring policy and operational proposals with financial implications are signed off by the finance function.
- Advising on the financial thresholds for 'key' decisions where there is a requirement to do so.
- Developing and maintaining appropriate asset management and procurement strategies.

- Managing long-term commercial contract value.

Safeguarding public money

- Applying strong internal controls in all areas of financial management, risk management and asset control.
- Signing the authority's published statement on internal financial control in line with the *Code of Practice on Local Authority Accounting in the United Kingdom*.
- Establishing budgets, financial targets and performance indicators to help assess delivery.
- Implementing effective systems of internal control that include standing financial instructions, operating manuals, and compliance with codes of practice to secure probity.
- Ensuring that the authority has put in place effective arrangements for internal audit of the control environment and systems of internal control as required by professional standards and in line with CIPFA's Accounting Code.
- Ensuring that delegated financial authorities are respected.
- Promoting arrangements to identify and manage key business risks, including safeguarding assets, risk mitigation and insurance.
- Overseeing of capital projects and post-completion reviews.
- Applying discipline in financial management, including managing cash and banking, treasury management, debt and cash flow, with appropriate segregation of duties.
- Ensuring the effective management of cash flows, borrowings and investments of the authority's own funds or the pension and trust funds it manages on behalf of others; ensuring the effective management of associated risks; pursuing optimum performance or return consistent with those risks.
- Implementing appropriate measures to prevent and detect fraud and corruption.
- Establishing proportionate business continuity arrangements for financial processes and information.
- Ensuring that any partnership arrangements are underpinned by clear and well-documented internal controls.

Assurance and scrutiny

- Reporting performance of both the authority and its partnerships to the board and other parties as required.
- Ensuring that financial and performance information presented to members of the public, the community and the media covering resources, financial strategy, service plans, targets and performance is accurate, clear, relevant, robust and objective.
- Supporting and advising the audit committee and relevant scrutiny groups.
- Ensuring that clear, timely, accurate advice is provided to the executive and the scrutiny functions on what considerations can legitimately influence decisions on the allocation of resources, and what cannot.
- Preparing published budgets, annual accounts and consolidation data for government-level consolidated accounts.

- Ensuring that the financial statements are prepared on a timely basis, meet the requirements of the law, financial reporting standards and professional standards as reflected in the *Code of Practice on Local Authority Accounting in the United Kingdom* developed by the CIPFA/LASAAC Joint Committee.
- Certifying the annual statement of accounts.
- Ensuring that arrangements are in place so that other accounts and grant claims (including those where the authority is the accountable body for community-led projects) meet the requirements of the law and of other partner organisations and meet the relevant terms and conditions of schemes.
- Liaising with the external auditor.

Principle 4: lead a suitably resourced finance function – core CFO responsibilities

- Leading and directing the finance function so that it makes a full contribution to and meets the needs of the business.
- Determining the resources, expertise and systems for the finance function that are sufficient to meet business needs and negotiating these within the overall financial framework.
- Implementing robust processes for recruitment of finance staff and/or outsourcing of functions.
- Reviewing the performance of the finance function and ensuring that the services provided are in line with the expectations and needs of its stakeholders.
- Seeking continuous improvement in the finance function.
- Identifying and equipping finance staff, managers and the leadership team with the financial competencies and expertise needed to manage the business both currently and in the future.
- Ensuring that the head of profession role for all finance staff in the authority is properly discharged.
- Acting as the final arbiter on application of professional standards.

Principle 5: professionally qualified and suitably experienced – core CFO responsibilities

There are no specific responsibilities for this principle.

Consultation, July 2014

In July 2014, CIPFA issued a consultation on its statement, which asked the following questions:

- Do you find the current statement helpful as a definitive source of reference on the role of the CFO?
- If no, how could the current statement be improved?
- If yes, what would you like to see guidance on and what form should that guidance take?

- Do you think the statement should be extended to cover the deputy CFO, given the specific status of a deputy s151 officer in local government?
- Do you agree that the current statement should be updated to deal more explicitly with the CFO's responsibilities in relation to partnerships and other external service delivery vehicles?
- If yes, which areas do you think the statement should deal with?
- What do you believe the CFO's responsibilities should be in respect of alternative forms of service delivery?
- What are the key methods currently used for ensuring probity for public money within alternative forms of service delivery, eg open book accounting, rights of audit access, performance monitoring regimes, market testing?
- What are the barriers to ensuring probity?
- Where partnership and outsourcing arrangements are used to deliver finance-related functions, does this bring additional challenges for the CFO, and what are these?
- How are these contracts currently managed to ensure that CFOs receive the information they need to make informed judgements?
- Do you agree that the current statement should be updated to deal more explicitly with the CFO's wider responsibilities?

A revised version of the statement will be published in 2015.

Proper administration of financial affairs

The *Local Government Act 1972* abolished specific statutory reference to the need to appoint a treasurer and to the making of safe and efficient arrangements for receipts and payments, but imposed a wider and more general responsibility on local authorities for the financial administration of their affairs. Section 151 of the 1972 Act specifies that:

Every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs.

The same requirement was made for the metropolitan police, fire and civil defence authorities and for transport authorities by section 73 of the *Local Government Act 1985*, for combined police and combined fire authorities by section 112 of the *Local Government Finance Act 1988* and for the new police authorities set up in April 1995 by paragraph 33 of Schedule 4 of the *Police and Magistrates' Courts Act 1994*.

Qualifications

Section 113 of the 1988 Act requires the officer appointed under section 151 of the 1972 Act to be a member of one of six recognised chartered accountancy bodies in Great Britain and Ireland. CIPFA is one of these bodies and the premier accountancy body for the public services and is unique in having responsibility for setting accounting standards in local authorities.

Section 114 report

Sections 114 to 116 of the 1988 Act set out what the CFO and the authority must do if serious financial problems arise. These were further amended by the *Local Government and Housing Act 1989* to require consultation between the authority's CFO, its monitoring officer (usually its solicitor) and the head of its paid service (ie its chief executive) before a section 114 report is made to the council.

Section 114 requires a CFO to report to the council if the authority, one of its committees or one of its officers:

- has made, or is about to make, a decision which has or would result in unlawful expenditure
- has taken, or is about to take, an unlawful action which has or would result in a loss or deficiency to the authority; or
- is about to make an unlawful entry in the authority's accounts.

In addition, the CFO must report to the council if it appears that the authority's spending is likely to exceed its resources in any financial year.

Where a report is made under section 114 of the 1988 Act (as amended), a copy of that report must be sent to every member of the authority and to the authority's external auditor.

Section 115 of the 1988 Act specifies that the council must meet to consider a report under section 114 not later than 21 days after the report is dispatched and:

- must not pursue the course of action which led to the report being made, or
- if the report was made because the authority had insufficient resources to meet its spending, the authority must not incur any further spending until the report has been considered.

If an authority ignored the prohibition on activities or spending during the period before a report under section 114 was considered, then it would be acting unlawfully or in an ultra vires manner.

The *Local Government Act 2003* (England and Wales) provides for the CFO to be able to authorise the entering into of certain agreements following the receipt of a section 114 report. The CFO may only give authority if he or she considers that the agreement concerned is likely to:

- prevent the situation that led him or her to make the report from getting worse
- improve the situation, or
- prevent the situation recurring.

Section 116 of the 1988 Act states that the authority's external auditor has to be given details about the date, time and place of a meeting to consider a section 114 report and must be told what the authority decided to do after considering the report.

It was the intention of these provisions of the 1988 Act that section 114 reports would be called for only in the most serious circumstances and it is clear that any which are made cannot be treated lightly by the authority concerned. They deal with the rare but difficult issues sometimes faced by a council.

Section 114 of the 1988 Act also:

- requires the CFO to nominate a properly qualified member of staff to deputise, should the CFO be unable to perform the duties under section 114 personally
- makes it clear that the authority must provide the CFO with sufficient staff, accommodation and other resources – including legal advice where this is necessary – to carry out the duties under section 114.

Articles 20 and 21 of the Local Authorities (Executive and Alternative Arrangements) (Modification of Enactments and Other Provisions) (England) Order 2001 modify sections 114 and 116 of the *Local Government Finance Act 1988* and insert new sections 114A and 115B into that Act to provide that a CFO's report about unlawful expenditure is considered by the executive where it relates to actions taken by the executive and that all members of the council (and, where there is one, the council manager) must receive a copy of such a report.

In the same way as section 115 as originally enacted, all action in respect of such a report must be suspended until the executive has considered the report. After considering it, the executive must provide a report to the council, the CFO and the council's auditor explaining what, if any, action is to be taken in consequence of the report and the reasons for that action, or for not taking action.

Where such a CFO's report is made, the relevant overview and scrutiny committee or committees should consider whether it would be appropriate to hold a short enquiry into the matter which is the subject of that report prior to the executive's consideration of it.

The CIPFA *Statement on the Role of the Chief Financial Officer in Public Service Organisations* contains a flowchart for section 114 procedures under the *Local Government Finance Act 1988* (England and Wales).

Local Government Act 2003

Section 25 of the *Local Government Act 2003* requires an authority's CFO to make a report to the authority when it is considering its budget and council tax. The report must deal with the robustness of the estimates and the adequacy of the reserves allowed for in the budget proposals, so members will have authoritative advice available to them when they make their decisions. The section requires members to have regard to the report in making their decisions.

Relationship with elected members

In recognition of their enhanced roles under executive arrangements, regulations (see also the 'Role of the Chief Financial Officer' section earlier in this module) provide that the head of paid service (except where that person is also the council manager), monitoring officer and CFO may not be suspended for more than two months for the purposes of investigating misconduct unless it is in accordance with a recommendation in a report made by an independent person whose appointment has been agreed between the officer in question and the council. The secretary of state consulted in March 2013 on removing this requirement but at the time of writing no final decision had been announced.

In addition to their traditional role of advising all members and officers about vires, maladministration, financial impropriety and probity, under executive arrangements the

monitoring officer and the CFO will also have a role in advising where particular decisions were, or are likely to be, contrary to the policy framework or contrary to the budget.

The guidance to English local authorities on the new council constitutions emphasises that in order to undertake these roles, the council will need to ensure that the monitoring officer and CFO have access as necessary to meetings and papers and that members consult with him or her regularly.

The *CIPFA Statement on the Role of the Chief Financial Officer in Local Government* says that councils should ensure that governance arrangements allow the finance director and head of audit to advise and report directly to the executive and non-executive leaders of the organisation, and to external audit. It is highly desirable that a good working relationship should exist with all members of the authority, especially senior members such as the chairs of committees.

The provisions set out in sections 114 to 116 of the 1988 Act were introduced as a government response to some of the difficult situations that arose in the mid-1980s. If the CFO recognises that members are elected to carry out a programme (often backed by a political manifesto) and elected members recognise that the CFO is responsible for upholding professional standards which should not be compromised, a good working relationship can be maintained.

Apart from the statutory duties that an authority must confer on the CFO under section 151 of the 1972 Act, it can confer other duties and this may affect the relationship between the CFO and elected members.

An authority must appoint an officer, rather than a member or other associate of the authority, to the position of section 151 officer. It is the CFO's duty to effect the employing authority's lawful and reasonable orders within the scope of that appointment. However, the authority has no power to require a CFO, or any other officer, to act contrary to law; any such requirement would be invalid and unenforceable. If a CFO is of the view that a conflict between duties has arisen, the overriding duty is to act professionally within the law.

Relationship with other officers

The CIPFA statement on the role of the CFO makes it clear that the CFO should have direct access to the paid head of the organisation (such as the permanent secretary or chief executive) and have a seat on the departmental board, at a level equivalent to other board members.

A close working relationship with the chief executive and all other chief officers is therefore necessary. The CFO should function as the key adviser to the finance committee of the council and, together with the chief executive, to the policy or policy and resources committee on financial matters. The need for close working relationships between key officers is highlighted by the provisions in the *Local Government and Housing Act 1989*, which confer specified duties on the head of the paid service (ie the chief executive) and on the monitoring officer (often the solicitor) in regulating actions or potential actions of the authority in both non-financial and financial matters. The Act goes on to require cross-consultation between these officers before a report on matters covered by the Act goes to the authority. These requirements were reinforced and strengthened by the *Local Government Act 2000*.

Similarly, there should be a close working relationship between the finance department and other departments of the council, and it is the responsibility of the CFO to ensure that this

exists. The relationship needs to safeguard the provision of financial information and advice in order to facilitate and inform effective management and policy-making decisions. All committees, including those responsible for spending on services as well as the finance and policy committees, need to be advised of the financial implications of their proposals and decisions. The CFO should provide this advice by outlining the financial implications of a proposal when it goes to committee for consideration.

As more and more services are contracted out to private firms, delegated to service budget holders or undertaken through strategic partnerships, the emphasis of the work of the CFO will change from keeping detailed financial records to providing advice and monitoring financial performance and adherence to budgets. However, the ultimate responsibility for an authority's financial affairs remains with the CFO.

The CFO is directly responsible for the effective management of the finance function and for the technical responsibilities assigned to it, whether these are performed by a central finance or a corporate services department, contracted out to third parties, devolved to service departments or delegated to service managers.

Professional responsibilities

In addition to the statutory duties and personal liability under law, the CFO must by law be a member of a recognised chartered accountancy body and as such has a professional responsibility to meet the requirements of that body. Those professional responsibilities become particularly important in circumstances where an authority's legal position is unclear.

CIPFA issues *Standards of Professional Practice*, which define the personal responsibilities of CIPFA members in carrying out their professional duties. To date CIPFA has issued standards covering:

- ethics (see the section on 'Ethical standards' earlier in this module)
- auditing
- financial reporting
- tax management
- treasury management
- budgetary planning and control
- financial transactions management
- suspected fraud and corruption
- continuing professional development.

The statement on continuing professional development was passed by the CIPFA Council in September 2005 and sets out the standards of conduct for members with respect to continuing professional development.

Failure to comply with CIPFA's standards may lead to disciplinary action being taken by CIPFA. Given that CIPFA members comprise the majority of senior council finance staff, CIPFA's *Standards of Professional Practice* provide a further basis for sound financial management within local authorities.

FURTHER READING

Audit Committees: Practical Guidance for Local Authorities and Police Bodies, CIPFA, 2013

CIPFA's Submission to the Committee on Standards in Public Life 12th Inquiry, CIPFA, 2009

CIPFA Statement on the Role of the Chief Financial Officer in Local Government, CIPFA, 2010

CIPFA Statement on the Role of the Chief Financial Officer in Public Service Organisations, CIPFA, 2009

CIPFA Statement on the Role of the Head of Internal Audit in Public Service Organisations, CIPFA, 2010

Code of Practice on Local Authority Accounting in the United Kingdom, CIPFA, annual

Code of Practice on Managing the Risk of Fraud and Corruption and Guidance, CIPFA, 2014

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MODULE 7

Education

INTRODUCTION

Education is still the biggest local government service and is one that attracts much debate, particularly over the responsibility for and funding of schools. This looks set to continue with policy initiatives encouraging academies and free schools.

This module looks at education finance in the national context and describes the many and significant changes that the coalition government, elected in 2010, has been putting in place. The module also covers the legal framework and how schools are funded. It refers to headline figures from the spending review 2010 and spending round 2013 and those changes to schools and their funding that are in the pipeline. Finally it looks at capital expenditure and a number of other relevant topics.

Education is a function for which county, metropolitan and unitary councils have responsibilities. In London, the London boroughs have responsibility for education, while the mayor has a role in promoting educational standards across London.

Education is provided in England by the main types of school described below.

EDUCATION IN ENGLAND

Local authority funded schools

- Local authorities fund four main types of school:
 - community schools that are not influenced by religious or business groups
 - voluntary controlled schools
 - voluntary aided schools
 - foundation schools.
- in January 2014, there were 8,598 community primary schools in England:
 - 3,436 were voluntary aided
 - 2,319 were voluntary controlled.
- there were 646 foundation schools
- there were 744 community secondary schools:
 - 324 were voluntary aided
 - 50 were voluntary controlled.
- there were 315 foundation schools.

Approximately 3.9m primary school pupils and 1.3 m secondary school pupils were educated in these schools.

Many schools have converted or are considering converting to academy status.

Academies

Academies are funded directly by the government through the Education Funding Agency (EFA), an executive agency sponsored by the Department for Education (DfE). They have more freedom to decide how they will operate, and they can also have involvement from private sector companies and sponsors.

In January 2014:

- there were 1,789 primary, 1,893 secondary and 109 special academies; there were also 36 alternative provision academies – a total of 3,827 academies
- approximately 0.5 m primary and 1.9m secondary school pupils were taught in academies.

More secondary schools students were taught in academies than in community schools.

For councils, the main issues around schools converting to academy status are likely to be managing the change and minimising the impact on their finances, particularly where the level of services sold to schools changes if the new academies then choose to buy those services from elsewhere. Councils may also find that the funding that the government keeps for academies in its area is more than was previously paid directly to those schools, because of expenditure on things like school improvement and planning that was spent directly by the council.

Free schools

Free schools are very similar to academies in the way they are funded and in their freedom to decide how they will operate. Introduced by the current government, they are established in response to groups of local parents getting together to decide that there is a need for a new school in their area.

In June 2014, the government approved 38 new free schools, bringing the number of open and approved free schools to 331.

Other schools

In January 2015, there were 30 university technical colleges. A further 20 will open by 2016. There are also 45 studio schools open or in development. They are also funded by the EFA.

SCHOOLS IN WALES

Wales has a simpler system of schools with all its schools being community-type schools. In January 2014:

- there were 17 nursery, 1,359 primary, 213 secondary, 4 middle and 42 special schools
- the total number of pupils (headcount) in local authority maintained nursery, primary, secondary and special schools was approximately 465,000.

EDUCATION SPENDING

Education remains a key priority for the government and the spending review in 2010 included a commitment to maintaining spending at a flat cash level per pupil plus the pupil premium for the spending review period 2011/12 to 2014/15 for the school budget for pupils aged 5 to 16. The spending round 2013 announced a real terms protection for school budgets and the pupil premium for 2015/16.

Education is the biggest local government service, with budgeted revenue expenditure of £35.8 bn in England in 2014/15. This figure excludes expenditure on academies, which are funded directly by the DfE via the EFA. Education accounted for around 31.2% of total spending on all local government services, comparable with the combined spending on social care, police and the fire service. Within the total, the breakdown between categories of schools is as follows.

Education services: budgeted expenditure 2014/15

| | Net current expenditure |
|---|-------------------------|
| Education services | £m |
| Early years | 2,869 |
| Primary schools | 17,109 |
| Secondary schools | 8,940 |
| Special schools and alternative provision | 3,098 |
| Post-16 provision | 569 |
| Other education and community budget | 3,250 |
| Total education services | 35,835 |

Note: figures exclude academies as these are funded directly from central government.

Source: Local Authority Revenue Expenditure and Financing: 2014-15 Budget, England (Revised), October 2014, DCLG.

Education is also the biggest local government service in Wales, with budgeted revenue expenditure of almost £2.6bn in 2014/2015, accounting for 33% of total budgeted expenditure.

LEGAL FRAMEWORK – KEY MILESTONES AND RECENT CHANGES FOR EDUCATION

The education service has evolved over the past 150 years. Some of the key Acts of Parliament that shaped that evolution are listed below. The recent changes to the financial framework are also highlighted.

Key historic education Acts include:

- The *Elementary Education Act 1870* recognised that elementary education was a state responsibility and established the first school boards.

- The *Education Act 1902* established local education authorities (LEAs) with the power to provide elementary and higher education. School boards were abolished.
- The *Education Act 1944* was an especially important act. It gave LEAs the power and the duty to provide primary, secondary and further education. It also empowered LEAs to maintain and assist primary and secondary schools not established by an LEA; that is, voluntary schools (generally church schools).
- The *Education Act [no 2] 1986*, however, reduced local authority control of schools by changing the composition of governing bodies and increasing the power of governors. LEAs were required to provide each governing body with an annual statement of the running costs of their schools and to make available to them funds which they could spend at their discretion. This Act marked the introduction of devolved budgets for schools, resulting in the creation of schools as semi-independent institutions.

Education Reform Act 1988

The *Education Reform Act 1988* introduced the national curriculum and the local management of schools (LMS). This act allowed for the creation of grant-maintained schools and abolished the Inner London Education Authority. Grant-maintained schools were independent of local authority control. They were initially funded by central government directly. Part of local authority expenditure on education consisted of payments back to the government for the funding of these schools.

School Standards and Framework Act 1998

The *School Standards and Framework Act 1998* provided for greater devolution of funding from LEAs to schools. Schools started to receive dedicated budgets for a further range of services which could be used to buy back services from the council – or from other suppliers. Schools could also provide these services themselves.

With effect from April 1999, the funding of grant-maintained schools was transferred back to councils. Most of these schools then became foundation schools.

Education Act 2002

The *Education Act 2002* brought in a framework for a new system of education finance. A key part of this involved the separation of the schools budget from the LEA budget. The schools budget covers all expenditure that was previously (generally speaking) delegated to schools plus most other expenditure which relates to the direct provision for pupils. The LEA budget covers functions, such as home to school transport, that are more sensibly carried out by the LEA. School finance regulations set out in detail the specific classes and descriptions of expenditure that comprise each budget. The intention behind this was to provide greater transparency, making it clear how government funding was divided between LEAs' responsibilities and schools' responsibilities. This Act also required each LEA in England to set up an advisory schools forum, broadly representative of the schools in that LEA area.

Education Act 2005

The *Education Act 2005* paved the way for the introduction of the Dedicated Schools Grant (DSG). It introduced the concept of ‘funding periods’ instead of ‘financial years’ – thus facilitating the introduction of academic year budgets if desired as a later stage.

Education and Inspections Act 2006

The *Education and Inspections Act 2006* brought together the remittance of four separate inspectorates previously responsible for the inspection of children’s services. It placed a duty on LEAs to provide free home to school transport for certain pupils and it created a new statutory procedure for schools to acquire a foundation.

Academies Act 2010

The *Academies Act 2010* legislated to allow schools to opt out of local authority control if they can successfully apply to convert to academy status. Academies are publicly funded independent schools. They are outside local authority control, they can set their own pay and conditions for staff, they have freedoms around the delivery of the curriculum and they have the ability to change the lengths of terms and school days.

The *Academies Act 2010*:

- allows maintained schools to apply to become academies and permits the secretary of state to issue an academy order requiring the local authority to cease to maintain the school
- allows the secretary of state to require schools that are eligible for intervention to convert to academies
- provides for secondary, primary and special schools to become academies
- ensures there is no change of religious character as a result of the conversion process
- allows schools that apply to become academies to keep any surplus financial balance
- requires the governing bodies of maintained schools to consult with those persons whom they think appropriate before converting to an academy
- ensures that for foundation and voluntary schools with a foundation, there is consent from that school’s foundation (often a diocesan board of education) before the school can apply to become an academy
- deems academy trusts to be charities, and therefore they have to fully comply with all the requirements of charitable companies’ accounts
- ensures that a converting school will continue, as an academy, to be able to occupy the land and buildings it had as a maintained school, and that the school’s other assets may also transfer to the new academy for the benefit and use of the pupils of that school.

Academies are funded using their previous local authority’s funding formula mechanism so there should be no funding advantage or disadvantage in converting to an academy. Because the local authority’s funding formula is used, this entitles academies to be represented on the local schools forum.

As of April 2014, there were 3,854 academies open in England.

The Education Act 2011

The *Education Act 2011*:

- Enables a new entitlement for disadvantaged two-year-olds to 15 hours' free early years education.
- Replaces independent appeals panels for exclusions with independent review panels.
- Removes the duty on councils to appoint a school improvement partner for every school.
- Gives precedence to academy proposals, where a council identifies the need for a new school, and expands the academies programme to allow 16–19 and alternative provision academies.
- Extends the secretary of state's powers to intervene in underperforming schools.
- Provides for the closure of the Local Government Ombudsman's school complaints service, and removes the duty to consider complaints about the curriculum from councils. General complaints about schools will now be made to the secretary of state.
- Allows for pilots of direct payments for SEN education services.
- Makes changes to local authority powers over sixth form colleges.
- Provides for the abolition of five arm's-length bodies (the Training and Development Agency for Schools, the General Teaching Council for England, the Qualifications and Curriculum Development Agency, the Young People's Learning Agency and the School Support Staff Negotiating Body).

The Children and Families Act 2014

A Green Paper, *Support and Aspiration: A New Approach to Special Educational Needs and Disability*, was published in April 2011. The Green Paper made wide-ranging proposals to radically reform the current system for identifying, assessing and supporting children and young people who are disabled or have special educational needs (SEN) and their families. A progress report followed in May 2012, *Support and Aspiration: A New Approach to Special Educational Needs and Disability – Progress and Next Steps*. This report sets out the next steps in taking forward the Green Paper reforms. The *Children and Families Act 2014* progresses the programme set out in this report by:

- replacing old statements with a new birth to 25 education, health and care plan
- improving co-operation between all services that support children and their families, particularly requiring local authorities and health authorities to work together.

School Funding Reform: Next Steps towards a Fairer System

On 26 March 2012, the secretary of state published *School Funding Reform: Next Steps towards a Fairer System*. This explained how the DfE plans to proceed until the end of the current spending review period and invited views on areas where there are different options. Key points from the document include:

- The government will work towards introducing a national funding formula in the next spending review period. The minimum funding guarantee will continue to be set at minus 1.5% for 2013/14 and 2014/15.

- Local funding arrangements will be simplified so that local funding formulae are made simpler, more consistent and transparent.
- There will be changes to schools forums' composition and operation so that their business is more transparent and decisions better reflect the views of providers.
- The EFA will play a strong role in ensuring fairness within the new system.
- A new methodology will be introduced for funding high-need pupils which will provide a consistent approach to funding across all types of providers, and ensure funding flows with the individual.
- The funding of early years provision will be simplified and made more transparent.

As part of spending round 2013, the chancellor announced that the government would begin consultation on the introduction of a new national funding formula for schools. This is discussed in more detail in the 'Review of school funding' section later in this module.

EDUCATION REVENUE EXPENDITURE

Revenue or current expenditure is spending on the costs of running council services on a day-to-day basis within a financial year. It includes costs such as staffing, heating, lighting and cleaning, together with expenditure on goods and services consumed within the year. Net revenue expenditure is the total revenue expenditure less income from any sales, fees and charges, etc.

For councils, the main source of funding for revenue spending on children's services is formula grant from central government. There is also a smaller proportion of income from fees and charges.

The responsibility for education matters outside England, including funding matters, rests with the Scottish Parliament, the Welsh Government and the Northern Ireland Assembly. The funding they provide for their pupils will be different, representing their own national priorities.

For England, the DfE divides the money designated by the government as spending for schools into a number of grants, the core element of which is the DSG, which must be passed on in its entirety to maintained schools – the authority's chief finance officer is required to confirm that this happens. The DSG is the main source of funding for teacher and support staff salaries, school running costs and other non-pay items such as books and equipment. The DSG is split into three blocks – schools block, high needs block and early years block.

Under the current school funding system in England, most funds are allocated on a per-pupil basis. The more pupils a school has, the more funding it receives. However, the money a school receives for each pupil is weighted to take into account pupils' characteristics, such as their age, whether they have special education needs and whether they come from a deprived background.

Under DSG, each school is guaranteed a minimum per-pupil increase each year. There is also a cash floor, so that authorities with rapidly falling school rolls will be guaranteed a minimum cash increase.

Most of the DSG is distributed to maintained schools using locally determined formulae. Councils create their own fair funding formula, deciding how much extra money the schools under their control receive for different sorts of pupils. However, there has been significant variation in how local authorities allocate funding to schools. In order to move to a more consistent, comparable and transparent system, local authorities are now limited to a maximum of 12 factors in their formulae, which relate largely to pupil characteristics and pupil numbers (taken from the Annual School Census data), and less on the circumstances of the school. Funding is available for pupils with high needs in special schools or mainstream schools, based on the needs of the pupil. The government requires that a minimum of 80% of delegated schools block funding is allocated through an appropriate and locally determined combination of the pupil-led factors.

To protect schools from significant budget reductions, the government ensured that no school saw a reduction larger than 1.5% per pupil in their 2014/15 budget compared to 2013/14 (excluding sixth form funding). This has been continued for 2015/16.

As in previous years, a cash floor of minus 2% has been applied to the DSG allocations, to protect local authorities with significant falling rolls.

All delegated funding may be spent on anything required for the purposes of the school, so there is rarely a close link between individual formula factors and specific categories of expenditure. Schools therefore make their own decisions on how much to spend on staff, premises maintenance, etc, in order to most effectively fulfil their duties to current and future pupils. For example, funding for building maintenance is partly included in key stage weighted pupil funding and partly in floor area funding, so it is not possible to identify a 'budget' for building maintenance simply by looking at the formula allocations.

The total amount of resource for school and pupil provision in any one year is referred to as the schools budget. The funding retained centrally from the schools budget by the local authority to support the kinds of activities and meet their costs referred to above is the central expenditure. The balance of funding left in the schools budget is referred to as the individual schools budget (ISB) and this is the total amount of resource that is delegated to individual schools in the form of school budget shares.

The value of these formula components for each school's budget share is included within the various tables of the statutory financial reporting requirements provided to each school – currently these are the section 251 statements.

Purposes of central expenditure

The school finance regulations specify the kinds of activities a council can fund from, and the costs it can incur in, its central expenditure. In summary these are:

- funding for pupils with special educational needs that is not delegated to school budget shares – in the main this relates to expenditure on pupils with exceptionally low incidence (ie less common) special educational needs but in some cases it also includes funding for statements which has not been delegated to school budgets
- funding for the provision of pupil referral units
- funding for non-maintained early years provision

- miscellaneous school and pupil-related expenditure, including school admissions, primary and special school meals where not delegated, licences and subscriptions, some supply cover costs (including ante-natal/maternity, adoption and paternity leave, long-term sickness, the costs of teacher suspensions and civil and trade union duties)
- library services for primary and special schools where they are not delegated to schools
- revenue funding used to support school capital projects.

In addition to these costs, there are other types of funding that can be retained centrally by the council, but only on condition that the schools forum agrees the amounts held against each item. These are:

- school-specific contingency for the purposes of making in-year adjustments of school budget shares (for named SEN pupils and rates, for instance)
- funding for combined services
- funding for servicing the costs of a prudential borrowing scheme
- funding for termination of employment costs
- SEN transport costs.

In addition to the kinds of activities and costs that can be incurred in the central expenditure of a council, there is also a limit placed on its size. This limit (known as the central expenditure limit or CEL) operates by restricting the increase in a council's centrally retained expenditure.

The methodology underlying the allocation of DSG, the guaranteed unit of funding to individual councils, can be found in the *Dedicated Schools Grant: Technical Note for 2015–2016*.

The sanction of the schools forum is required if a council wishes to 'break' the central expenditure limit and increase the spending on support services within the central spend at a greater rate of increase than the one applying to the increase in individual schools. It has to be recognised that this is one of the few decision-making powers of the schools forum – but this approval requirement can cause tension between schools and their council, which is generally the decision-making body.

These also go directly to schools, although the payment mechanism is that councils receive the appropriate monies and distribute these to individual schools in accordance with the grant arrangements, either directly into schools' bank accounts (where they have them) or into the authority's bank account if a school does not have its own bank account.

The schools' budget includes delegated budgets to schools, plus a number of centrally managed functions relating largely to the provision of support for pupils with SEN, out-county and independent SEN placements and funding for three-year-olds in private nurseries.

Councils can add to the schools budget from local sources of income. Councils retain responsibility for setting the overall level of their individual schools budget and for determining schools' budget shares, subject to the *School and Early Years Finance (England) Regulations 2014*.

Spending review 2010

The 2010 spending review set the parameters for government spending for the DfE for 2011/12 to 2014/15.

The main points were:

- After subsequent changes to the GDP deflators used, spending per pupil will be a 'flat cash' per-pupil position, plus a new pupil premium for the schools budget. The secretary of state has said that the minimum funding guarantee protection at individual school level will remain at minus 1.5% in both 2013/14 and 2014/15. This was reiterated for 2015/16,
- Extending 15 hours a week of early years education and care to all disadvantaged two-year-olds from 2012/13, and maintaining the universal entitlement to 15 hours for all three- and four-year-olds implemented by the coalition government.
- Sure Start services to be maintained in cash terms, including new investment in Sure Start health visitors, and Sure Start will be refocused on its original purpose of improving the life chances of disadvantaged children. (The new financial arrangements are difficult to assess as the Sure Start supported activities are now included within the early intervention grant (EIG) which was new for 2011/12.
- The EIG replaces the Sure Start grant and funding through the area based grant, which is 24% lower following the coalition government's mid-year reduction in 2010/11.)
- £15.8bn of capital funding over the spending review period to be used to rebuild or refurbish over 600 schools from the Building Schools for the Future (BSF) and academies programme. The decision to end BSF allowed new capital to be focused on meeting demographic pressures and addressing maintenance needs.
- Overall resource savings in the DfE's non-schools budget of 12% in real terms by 2014/15, contributing to overall DfE savings of 3% in real terms, to be achieved by cutting administration and back-office costs, reducing 16-to-19s unit costs, focusing the support previously provided by education maintenance allowances on the most disadvantaged children in the context of raising the participation age to 18, and rationalising and ending centrally directed programmes for children, young people and families.

Spending round 2013

The spending round 2013 included in its plans for 2015/16 spending:

- real terms protection of the schools budget
- real terms protection of the pupil premium
- a commitment to consult on how to introduce a fair national funding formula for schools in 2015/16 (see the 'Review of school funding' section later in this module)
- continued roll-out of academies and funding for new free schools, studio schools and university technical colleges
- savings through reductions to the department's centrally held programme budgets and administration budget.

Pupil premium

The pupil premium aims to provide significant funding for disadvantaged children to help close the attainment gap. The pupil premium is allocated to schools for most pupils and can be seen separately in their funding. Schools can decide how the pupil premium is spent but they have to say how they have used the extra money to support deprived pupils.

Schools received £2.5bn through pupil premium funding in 2014/15, representing around 5% of all education funding. From April 2014, schools attract £1,300 for primary school pupils, £935 for secondary school pupils and £1,900 per looked after child. The pupil premium is allocated based on the number of children who are known to be eligible for free school meals and children who have been looked after (by the council) for more than six months. From April 2014, children looked after attract funding from the first day of care. Eligibility will include those adopted from care or leaving care under a special guardianship order or residency.

Review of school funding

A new funding formula for schools (or national funding formula as it is sometimes called) has frequently been proposed in recent years, especially by councils and schools in those areas that tend to receive relatively less funding under the current complex arrangements. Change, however, has not yet actually come, partly because of the sheer difficulty of creating a genuinely equitable system and partly because with any change, there will inevitably be winners and losers. A national funding formula will struggle to address the significant funding disparities between councils. It will also struggle to fund the different local recommendations made by various local schools forums which have allocated differing levels of per-pupil funding to particular key stage levels in their locality. In addition, there is a very wide range of per-pupil funding in high-cost facilities such as special schools, pupil referral units and schools with specialist units that cater for pupils with learning difficulties and disabilities.

However, in April 2011, the DfE published a consultation on reforming the funding formula: *A Consultation on School Funding Reforms: Rationale and Principles*. The consultation document set out the government's preferred options and other ways in which a national funding formula might work. The government's view is that the formula should be based on 'pupil characteristics' such as the proportion from deprived backgrounds *'with the probable exception of some mechanism to support small schools'*. It is concerned however that a formula taking into account a school's characteristics would be less supportive of new providers into the system *'and risks ossifying the current pattern of provision'*. It might also be a disincentive to greater efficiency, although it might *'be better able to reflect the cost of existing provision'*.

It adds: *'the government is clear that any formula should include a basic per-pupil amount for all pupils (this will be higher for secondary pupils than primary) plus extra funding per deprived child. The pupil premium will also continue to provide additional funding. It is our long term aim for the pupil premium to be fully integrated within the national funding formula, and to be the vehicle for clear and transparent distribution of all deprivation funding'*.

On 26 March 2012, the secretary of state published *School Funding Reform: Next Steps towards a Fairer System*. This confirmed that the government will work towards introducing

a national funding formula in the next spending review period. The minimum funding guarantee will continue to be set at minus 1.5% for 2013/14 and 2014/15.

As part of spending round 2013, the government committed to consultation on the introduction of a national funding formula from 2015/16. However, in March 2014 the government announced that it had decided not to set out a multi-year process of converging all local authorities towards a single funding formula. The government's view is that the right time to do this would be when there are multi-year public spending plans, so they can give greater certainty to schools. Instead, the government published a consultation on fairer school funding in 2015. This proposes to allocate additional funding of £350m; for 2015/16, every local authority will attract a minimum funding level for every pupil and school. The government proposes to set a minimum funding level for the basic amount that all pupils should attract; for deprived pupils; for pupils with English as an additional language; for pupils with low levels of attainment on entering school; and for pupils who have been looked after – for example, in foster care. Where a local authority's budget already exceeds what it needs to meet minimum funding levels, the government will not make any change to the amount of per pupil funding that it receives from the DfE. No local authority and no school will receive less funding per pupil as a result of these proposals.

Approach for 2015/16

Following the above consultation and the government's response, the DfE published *Fairer Schools Funding: Arrangements for 2015 to 2016* in July 2014. This sets out a number of reforms that the government is making to the schools funding system for 2015/16. The main proposals include:

- all local authorities will be funded to at least the same cash level as in 2014/15
- to allocate an additional £390m (rather than £350m announced earlier) to fund schools in the least fairly funded authorities.

The additional funding means that each local area's allocation of funding will reflect a minimum basic per-pupil amount, and amounts reflecting other pupil and school characteristics. This will mean that in each local area, the most deprived pupils in primary schools will attract at least £4,454. In key stage three, they will attract at least £5,820, and at key stage 4, at least £6,372. This will continue to be supplemented through the pupil premium.

The minimum funding levels for 2015/16 will be:

- a per-pupil amount ('age weighted pupil unit') – primary: £2,880; key stage 3: £3,950; key stage 4: £4,502
- deprivation – between £882 and £1,870
- looked after children – £1,004
- low prior attainment – primary: £669; secondary: £940
- English as an additional language – primary: £466; secondary: £1,130
- a lump sum for every school – primary: £115,797; secondary: £125,155
- additional sparsity sum for small schools vital to serving rural communities – primary: up to £44,635; secondary: up to £66,656

- an area cost adjustment to increase minimum funding levels in areas with higher labour market costs.

The list above includes seven of the characteristics used in local formulae. Local authorities are not obliged to use all these factors in their local formulae in 2015/16 (with the exception of the basic per-pupil amount and the deprivation factor, which are mandatory). Local authorities have the same freedom to set local formulae for their schools in 2015/16 as they did in 2014/15 (with the exception of a minor revision to the sparsity factor).

In order to calculate whether a local authority will attract additional funding to reach the minimum funding levels, the DfE has applied the same methodology as it proposed in March 2014. First, it has looked at what each local authority will receive in 2014/15 (schools block unit of funding only), then applied the minimum funding levels described above. This has been done by:

- 1 multiplying each of the minimum funding levels by the relevant number of eligible pupils or schools in the local authority
- 2 summing each of the totals in 1 to create a new funding amount for the local authority
- 3 applying the area cost adjustment to the total in 2
- 4 dividing this total by the number of pupils in the local authority
- 5 if the result of 4 is more than the local authority's per-pupil funding in 2014/15, increasing the local authority's funding to reach this new level;
- 6 if not, keeping the level of funding per pupil the same.

The report also sets out how the DfE will move to a single system for the funding of academies and how the funding of local authorities will be amended for pupils in free schools. Funding for most academies is currently included in the DSG that is given to each local authority to fund its schools. As the EFA funds academies directly, it recoups the academies' share of the DSG from each local authority. However, funding for around 10% of academies – known as non-recoupment academies – is not included local authorities' DSG allocation and is therefore not recouped. The arrangement for free school funding is similar to that for a non-recoupment academy: funding is not recouped from a local authority's DSG when a free school opens.

Following the consultation, for 2015/16, the DfE will:

- work out how much the EFA would recoup for former non-recoupment academies in 2015/16 if the local authority's formula remained the same as in 2014/15
- increase this amount in line with the local authority's percentage gain from minimum funding levels.

The DfE will add to this the greater of:

- the amount of central expenditure the EFA paid to non-recoupment academies in the local authority's area in 2014/15
- the amount of central expenditure the local authority pays to former non-recoupment academies in 2015/16.

The DfE will add the resulting total to the local authority's DSG in 2015/16.

For free schools, the government allows local authorities to make retrospective adjustments the following financial year to address any variation between estimated and actual pupil numbers.

Further plans

The report also notes the government's intention to reform the systems for funding higher needs. This will be subject to consultation.

Local authority early intervention grant

The government has said it wants councils to focus on essential front-line services, and to invest in early intervention and prevention to produce long-term savings and better results for children, young people and families.

A key element of this approach was the creation of a new early intervention grant (EIG) for local authorities in England, worth £2,212m in 2011/12 and £2,297m in 2012/13. It replaced a number of former funding streams. Given the tight funding settlement, some reduction in central government support was inevitable and in 2011/12, the amount to be allocated through EIG is 10.9% lower than the aggregated 2010/11 funding through the predecessor grants (some of which were already reduced by 24% following the coalition government's decision in June 2010 to reduce the education area based grants by £311m).

From 2013/14, the bulk of EIG was transferred into the base funding for local authorities with the exception of funding for free places for two-year-olds, which is incorporated into the DSG. In 2013/14 and 2014/15, the transfer excluded £534m and £760m respectively for free education for two-year-olds, and £150m in 2013/14 and 2014/15 for future use in funding early intervention and children's services.

Fairer Schools Funding: Arrangements for 2015 to 2016 notes that for 2015/16, additional funding for early years is being provided through a new early years pupil premium – an additional £50m to provide nurseries, schools and other providers of government-funded early education with additional funding for disadvantaged three- and four-year-olds. A consultation on this – *Early Years Pupil Premium and Funding for 2-year-olds* – was published on 25 June 2014.

Income from fees and charges

Income from fees and charges remains a very small proportion of total funding for children's services, but the spending review 2010 with its clear programme of government grant reductions has motivated councils to maximise every possible funding source. Fees and charges offer some scope for authorities to increase income. Authorities can also use charging structures to help deliver some policy objectives. But in the current difficult economic circumstances, authorities need to be realistic in their charging policies.

Schools are one (large) group of clients that pay fees and charges for council services but the context now is one of a fast-increasing number of academies – and academies can choose other suppliers if they wish. The move towards academy schools could have a significant financial impact on education authorities. Academies themselves can provide services (such as behaviour support) which the council would normally provide to a maintained school. It is

the extent to which the council's funding for these services is diverted to academies that is at stake. Councils are however able to derive income by selling their services to academies on a quasi-commercial basis. The key to maximising such income lies in accurately assessing and driving down costs while charging what the new market environment will bear.

For discretionary (ie non-statutory) services, in the past many authorities have simply nudged up charges year on year, often basing changes on the general rate of inflation. A 2008 Audit Commission report, *Positively Charged*, recommended that councils take a much more positive role in their charging. The report suggests:

- calculating what units of service cost to provide, and hence what proportion of service cost is covered by charges
- deciding – once the degree of subsidy is known – whether it is in the authority's interests to provide the service.

The government announced (in the Queen's speech in 2012) its plans to reform the system of SEN statements. These are being replaced by integrated education, health and care plans. When these changes are implemented, authorities will have to watch very carefully the level of resource input from other agencies. Securing adequate funding from other agencies may already be a source of tension in some local authority areas. The legislation – the *Children and Families Act* – received royal assent in March 2014.

CAPITAL EXPENDITURE AND CAPITAL FUNDING

Capital expenditure by councils is spending mainly on buying, constructing or improving physical assets such as:

- buildings – including schools
- land – such as playing fields
- vehicles, plant and machinery.

Building schools for the future

Prior to 2010, the largest capital spending programme on schools since Victorian times was the £55bn Building Schools for the Future plan. This aimed to renew every secondary school in England over a 15-year period, starting from 2005/06. It was prioritised to groups of schools with the poorest standards and greatest needs as measured by pupils' GCSE attainment and eligibility for free school meals. A national procurement body, Partnership for Schools, was established to support councils in ensuring that the new schools were well designed, built on time, at a reasonable cost to the taxpayer and properly maintained throughout their lives. However, the strategy was always subject to future government spending decisions and the coalition government, faced with the need to reduce the national deficit drastically, announced in July 2010 the ending of the programme.

Building Schools for the Future experienced a number of problems during its implementation, most notably delays in building. By June 2010, some 178 school rebuilds or refurbishments had been completed, with a further 231 in construction or nearly in construction. When the end of the scheme was announced, about 150 school projects were left waiting for a decision

still to be made on whether they would proceed. In the end, about half of these were told their developments would go ahead.

James review

To inform government decisions on the future for school building, a review was commissioned, headed by Sebastian James of the Dixons Group, to look at how school building should be carried out in the future. The review, published in April 2011, recommended that new schools be built to standardised drawings, incorporating the latest thinking on educational requirements. It also recommended that a new central body should be set up to negotiate contracts with the construction industry.

In June 2011 the DfE confirmed the closure of Partnerships for Schools and the appointment of the new chief executive of the EFA.

The EFA, an executive agency of the DfE, brings together in a single agency the allocation and management of revenue and capital funding, including the delivery of capital programmes.

Priority school building programme

In response to the James review, the government set up the priority school building programme (PSBP). The PSBP is a centrally managed programme set up to address the needs of the schools most in need of urgent repair.

Schools in need of urgent repair were invited to bid, and on 24 May 2012 the secretary of state confirmed that 261 schools would be rebuilt, or have their condition needs met, through the PSBP. A limited amount of capital grant was made available for schools in the worst condition and all special schools in the programme.

On 1 May 2014, the minister of state for schools announced that there would be a further phase of PSBP, known as PSBP2, with a value of around £2bn. This is a five-year programme operating between 2015 and 2021 and will undertake major rebuilding and refurbishment projects in schools and sixth form colleges that are in the worst condition.

Capital spending 2013 to 2015

On 24 January 2014, the DfE announced:

- Devolved formula capital (DFC) for financial year 2014/15 of £200m.

DFC is capital funding that is calculated on a purely formulaic basis. It is calculated for all mainstream nursery, primary and secondary schools, special schools, pupil referral units, academies, city technical colleges, sixth form colleges and non-maintained special schools.

For 2014/2015, the calculation of DFC uses a per school sum of £4,000 and a per pupil sum that varies. Secondary school pupils are allocated 1.5 times the amount for primary pupils, and special school and pupil referral unit pupils three times the amount for primary school pupils.

Ninety per cent of the DFC allocation is provided by the DfE for voluntary-aided (VA) schools – the governing body is required to raise the additional 10%.

- Maintenance for financial year 2014/15 of £1.2bn.

The overall maintenance budget is split across the sectors using weighted pupil numbers (as outlined for DFC above).

The allocation made to each local authority and VA school is based on the relative proportion of DFC paid to the schools by the local authority. For example, if a local authority receives 1% of the national DFC budget, it will receive 1% of the maintenance budget.

For 2014/2015, £442m of the maintenance budget will be allocated to the academies capital maintenance fund (ACMF).

Condition Improvement Fund 2015/16

The DfE provides a Condition Improvement Fund (CIF) for academies and sixth form colleges to access in the 2015/16 financial year. The CIF replaces the Academies Capital Maintenance Fund for academies and the Building Condition Improvement Fund for sixth form colleges.

Targeted basic need programme

On 18 July 2013, the minister of state for schools announced details of capital funding of around £820m that will provide new, high quality school places in locations that need more school places.

This funding is intended to provide the 417,000 places needed by 2015. The targeted basic need programme will deliver around 74,000 new pupil places in 45 new schools and through the expansion of 333 outstanding and good schools. A full list of projects that will be funded is available and more details of the funding are provided in the written ministerial statement on GOV.UK.

The level of need was the main factor taken into account within the targeted basic need programme assessment, but other factors included how readily the project could be delivered, and how the local authority had used other capital funding to address basic need.

In Wales, the elements for capital investment in schools include:

- 21st Century Improvement Programme.

The Welsh Government is implementing the *21st Century Schools and Education Capital Programme: Much More than a Building* – a strategic capital investment programme intended to focus resources on the right schools in the right places, for early years through to post-16.

- The VA schools capital grant.

The Welsh Government has the power to grant 85% of the costs of the governing body's approved expenditure – the governing body is required to raise the additional 15%.

- General capital funding.

A notional amount is included in the annual capital allocations provided to local authorities in the general capital fund for education.

Other sources of finance

Other sources of capital funding include contributions or grants from elsewhere (for example, the Lottery), the use of any capital receipts from the sale of surplus assets, private finance initiatives, council borrowing and revenue contributions to capital.

Private finance initiatives (PFI) are a form of public private partnership. Councils pay for the use of new or improved capital assets (and some associated services such as heating, lighting, technology or catering) rather than purchasing them outright. They do this by entering into a contract with the private sector which designs, builds, finances and operates the asset. Under a PFI contract, the council's regular payments to the contractor are linked to the contractor's operational performance. In this way, it is intended that risk will be transferred from the public to the private sector. It is crucial in PFI contracts that all risks are properly identified and a good working partnership should be established. At the end of the contract the asset reverts to the council, usually at nil cost and fit for further use.

Through the council PFI programme the government provides financial support for council projects provided they meet a set of defined criteria. A PFI credit is then issued to the authority once a contract for the project has been signed. The credit measures the capital value of the project which the government will support through revenue grant. In addition, there are potential complications in the local authority's funding formula mechanism because of the facilities management costs of the PFI scheme. These are also tied into contractual arrangements for up to 25 years, which can lead to excessive pressures on an individual school's delegated budget, especially when in a falling rolls environment.

Councils can borrow to finance capital projects but this borrowing must be 'prudential'; that is, the council must be sure that it will be able to afford to repay the loan plus interest out of its annual revenue budget according to CIPFA's *Prudential Code*. The *Prudential Code* requires the council to agree and monitor a number of prudential indicators, covering affordability, prudence, capital expenditure, debt levels and treasury management. These indicators will also form the basis of in-year monitoring and reporting.

Revenue contributions to capital are, straightforwardly, payments towards capital projects made from the annual revenue budget of the council. Because of the many other pressures on an authority's revenue budget, and the relatively large costs of most capital projects, this method of financing capital is seldom adequate by itself.

ACADEMIES AND FREE SCHOOLS

The most significant changes introduced by the coalition government are the move to hugely increase the number of academy schools and the encouragement of free schools. In January 2014, there were 1,789 primary, 1,893 secondary and 109 special education academies.

There is a large amount of information and advice for those converting or considering conversion to academy status on the GOV.UK website.

The main issues for councils around schools converting to academy status are likely to be managing the transitions and minimising any turbulence for council finances where the volume of central services provided to schools – and consequent economies of scale – change

in response to academy schools exercising their new-found choices in the procurement of these services.

The government's proposal to allow teachers, charities and parents to set up free schools was published as early as June 2010. Free schools are defined by the DfE as '*all-ability state-funded schools set up in response to what local people say they want and need in order to improve education for children in their community*'. They are essentially academies in terms of structure. The proposals included:

- a wider range of sites to be allowed without the need for change of use consent
- guidelines to be updated with a presumption in favour of new schools
- reallocating £50m to create a standards and diversity fund.

Information on how to set up a free school, an example of a model funding agreement, and advice on free schools funding and how revenue funding is calculated can be downloaded from GOV.UK.

OTHER EDUCATION ISSUES

Sixth form and further education

The government is committed to helping all 16- and 17-year-olds to take part in education or training and to raising the participation age to 18 by 2015.

Responsibility for funding post-16 learning in England is shared between the DfE (16–18-year-olds) and the Department for Business, Innovation & Skills (19-year-olds and over).

Raising the participation age does not mean young people must stay in school; they will be able to choose one of the following options:

- full-time education, such as school, college or home education
- work-based learning, such as an apprenticeship
- part-time education or training if they are employed, self-employed or volunteering for more than 20 hours a week.

If this is to be successful, all sections of the education system will need to play their part. Councils are expected to play a key role in championing the needs of young people in their areas and in working with local partners to achieve full participation.

Managing surplus school balances

Over a number of years there has been a significant problem with the levels of surplus balances held by schools, which have been as high as over £2bn overall, with over 160 schools in 2008/09 having surplus balances in excess of £1m and two schools having a surplus balance in excess of £3m. These (public) monies could otherwise have been used towards educating those schools' children.

The DfE has previously attempted to address this problem, but it then passed it to councils to resolve. At the end of 2009/10 the level of schools' surplus balances had reduced by £100m, but by the end of 2011/12, the level of schools' surplus balances had increased again to

£2.3bn as schools sought to prepare for the effects of the recession and anticipated possible reductions in the spending power of their delegated budgets.

Balance control arrangements for schools' balances are included within each council's scheme for financing schools which was originally approved by the secretary of state and each local schools forum in April 2007. Issue 6 of statutory guidance from the DfE for local authorities on schemes for financing schools (February 2014) includes the following extract:

The scheme may contain a mechanism to claw back excess surplus balances. Any mechanism should have regard to the principle that schools should be moving towards greater autonomy, should not be constrained from making early efficiencies to support their medium-term budgeting in a tighter financial climate, and should not therefore be burdened by bureaucracy. The mechanism should therefore be focused on those schools which have built up significant excessive uncommitted balances and/or where some level of redistribution would support improved provision across a local area.

Schools financial value standard and assurance

In November 2010, the secretary of state for education announced the end of the financial management standard for schools, with immediate effect. Its replacement, the schools financial value standard (SFVS), was designed in conjunction with schools to assist them in managing their finances and to give assurance that they have secure financial management in place. Governing bodies have formal responsibility for the financial management of their schools, and so the standard is primarily aimed at governors.

Maintained schools are required to complete the SFVS once a year. Local authorities are required to fill out the DSG chief financial officer form every year to cover all maintained schools in their area.

SFVS is not externally assessed but councils are expected to use schools' SFVS returns to inform their programme of financial assessment and audit.

The Carbon Reduction Commitment Energy Efficiency Scheme

The Carbon Reduction Commitment Energy Efficiency Scheme is an important part of plans to reduce UK emissions in line with requirements established by the *Climate Change Act 2008*. It is a mandatory scheme aimed at improving energy efficiency and cutting emissions in large public and private sector organisations. Together these organisations are responsible for around 10% of the UK's emissions.

The scheme features a range of reputational, behavioural and financial drivers which aim to encourage organisations to develop energy management strategies that promote a better understanding of energy usage. It developed from the recommendation for the establishment of a price for carbon in the Stern Report and is seen as a key mechanism for bringing about a reduction in greenhouse gas emissions.

The scheme affects government departments and those local authorities, schools, NHS trusts, fire authorities and police authorities that qualify for the scheme – but state-funded schools in England were excluded from April 2013. Instead, the DfE reduced each local authority's DSG in order to pay for schools' contribution to the CRC scheme. The DfE calculated the deduction for each local authority on the basis of their spending in 2013/14 on

CRC allowances for schools, as declared in their section 251 returns to DfE. These deductions totalled £51m – around 0.15% of the DSG. For 2015/16 this method has been revised. Funding for the CRC scheme from the DSG will be deducted on a simple per-pupil basis. First, per-pupil funding will be adjusted to take account of minimum funding levels, then each local authority's per-pupil funding will be reduced by £7.51. This will reduce the cost of the DSG by £51m, the same as the amount by which DfE reduced local authorities' DSG in 2014/15.

Schools forums

Schools forums are advisory bodies, established by local authorities to represent schools' views to the council. In October 2013, the government updated its operational and good practice guidance to support schools' forums in line with the provisions of the *Schools Forum Regulations 2012*. The schools forum is made up of representatives from schools and academies, but with some representation from other non-school organisations, such as nursery and post-16 providers. Schools' and academies' representatives on the forum should be roughly proportionate to the number of pupils in each sector.

Schools forums have an important role. Councils are required to consult them especially on:

- changes to the schools funding formula
- the terms of contracts to be let by the council for services to schools, paid from the schools budget (subject to a de minimis level)
- proposed changes to the operation of the minimum funding guarantee
- arrangements for pupils with special educational needs, in pupil referral units and in early years provision.

The forum is responsible for decisions on:

- How much funding may be centrally retained within the DSG (eg for the admissions service)
- any proposed carry-forward of deficits on central spend from one year to the next
- Proposals to de-delegate funding from maintained primary and secondary schools (eg for staff supply cover)
- changes to the scheme of financial management

The *Schools Forum Regulations 2012* were amended in 2014 to reflect the *School and Early Years Finance (England) Regulations 2012* and *2013*.

Detailed guidance on the role of schools forums is available on GOV.UK.

Financial reporting requirements

Since the inception of local management of schools in 1988, councils have been required to prepare a budget statement before the start of the relevant financial year setting out their planned expenditure, the schools formula funding mechanism and how much is allocated to each individual school, including the component value of the formula factor for each individual school.

The budget statement is governed by a Statutory Instrument issued each year along with appropriate guidelines published by the DfE to improve consistency in the published figures.

This statement is called the section 251 statement and it contains several tables to provide schools, parents and others with an interest in education with details about schools' and children's services' funding. These statements are distributed to each headteacher and chair of governors as well as being published on each council's website.

School governing bodies have to approve their budget within two months of receiving their section 251 statements and should also submit a multiple-year budget at the same time in order to indicate potential future issues.

Schools, through their council, have to complete a consistent financial reporting (CFR) return by July of each year. The CFR returns analyse a school's income and expenditure in the previous financial year on a consistent basis to aid benchmarking. The *Consistent Financial Reporting (England) Regulations 2012* provide definitions for each CFR code.

To understand this process better, a comparison can be made on a personal level:

- The section 251 statement would be equivalent to a contract of employment that states your annual income.
- The budget spending plan would be equivalent to a plan of how you are intending to spend your salary, for example mortgage payments, car running costs, food bills, utility bills, clothes, holidays, entertainment, etc.
- The financial monitoring statements would be the equivalent to checking your bank statements are yours and are in line with your spending plans.

EDUCATION IN WALES

Education in Wales is compulsory between the ages of 5 and 16 and there are some 1,618 state schools, with around 465,000 pupils. Secondary school education is provided through community-based comprehensive schools. The Welsh Government has steadfastly refused to consider introducing academy schools so far.

The Welsh Government provides funding to councils for pre-16 provision in schools in Wales – whether they are maintained by the local authority or are voluntary-aided schools – mainly through the local government finance settlement (revenue support grant). The other main sources of funding for local authority education budgets are council tax income and non-domestic rates income. Local authorities may also receive specific funding from the Welsh Government where the Welsh Government considers this to be the most effective way to develop a particular policy. Funding for post-16 provision in schools is by specific grant from the Welsh Government.

The Welsh Government also provides capital funding for schools (apart from voluntary-aided schools) including school building improvement grant, disabled access to schools, school premises issues and school playing fields.

The future delivery of education services in Wales

A critical report in 2012 from the schools inspectorate, Estyn, highlighted, among other things, that 40% of pupils starting secondary school had a reading age below their actual age and has prompted a review of the current education system. In January 2013, the minister announced the appointment of Robert Hill to undertake the review on the future delivery of

education services in Wales. It focused on looking at the effectiveness of current education delivery at school and local authority level, considering what should be undertaken at school, local authority, regional and national level.

The report resulting from Robert Hill's wide-ranging review suggested transferring some statutory education functions to Wales' regional education consortiums. There are four formal education consortiums in Wales covering North Wales, South West and Mid Wales, Central South Wales and South East Wales. These were set up with the aim of sharing good practice, knowledge and skills. However, the Welsh Government has chosen not to consider restructuring school services, pending the results of the Commission on Public Service Governance and Delivery. The aim of the commission was to *'look hard, honestly and objectively at the way public services are governed and delivered in Wales, and how they may be improved'*. The commission's report was published in January 2014 and recommended that councils in Wales should merge, leaving 10, 11 or 12 local authorities rather than the current 22. This is ongoing. Following this, legislation was introduced to allow voluntary mergers among councils ahead of full reorganisation in 2020.

Post-16 education

The policy and framework for reforming post-16 education in Wales, *Transforming Education and Training Provision in Wales*, was launched back in September 2008. The document challenged all schools, colleges, universities and work-based training providers to plan collectively across a geographic area. The aim was to remove duplication of training and direct more money to teaching, learning and support for learners.

In November 2009, *Transformation – Y Siwrnai* was published. This document reported on the progress made on post-16 transformational change one year on from the launch of the transformation policy. The *Structure of Education Services in Wales – Independent Task and Finish Group Report*, published by the Welsh Government in March 2011, recommended the continued rationalisation of Welsh colleges and further mergers have taken place. The Welsh Government continues to work with learning partnerships on the development and implementation of effective plans for change. These fall into four types: college/secondary school collaboration; single post-16 learning provision in an area; further education institution mergers; and council area reorganisation.

Further information

Detailed information about the arrangements for funding schools in Wales, including the respective roles of the Welsh Government and councils, the legal framework and statistical information is available from the Welsh Government website.

FURTHER READING

Capital Funding Technical Note for DFC and Maintenance (Financial Year 2014 to 2015), DfE, 2014

Comprehensive Spending Review 2010, HM Treasury, 2010

Comprehensive Spending Round 2013, HM Treasury, 2013

The Consistent Financial Reporting (England) Regulations 2012

A Consultation on School Funding Reform: Rationale and Principles, DfE, 2011

Dedicated Schools Grant: Technical Note for 2015–2016, DfE, 2014

Early Intervention: The Next Steps, DWP, 2011

Early Years Pupil Premium and Funding for 2-year-olds, DfE, 2014

Fairer School Funding: Arrangements for 2015 to 2016, DfE, 2014

The Future Delivery of Education Services in Wales: Consultation Document, Welsh Government, 2013

Local Authority Revenue Expenditure and Financing 2014 to 2015 Budget, England (Revised), October 2014, DCLG

A Practical Guide for Local Authorities on Income Generation (2013 Edition), CIPFA, 2013

The Report of the Commission on Public Service Governance and Delivery, Welsh Government, 2014

Review of Education Capital, Sebastian James, 2011

School and Early Years Finance (England) Regulations 2014

Schools Funding Reform: Next Steps Towards a Fairer System, DfE, 2012

Schools Forum Regulations 2012

The Structure of Education Services in Wales – Independent Task and Finish Group Report, Welsh Government, 2011

Tackling Child Poverty and Improving Life Chances, HM Treasury/DWP/DfE, 2011

Targeted Basic Need Programme, EFA, 2014

MODULE 8

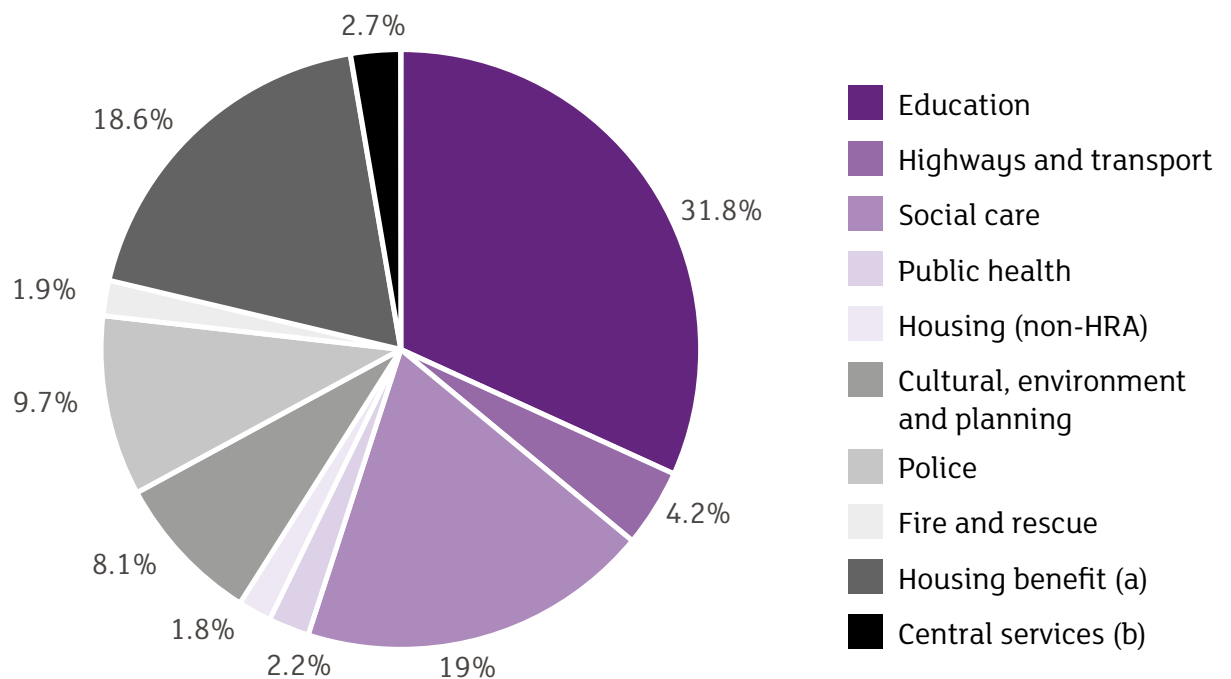
Housing

INTRODUCTION

Housing is vital to the country's economy because it enables people to have social mobility, health and wellbeing. Because housing is a base from which children access education, the quality and choice of housing has an impact on social mobility and wellbeing from an early age.

By statute, councils must aim to balance their HRA accounts and not budget for any deficit. The following chart therefore only shows local authority housing expenditure from the general fund, on non-landlord functions, such as homelessness (and so is **not** total housing expenditure):

Total service expenditure – England 2013/14



(a) *Housing benefit includes mandatory rent allowances and rent rebates.*

(b) *Central services include courts and other services relating to administration costs for council and no-domestic rates collection.*

Much is being written about the problems faced by people seeking housing in the UK, such as the NHF report *Broken Market, Broken Dreams*.

The income of an average first-time buyer today (£36,500) is nearly double that of their parents as average first-time buyers in the early 1980s (£20,000) after accounting for inflation. In real terms, this means that while in the early 1980s an average mortgage for a first-time buyer was 1.7 times their annual income, today this ratio has risen to 3.419.

By contrast, the local authority average weekly rent ranges from £69 to £128 per week, making this an option for many seeking accommodation, but supply often falls below demand.

There were 1.37 million households on local authority waiting lists on 1 April 2014, a decrease of 19% over the 1.69 million on 1 April 2013.

In the UK, the public sector's role is to provide shelter for people who could not otherwise provide it for themselves. However, in the social housing sector spending cuts and other restrictions on councils plus revised government priorities mean that available resources for social housing across the sector are limited.

The financial and other arrangements (eg statutes and regulations) for social housing are not uniform across the UK. The two main categories of social housing providers are housing associations (previously called registered social landlords) and local authorities (councils). In previous years, many council homes were transferred to housing associations. Such transfers are still possible. Housing association housing is both funded differently and accounted for differently from that of local authority housing. From the tenant's viewpoint, the services provided by the two categories of landlord are broadly similar and government policy has been until recently to encourage rents to converge to (eventually) the same level.

Local authority housing powers are extensive. Excellent financial management of the function has a vital part to play, both in the provision of housing services and in the implementation of the government's wide range of strategic changes in housing policies.

CHALLENGES FOR SOCIAL HOUSING

The biggest upcoming challenges in the social housing sector are likely to be:

- the urgent need to increase the supply of housing, especially affordable housing, in a climate of scarce funding
- the changes to housing benefits and the implementation of a new universal benefit under welfare reform.

Increasing supply

Overall, UK the housing market has been considerably depressed in recent years. This is primarily because of the tough economic and financial climate and the consequent lack of funding for new build, and difficulties for buyers in obtaining mortgages. Despite these difficulties, house prices have remained high. The house price index for August 2014, excluding London and the south east, showed that UK house prices increased by 7.8% in the 12 months to August 2014. Many commentators have gone so far as to describe the situation as a housing crisis. The Institute for Public Policy Research suggests that a whole generation may be locked out of home ownership, destroying community spirit and preventing young people from building careers, forming relationships and starting families. Their research

suggested that by 2020, the number of 18–30-year-old homeowners will almost halve, falling by 1.1m to only 1.3m. These findings were supported by the report *Broken Market, Broken Dreams*.

In 2011, the government produced *Laying the Foundations: A Housing Strategy for England*. The main points of the strategy included:

- a new mortgage indemnity scheme to help house-buyers
- an invitation to councils to come forward with proposals for locally planned large-scale development
- cash rewards to incentivise councils to bring empty homes back into use
- a new deal on housing for older people to help them to adapt their homes and stay independent if they wish
- help to people and communities who want to design and build their own homes
- improving fairness in council housing through increasing rents for the most well-off, recycling the income into new housing.

The Elphicke–House Report, published in January 2015, contained recommendations on local authorities' role in housing supply. It stated:

We believe that councils could achieve much more by taking a more central role in providing new homes. Our key recommendation is that councils change: from being statutory providers to being Housing Delivery Enablers. Councils have a primary role in setting out a vision for the development of their areas. They can be active in creating housing opportunity. Councils can be proactive in identifying housing need, growth and opportunity. They can work closely with businesses and other partners to share ideas and experience – and actively use their own assets and knowledge to unlock housing opportunities and deliver more homes, to build strong and sustainable communities.

The challenge to social housing providers, in both the local authority sector and the housing association sector, is to increase the supply of affordable housing within the context of the current adverse financial climate and the framework of government and regulatory restrictions, while managing and maintaining their existing housing stock. Councils also have wider and more strategic housing responsibilities.

Welfare reform and housing benefit

Housing benefit is an income-related social security welfare scheme to help people pay their rent. It is sometimes referred to as rent allowance or rent rebate.

Overall, the housing benefit programme costs some £24bn (including both the administration and the payment of housing benefit and council tax benefit) and is forecast to rise in 2015/16. It makes up about 14% of welfare spending. The government has identified it as a key area for spending reductions and is introducing major changes to housing benefits and a wider welfare reform. The first changes were heralded by the 2010 emergency budget, and the *Welfare Reform Act 2012* received royal assent in March 2012. The Act introduced a wide range of reforms which aim to make the benefits and tax credits system fairer and simpler and to create incentives to get more people into work.

Local authorities were originally told that their responsibilities for the provision of support with housing costs would reduce year on year between April 2014 and October 2017, with housing benefit being merged into universal credit and administered by DWP agencies. The original plan was that all new claims for housing benefit would end from April 2014, with existing claims starting to be migrated from October 2014 and completed by mid-2017.

Despite consistently expressed concerns over the progress of the project from a wide range of organisations, extending from the Public Accounts Committee, the National Audit Office, the Office for Budget Responsibility and the Major Projects Authority, Iain Duncan Smith has continued to insist the project remains *'on time and on budget'*.

In its December 2014 Economic and Fiscal Outlook (EFO), the Office for Budget Responsibility set out forecasts for the economy and the public finances, and an assessment of whether the government is likely to achieve its fiscal mandate.

This includes an assessment that even the much-revised schedule to introduce the new benefit remains *'too optimistic'*.

Housing benefit is an essential part of many people's ability to meet rent payments and an increasing number of in-work claimants require support. One of the areas of most concern to all housing providers is the introduction of direct payments, which, while providing the tenant with personal freedom, will also lead to some tenants falling in to rent arrears. The risk is that some tenants will have difficulties prioritising payments of rent against competing demands on their monthly budget.

Overall, these changes have significant financial implications for councils – and for housing associations. Tenants whose full housing benefit (or, when universal credit has been implemented, the housing benefit related part of the universal credit) no longer covers their total rent may struggle to pay their rent. There is a risk therefore of rising rents arrears and rising costs relating to bad debt provision.

LOCAL AUTHORITY HOUSING FINANCE

Not all councils or local authorities provide housing or have social housing responsibilities. The ones that do in England are:

- London boroughs and the City of London
- metropolitan districts
- unitary authorities
- district councils in county council areas.

A couple of specific kinds of housing service are run differently from the main housing service. Supporting People (a programme for funding, planning and monitoring housing-related support services) is run by councils with social services responsibilities and in county council areas, it is the county council, rather than the district councils, that do this. Services for Gypsies and travellers are provided similarly.

Local housing authorities have a wide range of powers and duties. Most of their housing functions are overseen by the relevant government department, DCLG, though housing benefit is currently overseen by DWP.

Local authorities in England owned 1.67 million dwellings on 1 April 2014, following a general decline from 3.67 million on 1 April 1994. This has been associated with right-to-buy sales and large-scale voluntary transfer of local authority stock to private registered providers.

Housing powers and duties

All local housing authorities (LHAs) have a number of statutory housing duties – responsibilities that they must carry out. Additionally, they have some housing powers that enable them to choose whether and how to provide some housing services. These powers and duties are summarised in the box below. These are the existing powers and duties; where major changes are planned by the government, this is stated.

Local housing authority powers and duties

LHAs must identify housing need and publish a strategy to address those needs.

LHAs must ensure a free housing advice service is available.

LHAs must improve private sector stock in their areas through grants and loans, but they can decide on the scale of such activity.

Provided that they can justify it (through a risk assessment process), LHAs may apply some controls (at an appropriate level, ie a proportionate level) to private rented homes – especially those in multiple occupation (where health and safety problems and overcrowding might otherwise arise).

LHAs must pay disabled facilities grants for home improvements to those applicants who are eligible.

LHAs must operate a housing allocations scheme to decide who will be offered social housing as it becomes available. They will do this jointly with local housing associations, offering choice-based lettings. Changes to the rules on allocations allow more local flexibility, and the discretion to grant two-year tenancies instead of tenancies for life.

LHAs must determine whether homeless applicants are unintentionally homeless and in priority need. If so, they must provide accommodation. An offer of a 12-month private tenancy counts as fulfilling the homelessness duties.

LHAs must monitor the number of empty houses in their areas, and encourage owners to bring them back into use.

LHAs must make appropriate housing provision for Gypsies and travellers.

LHAs must determine and pay applications for housing benefit in accordance with the national scheme. The government is moving to a national scheme of universal credit. An element for housing benefit will be included within the new universal credit.

LHAs may provide housing-related support that encourages vulnerable people to achieve or maintain independent living.

LHAs may support the government's New Homes Bonus scheme. Authorities that grant planning permission for new developments gain funding. They may choose to use the additional funding for providing the facilities associated with the new development.

Stock-owning authorities

About half of local housing authorities provide council housing. These are referred to as stock-owning authorities. Before 1988, all local housing authorities were stock owners. From 1988 onwards, the government encouraged local housing authorities to transfer their stock or at least some of their stock to housing associations, subject to government permission and the tenants' approval. This was aimed at offering tenants the prospect of better housing services in the longer term.

In other, later moves, some authorities set up arm's-length management organisations (ALMOs) to manage their housing stock and a few authorities had parts of their stock improved and managed by private finance initiative (PFI) contractors.

Local housing authorities that do own stock have an additional set of powers and duties, set out in the following box. They fall into three broad categories:

- strategic change
- business as usual or ongoing responsibilities
- investment and improvement.

Powers and duties of stock-owning authorities

Strategic change

Most local housing authorities have now largely improved their stock to the target decent homes standard. Some are working towards the 'decent homes plus' standards. Future funding for the maintenance of standards of decency in the local authority housing sector is now the responsibility of individual authority business plans under the self-financing regime.

Business as usual

Stock-owning authorities must operate an HRA, ie a separate account from the council's general fund.

Stock-owning authorities must include leasehold properties in their maintenance and improvement programmes where this is a condition of the lease. They must assess and collect service charges from leaseholders. (Leaseholds generally arise where tenants have bought their council home; leases tend to cover common facilities, such as roofs and lifts in the case of flats.)

All landlords are encouraged to reduce anti-social behaviour by tenants and around their properties.

Stock-owning authorities must carry out statutory landlord repairs, and will provide many other repair and maintenance services.

Stock-owning authorities must help groups of tenants to take over housing management functions for their estate, subject to a ballot of the tenants affected.

Stock-owning authorities must process tenants' right-to-buy applications in accordance with national policy.

Stock-owning authorities may provide sheltered housing for vulnerable tenants.

Stock-owning authorities must ensure their general funds make a fair contribution to the HRA for the cost of any council housing facilities if these are also used by non-council tenants.

Investment and improvement

Stock-owning authorities may, within the limits of a debt cap set by government, borrow to build properties. Usually, seeking to do so is dependent on obtaining funding for such building from the Homes & Communities Agency.

Stock-owning authorities may, with government consent, establish an ALMO.

Stock-owning authorities may, with government approval, transfer all or part of their housing stock to a housing association in order to achieve decent homes for the transferred property and in the best long-term financial interests of the transferred tenants.

The housing finance system before 2012

A brief look at the previous housing finance system, which was in place for many years until April 2012, is useful for understanding the impact of the changeover to the current system.

Before April 2012, the system worked as follows. An authority's entitlement (or not) to subsidy was based on government assumptions about the key elements of their housing expenditure and income. The main costs were management and repairs. A major repairs allowance was paid to keep stock in good condition. Support for borrowing costs was also paid. The subsidy calculation then made an assumption about the rents that councils should be charging. If the assumed income from rents amounted to enough to cover assumed expenditure (or more), then the authority had to pay the difference to the government. But if the rent income assumed amounted to less than was needed to pay for their assumed expenditure, then the authority received a subsidy from the government.

So, for stock-owning authorities, the annual decision – or 'settlement' – was a very important part of their budget process. Note, though, that the settlement gave income certainty only for that year, thus greatly limiting an authority's ability to plan long-term investments in its housing stock.

As an HRA is still operated by authorities that have transferred their housing stock management to an ALMO or that use PFI, the subsidy system also catered for housing managed under these options.

The subsidy entitlement drove the HRA budget. Authorities could not safely move very far from the government's subsidy assumptions because if they did, either the HRA would be in danger of spending more than its income, or very high rents might need to be levied.

Over time, the subsidy system became very complex, making it difficult for tenants – and even decision makers such as councillors – to understand. It also began to build up surpluses as the amounts paid in by councils exceeded the amounts paid out by central government. These surpluses were retained by the government at a time when more and better affordable housing was urgently needed.

The housing finance system since 2012: self-financing

The problems with the subsidy system were widely recognised by practitioners and by central government alike, but designing and modeling a fully functional replacement system took many years. Finally, the new self-financing system was introduced in April 2012.

From 2012/13 on, each stock-holding housing authority relies on its own rent income to provide council housing. To bring this change into operation, 30-year business plans were drawn up for all local authority HRAs to assess their long-term investment needs as well as the day-to-day costs of running their homes. A one-off settlement in 2012, intended to last the full 30 years, was made. In this settlement, depending on its business plan and its current long-term borrowing, each authority (in England) either took on an additional share of the total housing debt or received a sum towards repayment of its housing debt. The point of this was to start the new system from a position of parity between different housing authorities.

Under self-financing, councils – not government – are responsible for the long-term funding of their HRAs. The affordability of the 30-year HRA business plan is therefore critical. It should take into account either the cost of financing the additional debt received as part of the self-financing settlement or the savings from the repayment of debt. Within that context, councils can then borrow anew, under the prudential system, to invest in their stock – except that the government has set a housing debt cap for each of authority which means that for most, new investment is in practice likely to be restricted, especially in the earlier years of the business plan.

The 30-year business plans should not be considered as one-off, static plans. The impacts of government policy – and government policy changes – need to be factored into them. For example, right-to-buy sales can reduce an authority's expected rent income. Welfare reform and the introduction of benefit payments direct to claimants (not to the council) may lead to increased rent arrears.

In May 2014, the government published its final policy on rents for social housing for the ten years from April 2015 – *Guidance on Rents for Social Housing*. The guidance applies only to local authorities, although the social housing regulator is expected to have regard to it when setting the rent standard for private registered providers.

The government's guidance confirmed it would proceed with its policy of abolishing the provision for landlords to increase rents by an additional £2 per week to achieve convergence. It also confirmed the introduction of a CPI-linked calculation on which local authorities are expected to set their rents from April 2015 onwards.

The capital programme

Local housing authorities invest in a whole range of investments and improvements. If they are stock-owning authorities, the greatest demand is usually for works to their own properties. But there are also many other demands on capital such as paying grants to private owners or working with housing associations. The main sources of funding for these investments and improvements are:

- Capital receipts (receipts from the sales of assets such as buildings). Note that there are restrictions on the percentage of capital receipts that may be used.
- Meeting capital expenditure directly from HRA revenue (day-to-day expenditure).
- Borrowing.
- Grants from DCLG or the Homes & Communities Agency.

In the ten years or so from 2000, the government committed very large capital resources to stock options such as stock transfer, PFI and ALMOs and the achievement of the decent homes standard. There was also funding for housing market renewal. However, in the current financial climate and following the 2010 spending review, local housing authorities have had to be much more dependent on generating their own capital resources locally.

Decent homes standard

The decent homes standard is a specific standard that the government introduced in 2000 as a target for public sector housing. The standard is that all homes should be warm, weatherproof and have reasonably modern facilities. It applies to social rented housing (predominantly council or housing association housing).

As a broad principle, a home must have reasonably modern facilities. The specified requirements are:

- The home must meet the statutory minimum standard for housing (under the housing health and safety rating system). So it should have no safety hazards (such as a sub-standard gas heating boiler).
- It must be in a reasonable state of repair. No key building component should be too old or need replacing. (Key building components are items such as walls, roof, windows and the heating system.) Not more than one other building component should need replacing.
- It must have reasonably modern facilities and services. In particular, the kitchen should be less than 20 years old and the bathroom less than 30 years old. No more than two of the main facilities may be too old.
- It must provide a reasonable degree of thermal comfort. This means an efficient heating system, and good insulation.

Inspection and regulation

When the Tenant Services Authority was closed in April 2012, the regulation of social housing was transferred to the Homes & Communities Agency. The *Regulatory Framework for Social Housing in England from April 2012* brought together the changes within the *Localism Act 2011* and set out how co-regulation will operate with a revised set of principles of co-regulation. Following consultation, a revised regulatory framework will come into effect on 1 April 2015.

The inspection of local authority housing was passed briefly from the Audit Commission to the Tenant Services Agency before the TSA's closure. The *Local Audit and Accountability Act 2014* closed down the Audit Commission and replaced it with a new local audit framework under which councils appoint auditors from an open market, with the model based on private sector auditing and overseen by the Financial Reporting Council and the National Audit Office.

Housing advice

Local housing authorities must provide free housing advice to anybody who is homeless or threatened with homelessness. (In some cases there is also a duty to provide housing.)

Most authorities provide a comprehensive housing advice service to all residents, with good signposting to other organisations.

Private sector licensing and houses in multiple occupation

Authorities must keep the housing conditions in their area under review. Under the *Housing Act 2004* a housing health and safety rating system is used to determine whether the authority needs to intervene. It may decide to introduce a licensing system for specific categories of rented property. A particular problem area is usually houses in multiple accommodation (HMOs – an HMO is a house occupied by persons who do not form a single household).

Private sector renewal

Councils have a wide range of powers to pay grants to owner-occupiers or tenants to bring their property up to a decent standard but generally, in the current financial climate, they have little funding available. Authorities usually concentrate their resources on those on low incomes by assessing contributions from the applicant.

New homes bonus scheme

The new homes bonus scheme is an initiative aimed at increasing the number of available council homes. It is paid by central government for the increase in the number of homes (from one year to another) on a council's valuation lists. The increase is analysed by council tax banding. Each year's bonus is paid for six financial years at the national average council tax for each band's increase. It is paid to the council that actually bills for council tax, though in some areas where there are two tiers of local authority some of the bonus will be paid to the first-tier authority. This payment is not without criticism, and the Lyons Housing Review proposed that the new homes bonus should be reviewed to consider:

- whether it should be retained in its current form
- whether it has an element of deadweight, rewarding housing growth that it has not incentivised
- the redistributive impact of the policy.

HomeBuy

HomeBuy is a programme to promote affordable home ownership. The Homes & Communities Agency oversees the scheme and it is mainly operated by approved local agents. There are four schemes:

- equity loans
- mortgage guarantee
- shared ownership
- new buy.

The HomeBuy scheme in Wales offers support to households by providing an equity loan to assist in purchasing a property. It is the responsibility of Welsh local authorities to decide whether HomeBuy is a priority for their social housing grant allocation.

Cash incentive scheme

Housing authorities can set up schemes at their discretion. Under these, tenants are paid a sum similar to their right-to-buy discount entitlement in return for surrendering their property and proceeding with the purchase of another property or moving to smaller rented properties if their home is now larger than they need. The scheme frees up rented accommodation and makes home purchase an option for those who do not want to buy the particular property they are renting.

Disabled facilities grants

Disabled facilities grants (DFGs) are paid to enable property owners or tenants or their dependants to continue living in their own homes by adapting them to provide disabled facilities. Certain works are specified in regulations; if the claimant needs those works in order for him/her to be able to remain in their home, the housing authority must award a grant. However, all grants are subject to a means test. Examples would include widening doors and installing ramps or a stairlift. Government grant for DFG was set at £180m for 2014/15 (but because this money is not ringfenced it is possible that authorities actually spend some of the money elsewhere). A council can also of course pay out additional grants over and above the mandatory ones.

Housing allocations

Local housing authorities often work with local housing association partners, operating joint housing waiting lists and allocation policies. Before the *Localism Act 2011*, local housing authorities' allocations policies had to give reasonable preference to unintentionally homeless applicants who were in priority housing need. Now, under the Act, they have more freedom to decide who is eligible to go on to their waiting list. Certain categories of applicants (such as returning armed forces) are now eligible for inclusion under legislation.

Housing authorities may have nomination rights for the allocation of some local housing association properties.

Councils must also offer choice-based lettings. Under choice-based lettings, rather than be allocated the next available tenancy on a 'take it or leave it' basis, applicants can 'bid' for properties they like on the strength of their waiting list points.

Homelessness

Housing authorities have a duty to provide accommodation to those who present themselves as homeless or threatened with homelessness and are in priority need. This duty is discharged by providing temporary and eventually settled accommodation. The settled accommodation provided has generally been a social housing tenancy but now, under the *Localism Act 2011*, the offer of a year's private sector tenancy will count as fulfilling the homelessness duty.

Housing authorities must maintain a homelessness strategy. The government is to provide £80m in homelessness prevention grants to councils in 2014/15.

The government is putting additional resources into tackling rough sleeping, in partnership with the voluntary sector. It was estimated in autumn 2013 that there were around 2,414

rough sleepers in England – but this was a ‘snapshot’ estimate and the numbers reported by councils over a yearly period suggest a much higher figure. According to outreach database CHAIN, 6,437 people slept rough at some point in London alone during 2012/13.

In 2013/14, housing authorities made 113,181 homeless decisions, accepting 45.5% as in priority need and unintentionally homeless

Empty homes

A proactive approach to reducing the number of empty homes will assist local housing authorities in addressing housing demand. Authorities do have powers to take empty homes into their own management, but these powers are being modified to restrict the powers to properties where there is a nuisance (for example, caused by squatters). Possession orders are adjudicated by the Residential Property Tribunal Service and are very seldom used in practice. A recent council tax change, increasing the amount of council tax paid on empty homes, is also part of this approach.

Gypsies and travellers

Both local housing authorities and county councils provide and operate sites for Gypsies and travellers. There is now no government grant funding for the sites.

Supporting People

Supporting People is a government programme, delivered through councils and with partner agencies such as primary care trusts and the Probation Service, aimed at providing housing-related support to vulnerable people. Supporting People services enable over 1.2 million people across England and Wales to live as independently as possible. They provide accommodation, hostels, and staff to support people to move on to fully independent accommodation, and also support people in their homes or temporary accommodation.

Housing revenue account

The HRA is a separate landlord account that any council with more than 50 council dwellings must keep. It covers the income and expenditure necessary to manage and maintain the housing stock, including major repairs, and associated debt charges.

The HRA is ringfenced, meaning that its funds must be kept separate from other council income and expenditure streams. The reason behind this is the need to ensure that council house rents are not used to subsidise general council expenditure and to prevent the general council taxpayer subsidising council housing. Councils must balance their HRA each year – they should not budget for a deficit.

Arm’s-length management organisations

Many housing authorities that retain stock have established ALMOs. These offer greater operational flexibility, and give tenants a greater say in housing management. Key features of an ALMO are:

- ownership of the housing stock remains with the local authority
- the local authority remains the legal landlord

- secure tenants remain secure tenants of the authority and there will be no change in their rights, such as the right to buy, right to repair and right to manage.

An ALMO may manage all or part of an authority's stock. ALMOs are normally companies and 100% controlled by the authority. Local authority based companies of the kind suggested, formed to carry out a charitable or non-profit-making activity, normally take the form of a company limited by guarantee. It is not appropriate for the companies to trade for profit or issue share capital and pay dividends.

Rents, service charges and other income

Rent income is not entirely a matter for council decisions; it is influenced by government policy. The rent restructuring programme began in 2002/03. The aim was to move local authority rents to a comparable level, known as formula rents, with housing association rents. Formula rents are based on local earnings levels and property values in 2000. They are updated annually for inflation and to bring about the real-terms increase needed for local authority rents to catch up with those of housing associations. The scheme was complicated by rules on the amount by which any individual tenant's rent can increase and rent caps based on the number of bedrooms in a property. It had been expected that rent restructuring would only be achieved by 2015/16 at the earliest, but government policy on rent setting has changed and April 2015 will see new rent-setting policies in place.

The government has introduced a new system of 'affordable rents': rents that are closer to market rents for new housing association developments funded by the HCA. Councils will be able to offer flexible two-year tenancies in addition to traditional secure tenancies.

Local housing authority income includes service charges: authorities may make separate service charges to tenants for items such as a concierge service or community aerials. In some accommodation there are communal heating systems, and authorities recover the cost of these from individual tenants and leaseholders.

Another income source can be rents from individual garages or parking spaces.

Leaseholders

Because of the right to buy, many council estates are now a mix of tenanted property and owner-occupation (leaseholders). Local housing authorities try to ensure that leaseholders pay their fair share of estate costs (for example, for maintaining lifts) in order to avoid unnecessary expense to the HRA. However the rules on recovery are complex, especially where major works (such as reroofing a block of flats) are concerned. For example, for five years after a right-to-buy sale is completed, only works that had already been identified in the sale documents can be recharged to leaseholders. Leaseholders have statutory rights to loans from the authority to help them pay their share if the works exceed a certain value. Authorities may operate local loan schemes that are more generous than the statutory ones. Leaseholder case law (Florrie's Law, 2014) introduces a £15,000 cap on repair bills for local authority leaseholders.

Repairs and maintenance

Stock-holding authorities need to strike a balance between planned maintenance and reacting to responsive repairs. Certain repairs are subject to a tenant's right to repair. If the council does not complete the repair within the regulatory timetable, compensation must be paid to the tenant at a stipulated daily amount. There is also a statutory duty to keep property in good repair under wider landlord and tenant legislation; failure to do so can involve authorities in expensive litigation.

A tenant cash-back scheme is available, aiming to enable tenants to be paid cash for carrying out or commissioning their own repairs. A £3,000 start-up grant is payable to encourage take-up.

Tenant empowerment

Stock-holding authorities are encouraged to establish tenant participation agreements or 'compacts' setting out how tenants will be involved in running housing including financial decisions. Tenants can also group together to form tenant management organisations (TMOs). The TMO would then receive annual funding from the housing authority to carry out a specified set of functions. Essentially, a TMO must be funded at least as generously as the council is for property it manages directly. More flexible forms of tenant management can also be used by agreement between the authority and groups of tenants.

Right to buy

Right to buy is a scheme under which longstanding local authority tenants are entitled to purchase their homes at a heavily discounted price. Since the 1980s, nearly two million council properties have been sold under the right to buy. However, the recession and tighter rules on discounts caused the volume of right-to-buy sales to fall away considerably in later financial years and in 2011/12 just 3,080 sales were completed, generating capital receipts after discount of £238m. In 2012, the government announced an initiative to reinvigorate right to buy and from April 2012 the maximum available discount was increased to £75,000.

Note that specialised properties such as sheltered accommodation are not eligible for right to buy. There are also restrictions on resale for properties bought in designated rural areas.

For qualifying tenants of housing associations, there is a similar scheme called 'right to acquire'.

Sheltered housing

Local housing authorities provide around 400,000 sheltered or extra care properties. Some of this accommodation is hard to let, and authorities find it difficult to identify funding to modernise them and make them more attractive lets.

Communal areas and shared facilities

In many authorities the HRA pays for facilities – such as a recreational area – that are also used substantially by the wider public. In such cases, the appropriate proportion of the cost of facilities used by the wider public should be recharged to the general fund.

Anti-social behaviour

As announced in the May 2013 Queen's Speech, the government introduced legislation – the *Anti-social Behaviour, Crime and Policing Act 2014* – to require councils to repossess any property where the tenant has an ongoing record of anti-social behaviour. Anti-social behaviour orders themselves are to be replaced with criminal behaviour orders and crime prevention injunctions.

In conclusion

Local authority housing powers are extensive. Excellent financial management of the function has a vital part to play, both in the provision of housing services and in the implementation of the government's wide range of strategic changes in housing policy.

HOUSING ASSOCIATION FINANCE

Housing associations are not-for-profit organisations. In the UK there are some 1,200 housing associations. Housing associations vary in size from fewer than 10 homes, to more than 50,000.

Altogether, housing associations provide about two-and-a-half million homes for more than five million people in England. They are voluntary bodies and vary greatly in size. Some are charitable trusts or companies; others, industrial or provident societies, which may be charitable or non-charitable. Their business, that of providing social housing, is in many ways similar to that of local housing authorities but their governance, funding and accounting regimes are different. Rent levels for housing association tenants are, generally, higher than those for local authority housing tenants. Despite these differences, local authorities and housing associations obviously need to work together over the provision of housing in a local authority area. And there are many specific issues, such as the introduction of international financial reporting standards, where it is helpful for both types of organisation to share and learn from their experiences.

The two main challenges for housing associations, as those for the social housing sector overall, are:

- the urgent need to increase the supply of housing, especially affordable housing, in a climate of scarce funding
- the changes to housing benefits and the implementation of a new universal benefit under welfare reform.

Funding for housing associations is based on a one-off capital grant (social housing grant or SHG) paid to the housing association when a building is built or acquired. No further public capital funding is usually available. Instead, housing associations are expected to anticipate the cost of repairing and improving their stock, and to make funds available when required through a mixture of revenue funding, reserves, sales and borrowings or from sources other than grant. (There are some very limited exceptions to this.)

SHG is provided by the Homes & Communities Agency through the affordable homes programme, or by local authorities (LA SHG). However, SHG is not intended to cover the full costs of a development programme. Although some project costs might be paid for out of

revenue surpluses, the great majority of non-grant-funded project costs are paid for from borrowing. The borrowing power of the housing association will be one of the main factors that determines the scale of the development programme.

Receipt of SHG is conditional upon the housing association meeting the annually published funding conditions. The main conditions require the housing association to comply with the HCA's *Capital Funding Guide* and the *Regulatory Framework*.

The main sources of revenue income for housing associations are rents, service charges and charges for support services. The main features of these streams are broadly comparable to those described above for local authorities. Many housing association tenants receive housing benefit, currently often paid directly to the housing association. Charges for support services are underpinned by Supporting People funding, administered by councils.

Asset management is key to the long-term viability of a housing association. Asset management comprises all the activities that are part of maintaining the value, financial and non-financial, of the 'bricks-and-mortar' assets of an association. The main operational focus of asset management will be on the maintenance of the association's buildings, but asset management should go further, covering everything that may affect how well the association's assets can continue to serve its corporate objectives.

HOUSING FINANCE IN WALES

After lengthy negotiations, the Welsh Government and the UK Treasury reached an agreement in July 2013 that will allow the 11 local authorities in Wales with council housing stock to exit from the HRA subsidy system and become self-financing from April 2015.

The agreement has two parts:

- first, local authorities will be required to buy their way out of the current HRA subsidy system with payment of a one-off settlement figure to the UK Treasury
- second, local authorities will be subject to a cap on HRA borrowing.

HM Treasury requires that the settlement is '*fiscally neutral over the long term*'. This will require the 11 authorities to take out loans from the Public Works Loan Board (PWLB) to fund their share of the settlement figure. Under the terms of the agreement with the Treasury, the agreed £40m interest will be converted to a total settlement value using the PWLB 30-year maturity rate.

The settlement figure has been estimated to be £920m, but the precise figure will depend on the interest rate for PWLB loans on 31 March 2015 when the loans are finalised.

HOUSING REGULATION IN WALES

Housing regulation in Wales has had a new regulatory framework since December 2011. This applies to housing associations registered with the Welsh ministers. The framework describes the principles, approach to regulation and the main features of regulation. It also explains how housing associations are assessed.

The regulatory framework contains a number of ‘delivery outcomes’ to be met by housing associations in connection with their functions relating to the provision of housing, and matters relating to their governance and financial management.

The regulatory framework aims to put tenants at its heart by:

- ensuring that housing associations work with their tenants and people who use their services in planning and assessing the quality of services
- providing information that allows tenants and others to compare the performance of their housing association to that of others
- ensuring that the Welsh ministers take account of the views of tenants and service users.

The framework applies to housing associations but the Welsh Local Government Association (WLGA) and the All Wales Chief Housing Officers’ Panel have developed and agreed a complementary set of draft delivery outcomes for local authority housing services. These can be used on a voluntary basis by councils to support service improvement, ie not as part of any formal regulation arrangements.

These delivery outcomes can be found on the WLGA website and are very similar to those in place for housing associations – thereby seeking to address concerns from tenant groups that local authority and housing association tenants were being treated differently, and allowing for ready comparisons to be made between social landlords in an area, whether local authority or housing association.

FREQUENTLY ASKED QUESTIONS

The following are some of the questions CIPFA is frequently asked, together with the answers given.

Q: WHAT ARE THE STATUTORY FINANCIAL RESPONSIBILITIES OF A LOCAL AUTHORITY WITH HOUSING STOCK?

A: In summary, the local authority’s statutory responsibilities (assuming their housing stock comprises 50 homes or more) are:

- the local authority ‘*must keep a housing revenue account*’ (*Local Government and Housing Act 1989, s74*)
- the local authority’s statutory entries to the HRA are as set out in the *Local Government and Housing Act 1989, Sch4*
- the local authority has a duty to prevent a debit on the HRA (*Local Government and Housing Act 1989, s76*).

Q: WHY DID THE RINGFENCE ARISE AND WHERE IS IT SET OUT?

A: The *Local Government and Housing Act 1989* ringfenced the HRA, thereby preventing any cross-subsidisation from or to the general fund; that is, so that council taxpayers would neither subsidise nor be subsidised by council tenants. The Act also prescribes the items of expenditure and income to be included within the account and the accounting treatment of capital financing charges. Income typically includes rents, service charges and HRA subsidy (if paid) while expenditure involves costs for repairs and maintenance, supervision and management, rent rebates, capital charges and debt repayment.

Guidance from the government was for a long time provided by the DCLG's HRA Manual and by DOE circular 8/95. DCLG is no longer planning to revise DOE circular 8/95 – so although some parts of it have been overtaken by self-financing, the general thrust of that circular (and the Act and the Manual, etc) still holds. However, DCLG has stated (in their self-financing papers of 1/02/11): *'In line with our emphasis on localism we do not intend to issue new guidance on the operation of the ring-fence. We expect local authorities to take their own decisions, rooted in the principle that "who benefits pays".'*

Readers interested in more detail on the ringfence should consult LAAP Bulletin 22.

Q: IS THE RINGFENCE AFFECTED BY THE MOVE TO SELF-FINANCING?

A: It is important to note that since the implementation of self-financing, both the ringfence and indeed the need to have an HRA remain (despite some mistaken headlines in the press).

Q: SHOULD EXPENDITURE ON HOMELESSNESS BE HRA EXPENDITURE?

A: Homelessness costs, including associated costs such as the provision of furniture, property maintenance, rent, guarantees and nomination fees, should be accounted for in the general fund and not in the HRA.

Q: CAN THE HRA BE USED TO FUND THE COST OF PRIVATE REGENERATION?

A: The HRA cannot fund the cost of private regeneration and the repurchase of properties prior to demolition. It is worth noting that the adoption of self-financing did not alter the rules for the ringfence.

Q: WHAT ARE THE RULES FOR NON-RIGHT-TO-BUY CAPITAL RECEIPTS?

A: It continues to be the case that non-right-to-buy receipts can be used to fund affordable housing and regeneration. This was reaffirmed in the Consultation paper *Streamlining Council Housing Asset Management: Disposals and Use of Receipts*, which was issued in August 2011 and responded to by government in May 2012.

Q: WHAT ARE THE RULES FOR RIGHT-TO-BUY CAPITAL RECEIPTS?

A: The new rules governing use of these receipts are covered in *Reinvigorating the Right to Buy and One for One Replacement*. The consultation was issued on 22 December 2011; government response together with information for local authorities was issued 12 March 2012.

These rules explain that the 25% non-pooled element as estimated in the self-financing model is available to fund any capital spend (ie it is not ringfenced to housing). The additional receipts net of debt repayment over and above those estimated in the self-

financing model can all be used for up to 30% of each affordable housing scheme (including grants to housing associations) where an agreement has been entered into with government. Each council's position will vary according to their returns to government and their decision on whether to enter into an agreement. If an agreement is not entered into, these receipts must be submitted to government for pooling.

The limited allowance for buy-back of former council properties is also explained and there is also some new guidance for local authorities applying to use receipts from the disposal of council housing assets in ways not prescribed in regulations.

Q: WHAT TRIGGERS THE NEED TO SET UP AN HRA?

Our district council does not currently have any housing stock (we carried out a large-scale voluntary transfer many years ago). Can you advise what would trigger us to need to set up an HRA? For example, would it be as soon as we own one property and rent it out?

A: This is covered by DCLG's HRA Manual. Although parts of the manual are outdated (eg references to HRA subsidy), the main body of the manual remains relevant. If in doubt, the enquirer should check with DCLG.

Section 12 of the manual describes the circumstances in which an HRA may be closed and includes an outlining of the procedures to be followed if further dwellings are acquired after a prior closure of the HRA:

Re-opening the HRA

12.20 After the HRA is closed, if an authority which had no dwellings within the HRA at the time that consent to close was given again acquires any property which under section 74(1) falls within the HRA – for example, following a local authority boundary change or where the authority has acquired or appropriated land for the purposes of Part II Housing Revenue Account Manual of the Housing Act 1985 (i.e. for the provision of housing) – it is required to re-open its HRA. An authority which proposes to acquire dwellings may however apply for a direction under section 74(3)(d) in advance of acquisition, provided that the number of dwellings is 50 or less and that the properties can be specifically referred to in a direction (for example, on a “subject to contract” basis). If granted, this would allow it to acquire the properties without re-opening its HRA. The direction would normally take effect from the date of acquisition of the properties.

12.21 If, however, the number of dwellings, including any for which a section 74(3)(d) direction had previously been given, exceeded 50, the previous direction may be revoked, and all the dwellings would fall to be accounted for within the re-opened HRA. Similar arrangements would apply where an authority which had been granted a section 74(3)(d) direction acquired additional dwellings but had not yet closed its HRA. Those dwellings which had previously been taken out of the HRA would be brought back within the authority's HRA (by revoking the section 74(3)(d) direction). However, if the total number of dwellings would remain fewer than 50, consideration would similarly be given to granting a new direction to allow both the new acquisitions and the dwellings referred to in the original direction to be held outside the HRA without its being re-opened.

12.22 In either case, one of the normal conditions for granting consent to close the HRA is that the authority shall inform Communities and Local Government as soon as it re-opens its HRA. The Secretary of State would then consider giving a direction under Item 9 of Part I of Schedule 4 to the 1989 Act requiring the authority to credit an amount to the HRA, based either on any credit balance shown on the HRA when it was closed, or on such amount as the Secretary of State, after consulting the authority, considers necessary.

Q: COULD THE COUNCIL BECOME A RESIDENTIAL LANDLORD RENTING PROPERTIES WHICH WE OWN AT MARKET RENT?

A: The short answer is no – not if the properties are within the HRA. There are a number of reasons why not – eg, first, local housing authorities are required to follow national rent policy. The current rent restructuring policy includes a cap or maximum formula rent for different sizes of property. This applies to properties within the HRA.

Second, the HRA account is supposed (see the *Local Government and Housing Act 1989*) to balance, which could be seen as at odds with ‘profit-making’ rents.

If the properties were instead to be held under the general fund, the council would need to be clear under what power it would be doing that.

Since 1989, the HRA has been ringfenced. Ringfencing means that HRA resources may only be expended within the HRA. Councils are also not allowed to transfer resources between the HRA and their general funds. This means that council taxpayers are not called on to subsidise the provision of council housing.

FURTHER READING

- 2011–15 Affordable Homes Programme – Framework*, HCA/DCLG, 2011
- ‘About right to buy’ section on the DCLG website*
- Affordable Housing Capital Funding Guide*, HCA
- Broken Market, Broken Dreams: Home Truths 2014/15*, National Housing Federation, 2014
- Code of Practice on Local Authority Accounting in the United Kingdom*, CIPFA/LASAAC, annual
- The Decent Homes Programme*, NAO, 2010
- Empty Homes Toolkit*, Homes & Communities Agency
- From Statutory Provider to Housing Delivery Enabler: Review into the Local Authority Role in Housing Supply (the Elphicke–House Report)*, DCLG, 2015
- Guidance on Rents for Social Housing*, DCLG, 2014
- Housing Finance under Self-financing*, CIPFA, 2013
- Housing Revenue Account Manual: 2006 to 2007 Edition*, DCLG, 2007
- Housing Revenue Account Self-financing Determinations*, DCLG, 2012
- The HRA Ringfence (LAAP Bulletin 22)*, CIPFA, 1996
- The Impact of Funding Reductions on Local Authorities*, NAO, 2014
- Improving Lives and Communities – Homes in Wales*, National Assembly for Wales, 2010
- Increasing the Number of Available Homes*, DCLG Policy Paper, updated February 2013
- Laying the Foundations: A Housing Strategy for England*, DCLG, 2011
- Live Tables on Social Housing Sales*, DCLG
- Local Growth Fund: Housing Revenue Account Borrowing Programme (2015 to 2016 and 2016 to 2017)*, DCLG, 2014
- Mobilising across the Nation to Build the Homes our Children Need (the Lyons Housing Review)*, the Labour Party, 2014
- The Prudential Code for Capital Finance in Local Authorities (2011 Edition)*, CIPFA, 2011
- The Regulatory Framework for Housing Associations Registered in Wales*, Welsh Government, 2011
- The Regulatory Framework for Social Housing in England from April 2012*, Homes & Communities Agency, 2012
- Reinvigorating Right to Buy and One for One Replacement: Information for Local Authorities*, DCLG, 2012
- Right to Acquire Discounts by Location*, DCLG, 2013
- Service Reporting Code of Practice for Local Authorities*, CIPFA, annual
- Social HomeBuy: Guidance for Local Authorities*, DCLG, 2010
- Survey of English Housing*, DCLG, continuously updated
- Welfare Reform Act 2012*

MODULE 9

Police

INTRODUCTION

Policing in England and Wales was radically reformed during 2012 with the introduction of police and crime commissioners (PCCs), who are responsible for commissioning police services in their areas. This means that they are responsible for setting the overall budget for police services and setting the priorities and objectives for policing for their local areas. The PCC is a directly elected individual (other than in London, where the mayor has responsibility for policing, apart from in the City of London, which has its own police force). The chief constable remains responsible for delivering policing in his or her area in accordance with the budget, priorities and objectives set by the police and crime commissioner. The PCC and the chief constable have been established as separate organisations, which has implications for police finance.

EXPENDITURE AND BUDGETS

Funding overview

Total budgeted expenditure on policing for 2014/15 was £12.1bn in England and £0.7bn in Wales. From April 2013, policing has been paid for by a mixture of council tax and police grant received from the Home Office. Police are not part of the new localisation of non-domestic rates regime but are affected by the localisation of support for council tax. The PCC is responsible for setting the precept for policing for his or her area as well as the overall police budget.

Recognising that policing is outside the business rates retention scheme, all police funding (including what was previously included in Communities and Local Government announcements) is paid via the Home Office Grant Report issued before the start of each financial year. Police funding permanently transferred to the Home Office at spending review 2013.

Police forces received approximately £8bn in grant for 2014/15.

The grant of each of the 43 police forces in England and Wales was reduced by 4.8% in 2014/15, following reductions of 1.6% in 2013/14, 5.1% in 2011/12 and 6.7% in 2012/13.

Total central government police funding, including specific grants, reduced by 20% in real terms between 2010/11 and 2014/15.

In July 2014, Her Majesty's Inspectorate of Constabulary (HMIC) reported that police forces had reported to them that they needed to find £2.53bn of savings between 2010/11 and

2014/15 in order to manage the funding reduction and the rising costs of pay, fuel, utilities and other inflation.

LEGISLATIVE FRAMEWORK AND THE POLICING PROTOCOL

The *Police Reform and Social Responsibility Act 2011* establishes PCCs within each police force area and gives them responsibility for the totality of policing within that area. The Act requires a PCC to hold the force area chief constable to account on behalf of the public, which both the PCC and the chief constable serve.

Both the PCC and the chief constable are established in law as corporations sole within the Act. The chief constable is charged with the employment and impartial direction and control of all constables and staff within the police force that they lead. The Act does not impinge on the legal authority and statutory foundation for the office of constable to maintain the Queen's peace without fear or favour.

The public accountability for the delivery and performance of the police service is placed into the hands of the directly elected PCC. The PCC shapes the strategic objectives of their force area in consultation with the chief constable. The PCC of each force area is accountable to the electorate; the chief constable is accountable to the PCC.

The Act sets up a police and crime panel within each force area to maintain a regular check and balance on the performance of the PCC.

Policing protocol

The protocol draws on the provisions made for the reform of policing within the *Police Reform and Social Responsibility Act 2011*. The protocol does not supersede or vary the legal duties and requirements of the office of constable. The operational independence of the police service, and the decisions made by its operational leadership, remain reserved to the office of the chief constable and that office alone.

The protocol applies to every PCC and chief constable within England and Wales. Their staff and the constables of each force are expected to have regard to the principles and spirit of the protocol, issued by the home secretary. The protocol requires all parties to abide by the principles of public life set out by the Nolan Committee and the core principles of *The Good Governance Standard for Public Services*. A summary of the powers and duties is set out below. For the full detailed list, please refer to the protocol itself.

The PCC

The PCC has the legal power and duty to:

- set the strategic direction and objectives of the force through the police and crime plan
- scrutinise, support and challenge the overall performance of the force including against the priorities agreed within the plan
- hold the chief constable to account for the performance of the force's officers and staff
- decide the budget, allocating assets and funds to the chief constable; and set the precept

- appoint the chief constable (except in London where the appointment is made by the Queen on the recommendation of the home secretary)
- remove the chief constable subject to certain conditions
- maintain an efficient and effective police force for the police area
- enter into collaboration agreements with other PCCs, other policing bodies and partners
- provide the local link between the police and communities
- hold the chief constable to account for the exercise of the functions of the office of the chief constable and those under his/her direction and control
- prepare and issue an annual report to the panel on the PCC's delivery against the objectives set within the plan
- monitor all complaints made against officers and staff, while having responsibility for complaints against the chief constable
- not fetter the operational independence of the police force and the chief constable who leads it.

The protocol also sets out the PCC's right to access information and the wider duties of the PCC in relation to community safety.

The chief constable

The chief constable is responsible to the public and accountable to the PCC for:

- leading the force in a way that is consistent with their responsibilities to maintain the Queen's peace and to ensure impartiality
- appointing the force's officers and staff (after consultation with the PCC, in the case of officers above the rank of chief superintendent and police staff equivalents)
- supporting the PCC in the delivery of the strategy and objectives set out in the plan
- assisting the PCC in planning the force's budget
- providing the PCC with access to information, officers and staff as required
- having regard to the strategic policing requirement when exercising and planning their policing functions
- notifying and briefing the PCC of any matter or investigation on which the PCC may need to provide public assurance
- being the operational voice of policing in the force area
- entering into collaboration agreements with other chief constables, other policing bodies and partners with the agreement of their respective policing bodies
- remaining politically independent of their PCC
- managing all complaints against the force, its officers and staff, except in relation to the chief constable
- exercising the power of direction and control in such a way as is reasonable to enable their PCC to have access to all necessary information and staff within the force
- having day-to-day responsibility for financial management of the force.

The protocol emphasises the operational independence of the chief constable.

The police and crime panel

While the panel is there to challenge the PCC, it must also exercise its functions with a view to supporting the effective exercise of the PCC's functions. This includes:

- the power of veto (outside the Metropolitan Police District), by a two-thirds majority of the total panel membership, over the level of the PCC's proposed precept
- the power of veto (outside the Metropolitan Police District), by a two-thirds majority of the total panel membership, over the PCC's proposed candidate for chief constable
- the power to ask Her Majesty's Inspectorate of Constabulary (HMIC) for a professional view when the PCC intends to dismiss a chief constable
- the power to review the draft plan and make recommendations to the PCC who must have regard to them
- the power to review the PCC's annual report and make reports and recommendations at a public meeting, which the PCC must attend
- the power to require relevant reports and information in the PCC's possession (except those which are operationally sensitive) to enable them to fulfil their statutory obligations
- the power to require the PCC to attend the panel to answer questions
- the power (outside the Metropolitan Police District) to appoint an acting PCC where the incumbent PCC is incapacitated, resigns or is disqualified
- responsibility for complaints about a PCC, although serious complaints and conduct matters must be passed to the Independent Police Complaints Commission in line with legislation.

In order to reflect London's unique governance arrangements, the powers of the London Assembly police and crime panel are different to those outside London in the following ways:

- the London Assembly has the power to amend the mayor's proposed budget for the Mayor's Office for Policing and Crime (MOPAC) by a two-thirds majority vote
- if the mayor is incapacitated, resigns or is disqualified, the deputy mayor of London would occupy the office of mayor, and thus MOPAC
- the London Assembly police and crime panel does not have a formal role in the appointment or dismissal of the commissioner of police of the metropolis or other senior police officers
- the London Assembly police and crime panel has the power to veto the appointment of a deputy mayor for policing and crime if the individual is not an assembly member
- complaints against the holder of the MOPAC are dealt with in accordance with the GLA's existing standards regime.

The panel provides checks and balances in relation to the performance of the PCC but does not scrutinise the chief constable.

Finance Act 2013

The *Finance Act 2013* contains provisions to exempt chief constables and the commissioner of police for the metropolis from any corporation tax liability.

Anti-social Behaviour, Crime and Policing Act 2014

The Act provides the College of Policing with powers to set standards for police in England and Wales and extends the powers and remit of the Independent Police Complaints Commission. The Act also gives PCCs powers to commission victims' and witnesses' services and abolishes the Police Negotiating Board, replacing it with a new Police Remuneration Review Body.

In relation to the finance provisions, s141 of the Act covers capital finance and accounts of chief constables and temporary overdrafts to allow stage 2 transfers, though there was a transitional provision order in place until the Act received Royal Assent. S142 covers grants to local policing bodies (allowing police grant to be used by PCCs for anything under their remit, rather than being restricted to policing purposes) and s143 covers PCCs being able to commission services to reduce (or contribute to the reduction of) crime and disorder in their area and services for victims and witnesses.

FINANCIAL MANAGEMENT

The *Financial Management Code of Practice* (FMCP), published by the Home Office, sets out key principles that PCCs and chief constables must follow as well as a protocol for how the two organisations will work together. The PCC must decide how much financial freedom he or she wishes to give to the chief constable and this will vary from area to area. There are however a few important principles that must be followed:

- Responsibility for setting the council tax must stay with the PCC.
- The PCC retains responsibility for the police fund (this is the equivalent of the general fund in local councils and manages all income and expenditure and reserves that are the ultimate liability of the council taxpayer).
- The chief constable cannot borrow money (other than temporary overdrafts set out in s141 of the *Anti-social Behaviour, Crime and Policing Act 2013*), so that all borrowing for capital investment is undertaken by the PCC.
- Initially all liabilities for employees remained with the PCC, although many staff, and in some cases assets, were transferred to chief constables in 2014 under what was known as 'stage two'.

It is important that individual PCCs pay careful attention to the arrangements they put into place for their financial arrangements as there is no single solution and they will have to implement arrangements that reflect local circumstances.

The FMCP was updated in October 2013 and was issued under section 17 of the *Police Reform and Social Responsibility Act 2011* and section 39A of the *Police Act 1996*, which permit the secretary of state to issue codes of practice to all PCCs, MOPAC and chief constables.

The FMCP applies to all PCCs, and the police forces maintained by them, in England and Wales, including the MOPAC. The FMCP does not apply to the commissioner of the City of

London Police or the Common Council, who continue to form the Police Authority for the City of London. However, they are encouraged to abide by the working principles of the document.

Financial Management Code of Practice key points

Roles and responsibilities

The chief finance officer (CFO) of the PCC and the CFO of the chief constable both have a personal fiduciary duty by virtue of their appointment as the person responsible for the proper financial administration under the *Police Reform and Social Responsibility Act 2011*. This includes requirements and formal powers to safeguard lawfulness and propriety in expenditure (section 114 of the *Local Government Finance Act 1988*, as amended by paragraph 188 of Schedule 16 to the *Police Reform and Social Responsibility Act 2011*).

The chief executive of the PCC is designated as the monitoring officer for the purposes of section 5(1) of the *Local Government and Housing Act 1989* with responsibility for ensuring the legality of the actions of the PCC and the PCC’s staff (see paragraph 202 of Schedule 16 to the 2011 Act, which amends section 5 of the 1989 Act).

There is a reciprocal fiduciary duty on both chief finance officers to support the other in the execution of their duties in relation to policing matters. It is therefore recommended that if either of the chief finance officers intends to exercise their statutory powers under section 114 of the 1988 Act, they should inform the other (as well as the chief executive) as soon as possible.

| The chief finance officer of the PCC is responsible for: | The police force chief finance officer is responsible for: |
|--|--|
| Ensuring that the financial affairs of the PCC are properly administered and that financial regulations are observed and kept up to date. | Ensuring that the financial affairs of the force are properly administered and that financial regulations drawn up by the PCC (in close consultation with the chief constable, the two chief finance officers and the chief executive) are observed and kept up to date. |
| Ensuring regularity, propriety and value for money in the use of public funds. | Advising the chief constable on value for money in relation to all aspects of the force’s expenditure. |
| Ensuring that the funding required to finance agreed programmes is available from central government and Welsh Government funding, precept, other contributions and recharges. | |
| Reporting to the PCC, the police and crime panel and to the external auditor any unlawful, or potentially unlawful, expenditure by the PCC or officers of the PCC. | Reporting to the chief constable, the PCC and the external auditor, any unlawful, or potentially unlawful, expenditure by the chief constable or officers of the chief constable. |
| Reporting to the PCC, the police and crime panel and the external auditor when it appears that expenditure is likely to exceed the resources available to meet that expenditure. | Reporting to the chief constable, the PCC and the external auditor when it appears that expenditure of the chief constable is likely to exceed the resources available to meet that expenditure. |

| The chief finance officer of the PCC is responsible for: | The police force chief finance officer is responsible for: |
|--|--|
| Advising the PCC on the robustness of the budget and adequacy of financial reserves. | Advising the chief constable and the PCC on the soundness of the budget in relation to the force. |
| Ensuring production of the statement of accounts of the PCC. | Producing the statement of accounts for the chief constable, and providing information to the chief finance officer of the PCC as required to enable the production of group accounts. |
| Ensuring receipt and scrutiny of the statement of accounts of the chief constable and ensuring production of the group accounts. | |
| Liaising with the external auditor. | Liaising with the external auditor. |
| Advising the PCC on the application of value for money principles by the police force to support the PCC in holding the chief constable to account for efficient and effective financial management. | |
| Advising, in consultation with the chief executive, on the safeguarding of assets, including risk management and insurance. | |

The chief finance officer of the PCC and the chief constable have certain statutory duties which cannot be delegated, namely, reporting any potentially unlawful decisions by the PCC/ chief constable on expenditure and preparing each year, in accordance with proper practices in relation to accounts, a statement of accounts.

Schemes of governance

A scheme of governance has to be prepared by the PCC, advised by the chief finance officer of the PCC in consultation with the chief executive, the chief constable and the police force chief finance officer, at the start of each financial year. The scheme has four key elements:

- scheme of consent
- financial regulations
- standing orders relating to contracts
- scheme(s) of delegation.

This integrated scheme sets out the extent of, and any conditions attaching to, the PCC's consent to the chief constable's exercise of the powers to enter into contracts and acquire or dispose of property.

The scheme also provides an opportunity to set out in more detail any terms on which the respective functions of the PCC and the chief constable will be exercised in order to achieve the objectives set out in the PCC's police and crime plan. The FMCP requires the scheme to, as a minimum, set out how:

- the PCC expects the funds provided to the chief constable for policing to be applied
- the PCC will hold the chief constable to account for the day-to-day management of those funds

- the chief constable will carry out their duty to assist in the exercise of the PCC's functions
- the chief constable will exercise his or her power to do anything calculated to facilitate the exercise of his or her own functions
- the PCC will exercise their power to delegate the exercise of their functions to their own staff.

Financial regulations and standing orders on contracts

Each PCC is required to adopt a single set of standing orders relating to contracts as well as detailed financial regulations within the overall scheme of governance. The standing orders and financial regulations govern the relationship between the PCC and the chief constable in financial matters and should be developed in close consultation with the chief constable, the two chief finance officers and the chief executive. CIPFA supports the production of a single set of joint financial regulations, which will need to be signed independently by each corporation sole.

The FMCP recommends that the financial regulations should:

- ensure that the financial dealings of the PCC and the chief constable are conducted properly and in a way which incorporates recognised best practice (as set out in guidance published by relevant bodies) and which focuses on bringing operational and financial management together with accurate, complete and timely financial information
- include sufficient safeguards for both chief finance officers who are responsible for ensuring that the financial affairs of the force and the PCC are properly administered to discharge their statutory obligations.

Accounting

The chief finance officer of the PCC is required to set out the arrangements for the production of the group accounts. The police force chief finance officer is responsible for producing the chief constable's accounts in accordance with the timetable and requirements of the group accounts as agreed locally and in accordance with the financial reporting framework.

The PCC is required to establish a policy on reserves (including how they might be used by the chief constable) and provisions in consultation with the chief constable.

Strategic and financial planning

The PCC and the chief constable share a responsibility to provide effective financial and budget planning for the short, medium and longer term. The FMCP requires the financial regulations to include the requirement for the PCC, in consultation with the chief constable, to identify and agree a medium-term financial strategy. The PCC is required to consult with the chief constable in planning the overall annual budget, which will include a separate force budget.

The FMCP reinforces the need to comply with the legislative requirements around the balanced budget requirement and with CIPFA's *Prudential Code*.

Financial management

The FMCP requires the chief constable to have day-to-day responsibility for financial management of the force within the framework of the agreed budget allocation and levels of authorisation issued by the PCC. The chief constable must ensure that the financial management of their allocated budget remains consistent with the objectives and conditions set by the PCC.

The PCC initially owned and funded all assets regardless of whether they were used by the PCC, by the force or by both bodies. However, some PCCs subsequently transferred assets to chief constables within their stage two transfer arrangements. If consent is given by the PCC, chief constables can acquire property (other than land or buildings) and this should be set out in the scheme of governance. The PCC has overall responsibility for property and contracts but with consent from the PCC, the responsibility for carrying out the daily administration of property and contracts can be carried out by the chief constable or staff of the chief constable. In addition, with consent from the PCC, chief constables can enter into contracts. Any such arrangements should be set out in the scheme of governance.

Treasury management

The FMCP requires financial regulations to cover banking arrangements and that the chief finance officer of the PCC is responsible for these. It is also recommended that the PCC and the chief constable have shared banking arrangements for their main banking requirements.

The PCC is directly responsible for loans, investments and borrowing money as he/she holds the police fund. The chief constable is not able to borrow money (other than temporary overdrafts set out in s141 of the *Anti-social Behaviour, Crime and Policing Act 2013*). It is recommended that any surplus funds be pooled and invested. All loans and investments should be arranged in line with the CIPFA *Treasury Management Code* and all borrowing should comply with the CIPFA *Prudential Code*.

Corporate governance

The PCC and the chief constable are required to ensure that the principles of good governance are embedded in the way in which the PCC and the force operate and this should be set out in an annual governance statement published with the statement of accounts.

Audit

The PCC and the chief constable are required to maintain effective internal audit of their affairs by the *Accounts and Audit (England) Regulations 2011* and the *Accounts and Audit (Wales) Regulations 2005*. In fulfilling this requirement the PCC and the chief constable should have regard to the *Code of Practice for Internal Audit in Local Government in the United Kingdom* issued by CIPFA and subsequently replaced by the *Public Sector Internal Audit Standards* and associated *Local Government Application Note*. In addition, the FMCP highlights the *CIPFA Statement on the Role of the Head of Internal Audit in Public Service Organisations* as setting out best practice.

PCCs and chief constables are recommended to have a shared internal audit service which would cover both bodies.

The FMCP requires the PCC to use the reports of external auditors to aid it in its monitoring role. The CFO of the PCC should send the Home Office copies of these reports each year.

The PCC and the chief constable are required to establish an independent audit committee to consider the internal and external audit reports of both the PCC and the chief constable. The committee advises the PCC and the chief constable according to good governance principles and to adopt appropriate risk management arrangements in accordance with proper practices. In setting up the audit committee, the PCC and the chief constable should have regard to the CIPFA guidance on audit committees.

Value for money

The chief constable has a specific statutory duty under section 35 of the *Police Reform and Social Responsibility Act 2011* to ensure that they and the persons under their direction and control secure good value for money in exercising their functions. The PCC is required by section s1(8) and 3(8) of the 2011 Act to hold the chief constable to account for their compliance with this duty.

Transparency

PCCs are required to publish the information that they consider necessary to enable the local public to assess their performance and that of the chief constable. In addition they are required to publish information specified by the Home Secretary in *The Elected Local Policing Bodies (Specified Information) Order 2011* and in regulations issued under section 11 of the *Police Reform and Social Responsibility Act 2011*.

Collaboration

Under sections 22A to 22C of the *Police Act 1996* as inserted by section 89 of the *Police Reform and Social Responsibility Act 2011*, chief constables and PCCs have the legal power and duty to enter into collaboration agreements to improve the efficiency or effectiveness of one or more police force or PCCs.

Any collaboration which relates to the functions of a police force must first be agreed with the chief constable of the force concerned. PCCs shall hold their chief constable to account for any collaboration in which the force is involved and must consider doing so in co-operation with the other PCCs concerned.

Statement of accounts

Both the PCC and the chief constable will need to produce their own statement of accounts. The PCC will then have to bring these together into something called the group accounts. The group accounts will show the total costs of policing for the whole area. The individual accounts of the PCC and the chief constable have a large single item relating to money passed from the PCC to the chief constable, which will cancel each other out in the group accounts.

The role of the chief finance officer

Chief finance officer (CFO) is a term used to describe the person in the most senior finance role in a local authority (including police body) that also holds a specific legal role known as the section 151 officer. The CFO has to be a member of a professional accountancy body such as CIPFA. This means that in carrying out their job they are bound by very rigorous professional rules and expectations. The CFO also has very specific legal responsibilities to the local taxpayer. The *Police and Social Responsibility Act 2011* requires both the PCC and chief constable to appoint their own CFO.

The role and responsibilities of the ‘treasurer’ were developed by case law in England and Wales. In *Attorney General v De Winton 1906*, it was established that the treasurer is not merely a servant of the council, but holds a fiduciary responsibility to the local taxpayers. This means that when the CFO gives advice and carries out their job, they have to think about not only what is the best decision for the council, but also for local taxpayers.

Section 151 of the *Local Government Act 1972* requires local authorities, including PCCs, to ‘make arrangements for the proper administration of their financial affairs’ and appoint a CFO to have responsibility for those arrangements. This means that the CFO is legally responsible for ensuring that a local authority manages its finances properly.

In order to help CFOs do their job and organisations understand how they can ensure their arrangements support the CFO in their legal responsibilities, CIPFA produced its *Statement on the Role of the Chief Finance Officer of the Police and Crime Commissioner and the Chief Finance Officer of the Chief Constable* (updated March 2014). The statement goes into a lot of detail about the role but it is based upon the five principles set out below.

The CFO to the PCC and the chief constable:

- is a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver strategic objectives sustainably and in the public interest
- must be actively involved in, and able to bring influence to bear on, all material business decisions (subject to the operational responsibilities of the chief constable) to ensure immediate and longer-term implications, opportunities and risks are fully considered, and aligned with the financial strategy
- must lead the promotion and delivery of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities, the CFO to the PCC and the chief constable:

- must, in close working liaison with the PCC, PCC chief executive and the chief constable, ensure that the finance function is resourced to be fit for purpose
- must be a professionally qualified accountant and be suitably experienced and must ensure professional knowledge is kept current through continuing professional development.

PCCs as the holders of the police fund and chief constables as managers of resources provided to them by PCCs have a responsibility to operate within available resources and to remain financially sound over the short, medium and longer term. Schemes of governance

should detail funds provided to the chief constable and conditions under which they are provided including purpose, reporting and monitoring arrangements and the flexibility to apply funds to different areas. The chief constable has a responsibility to operate within these available funds and conditions and will need to determine internal delegation arrangements to ensure effective local management. The chief constable also needs to implement reporting arrangements to the PCC, and should ensure prior approval of the PCC before incurring a liability that the PCC might reasonably regard as novel, contentious or repercussive.

The PCC will need to establish what financial monitoring information is required by the police and crime panel. This could include information on the annual PCC group and individual accounts. The PCC CFO is not an advisor to the police and crime panel; he or she should supply the PCC with information to enable the PCC to report to and respond to questions from the panel. The panel is responsible for securing its own independent financial advice. The PCC's CFO and chief constable's CFO should consider submitting the annual PCC/group and chief constable's accounts to the audit committee for review prior to the approval of the accounts by the PCC and the chief constable.

Section 114 of the *Local Government Finance Act 1988* requires a report to all the local authority members to be made by the CFO, if there is or is likely to be unlawful expenditure or an unbalanced budget. Such reporting under section 114 of the 1988 Act, or for the Metropolitan Police, section 130 of the *Greater London Authority Act 1999*, should be made to the PCC, the chief constable and the external auditor. Both PCCs and chief constables are required to establish an independent audit committee and any such report should also be made to members of this committee, the police and crime panel and the internal auditors.

Before either CFO decides to exercise their section 114 powers, they should consult with the other CFO, the PCC chief executive and the chief constable, and should seek independent legal advice. As holders of the 'red card', the CFO must always exercise professional responsibility in order to intervene in spending plans to ensure the balance of resources is maintained so that the PCC and the chief constable remain in sound financial health. For this, the CFO must have direct access to the PCC or the CC (depending on which CFO is concerned), the PCC chief executive, other leadership team members, the audit committee and internal and external audit.

ACCOUNTING, FINANCIAL REPORTING AND AUDIT

Policing bodies are required to produce accounts under the local authority accounting regime. Local authority accounting differs from private sector accounting in a number of important ways. Although local authority accounting is based on the same accounting standards, these are mainly designed for the private sector so need to be adapted.

In addition, the government makes specific rules known as statutory requirements that policing bodies must follow when they prepare their financial statements limiting the amount that can be charged to council taxpayers and avoiding significant changes in expenditure from one year to the next.

All the accounting requirements for local authorities are brought together in CIPFA's *Code of Practice on Local Authority Accounting in the United Kingdom*.

PCC and chief constable annual statement of accounts

The way the new policing bodies were set up is unique among local authority bodies. The two corporations sole mean that the PCC and the chief constable must each produce a separate set of accounts, with the PCC also being required to produce a set of group accounts that consolidate together the income and expenditure and assets and liabilities of both bodies.

STAGE 2 TRANSFERS

The *Police Reform and Social Responsibility Act 2011* transferred to police and crime commissioners all of the assets, liabilities and staff formerly employed by police authorities. The Act also provided for a further transfer so that police and crime commissioners could agree what assets and police staff would be transferred from the commissioner to the chief constable under a stage two transfer. All transfers have now been completed. The *Anti-social Behaviour, Crime and Policing Act 2013* facilitated the finance elements of stage 2 transfers.

FURTHER READING

Accounting for the Impact of Police Reform (LAAP Bulletin 95), CIPFA, 2012

Anti-social Behaviour, Crime and Policing Act 2013

Audit Committees: Practical Guidance for Local Authorities and Police (2013 Edition), CIPFA, 2013

CIPFA's Position Statement: Audit Committees in Local Authorities and Police, CIPFA, 2013

CIPFA Statement on the Role of the Chief Finance Officer of the Police and Crime Commissioner and the Chief Finance Officer of the Chief Constable, CIPFA, 2014

Closure of the 2013/14 Accounts in the Single Entity Financial Statements of Police and Crime Commissioner and Chief Constable (LAAP Bulletin 98A), CIPFA, 2014

Delivering Good Governance in Local Government: Guidance Note for Police (2012 Edition), CIPFA/SOLACE, 2012

The Elected Local Policing Bodies (Specified Information) Order 2011

Financial Management Code of Practice for the Police Service of England and Wales, Home Office, 2013

Police Reform and Social Responsibility Act 2011

The Policing Protocol Order 2011

Practitioner Briefing Note on Asset and Liability (including Employment) Recognition in Police and Crime Commissioner and Chief Constable Accounts, CIPFA Police Panel, 2013

MODULE 10

Social care

INTRODUCTION

Council expenditure on social care exceeds spending on all local government services other than education. This module looks at adult and children's social care services in the national context, council social care budgets, the inspection regime and major developments.

The module covers the policy framework of adult social care within England, including *Valuing People Now*, *Putting People First* and the associated *Think Local, Act Personal*, the National Dementia Strategy, *A Vision for Adult Social Care* and the *Adult Social Care Outcomes Framework*. It also considers the implications of the *Health and Social Care Act 2012* and the *Care Act 2014*.

As with most local government services, the bulk of funding comes via a combination of the Revenue Support (formula) Grant, business rates and council tax. There has been a move away from specific grants in recent years, though a small number remain, and most notably the newly introduced Better Care Fund and funding for new responsibilities for the *Care Act* take this form.

The module covers what is happening in Wales, in particular, the 2009 Advisory Group report on paying for long-term care in Wales, together with the subsequent Green Paper on the subject and the guidance that followed. Also covered are the Assembly's 2005 ten-year strategy outlining what the public sector must do to improve health and social care in Wales; and the new Independent Commission on Social Services.

The module also covers the legal aspects of the children's social care system in England.

CHALLENGES FOR SOCIAL CARE

Social care services are demand led. This means that if a service user is assessed as requiring a service and meets the eligibility criteria set by the council, that service must be provided. This can make planning very difficult. The population is ageing, meaning more people are requiring services as they live for longer. In addition, there are an increasing number of younger adults requiring support as medical advances lead to longer life spans for service users with life-limiting conditions. In many cases the need for council support is exacerbated when elderly parents are no longer able to cope. These pressures make the service difficult to manage.

Services have historically been provided predominantly by councils. Over recent decades this focus has changed, with many services provided by the independent or the third sector. This change has led to the development of councils' commissioning role, which analyses the

current and anticipated future needs within the community and seeks to ensure that the resources and services are available to meet those needs.

The key challenge for the sector now is to develop the integration agenda between health and social care, the government's aim being that service users see a seamless service provision and are not able to distinguish whether care is being provided by health or social care. It is hoped that closer working, especially on preventative solutions and intermediate care, will lead to efficiencies within the whole system as hospital admissions are reduced and fewer people are placed in permanent residential care.

This module explores these challenges further.

SOCIAL CARE IN THE NATIONAL CONTEXT

The budgeted net current expenditure in relation to adult social care for 2014/15 was just under £14.4bn for England and just over £1bn for Wales. For children's social care, the total for England was £7.7bn and almost £0.5bn for Wales, making the total budgeted net expenditure for social care for England and Wales £23.6bn. That reflected an ongoing real terms reduction in adult social care spend (£200m less in cash terms than in 2013/14) and an increase in children's spend (£990m more than in 2013/14).

Social care includes services for elderly people and a wide range of services for those in the 18–64 years age group. The following table gives an analysis of budgeted net current expenditure for social care for England and Wales for 2014/15.

Services for older people consume over a third of money allocated to social care for both England and Wales. Services for adults with learning disabilities are close behind, with 21% in both England and Wales. The third major element is children looked after, with 15% of the budget in England and 14% in Wales.

Analysis of net estimated expenditure 2014/15 England and Wales

| | England | Wales |
|--|--------------|------------|
| | £m | £m |
| Children's Social Care | | |
| Sure start children's centres/flying start and early years | 651.1 | 36.6 |
| Children looked after | 3,289.2 | 233.3 |
| Other children and family services | 347.2 | 37.8 |
| Family support services | 973.0 | 66.5 |
| Youth justice | 220.9 | 20.7 |
| Safeguarding children and young people's services | 1,589.6 | 104.8 |
| Asylum seekers | 64.3 | 1.3 |
| Services for young people | 590.4 | 9.8 |
| Total Children's Social Care | 7,726 | 474 |

| | England | Wales |
|--|---------------|---------------|
| | £m | £m |
| Adult Social Care* | | |
| Physical support – adults (18–64) | 1,066.0 | |
| Physical support – older people (65+) | 3,327.7 | |
| Sensory support – adults (18–64) | 66.6 | |
| Sensory support – older people (65+) | 172.5 | |
| Support with memory and cognition – adults (18–64) | 41.6 | |
| Support with memory and cognition – older people (65+) | 884.3 | |
| Learning disability support – adults (18–64) | 4,189.3 | |
| Learning disability support – older people (65+) | 443.2 | |
| Mental health support – adults (18–64) | 630.1 | |
| Mental health support – older people (65+) | 424.4 | |
| Social support – substance misuse support | 41.8 | |
| Social support – asylum seeker support | 21.3 | |
| Social support – support for carer | 139.6 | |
| Assistive equipment and technology | 166.9 | |
| Social care activities | 1,568.6 | |
| Information and early intervention | 225.8 | |
| Commissioning and service delivery | 954.7 | |
| Total Adult Social Care | 14,364 | 1,125* |
| TOTAL SOCIAL CARE | 22,090 | 1,599 |

* Wales has not yet adopted the new classifications. The detail is therefore:

- Service strategy – £4.9m
- Older people (over 65) including mentally ill – £547.2m
- Physical/sensory disability (under 65) – £94.2m
- Learning disabilities (under 65) – £331.8m
- Mental health (under 65) – £78.8m
- Other – £31.4m.

Source: CIPFA Finance and General Statistics Estimates 2014/15.

Adult social services are provided to the following main groups of clients: older people, people with learning disabilities, people with physical disabilities and people with mental health needs. When a client reaches 65 they will be classed for financial reporting purposes as an older person. The key services provided include assessment and care management, residential care, nursing care, homecare, day care and equipment/adaptations. A client may receive what is known as a direct payment, where they purchase their assessed care requirements directly themselves. The aim of this is to promote independence.

The reporting requirements for England changed from 2014/15 in line with a review undertaken by the Social Care Information Centre. This is reflected in the categories of analysis shown above.

Adult social care is a demand-led service. This means that if a person is assessed as needing care and that care is within the eligibility range set by the council, then the person must receive that care. Historically this has made social care one of the most difficult budgets to manage. This dynamic provides a financial as well as a service logic for intervening early in a client's care in order to prevent or delay admission to residential care, which is an expensive commitment.

The Audit Commission published the first of a series of briefings in June 2011, entitled *Improving Value for Money in Adult Social Care*. The briefing found that, as demographic change and financial pressures combine to create tough times for adult social care, councils have looked at many aspects of the service in order to provide better, more efficient services.

The second of the Audit Commission's briefings was entitled *Joining Up Health and Social Care* and was published in December 2011. It looks at improving value for money across the health and social care interface.

The third briefing was entitled *Reducing the Costs of Assessments and Reviews* and was published in August 2012. Better procurement, improved back-office arrangements, and a preference for community-based rather than residential care where possible are just some of the changes that councils have implemented to help them meet the challenges they face. The briefing also finds that the pace and scale of change need to increase if councils want to release material savings, as well as improve care for people.

In 2014, the National Audit Office (NAO) produced the first of a series of reports on the adult care system, *Adult Social Care in England: Overview*. The report points out that government does not know if the limits of the capacity of the care system to continue to absorb pressures are being approached. It warns that major changes to the system to improve outcomes and reduce costs will be challenging to achieve.

The report details increasing pressures on the system: adults with long-term and multiple health conditions and disabilities are living longer; demand for services is rising while public spending falls; and there is unmet need for care. Government is engaging well with the adult care sector and aims to tackle the pressures in the adult care system through introducing the *Care Act*.

While the need for care continues to rise, local authorities' spending on adult social care fell by 8% in real terms between 2010/11 and 2012/13. The longer-term trend of reducing the amount of care provided has continued, but the analysis shows that local authorities have also improved their ability to control their costs in delivering core services since 2010/11. Local authorities are making efficiency savings by changing contractual agreements, paying lower fees and negotiating bulk-purchasing discounts.

Paying lower fees to independent sector providers of care can put pressure on their financial sustainability, with some providers reporting problems meeting all but users' basic needs and investing in training for their staff. Over the last ten years, many local authorities have raised the eligibility level they set for individual packages of care. Eighty-seven per cent of

adults now live in local authorities that arrange care services only for those with substantial or critical needs.

The NAO report also highlights the increasing pressure on other parts of the care and health systems. Informal carers now provide more hours of care per week and on average they are getting older. In addition, poor-quality social care can lead to unnecessary emergency hospital admissions. National and local government do not know the capacity of the care and health systems to continue to absorb these pressures and how long they can carry on doing so.

The adult care system is changing significantly and rapidly. The Department for Communities and Local Government is expecting local efficiency initiatives, service transformation and the Better Care Fund to help local government manage financial pressures. However, there is weak evidence for which ways of commissioning and providing services are the most cost-effective. The *Care Act* will introduce significant changes for local authorities, which will be challenging to plan for because of a lack of information, lack of evidence on what works and short timescales.

The NAO warns that, while the Department of Health (DH) and the Department for Communities and Local Government (DCLG) are working together to understand the cumulative implications of changes to, and reduced spending on, health and social care, welfare and related local services, other departments are not. For example, changes to benefits for adults with disabilities and their carers will put further strain on care users' ability to pay for their own care and for informal carers to provide support.

The Adult Social Care Efficiency Programme

The LGA's Adult Social Care Efficiency Programme is the most recent and comprehensive look at the potential to improve efficiency in adult social care. The final report (2014) acknowledges that since 2010, spending on adult social care has fallen by 12% in real terms as councils have delivered savings of over £3.5bn to adult social care budgets, even though the number of people looking for support has increased by 14%.

The LGA, working in partnership with the DH, DCLG and the Association of Directors of Adult Social Services (ADASS) developed the Adult Social Care Efficiency Programme. Over a third of upper-tier authorities have participated in the three-year programme, working on 44 projects.

Most of the councils who participated in the programme were required to deliver savings of 8–10% over the three-year period in order to balance the books. The evidence suggests that if a council can retain a relatively balanced cash spend on adult social care, it will be required to deliver at least 3% savings per annum to meet competing demands from inflationary and demographic pressures alone. Some councils have had to make significantly higher levels of savings.

The biggest lessons emerging from the programme about how councils are making efficiencies are as follows.

Developing a new contract with citizens and communities

Councils are beginning to develop a new contract with citizens and communities that means individuals take more responsibility for their own care, and families and communities are

supported to help those individuals to be as independent as possible. In the future, citizens will have a duty to contribute as well as a right to receive support. The approach is not about cutting services in response to financial pressures, but about proactively helping and encouraging people to live healthier lifestyles, thus reducing or delaying the need for formal social care services. To deliver this new model of care, there needs to be a fundamental shift in the expectations of individuals, communities and service providers if the most is to be made of diminishing resources while securing public wellbeing.

Suffolk started to have a dialogue with staff, citizens and communities to transform attitudes, cultures and behaviours in relation to care and support. Through raising understanding of the need to change, it aims to gain support for the new model of social care being developed.

Managing demand for formal social care

Most councils are going some way to meeting their savings targets by reducing the number of people receiving formal social care. The model of care has changed from one of paternalism to one which promotes independence and manages risk with customers. Councils such as Hackney based their transformation programme on the principle that they will increase opportunities to promote health and wellbeing, while services will aim to support residents to be as independent as possible with 'minimal interference' from the council. They are bold and clear in their aim to reduce packages of care as people achieve their outcome of becoming more independent. Significantly, only those councils that have developed a model based on decreasing dependency on social care and promoting independence have been able to achieve the higher level of savings that the future requires.

Councils are focusing on developing services such as reablement for older people or recovery models in mental health services, which help a person to maximise their potential for independence before putting in longer-term services. Several councils have improved the performance of their reablement service through the programme, with over 60% of people who use the service no longer requiring any ongoing formal care.

The access point to social care has been the cause of much consideration, with councils debating whether a generic or a specialist front-of-house model offers the best opportunity to divert people who do not require formal care to other solutions. Some areas previously operated a council-wide access point, but a specialist (but frequently more costly) service is now more prevalent and appears to offer the best opportunity to reduce demand for formal social care services. Through this model, councils might expect to divert 75% of people towards a solution that can be found within the voluntary sector or from local communities before an assessment or offer of formal help is made.

Transformation

Those councils that have had to achieve savings targets above 10% over the period of the programme have looked at radically new service delivery models which, through offering less formality and bureaucracy, can engender a more innovative environment. People2People in Shropshire offers a person-centred way of delivering social care. Staff and users are involved in running the organisation at all levels. While complying with formal reporting requirements, the social enterprise has the freedom and scope to be innovative.

Making optimum use of the workforce is a key consideration for councils. Detailed analytical work in Kent, Kingston and Central Bedfordshire revealed that individual social workers commission different services, with varying costs, for users presenting similar challenges. Peer development approaches coupled with more robust performance management is being used to address the differences and ensure workforce optimisation. It is recognised that the most significant element in transforming services to make savings is the transformation in culture and behaviours. Councils recognise that it is not possible to bring about this culture change within a short time frame and participants in the programme suggest that it takes two to three years to even begin to embed a new culture.

Commissioning, procurement and contract management

As in the case of Shropshire, many councils are moving to becoming commissioning organisations, developing new models of care that are separate to the formal council structure. Others are looking to improve the way in which services are commissioned and many are adopting the pioneering approach developed by Wiltshire, which procures for outcomes from providers and pays on the achievement of those outcomes. Councils are working with providers to develop the market in response to need and to negotiate the right price for services to demonstrate value for money. Evidence from the programme suggests that those councils that rely on the external market are more likely to have lower costs than those delivering in-house services. However, performance management of contracts is important to ensure that those commissioning services get the right outcomes for users.

Integration

Councils have embraced the opportunity to integrate services with other public or independent provider services, most notably the NHS, and are engaging in a dialogue around the use of the Better Care Fund. Richmond, Swindon, Torbay, Northumberland and Calderdale report savings through an integrated approach to service delivery. Evidence from a number of councils suggests that savings from personal health budgets are best realised when operating within an integrated model of care. Others find that an integrated reablement model avoids duplication, brings together a range of intermediate care services to support hospital discharge, avoids admissions to residential care and helps older people in the community.

However, the number of councils and partners realising cashable savings from integration is still relatively small. So it seems unlikely that the scale of the savings required for adult social care in the near future will be found through integration with health services alone. To support the sector in this area, the LGA is launching a new project, working with councils and health partners to explore the efficiency opportunities of health and social care integration.

A range of opportunities

While there are some big lessons emerging from the programme, as well as a comprehensive range of fundamental activities and approaches that most, if not all, councils are taking to make savings, the message from councils is that there is no one magic solution to meet the funding challenge. Instead, a relentless focus on all the efficiency opportunities is required. Successful efficiency approaches have included:

- Many councils now operate a policy where no one can be admitted to permanent residential care from a hospital bed. This is being built into the Better Care Fund discussions.
- Those councils making the biggest reductions in admissions to residential care cite the importance of cultural change in the workforce.
- Extra care housing is increasingly being used as a potentially more efficient alternative to residential care, provided it is only used for those with high care needs.
- Many councils are taking actions to bring down the costs of domiciliary care and those that have retendered for domiciliary care services in the past 12 months found that prices continued to fall. This evidence appears to counter what is being stated at a national level about the pressures on costs in this market.
- Peer development approaches, coupled with more robust performance management, are being used to explore and address differences in the performance of individual social workers to ensure workforce optimisation.

Those councils that have had to save the most money have achieved this successfully by having a clear managerial and political vision for social care which is conveyed to staff, stakeholders and customers. The savings delivered are not seen as 'cuts' but have come about through an approach to delivering better outcomes for customers at a lower cost.

The LGA has followed up with the Towards Excellence in Adult Social Care programme to help councils improve their performance in adult social care. The programme is led by a partnership board and is delivered by the sector on a regional basis. Its purpose is to support and challenge local government to deliver excellent adult social care services, aiming to do this locally supported by a regional and national programme of support.

Six priorities were identified in 2014/15:

- 1 local accounts
- 2 identifying and sharing best practice
- 3 commitment to demonstrating outcomes
- 4 building confidence amongst stakeholders
- 5 identifying and supporting authorities who are struggling
- 6 clarifying the offer of support.

PAYING FOR CARE IN ENGLAND

In addition to an assessment of a client's needs, they will also receive a financial assessment which will determine their ability to pay for care themselves. The charges for residential care and community services are determined by two different charging regimes.

Residential care is means tested and takes into account capital such as property after 12 weeks. A client is financially assessed to determine how much they can afford to pay under rules called the *Charging for Residential Accommodation Guide*. The rules are national and there are limited areas of discretion for individual authorities. If a client has sufficient resources they are required to pay for the full cost of the service until their resources fall below a certain limit. A council can place a legal charge on a property in cases where the

resident has insufficient money to pay the residential charge because their capital is tied up in property.

For a client receiving nursing care, an assessment called a determination is undertaken of their nursing care requirements. The home then receives payment for the nursing element of a resident's care from the NHS with the council paying the balance of their fees for personal care and hotel costs.

Charges for community care services are made under the Fairer Charging rules. These differ from residential charges in that neither a person's home nor earnings are taken into account when assessing the charge. There is also an allowance made for costs relating to the person's disability. There is far more discretion in relation to charging for community services and there is no requirement that authorities do in fact charge. That said, given the difficult financial situations that many councils find themselves in, any additional income from charging for services will support the budget. Charging policies and changes to them must be consulted on, and where a maximum charge is set this must also be consulted on.

Charges cannot be made for intermediate care which must be provided free for six weeks, community equipment or for services provided to clients who are detained under section 117 of the *Mental Health Act 1983*.

The arrangements for paying for care in England will change with the *Care Act*. This provides for a reformed system of funding whereby there will be a cap on care costs incurred after April 2016 to limit what people pay for care over the period of their lifetime. The full details of how the proposed reformed system for paying for social care will work are to be set out in regulations in spring 2015.

PAYING FOR CARE IN WALES

In Wales, charging for residential care is done under the *Charging for Residential Accommodation Guidance* produced by the Welsh Government. This system is very similar to that in England.

In January 2009, the deputy minister for social services established an advisory group of key stakeholders to consider options for reform of the system of paying for long-term care in Wales. It was part of a wider programme of consultation and engagement around this issue, which included a three-month consultation exercise. The group submitted a report with 28 recommendations for reform in June 2009, *Paying for Care in Wales: Report of the Stakeholder Advisory Group*.

The advisory group's report was followed by a Green Paper, *Paying for Care in Wales: Creating a Fair and Sustainable System*, with a consultation period of 16 November 2009 to 28 February 2010. It sets out a number of options for reforming the current system, and sets out the main advantages and disadvantages of each.

The options in the Green Paper were developed by the UK government (which ran a separate consultation in England).

The *Social Care Charges (Wales) Measure 2010* gave Welsh councils a discretionary power to charge for non-residential social services.

Councils can set charges at what they see as reasonable levels. To introduce consistency in the way councils use this discretion, and to provide financial safeguards for those on low incomes, the Welsh Government has made regulations as part of the measure. This was provided in April 2011 with the publication of *Introducing More Consistency in Local Authorities' Charging for Non-Residential Social Services: Guidance for Local Authorities*.

As a result, where councils decide to charge adults for their non-residential social services, certain arrangements must occur. These include the following:

- Councils must issue an invitation for a means assessment (a financial assessment) to those receiving services for the first time where they plan to make a charge. They must also issue an invitation to existing service users where they plan to alter a charge as a result of a change in the service they receive or in their finances.
- Councils must undertake this assessment where service users request one and provide the information needed to do this.
- Councils cannot charge for particular services. This includes transport to attend a day service, where attending this and transport to it are included in the agreed services to be provided.
- Councils also cannot charge for providing information about their services or the charges they set for these. In addition, they cannot charge for undertaking assessments of care needs or means assessments.
- In setting charges councils must allow service users to keep at least the amount of their income support, employment and support allowance or pension credit guarantee credit plus 35% of that amount. They must also allow service users to keep a further 10% as a contribution towards their daily living costs which may be higher as a result of a disability or medical condition.
- Councils must not take into account any money earned by a service user.
- Councils cannot set charges that are more than £50 per week for all of the services a service user receives.
- Councils must operate a scheme where service users can ask for charges set to be reviewed.

The non-residential charging regime became effective from 11 April 2011.

SPENDING REVIEWS 2013 AND 2014 AND THE FUNDING POSITION OF SOCIAL CARE

The 2013 Spending Review made a number of significant funding announcements for health and social care for England, including:

- Ensuring that spending on health continues to rise in real terms and providing £2bn additional funding through the NHS for local health and care services to meet the needs of older and disabled people.
- Putting £3.8bn for 2015/16 in a single pooled budget for health and social care services to work more closely together in local areas, based on a plan agreed between the NHS and councils. (This shared pot includes an additional £2bn from the NHS and builds on

the existing contribution of around £1bn in 2014/15, with the aim of delivering better, more joined-up services to older and disabled people, to keep them out of hospital and to avoid long hospital stays.)

- Making an extra £200m available in 2014/15 as an upfront investment in new systems and ways of working that will benefit both services.
- Making £335m available to councils in 2015/16 so that they can prepare for reforms to the system of social care funding, including the introduction of a cap on care costs from April 2016 and a universal offer of deferred payment agreements from April 2015.

The 2014 Spending Review did not change these headline directions. The split of 2015/16 *Care Act* funding was adjusted, following consultation, within the same total, and allocation formulae were confirmed. The long-term future of the Better Care Fund will be a matter for the new government to decide. The provisional settlement, however, did increase the overall pressure on local government budgets, which will have the effect of sharpening the challenges for social care. Central government grant to run local services will fall by 3.7% next year, when the Better Care Fund is included in full. Without including that element of the fund, which will not be spent on social care or commissioned by local authorities, the reduction is 8.8%.

Examining the figures published by local government minister Kris Hopkins, who said funding would be cut by an average of 1.8% in 2015/16, CIPFA has found the impact on council budgets could be more than three times more severe. CIPFA's figures, produced in association with Pixel Financial Management, excluded areas of spending that are ringfenced for specific purposes or are already part of pooled budgets with the NHS, such as the Better Care Fund.

Chief Executive Rob Whiteman said the difference between what was presented by the government and the cash cuts faced by local councils is stark:

It demonstrates why we urgently need transparency about government funding instead of this continued conflation and inflation spending, which hides the true size and scope of the cuts many local authorities face.

The figures presented by the government also appear to hide the true impact of cuts upon some local authorities. Once you peer behind the opaque measurement of funding used today, you see that the disparity of impact across the country and between different types of authority is significant and needs to be considered carefully by policymakers.

Although council spending power per head remains higher in more deprived parts of the country, CIPFA said the gap continues to narrow as funding cuts are falling most heavily upon areas with the greatest need.

Commission on the Future of Health and Social Care in England

There is a widespread view – consistent with reactions to the 2014 Spending Review – that social care (and health) funding is becoming increasingly unsustainable. Given that the post-war settlement, which established separate systems for health and social care, may no longer be fit for purpose, The Kings Fund asked Dame Kate Barker to chair an independent commission to consider whether there are better ways of determining people's entitlement to health, care and support, and how these can be funded.

The commission's report in September 2014 favoured a single health and social care system, with a ring-fenced, singly commissioned budget, and more closely aligned entitlements. Accordingly, it set out its vision of:

- How to create a system of care that works better and more appropriately for individuals and their carers.
- How far social care costs should be funded by those in need and their families, and how far they should be shared across society (as we are committed to doing for health care costs).

The commission's conclusions were that:

- The 1948 settlement for health and social care is no longer fit for purpose. Huge changes in demography, technology and the pattern and burden of disease mean that running England's health and social care as two separate systems no longer makes sense.
- The current arrangements create confusion, perverse incentives and much distress for individuals and families who have to grapple with the interactions between an NHS that is largely free at the point of use and a social care system that remains both heavily needs- and means-tested.
- Much simpler pathways through this current maze need to be designed – ones that offer support related to the need, rather than to whether the need is classed as health or social care, and a graduated increase in support as needs rise, particularly towards the end of life.
- There is a lack of alignment in funding streams. The NHS is paid for out of general taxation and operates within a ring-fenced budget. Social care is paid for either privately or from non-ring-fenced local authority budgets; with councils retaining discretion over how much is actually spent. Who pays for what is a constant source of friction, with enormous and distressing impacts on individuals and families.
- To resolve that, to create simpler pathways, and to increase the opportunities for much more integrated services, England needs to move to a single, ring-fenced budget for both health and social care run by a single commissioner.
- Given its close relationship with social care, Attendance Allowance (which would be called care and support allowance) should be brought within the new single budget, with individuals offered, wherever possible, personal budgets that rise in line with needs but come with as much support as possible to restore independence.
- Care that is currently defined as 'critical' should become free at the point of use, ending the current distinction between NHS Continuing Healthcare and social care. As the economy improves, care free at the point of use should be extended to include those with 'substantial' needs. By 2025 support should be extended to people with 'moderate' needs, subject to a financial assessment.
- However, outside hospital, accommodation costs should be rationalised so that all these costs are met by individuals up to the £12,000 cap that the *Care Act* will introduce from 2016.

- Although a greater proportion of social care costs should be met by the taxpayer, the commission supports the underlying principle of a partnership approach in which costs are shared between the individual and the state.
- This is an ambitious view of the future and given the state of the public finances it cannot be introduced overnight. Getting to the full version of the new settlement will be a journey of a decade.
- The commission believes that it is affordable. By 2025 public expenditure on health and social care combined might reach somewhere between 11% and 12% of GDP, broadly comparable with current expenditure on health alone in some other countries. This should be kept under regular review.
- The costs of the new settlement can be met in number of ways:
 - from improved productivity and the better value for money that a single local commissioner and the greater use of personal budgets will bring
 - taking some existing public expenditure, for example some spending on winter fuel payments, and diverting it into health and social care
 - from tax increases, particularly changes to National Insurance
 - by raising some additional money from existing NHS charges (no new NHS charges are recommended), including a significant change to prescription charges, reducing the charges but reducing the number of people exempt from payment.
- The current generation of pensioners and those now approaching state pension age are much better off, in terms of both income and wealth, than their predecessors – and will be among the particular beneficiaries of the recommendations. The commission therefore believes it is right for them to make a contribution towards the additional costs and propose s that:
 - free TV licences for the over 75s and winter fuel payments should be restricted to the least affluent pensioners
 - the existing complete exemption from National Insurance for those who work past state pension age should end (with payment of National Insurance at a lower rate)
 - those aged between 40 and 65 should pay an additional 1% in National Insurance, introduced to match the phasing in of the settlement.
- To help fund the additional resources that will be needed in future years, the commission recommends a comprehensive review of wealth and property taxation. These are hard choices. But some way of raising extra revenue, or releasing revenue, will be needed if England wants health and social care that is fit for the 21st century.

Better Care Fund

The Better Care Fund (BCF) provides £3.8bn pooled funding in 2015/16 to support health and social care services to work more closely together in local areas. The main purpose of the BCF is to ensure that local authorities and clinical commissioning groups (CCGs) work in partnership, alongside health and wellbeing boards and the rest of the health system. Plans to deliver this take effect in full from 1 April 2015, and are subject to several conditions:

- Plans to be jointly agreed at local system level and with the health and wellbeing board.

- Protection for social care services and contributing share of the £135m national 2015/16 costs of implementation of the *Care Act*.
- As part of agreed local plans, seven-day working in health and social care to support patients being discharged and to prevent unnecessary admissions at weekends.
- Better data sharing between health and social care, based on the NHS number.
- Ensuring a joint approach to assessments and care planning.
- Ensuring that, where funding is used for integrated packages of care, there will be an accountable professional.
- Agreement on the consequential impact of changes in the acute sector. This will include delivery of the reduction of emergency admissions and other factors such as avoiding a negative impact on the level and quality of mental health services.

The plans developed by local authorities and CCGs must be approved by the relevant health and wellbeing board and by NHS England in order to gain access to the BCF. It is intended that the fund will support the aim of providing people with the right care, in the right place, at the right time, including through a significant expansion of care in community settings. This should build on the work CCGs and councils were already doing, for example, as part of the integrated care 'pioneers' initiative, through community budgets, through work with the Public Service Transformation Network, and on understanding the patient/service user experience.

Each statutory health and wellbeing board was required to sign off the plan for its constituent councils and CCGs by September 2014. The fund plan was to be developed as a fully integral part of a CCG's wider strategic and operational plan, but with the Better Care Fund elements extracted as a stand-alone plan in accordance with a template requiring a wide range of service and financial performance indicators to be set out.

The BCF has been viewed with a degree suspicion from all sides. This stems essentially from the source of the money, which was not new but was initially presented as such by the government. In 2015/16 the BCF will be created from:

- £1.9bn based on existing funding in 2014/15 that is allocated across the health and wider care system. This comprises:
 - £130m Carers' Break funding
 - £300m CCG Reablement funding
 - £354m capital funding (including £220m Disabled Facilities Grant and £50m for the capital aspects of *Care Act* implementation) £1.1bn existing transfer from health to adult social care.
- £1.9bn of NHS funding through CCGs.

CCGs are required to decommission services and make efficiencies in order to contribute this second £1.9bn to the plans. This places a significant financial risk on the NHS, because if activity in hospitals and other healthcare settings is not prevented or deflected into lower-cost, community-based provision as a consequence of the actions enabled by the BCF, then there will be no reduction in acute costs to offset the investment made. This led to a late adjustment to the BCF planning framework, whereby £1bn was specifically earmarked for

either plans to reduce unplanned hospital admissions or retention in the health system in order to cover the cost of dealing with any failure to make the necessary reductions.

The 2015/16 allocation of the BCF includes £135m of revenue funding linked to a range of new duties that come in from April 2015 as a result of the *Care Act 2014*. Most of the cost results from new entitlements for carers and the introduction of a national minimum eligibility threshold, but there is also funding for better information and advice, advocacy, safeguarding and other measures in the *Care Act*. This funding is within the BCF, so these monies need to have been identified by both local authority and CCG partners within plans for 2015/16.

The BCF exists partly in recognition that spending cuts in local government as a whole might undermine NHS services by reducing the ability of its partners to deliver.

The BCF is partly a mechanism for transferring money from health to local government to compensate for cuts, but to target transferring resources so that they support the 'right' services rather than just propping up local government more generally.

DIRECTOR OF ADULT SOCIAL SERVICES

The *Children Act 2004* made provision to amend the *Local Authority Social Services Act 1970* in order to require each council with social services responsibilities in England to appoint a director of adult social services alongside a director of children's services.

Councils with social services responsibilities have been able to appoint a director of adult social services since 1 April 2005, but were only required to do so as and when the government made an order appointing the date by which all councils with social services responsibilities must have appointed a director of adult social services.

In May 2007, Department of Health wrote to councils notifying them that the government was bringing into force legislation requiring councils with social services responsibilities to appoint a statutory chief officer to be known as the director of adult social services by 1 January 2008.

Best Practice Guidance on the Role of the Director of Adult Social Services was published by the Department of Health in May 2006.

POLICY FRAMEWORK IN ENGLAND

There have been a number of policy framework changes that have impacted on adult social care in recent years. Those that are still relevant are detailed below.

Valuing People Now

The White Paper *Valuing People* published in 2001 set out the government's vision for people with a learning disability, across a range of services. It was based on four key principles of rights, independence, choice and inclusion. The White Paper's vision covered a range of issues including health, housing and employment.

Since that time, *Valuing People Now: From Progress to Transformation*, a consultation on the next three years of learning disability policy, was published in December 2007. The

consultation ran until 28 March 2008. It sought people's views on the priorities for the learning disability agenda over the next three years.

In January 2009 *Valuing People Now: A New Three-Year Strategy for People with Learning Disabilities* was published, setting out the government's strategy for people with learning disabilities for the next three years following consultation.

In December 2010, DH published the *Valuing People Now Summary Report March 2009 – September 2010*. The report included findings from the learning disability partnership board self-assessments in 2009/10 and covered progress that had been made within the last 18 months under *Valuing People Now*. It focused on the key priorities of improving outcomes for people with learning disabilities in health, housing and employment, and shows where more work is needed to make the lives of people with learning disabilities better.

Putting People First and Think Local, Act Personal

Putting People First: A Shared Vision and Commitment to the Transformation of Adult Social Care was published in December 2007. *Putting People First* was unique in establishing a collaborative approach between central and local government, the sector's professional leadership, providers and the regulator. It set out the shared aims and values which would guide the transformation of adult social care.

Putting People First recognised that local government would need to spend some existing resources differently. In addition, the government would provide specific funding to support system-wide transformation through the Social Care Reform Grant, in line with agreements on new burdens. Councils and their partners would agree together how this funding would be spent to develop the personalised system described in *Putting People First*.

Think Local, Act Personal is a national, cross-sector leadership partnership focused on driving forward work with personalisation and community-based social care. It brings together people who use services and family carers with central and local government, major providers from the private, third and voluntary sector and other key groups. In January 2011 it published a partnership agreement *Think Local, Act Personal: A Sector-wide Commitment to Moving Forward with Personalisation and Community-based Support*.

This sector-wide statement of intent makes the link between the government's new vision for social care and *Putting People First* has now been finalised as the way forward for personalisation and community-based support.

It asserts that councils, health bodies and providers need to work more collaboratively to personalise and integrate service delivery across health and adult social care, and make vital public funding go further. It also recognises the contribution that individuals, families, carers and communities make in providing care and support – both to those who are publicly funded and to those who either pay for themselves or rely on family carers.

National dementia strategy

Living Well with Dementia: A National Dementia Strategy was published in February 2009. It set out a vision for transforming dementia services with the aim of achieving better awareness of dementia, early diagnosis and high quality treatment at whatever stage of the illness and in whatever setting.

Dementia is one of the most significant issues we face as the population ages. There are estimated to be over 750,000 people in the UK with dementia and numbers are expected to double in the next 30 years. The term 'dementia' is used to describe a syndrome that may be caused by a number of illnesses in which there is progressive decline in multiple areas of function. Although dementia is primarily a condition associated with older people, there are also significant numbers of people (currently around 15,000) who develop dementia earlier in life. Direct costs of dementia to the NHS and social care are in the region of £8.2bn annually.

Raising the quality of care for people with dementia and their carers is a major priority under the new coalition government. It is necessary to respond to the challenge in the context of a changed political and economic landscape, where the Department of Health's role is more enabling and less directive.

In line with this, the government is committed to ensuring there is a greater focus on accelerating the pace of improvement in dementia care, through local delivery of quality outcomes and local accountability for achieving them. This is a new outcomes-focused approach, a key element of which is ensuring greater transparency and provision of information to individuals. This enables people to have a good understanding of their local services, how these compare to other services, and the level of quality that they can expect.

The approach is set out in the document *Quality Outcomes for People with Dementia: Building on the Work of the National Dementia Strategy* (September 2010), which presents the Department of Health's revised, outcomes focused implementation plan. It updates the previous implementation plan for the strategy, which was published in July 2009.

The key purpose of this revised implementation plan was to set out for health and social care localities and their delivery partners:

- the Department of Health's role and its priorities during 2010/11 for supporting local delivery of and local accountability for the implementation of *Living Well with Dementia: A National Dementia Strategy*
- the strategy's fit with the vision for the future of health and care as set out in the July 2010 White Paper *Equity and Excellence: Liberating the NHS*
- the strategy's fit with the 2010 consultation document *Liberating the NHS: Transparency in Outcomes – A Framework for the NHS*.

The Department of Health is involved in a number of initiatives in this area, including:

- the dementia challenge which is an ambitious programme of work designed to make a real difference to the lives of people with dementia and their families and carers, building on progress made through the National Dementia Strategy
- the national awareness campaign with the Alzheimer's Society which started in 2012 and will run until at least 2015
- co-operation with NHS England to put together guidance for local NHS services on improving dementia diagnosis rates.

Preparing for an ageing society

In November 2008, the government published *Preparing for our Ageing Society: A Discussion Paper*. The discussion paper and a series of events run in 2008 and 2009 were part of the

first stage of a review of the government's strategy for meeting the challenges of our ageing society.

The government identified four areas where changes would make the most difference to meeting the challenges of an ageing society:

- creating an age-friendly society
- preparing for later life
- living well in later life
- providing stronger protection and support.

The Audit Commission also published a detailed report on the aging society in July 2008, *Don't Stop Me Now: Preparing for an Ageing Population*. The report looked at the challenges and opportunities facing England as its population gets older. It aimed to help local public services adapt to the needs of an older and more diverse society, and identified solutions that could be implemented quickly, as well as exploring how councils should plan strategically for the wider challenges ahead.

In February 2010, the Audit Commission published *Under Pressure: Tackling the Financial Challenge for Councils of an Ageing Population*. It highlighted that in the space of seven years (ie between 2000/01 and 2007/08), social care spending had increased by 46%. Spending is planned to reduce over the coming years, which creates a challenge when coupled with the fact that the population in the UK is ageing. In 1982, 30% of people were over the age of 50; in 2009 it was 34%, and by 2026 it will be 40%.

To respond to this, councils need to know their populations, understand cost drivers and understand the impact of early interventions. This information then needs to inform the council's strategic plan and direction.

Commission on Funding of Care and Support

Such is the scale of the problem that the coalition government launched the Commission on Funding of Care and Support in July 2010. The commission was chaired by Andrew Dilnot with Lord Norman Warner and Dame Jo Williams as fellow commissioners. The commission built on the extensive body of work that had already been done in this area and provided recommendations and advice on how to implement the best option to government in July 2011.

The commission was specifically asked to examine and provide deliverable recommendations on:

- how best to meet the costs of care and support as a partnership between individuals and the state
- how people could choose to protect their assets, especially their homes, against the cost of care
- how, both now and in the future, public funding for the care and support system can be best used to meet care and support needs

- how any option can be delivered, including an indication of the timescale for implementation, and its impact on local government (and the local government finance system), the NHS, and – if appropriate – financial regulation.

The commission reported on 4 July 2011. Its key recommendations were:

- the capping of lifetime contributions to adult social care costs between £25,000 and £50,000 with a recommendation for a figure of £35,000
- people contributing a standard amount to cover general living costs for food and accommodation in residential care in the range of £7,000 to £10,000 a year
- the continuation of means tested support for those of lower means with the asset threshold for those in residential care increasing from £23,250 to £100,000
- free state support for younger adults – those who enter adulthood already having a care and support need should immediately be eligible for free state support
- standardised and portable eligibility, set nationally at ‘substantial’ under the current system pending the development of a more objective framework.

The government’s response to Dilnot is incorporated in the *Care Act*.

Equity and Excellence

In July 2010 the government published the White Paper *Equity and Excellence: Liberating the NHS*, setting out its proposals for the devolvement of power from Whitehall to patients and professionals.

The government’s aim is for professionals to be free to focus on improving health outcomes so that these are among the best in the world, with improving the quality of care to become the main purpose of the NHS.

Patients were to get more choice and control, backed by an information revolution, so that services are more responsive to patients and designed around them, rather than patients having to fit around services. The principle will be ‘no decisions about me without me’.

Under the new plans, patients would be able to choose which GP practice they register with, regardless of where they live, and choose between consultant-led teams. More comprehensive and transparent information, such as patients’ own ratings, will help them make these choices together with healthcare professionals.

Groups of GPs would be given freedom and responsibility for commissioning care for their local communities as part of GP consortiums. Providers of services will have new freedoms and they will be more accountable. There will be greater competition in the NHS and greater co-operation. Services would be more joined up, supported by a new role for councils to support integration across health and social care.

Health and wellbeing boards would be created. These would bring together those who buy services across the NHS, public health, social care and children’s services, elected representatives and representatives from Healthwatch to plan the right services for their area. They would look at all health and care needs together, rather than creating artificial divisions between services.

As a result of the changes, the NHS would be streamlined with fewer layers of bureaucracy. Strategic health authorities and primary care trusts will be phased out. Management costs would be reduced so that as much resource as possible supports frontline services. The reforms build on changes started under the previous government.

Health and Social Care Act 2012

The *Health and Social Care Act* was passed in March 2012. It sets the basis for the NHS going forward, and given the growing importance of integration with social care, and the operation of the Better Care Fund in particular, an understanding of its implications is critical to social care finance. It:

- establishes an independent NHS board to allocate resources and provide commissioning guidance
- increases GPs' powers to commission services on behalf of their patients
- strengthens the role of the Care Quality Commission
- develops Monitor, the body that currently regulates NHS foundation trusts, into an economic regulator to oversee aspects of access and competition in the NHS
- abolishes primary care trusts and strategic health authorities.

New clinical commissioning groups led by GPs have replaced GP consortiums and taken on much of the commissioning of NHS services. Each group will have to include at least one registered nurse and a hospital doctor. Monitor's role has been reduced, and competition for services will still exist where it will *'improve quality and efficiency for patients'*.

The *Health and Social Care Act 2012* established health and wellbeing boards with the emphasis being on local communities' needs, a democratic involvement, agreeing priorities for the community and commissioning in a more joined-up way. Each authority has its own health and wellbeing board which must be made of the minimum:

- one local, elected representative
- a representative of the local Healthwatch organisation
- a representative of each local clinical commissioning group
- the local authority director for adult social services
- the local authority director for children's services
- the director of public health for the local authority.

The board is able to make up its membership of other representatives with a range of experts and different sectors. All boards have to ensure that the needs of local people as a whole are taken into account.

Boards involve democratically elected representatives and patient representatives in commissioning decisions alongside commissioners across health and social care. Boards are under a statutory duty to involve local people in the preparation of joint strategic needs assessments (JSNA) and the development of joint health and wellbeing strategies. The boards also provide a forum for challenge, discussion, and the involvement of local people.

The boards bring together the clinical commissioning group and the local council to undertake a JSNA of the community and develop a joint strategy to achieve these needs. This recognises the need for joined-up working and joint commissioning.

Through undertaking the JSNA, boards are able to drive local commissioning of healthcare, social care and public health and this creates a more effective and responsive local health and care system. Other services that impact on health and wellbeing such as housing and education provision are also addressed.

A vision for adult social care

Future plans for adult social care services were published by the Department of Health in November 2010 in *A Vision for Adult Social Care: Capable Communities and Active Citizens*. The Department of Health also launched a consultation on a new strategic approach to quality and outcomes in adult social care, *Transparency in Outcomes: A Framework for Adult Social Care*.

The vision is about making services more personalised, more preventative and more focused on delivering the best outcomes for those who use them. It encourages care and support to be delivered in a partnership between individuals, communities, the voluntary sector, the NHS and councils – including wider support services, such as housing.

The vision sets out a new agenda for adult social care based on a power shift from the state to the citizen, by committing to:

- extend the rollout of personal budgets
- increase preventative action in local communities
- keep people independent and help to build the ‘big society’
- break down barriers between health and social care funding
- encourage care and support to be delivered in a partnership between individuals, communities, the voluntary sector, the NHS and councils – including wider support services, such as housing.

Councils were required to provide personal budgets for everyone who was eligible by April 2013, with more local preventative activity to support people’s independence. Information about care and support is available for all local people, regardless of whether or not they fund their own care – a requirement given further emphasis by the *Care Act*.

Adult social care outcomes framework

A new approach to quality and outcomes in adult social care was launched in March 2011 with the publication by the Department of Health of the first *Adult Social Care Outcomes Framework*. The framework signalled a move away from top-down performance management and centrally driven process targets towards a system focused on quality and the issues that matter most to those with care and support needs. It followed the publication in November 2010 of the *Vision for Adult Social Care* and the consultation *Transparency in Outcomes: A Framework for Adult Social Care*.

It describes a set of outcomes for people who use social care services, their carers and families, and outlines what people should expect from high quality services and is seen as

being key to helping them hold local organisations to account. The purpose of the framework is three-fold:

- Locally, the framework supports councils to improve the quality of care and support. By providing robust, nationally comparable information on the outcomes and experiences of local people, the framework supports meaningful comparisons between councils, helping to identify priorities for local improvement, and stimulating the sharing of learning and best practice.
- The framework fosters greater transparency in the delivery of adult social care, supporting local people to hold their council to account for the quality of the services they provide. A key mechanism for this is through councils' local accounts, where the framework is already being used as a robust evidence base to support councils' reporting of their progress and priorities to local people.
- Nationally, the framework measures the performance of the adult social care system as a whole, and its success in delivering high quality, personalised care and support. The framework will support ministers in discharging their accountability to the public and parliament for the adult social care system, and will inform and support national policy development.

The framework remains relevant to developments that have followed.

Integration between health and social care

The number of people in England who have health problems requiring both health and social care is increasing. For example, in the next 20 years, the percentage of people over 85 will double. This means there are likely to be more people with 'complex health needs' – more than one health problem – who require a combination of health and social care services.

But these services often do not work together very well. For example, people are sent to hospital, or they stay in hospital too long, when it would have been better for them to get care at home. Sometimes people get the same service twice – from the NHS and social care organisations – or an important part of their care is missing.

This means patients do not get the joined-up services, leaving them at increased risk of harm. Health and care staff may miss opportunities to make things better for patients and service users, and taxpayers' money is not being used as effectively as possible.

The Department of Health therefore wants everybody who uses both health and social care services to have integrated care – services that work together to give the best care based on a person's personal circumstances. It wants local councils to help health and social care organisations to work together to meet people's needs, for example by making sure that care services know what help somebody needs in their home when they leave hospital.

The government provided additional funding in the spending round 2013.

It is also judged more efficient for people to have control over their own budget for health and social care, because they are less likely to duplicate services or choose services that are not right for them and therefore the government is:

- piloting extending the approach by giving people personal health budgets – an amount of money that people get with their care plan so that they can make informed choices about which services to spend it on
- making it easy for people to combine their personal health budget and their social care budget, if they have one.

The government is committed to working with other organisations to make evidence-based integrated care and support the norm over the next five years. Work is under way with national partners to remove barriers by:

- co-producing *Integrated Care and Support: Our Shared Commitment* – a document setting out how local areas can use existing structures for integrating care
- agreeing and publishing a definition of integrated care
- inviting and supporting local areas to act as pioneers and exemplars, to develop and demonstrate the use of innovative approaches to efficiently deliver integrated care.

Sometimes people find it difficult to understand the care system, particularly if they have complex needs. The government wants everyone with a care plan to be allocated a named professional who oversees their case (care co-ordination) and who can answer questions they have and is therefore:

- changing the NHS Constitution, which tells people what they can expect from the NHS, to include a pledge to provide care co-ordination
- making sure that the care plan system supports care co-ordination
- making sure that all hospitals and social care organisations use care co-ordination.

For health and social care staff to work together, they must be able to share information about a person's assessments, treatment and care. In order to achieve this, the government will create an electronic database that will provide information about what a person's care needs are and what treatment they are getting. So staff will be able to share information easily, and patients and service users will be able to make decisions about the types of health and social care that are right for them.

It is important that people do not lose support when moving from one service to another, for example moving from children's to adult's services or moving from hospital to home. The government is therefore:

- developing a new assessment process for people from birth to 25 that will include education, health and social care needs
- planning to change the law to allow adult social care services to assess young people under 18
- spending £1bn between 2010 and 2015 on making sure that old people returning home after hospital have a temporary care plan.

Care Act 2014

The Act contains provisions relating to adult care and support, care standards, health education and research.

The Act is intended to give effect to the policies requiring primary legislation that were set out in the White Paper *Caring for our Future: Reforming Care and Support*, to implement the changes put forward by the Commission on the Funding of Care and Support, chaired by Andrew Dilnot, and to meet the recommendations of the Law Commission in its report on adult social care to consolidate and modernise existing care and support law. The Act also gives effect to elements of the government's initial response to the Mid Staffordshire NHS Foundation Trust Public Inquiry that require primary legislation.

One element of the Act is the response to the Dilnot Commission and a reform of the way that care is paid for. In February 2013, the government announced it would reform the funding of care and support to ensure:

- everyone receives the care they need and more support goes to those in greatest need
- the unfairness of, and fear caused by, unlimited care costs would end
- people will be protected from having to sell their home in their lifetime to pay for care.

In July 2013 the government published a document seeking views on the practical detail of how these changes to the funding system should happen and be organised locally. It described the experience a person might have when they need care and support when the cap and extended access to financial support are introduced: helping people to maintain their independence, assessment of eligible needs, paying for care, meeting eligible needs, and what happens when a person's care costs reach the level of the cap.

The consultation covered a range of topics and will help inform the government in the design of the new system:

- How to help people make more informed choices over care through information, advice and assessments and help councils meet the demands for these.
- How the capped cost system should work with assessments, personal budgets, charging, and care and support planning.
- The design of the new charging framework for care and support and the choices around how the capped cost system should work for working-age adults.
- How deferred payment agreements should be managed and administered.
- The process for providing redress and resolving complaints.

Care Quality Commission

The Care Quality Commission (CQC) was established by the *Health and Social Care Act 2008* to regulate the quality of health and adult social care and look after the interests of people detained under the *Mental Health Act*. It brought together the Commission for Social Care Inspection, the Healthcare Commission and the Mental Health Act Commission. The CQC became a legal entity on 1 October 2008 and took up its responsibilities for the quality of health and adult social care on 1 April 2009.

The CQC regulates:

- providers of medical and clinical treatment and care given to people of all ages, including treatment given in hospitals, ambulance services and mental health services

- providers of care services for adults in residential homes, in the community and in people's own homes, focusing on vulnerable people including those with mental health problems, learning disabilities, physical disabilities or long-term health conditions and older people
- providers of services for people whose rights are restricted under the *Mental Health Act*.

DEVELOPMENTS IN WALES

Strategic plan

Designed for Life is the Welsh Government's ten-year vision for creating world-class health and social care in Wales in the 21st century.

Launched in May 2005, it describes the kind of health and social care services the people of Wales could expect by 2015 and how these could be developed. Its primary focus was on health services and health improvement.

At the launch of the strategy, Welsh minister Dr Brian Gibbons outlined what the public sector must do next to improve health and social care in Wales.

The timetable for the strategy was:

- by September 2005 – each health and social care community to have in place an updated '*delayed transfers of care plan*', setting targets for reduced delays
- by March 2006 – a methodology to be developed for researching, auditing and evaluating progress in health and social care in order to spread best practice.

The Welsh Local Government Association set up a dedicated improvement team for social services to link with the new National Leadership and Innovation Agency for Healthcare, aimed at building leadership.

There was greater government investment in prevention, screening, community-based assessment, carer support, rehabilitation and intermediate care, as well as domiciliary and respite care, and supported housing and home-based technology services.

More funding was provided to ensure health, social care and voluntary sector staff have the skills to deliver this new agenda.

Social services strategy

In Wales, social services support 150,000 people.

The Welsh Government's responsibilities are for funding, setting the policy, reviewing, and inspecting and regulating social services. Its responsibilities cover the following areas:

- adult and child care
- support and advice
- grants
- community voluntary care.

A ten-year social services strategy for Wales, *Fulfilled Lives, Supportive Communities: Improving Social Services in Wales from 2008–2018*, was launched in February 2007. It forms

the basis of the Welsh Government's social services and social care work. The strategy is addressed to councils which are responsible for:

- strategic planning
- arranging the provision of services to meet needs
- undertaking assessments and care management of those who need help and support
- safeguarding vulnerable adults and children.

The strategy is intended to deliver social services that are strong, accessible and accountable, in tune with citizens' and communities' needs, and that promote independence and social inclusion.

In June 2009, the deputy minister for social services announced the establishment of an independent commission on social services which will be looking at how the Welsh Assembly Government meets the challenges of the next decade, such as how it can, among other things:

- support the further development of professional practice
- build inclusive social services based on the contribution of all partners who work in social care
- effect a step change in collaboration
- ensure the achievement of integrated social services capable of meeting the needs of children, young people and adults and older people in the most effective way.

The commission published its report, *From Vision to Action*, in November 2010. It highlighted the options of retrench or reform, but stated that retreating into core services and away from prevention and collaborative improvement would undo gains made in recent years and would quickly become unsustainable. It said that instead social services need to seize opportunities for efficiency and transformational change and assess the longer-term impacts of investment decisions.

The Welsh Assembly Government built on this work and published its White Paper *Sustainable Social Services for Wales: A Framework for Action* in February 2011. This looks at the need to reshape and refocus in the light of the new challenges, in particular a shift in expectations of social services, demographic change, fragmentation of families and communities and the impact of issues such as substance misuse.

The White Paper recognises that demand is rising across social services and the financial outlook for all public services is difficult. It states that a more fundamental change than just pursuing the obvious efficiency measures needs to be made. Energy should be focused on sustainable renewal rather than on retrenchment.

It states that to drive the strategic change that is needed, the focus must be on a limited number of high level 'game-changing' actions:

- The Welsh Assembly Government will take greater responsibility for driving the direction of services. It will put in place more coherent and focused improvement arrangements, with robust arrangements for accountability for delivery within a new framework of strong national outcomes.
- It will ensure that existing capacity is used in a more efficient and effective way.

- It will ensure that service users and carers have a much stronger voice and greater control over the services they use.
- It will ensure that the workforce is more confident and is supported in applying its own professional judgement, using evidence of what works as professionals instead of an over-reliance on government guidance.
- It will prioritise integrated services, in particular for families with complex needs, looked after children, transition to adulthood, and frail older people – thereby capitalising on the benefits of integrated, family-based services.
- It will galvanise the strength that comes from social services being at the heart of local government, drawing on its community leadership duties and a wide range of services to deliver preventive services.
- It will be clearer that providers and commissioners of services are accountable for quality and safety, and for driving improvement in a more coherent way – thereby allowing an overall reduction in the burden of guidance, regulation and inspection.

These strategic changes are about stopping doing some things and prioritising new things, and are not intended to be another layer of activity. The paper set the date of December 2011 for the first stage of implementation.

Social Services and Well-being (Wales) Act 2014

The White Paper *Sustainable Social Services for Wales: A Framework for Action* highlighted a number of challenges faced by public services in Wales. These included demographic changes, increased expectations from those who access care and support as well as continuing hard economic realities. The *Social Services and Well-being (Wales) Act* aims to address these issues and to give people greater freedom to decide which services they need while offering consistent, high-quality services across the country.

The legislation aims to:

- strengthen powers for safeguarding children and adults, so that vulnerable people at risk can be protected more effectively
- allow Welsh ministers to consider extending the range of services available by direct payments, giving people will have more control over the services they use
- introduce national eligibility criteria and ensure people are assessed on what they need, rather than just on what services are available locally
- introduce portable assessments, which means if people move from one part of Wales to another they will not require their needs to be re-assessed if these have not changed
- introduce a national outcomes framework to set out very clearly what children and adults can expect from social services, to measure achievements and see where improvements are needed
- introduce equivalent rights for carers so that people who care for someone such as an elderly or disabled relative or friend would get similar rights to the people they care for
- establish a national adoption service to improve the outcomes of children in need of a permanent family.

Strategy for older people in Wales

In 2003, the Welsh Assembly Government committed itself to a ten-year strategy for older people. Phase 3 of *The Strategy for Older People in Wales*, published in 2013, outlines the key strategic objectives for the ten years from 2013. The Welsh Government's challenge for the next ten years is:

- to create a Wales where full participation is within the reach of all older people and their contribution is recognised and valued
- to develop communities that are age-friendly while ensuring older people have the resources they need to live
- to ensure that future generations of older people are well equipped for later life by encouraging recognition of the changes and demands they may face and taking action early in preparation.

The outcomes the Welsh Assembly Government wishes to achieve by 2023 are:

- **Social participation** – older people enjoy a better quality of life, have active social lives (if desired), and loneliness and unwanted social isolation is minimised. Older people are not subjected to abuse.
- **Diversity** – older people are not discriminated against because of their age, and do not experience multiple discrimination on account of gender, ethnicity, disability, religion and belief, or sexual orientation, in addition to their age.
- **Access to information** – older people have access to information and advice about services and opportunities, and are not disadvantaged when accessing them.
- **Learning and activities** – older people have opportunities to be engaged in lifelong learning and other appropriate social activities.
- **Healthy ageing** – older people enjoy good physical, mental and emotional health and wellbeing with the aim of being able to live independently for longer, with a better quality of life, and continue to work and participate in their communities.

OVERVIEW OF CHILDREN'S SOCIAL CARE

Many of the approaches to improving efficiency that have been developed for adult social care are equally applicable to children's services, but there has been less expectation of personalisation and integration with health in the sector. Consequently, the funding regime is simpler at this stage. Prevention and early intervention need to be at the heart of any new service delivery models, and the LGA's efficiency work specific to children's services – *Making Best Use of Scarce Resources* – identifies the key messages as:

- Effectively challenge your service and partners on productivity by being well informed on levels of demand, unit costs, quality and comparative performance.
- Monitor volatile areas of high cost and demand-led funding.
- Champion the shift towards prevention and early intervention at all stages of a child's life.
- Build on learning from community budgets and payment by results and from national programmes such as the Troubled Families initiative.

The director of children's services, under section 18 of the *Children Act 2004*, has responsibility for ensuring that a local authority meets its specific duties to organise and plan services, and to safeguard and promote the welfare of children. Each local authority is responsible for establishing a local safeguarding children board in their area and for ensuring it is run effectively.

Social workers take a lead role in:

- responding to children and families in need of support and help
- undertaking enquiries following allegations or suspicion of abuse
- undertaking initial assessments and core assessments as part of the assessment framework
- convening strategy meetings and initial and subsequent child protection conferences
- court action to safeguard and protect children
- co-ordinating the implementation of the child protection plan for children on the child protection register
- looking after and planning for children in the care of the local authority
- ensuring that looked after children are safeguarded in a foster family, children's home or other placement.

An effective child protection system

The principles of an effective child protection system were set out in the report by Professor Eileen Munro in May 2011 entitled *The Munro Review of Child Protection: Final Report – A Child-centred System*. The report explained the principles of a good child protection system that underpinned the review's recommendations for reform.

This set out that the system should be child-centred, and focused on the needs of the child as an individual, with varied services that can respond to varied needs and circumstances.

The family is usually the best place for bringing up children but sometimes difficult decisions are needed to protect a child from abuse and neglect. Working with families is the best way of supporting them and providing early help and intervention will have the greatest impact on children, by minimising the period of adverse experiences.

Services should be developed using professional good practice informed by knowledge of the latest theory and research. Uncertainty and risk are features of child protection work and risk management can only reduce, not eliminate this. Success can only be measured locally and nationally by whether children are receiving effective help.

The 'looked after' child

A 'looked after' child is one who is formally in the care of a local authority under section 22 of the *Children Act 1989*. The duties arising from classifying a child as 'looked after' drive much of the spending on children's social care. The category can include children placed at home with their parents, supervised by the local authority with a full care plan, placed in custody, or placed away from home in fostering or residential provision.

Local authorities have a responsibility to safeguard and promote the welfare and education of all the young people they look after. Local authorities have a 'corporate parenting' duty that requires them to do all the things a 'good parent' would.

Local authorities must ensure that children have care plans, and that these plans are kept up to date. These plans reflect the child's needs and take account of their wishes and feelings, as well as the views of family and other important people in their life.

If children are not placed at home, local authorities typically accommodate children in their care in fostering and residential placements.

Fostering

Usually the largest service for the accommodation of looked after children is fostering. Local authorities retain the duty to look after the children, but children are placed with volunteer carers. Carers must receive allowance payments in line with the national minimum fostering allowances set annually on 1 April by the Department for Education. The minimum allowance was established on 1 April 2007 according to guidance issued by the secretary of state in *The National Minimum Fostering Allowance & Fostering Payment Systems – Good Practice Guidance*.

Many authorities will pay above this level in order to attract carers to the role to ensure the sufficient provision of placements. Authorities will also often pay additional amounts for birthdays, holidays and religious festivals.

Fostering services will usually include a family placement service dedicated to the recruitment and support of foster carers. Children and their carers will have different social workers to ensure focused support and that there are no conflicts of interest for either's needs.

Local authorities will often make use of a number of purchased placements from independent providers. A number of operators from the voluntary and private sectors exist nationally and their use has typically grown in recent years following increased demand for placements from rising numbers in care.

Residential care

Although residential care has declined compared with the 1970s and before, it remains a positive choice particularly for some older children who cannot be cared for in a family setting due to their complex needs, and for those young people who do not wish to have a substitute family. Provision will usually take the form of a small unit of no more than six children with sufficient staffing around the clock.

While many local authorities retain their own residential units, a significant private and voluntary sector market exists for placements.

Secure children's homes

There are a small number of secure children's homes across the UK that provide an alternative to residential units for very vulnerable young people. These are often equipped to provide a greater level of supervision and security from outside influences. These may be in local

authority control, but available for use by other authorities, or owned and managed by the voluntary or the private sectors.

Troubled families

The government estimates that £8bn is spent on 120,000 families with multiple problems that can be intergenerational. Support is often unco-ordinated, reactive and costly to a range of public services such as police, local authorities, health, housing and probation. The government therefore invested £448m in a national Troubled Families programme, offering incentives to all upper-tier authorities to turn around the lives of this specific group of families. The programme was launched in 2012. Councils were allocated a target number of families by the national Troubled Families Unit. Funding has been given by the government to start the initiative, with an expectation of match funding provided through a local partnership of the council and other related agencies. The national focus of the programme is to:

- get children back into school
- reduce youth crime and anti-social behaviour
- put adults on a path back to work
- reduce the high costs these families place on the public sector each year.

Local partnerships are encouraged to include locally determined objectives, and to work with families in ways the evidence shows is more effective, such as:

- joining up local services
- dealing with each family's problems as a whole rather than responding to each problem, or person, separately
- appointing a single key worker to get to grips with the family's problems and to work intensively with them to change their lives for the better for the long term
- using a mix of methods that support families and challenge poor behaviour.

There is a payment by results reward grant on the basis of what is achieved within the first three years of the programme, the number of target families actively worked with, and whether the national and locally defined outcomes are achieved for these families. The original programme was funded to support families with school-age children and was expanded during 2014 to include families with children under the age of five. The Spending Review 2013 announced that the programme would be expanded to work with 400,000 more families from 2015 to 2020, with £200m of funding for 2015/16. As well as expanding from working with school-age children to those under five, the wider programme will have a focus on improving poor health, which is a particular problem in troubled families, with 71% having a physical health problem and 46% a mental health concern. Fifty-one top-performing authorities were given additional funding during the 2014/15 financial year to begin work with the expanded cohort of families.

LEGAL BACKGROUND

Children's social care services have evolved significantly over the past 60 years. Some of the key Acts of Parliament that have shaped that evolution are listed below.

Until 1948, the care of deprived children came under the *Poor Law* and later, the public assistance authorities. Assistance to children was provided by the workhouse, small family group homes and boarding out with foster parents. The administration of services for children was shared by various council departments.

The *Children Act 1948* consolidated these different responsibilities into the remit of one central children's department within the council. Each council was required to establish a children's committee and appoint a children's officer. Under the Act it became the duty of a council to '*receive the child into care*' in cases of abuse or neglect. These administrative arrangements stayed in place until the creation of social services departments in 1971, which brought together health, welfare and children's departments, under the terms of the *Local Authority Social Services Act 1970*.

The *Children Act 1989*, implemented in 1991, provided for the next major reform of services for children. It consolidated earlier legislation and repealed a number of Acts. The 1989 Act established a new legal concept of 'children in need', which included children with physical or mental disabilities.

The overall approach was to place a general duty on councils to provide specified services to children in need and to give the authorities powers to provide services to other children. The Act placed a general duty on councils '*to safeguard the welfare of children within their areas who are in need and, so far as is consistent with that duty, to promote the upbringing of such children by their families*'.

The *Children (Leaving Care) Act 2000* placed new responsibilities on councils to provide greater support to young people living in and leaving care.

The *Children Act 2004* followed the Green Paper *Every Child Matters* which in turn was prompted by the Victoria Climbié Inquiry Report into the abuse and murder of an eight-year-old child. Focusing on children's services rather than education, the Act established a children's commissioner at national level in England and placed a duty on councils to make arrangements through which all the key agencies co-operate to improve the well-being of children and young people. It widened services' powers to pool budgets in support of this. It required councils to put in place a director of children's services to be accountable for, as a minimum, councils' education and social services functions in respect of children. In parallel, at council level, the designation of the lead member for children's services was required. A new duty for councils to promote the educational achievement of looked after children was introduced.

One of the key outcomes for children and young people under the act is 'being safe', which led to three requirements for local authorities:

- the creation of children's trusts under the duty to co-operate – in 2012 the government revoked most of the statutory responsibilities of children's trusts, but the duty to co-operate remains in place
- the setting up of a local safeguarding children's board
- the duty on all agencies to make arrangements to safeguard and promote the welfare of children. Relevant agencies include:
 - district councils

- clinical commissioning groups
- youth offending teams
- police service
- probation service
- persons providing youth services
- Jobcentre Plus.

The *Childcare Act 2006* requires councils to secure (but not provide) sufficient childcare for working parents and improve the five Every Child Matters outcomes for all pre-school children and reduce inequalities in those outcomes.

Lord Laming's report *The Protection of Children in England: A Progress Report* in 2009 followed a serious case review into the death of the child known as Baby P in Haringey. It identified an absence of ring-fenced funding for child protection activities as a particular problem and recommended that children's services, police and health services should have protected budgets for staffing and training for child protection services.

Children and Families Act 2014

The *Children and Families Act 2014*, given royal assent in March 2014, brought about changes to the law to give greater protection to vulnerable children, better support for children whose parents are separating, a new system to help children with special educational needs and disabilities, and help for parents to balance work and family life.

The Act includes changes to the adoption system, the right for children in care to have the choice to stay with their foster families until they turn 21, reforms to children's residential care to make sure homes are safe and secure, and measures to improve the quality of care vulnerable children receive and to make young carers' and parent carers' rights to support from councils much clearer.

The changes made in the Act for children with special educational needs (SEN) and disabilities began development in March 2011 when the government published the Green Paper *Support and Aspiration: A New Approach to Special Educational Needs and Disability*. This paper proposed a radically different system to support better life outcomes for children and young people with SEN and disability; give parents confidence by giving them more control; and transfer power to professionals on the front line and to local communities.

The Act includes the legislative framework for the SEN reforms that were published in September 2012 for a period of pre-legislative scrutiny. In April 2013, all local authorities were required to implement changes to the way that SEN is funded, which included providing funding for students with high needs in post-16 provision, including, from September 2013, those in colleges, when funding them became the responsibility of the local authority.

The key elements of the Act with regard to SEN and disabilities are summarised below:

- There is a new requirement for local authorities, health and care services to commission services jointly, to ensure that the needs of disabled children and young people and those with SEN are met.

- Local authorities have a duty to publish a clear, transparent 'local offer' of services, so parents and young people can understand what is available; that is developed with parents and young people.
- There is a more streamlined assessment process, which integrates education, health and care services, and involves children and young people and their families.
- A new education, health and care (EHC) plan for children and young people aged from 0 to 25 has replaced the previous system of statements and learning difficulty assessments.
- The option of a personal budget for families and young people with an EHC plan is available to extend their choice and control over support.
- There are new statutory protections for young people aged 16 to 25 in further education and a stronger focus on preparing for adulthood.
- Academies, free schools, further education and sixth form colleges have the same SEN duties as maintained schools.
- Parents, carers, children and young people have a greater role in assessment and in developing the local offer. In addition, existing protections for parents/carers, including their right to directly request a local authority assessment of their child, have been maintained and extended.
- Mediation: the requirement for parents/carers and local authorities to engage in mediation before a parent/carer could appeal to the tribunal has been removed and replaced arrangements for parents/carers, children and young people to consider mediation but with an option for them to go straight to an appeal.
- Local offer: the local authority is required to publish any comments made on their local offer and what action has been taken in response to these. In addition to developing the local offer in consultation with parents/carers, children and young people, they must also be included in any reviews of the local offer.
- Post-16: young people on apprenticeships need to have their EHC plan maintained; previously this had not been the case. An EHC plan will also need to be maintained for young people aged between 16 and 18 who become NEET (not in education, employment or training). Local authorities will need to review the plan for those aged between 19 and 25 who become NEET, re-engage them in education and maintain an EHC plan for them if it is the right option. Youth offending teams have been included in the list of agencies with a duty to co-operate with the local authority.
- There is a legal duty on clinical commissioning groups to secure the health services that are specified in EHC plans. This includes specialist services such as physiotherapy and speech and language therapy.

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