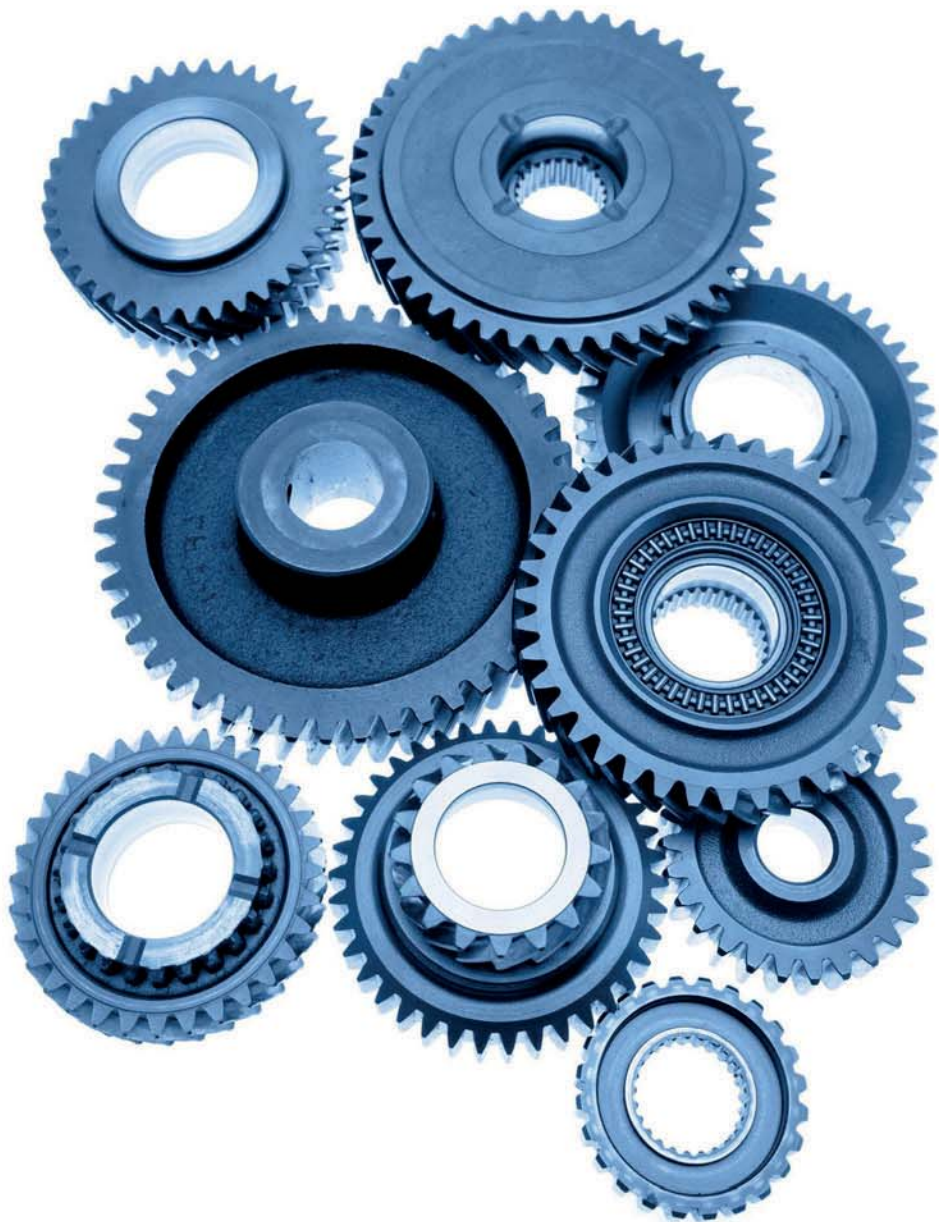
CIPFA The Chartered Institute of Public Finance & Accountancy

The guide to

local government finance

2017 edition



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The Chartered Institute of
Public Finance & Accountancy

The guide to

local government finance

2017 edition

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Foreword

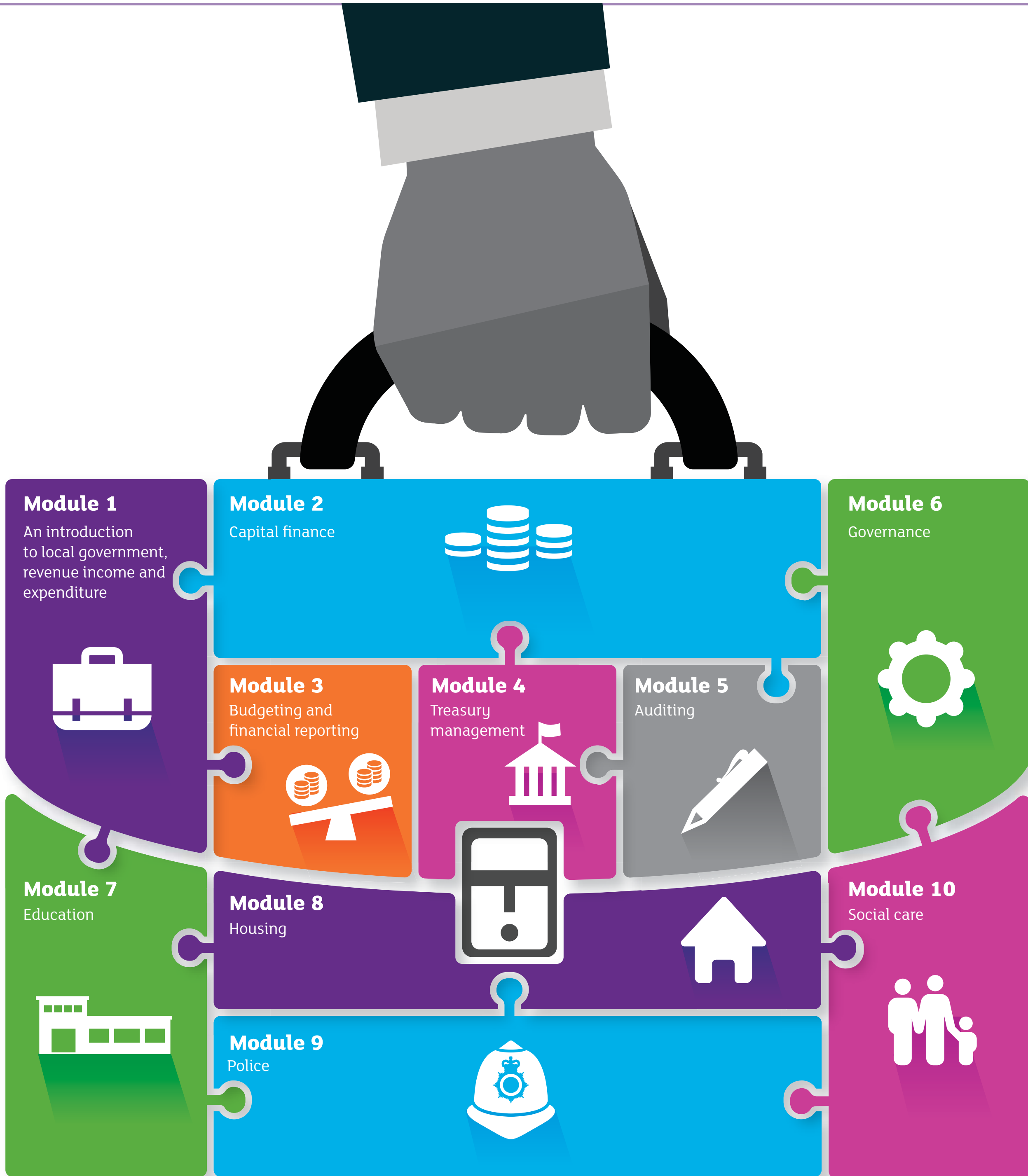
Although the vote to leave the EU took place in 2016, the political implications have continued into 2017 with an earlier than anticipated general election ushering in a period of uncertainty. For local government, the calling of the election had the important initial consequence that a number of important initiatives, including notably the 100% business rate retention scheme, were deferred. Most political commentators expected that these initiatives would still be implemented, albeit modified to some degree by a reconstituted Conservative government. The outcome has been very different; and at the time of writing political uncertainty is such as to rule out any confident prediction about the future direction of government policy.

Against this backdrop of uncertainty, a continuing theme has been local government's need to address financial austerity, including reduced Revenue Support Grant and increased demand on services. Individual local authorities have sought to balance budgets in innovative ways and the increase in commercial activity and business transformation continues. But for the sector as a whole there remains an uncertainty about whether for all authorities funding is sustainable into the future.

As was demonstrated during the election campaign, social care is one aspect of the local government finance agenda that commands media attention. Although the additional precept and £2bn additional funding announced at Spring Budget 2017 has been welcomed, it was not sufficient to plug the funding gap and a longer-term solution has to be found. School finance is another aspect of local government finance that periodically broke through into national media coverage of the election campaign, but again the outcome of the election makes it impossible to anticipate the direction of national policy.

Whatever the circumstances and by which ever means local authorities finance their activities, one enduring feature of local government finance is its complexity. This is increasing because services are being delivered in new and innovative ways, often motivated by the benefits of working with partners from within or outside the sector. Added to this is increased devolution which, while generally welcomed by local government, adds to the complexity by introducing a patchwork of local variation.

This guide, covering England only, seeks to provide the reader with a comprehensive overview of the local government finance system as a whole, explaining some of the challenges and introducing the reader to its essentials. While the reader is encouraged to read the whole guide to appreciate the relationship between the different aspects of local government finance, each module of this guide is designed to be relatively freestanding and so can be read in isolation.


Module 1
An introduction to local government, revenue income and expenditure
Module 2
Capital finance
Module 6
Governance
Module 3
Budgeting and financial reporting
Module 4
Treasury management
Module 5
Auditing
Module 7
Education
Module 8
Housing
Module 10
Social care
Module 9
Police

Contents

MODULE 1: AN INTRODUCTION TO LOCAL GOVERNMENT, REVENUE INCOME AND EXPENDITURE 1

LOCAL GOVERNMENT STRUCTURE 2

LOCAL COUNCIL SERVICES 2

CENTRAL GOVERNMENT FUNDING OF LOCAL GOVERNMENT 5

REVENUE EXPENDITURE 8

COUNCIL TAX 10

BUSINESS RATES 17

THE LOCAL GOVERNMENT FINANCE SETTLEMENT – ENGLAND 23

LOCAL GOVERNMENT FUNDING IN THE FUTURE 25

FURTHER READING 26

MODULE 2: CAPITAL FINANCE 27

INTRODUCTION 28

CHALLENGES FOR CAPITAL 28

WHAT IS CAPITAL EXPENDITURE? 28

SPENDING LEVELS 30

FUTURE SPENDING PLANS 31

THE PRUDENTIAL FRAMEWORK 32

RICS ASSET MANAGEMENT PRACTICE GUIDELINES 35

ONE PUBLIC ESTATE 35

HIGHWAYS NETWORK ASSET (FORMERLY HIGHWAYS INFRASTRUCTURE ASSETS) 35

FINANCING CAPITAL EXPENDITURE 36

FURTHER READING 41

MODULE 3: BUDGETING AND FINANCIAL REPORTING 43

INTRODUCTION 44

SETTING AND MANAGING BUDGETS 44

LOCAL AUTHORITY ACCOUNTING AND REPORTING 67

FURTHER READING 79

MODULE 4: TREASURY MANAGEMENT 81

INTRODUCTION 82

TREASURY MANAGEMENT CHALLENGES 82

PROVISIONS OF THE LOCAL GOVERNMENT ACT 2003 82

STANDARDS OF PROFESSIONAL PRACTICE 83

CIPFA TREASURY MANAGEMENT CODE 84

CONSULTATION ON CIPFA'S TREASURY MANAGEMENT CODE 85

INVESTMENT STRATEGY 85

TREASURY MANAGEMENT STRATEGY 86

TREASURY MANAGEMENT INDICATORS 86

TREASURY MANAGEMENT INDICATORS WITHIN THE PRUDENTIAL CODE 87

TREASURY MANAGEMENT PRACTICES 88

DAY-TO-DAY TREASURY MANAGEMENT 90
CASH FLOW FORECASTS 90
ROLE OF THE AUDITOR 91
RISK MANAGEMENT 91
FURTHER READING 94

MODULE 5: AUDITING 95
INTRODUCTION 96
THE ROLE OF AUDIT 96
INTERNAL AUDIT 96
STEWARDSHIP AND EXTERNAL REPORTING 103
EXTERNAL SCRUTINY 109
FURTHER READING 117

MODULE 6: GOVERNANCE 119
INTRODUCTION 120
DEFINING CORPORATE GOVERNANCE 120
GOVERNANCE STRUCTURES OF LOCAL AUTHORITIES 123
GOOD GOVERNANCE IN LOCAL GOVERNMENT 134
ROLE OF THE CHIEF FINANCIAL OFFICER 136
FURTHER READING 146

MODULE 7: EDUCATION 147
INTRODUCTION 148
EDUCATION IN ENGLAND 148
EDUCATION SPENDING 149
LEGAL FRAMEWORK – KEY MILESTONES 150
EDUCATION REVENUE EXPENDITURE AND REVENUE FUNDING 154
CAPITAL EXPENDITURE AND CAPITAL FUNDING 160
ACADEMIES AND FREE SCHOOLS 162
OTHER EDUCATION ISSUES 163
FURTHER READING 166

MODULE 8: HOUSING 167
INTRODUCTION 168
CHALLENGES FOR SOCIAL HOUSING 169
LOCAL AUTHORITY HOUSING FINANCE 171
HOUSING ASSOCIATION FINANCE 182
FURTHER READING 184

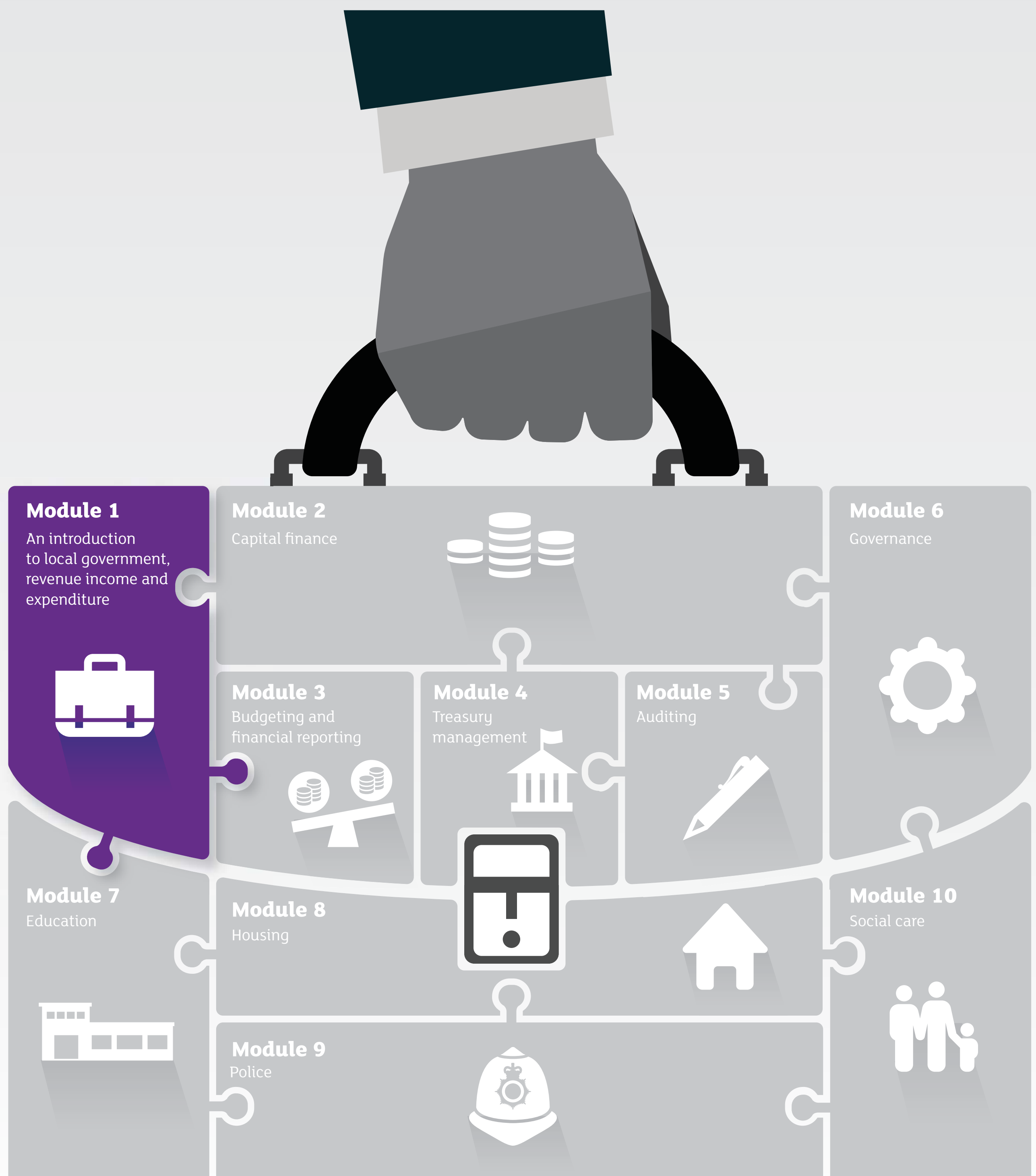
MODULE 9: POLICE 185
INTRODUCTION 186
EXPENDITURE AND BUDGETS 186
LEGISLATIVE FRAMEWORK AND THE POLICING PROTOCOL 187
FINANCIAL MANAGEMENT 190
ACCOUNTING, FINANCIAL REPORTING AND AUDIT 198
STAGE 2 TRANSFERS 198
FURTHER READING 199

MODULE 10: SOCIAL CARE ... 201

INTRODUCTION ... 202
OVERALL FUNDING AND LEVELS OF SPEND FOR SOCIAL CARE ... 202
INTEGRATION AND DEVOLUTION ... 204
ADULT SOCIAL CARE TRENDS AND PRESSURES ... 206
BUDGET SETTLEMENTS FROM 2017/18 ONWARDS ... 207
BETTER CARE FUND ... 209
ADULT SOCIAL CARE EFFICIENCY AND SAVINGS PROGRAMMES ... 210
ADULT SOCIAL CARE STATUTORY AND POLICY FRAMEWORKS ... 213
CHILDREN'S SOCIAL CARE TRENDS AND PRESSURES ... 218
CHILDREN'S SOCIAL CARE STATUTORY AND POLICY FRAMEWORKS ... 220
FURTHER READING ... 227

MODULE 1

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 metropolitan 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 are also provided by authorities which are part of the structure of local government.

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

England outside London		London
County councils	Metropolitan councils and unitary councils	Greater London Authority
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 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
- **police** – the Police Reform and Social Responsibility Act 2011.

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

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 directly 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 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 now be seen across the country. Nor are they limited to front line services. There are already several examples of the finance function and other support services being delivered in this way. The creation of shared services has taken place in an environment in which many services are now provided by private sector contractors or voluntary bodies, or through combinations of different types of 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 cannot, for example, impose new taxes, as other laws make it clear that they can't. 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) established the office of mayor, with responsibility for transport, strategic planning, economic development, the environment and culture. The Act gives the London Assembly the role of examining the mayor's proposals,

decisions and activities, helping the mayor to develop policies and approving or amending the mayor's budget.

Originally the most important of the mayor's functions were exercised by means of executive agencies, mayoral control over which was subject to checks and balances. The London Development Agency (LDA) was subsequently abolished by the coalition government and the London Fire and Emergency Planning Authority (LFEPA) is being abolished and responsibility for providing fire services passed to the mayor. 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.

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

- transport
- 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 and 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 regional housing budget. The mayor has powers to 'call in' and determine major planning applications where a borough is failing to follow London Plan policies or where there are unreasonable delays in making decisions.

London 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.

Devolution in England

The coalition government document Our Programme for Government (HM Government, 2010) supported the devolution of power away from Whitehall 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

has powers to support business growth and join up budgets in health and social care and to elect a metro mayor.

The Cities and Local Government Devolution Act 2016 formalised these powers and built on the Local Democracy, Economic Development and Construction Act 2009. These two pieces of relevant legislation provide for the legal structure known as the combined authority. A combined authority may be set up by two or more local authorities. The combined authority takes on functions transferred from the secretary of state or functions that the constituent members of the combined authority have agreed. Agreements have followed in areas including Sheffield, West Yorkshire and Cornwall. At the time of the spring 2017 Budget a devolution agreement was announced for London in which the capital will receive more powers over transport, infrastructure, health, criminal justice, skills and employment.

Funding

Local authorities 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 authorities 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.

CENTRAL 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

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), net public service pensions, gross central government debt interest, and spending financed by the National Lottery.

A spending review or occasionally comprehensive spending review is the governmental process by which HM Treasury sets firm expenditure limits. To understand the current fiscal environment it is necessary to go back to spending review 2010.

Spending review 2010

On 20 October 2010, the then 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 2004–2007 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 spending review announced a further 10% cut to council funding in 2015/16; this was 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) fell by £2.1bn in 2015/16. Acknowledging concern over adult social care, the government made available an additional £2bn funding in this area.

The 2013 spending review announced that the government would reduce total spending in 2015/16, 2016/17 and 2017/18 in real terms at the same rate as during the 2010 spending review period.

Spending review 2015

The November 2015 spending review provided a complex and concerning picture for local government. While a cash-terms increase in spending over the course of parliament was suggested by the chancellor, this was based on the premise that a cut in funding will be offset by an increase in taxation receipts, generated by council tax and business rates. For local government this spending review was accompanied by a number of important initiatives, notably the 100% business rate retention scheme and a national funding formula to be introduced for schools in England, which in the aftermath of the 2017 general election look likely to be delayed, modified or even abandoned.

Economic trends since the referendum vote have not so far led to the review of spending plans that some commentators anticipated. In its Autumn Statement 2016 the government confirmed that it will meet its commitments on public spending but the budgetary implications of the 2017 election remain to be seen.

Local government finance settlement

The local government finance settlement is the annual determination of central government financial support for funding to local government. It has to be approved by the House of Commons. The basic process is that each November or December the government announces the provisional local government finance settlement. After a period of consultation the allocations are then confirmed in the final local government finance settlement early in the New Year.

In line with the intentions set out in the 2010 spending review, the government started to provide more certainty by announcing 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 the 2013 spending review. The 2014/15 settlement included provisional figures for 2015/16. The 2016/17 settlement recognised the need for longer-term planning and provided indicative figures for four-year financial planning, which all but ten local authorities have signed up to. The government has committed to these funding levels bar any unforeseen changes in circumstances, giving more certainty to these authorities.

The final settlement for 2016/17 followed the framework for government expenditure contained in the 2015 spending review which covered the four years to 2019/20. The settlement also included an announcement of provisional figures for 2018/19 and 2019/20. The government offered four-year settlements to 2019/20 to authorities that published an efficiency plan. The aid that greater certainty offers to longer-term planning meant that 97% of local authorities in England have taken up the offer of a four-year settlement. For these authorities the settlement therefore confirms spending allocations first set out in 2015.

Lyons Inquiry 2007

There have been several attempts to initiate a comprehensive review of local government finance but wholesale reform faces political difficulties. The last national comprehensive review was initiated in 2004, when Sir Michael Lyons was appointed to undertake an independent inquiry into local government funding in England. Sir Michael's final report

was published in March 2007. It concluded that council tax was not broken and should be retained, but at the time proposed actions to ensure it would remain sustainable. Notably it proposed 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 then in place. Political developments since then give no reason to believe that there is now any better prospect of the required consensus.

REVENUE EXPENDITURE

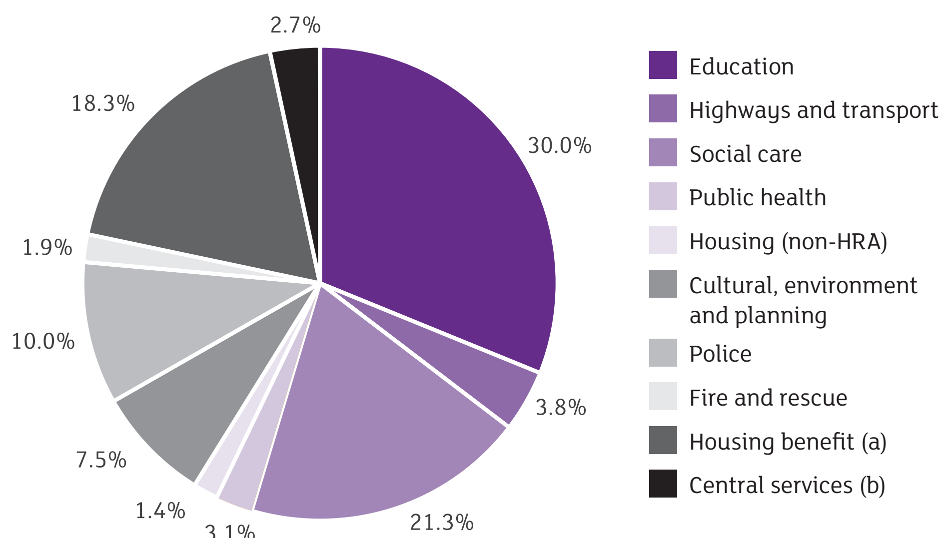
Revenue budget

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 pieces of equipment is known as the capital budget.

The total revenue expenditure by local authorities in England is budgeted at £94.5bn in 2017/18; this is an increase of 0.4% from £94.1bn budgeted in 2016/17 (DCLG statistical release, June 2017).

The chart below shows revenue expenditure by type of service.

Total service expenditure 2016/17 – 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 tax and non-domestic rates collection.

Note: the housing figure is shown net of rental income

Revenue expenditure by class of authority, England, 2016/17 and 2017/18

Revenue expenditure, £m				
	2016/17	2017/18	Change, £m	Change, %
England	**94,134**	**94,470**	**335**	**0.4**
Class of authority				
Shire counties	25,870	25,979	109	0.4
Metropolitan districts	18,709	18,342	-367	-2.0
Unitary authorities	17,268	17,143	-125	-0.7
London boroughs	14,019	13,851	-167	-1.2
Police authorities	8,298	8,368	69	0.8
Greater London Authority	5,130	5,792	661	12.9
Shire districts	3,086	3,066	-20	-0.6
Fire authorities	1,481	1,481	0	0
Other authorities (a)	273	447	174	63.9
Revenue expenditure per head, £ (b)	**1,703.23**	**1,709.30**	**6.07**	**0.4**

(a) Includes waste authorities, transport authorities and national park authorities.

(b) From ONS mid-year population estimates for 2016.

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 and Revenue Support Grant (until it is phased out) is subtracted to get the amount that must be financed from non-specific government grants, business rates or council tax.

Specific grants

Local councils receive a number of specific grants from central government to support government priorities. The table below sets out some of the key specific grants payable in 2017/18.

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 housing benefit.
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 five years for each new home from 2017/18 (four years from 2018/19). There is an additional amount payable if any of these new homes are affordable housing.

Around half of all budgeted local authority net current expenditure is on education and social care services combined. The largest budgeted increase in service spend is for adult social care services, increasing from £14.4bn in 2016/17 to £15.6bn in 2017/18. 2016/17 was the first year authorities were able to use the adult social care precept, allowing a maximum 2% increase on council tax for adult social care authorities on top of the referendum threshold amount. For 2017/18 authorities have been allowed to add another 3% in a bid to raise £1.4m, although this is the maximum amount they can increase in any year and only 6% can be added overall in the years 2017/18 to 2019/20.

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 from 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 they had been in existence in 1991. There has been no revaluation in England. Residents who do not agree with the council tax band their property has been placed in have a right of appeal.

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	Relative council tax
A	Less than £40,000	$^{6}/_{9}$
B	£40,001 to £52,000	$^{7}/_{9}$
C	£52,001 to £68,000	$^{8}/_{9}$
D	£68,001 to £88,000	1
E	£88,001 to £120,000	$^{11}/_{9}$
F	£120,001 to £160,000	$^{13}/_{9}$
G	£160,001 to £320,000	$^{15}/_{9}$
H	Over £320,000	$^{18}/_{9}$

The level of council tax can be reduced in certain circumstances, as 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 couples living together as if married – are usually jointly and severally liable.

The 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.

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 the 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 tax payers.

Council tax benefit

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

Council tax support

From 2013/14, council tax benefit has been replaced by a localised system of discounts designed and administered by individual local authorities. The changes only affected

working age claimants as government provided a national scheme to protect pensioners. 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.

A review of council tax support by Eric Ollerenshaw, Three Years On: An Independent Review of Local Council Tax Support Schemes (March 2016), found that "councils have implemented the government's localisation of council tax support effectively and professionally".

Billing and precepting authorities

The City of London Corporation, 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. The 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

Billing authorities are responsible for collecting council tax and dealing with any arrears. This includes issuing reminders for non-payment, making arrangements to pay and applying for a liability order via the issue of a Magistrates Court summons.

Once a liability order has been obtained the billing authority has a number of options to try to collect the debt including an attachment of earnings, an attachment to benefit, using an enforcement agent and, ultimately, applying for the debtor to be committed to prison. 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 were 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

In 2015/16 local authorities collected a total of £25.3bn in council tax (irrespective of the year to which it related). This was an increase of £0.8bn, or 3.1%, over 2014/15. £24.78bn of this was in respect of 2015/16, from a collectible debit of £25.52bn increasing collection rates

from 97% in 2014/15 to 97.1% in 2015/16. The only authorities not to achieve this increase were the outer London boroughs which remained static at 95.8%. The council tax requirement for 2016/17 is estimated to be around £26.1bn of which £382m will be in respect of the adult social care precept.

There were concerns that the introduction of local council tax support in 2013/14 would impact on collection rates as some households would be paying council tax for the first time. There was an initial drop in collection rate of 0.4%, from 97.4% in 2012/13 to 97% in 2013/14. This rate was maintained in 2014/15 and, as outlined above, in 2015/16 we saw an increase of 0.1%.

Calculating the council tax

The council tax is calculated by subtracting the amount of reserves to be used, 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 one. Conversely, where the billing authority has implemented the option of imposing a 50% premium on long-term empty properties, this would increase the tax base. If there were two long-term empty properties in a band this would increase the number of properties in that band by one.

The following example shows a very simplified version of how this works.

Band	Number of properties	Reduction due to discounts	Increases due to premiums	Adjusted number of properties	Ratio	Band D equivalent
A	3,000	1,300	100	1,800	2/3	1,200
B	4,000	1,350	50	2,700	7/9	2,100
C	6,000	1,510	10	4,500	8/9	4,000
D	4,500	1,000	0	3,500	1	3,500
E	3,200	500	0	2,700	11/9	3,300
F	1,950	150	0	1,800	13/9	2,600
G	1,850	50	0	1,800	15/9	3,000
H	920	20	0	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. Where the billing authority is also an adult social care authority, the element of adult social care precept must also be shown separately to the local council tax element.

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 tax payers			**1,270**

Council tax can be paid either in a lump sum or in instalments, usually by direct debit. From 2013/14 all residents have had the option to pay their council tax over 12 instalments rather than the traditional ten instalments.

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 tax payers 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 were to reject the increase.

For the 2017/18 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. For authorities with social care responsibilities, the referendum threshold was 5%, comprising 3% for expenditure on adult social care and 2% for other expenditure.

The government has also made a grant available to those authorities that 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 few years, with low increases in council tax. There was no council tax freeze grant for 2016/17 or 2017/18.

Average band D council tax percentage change 2005/06 to 2016/17

	Band D for areas change £	% 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
2015/16	1,484	1.1
2016/17 (incl adult social care)	1,530	3.1
2016/17 (excl adult social care)	1,507	1.6

Figures include parish precepts

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

The collection fund

Because a billing authority collects 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 tax 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).

Since 2013/14 the collection fund has also been used to account for and distribute business rates income.

BUSINESS RATES

Business rates are payable by ratepayers based on the rateable value of the premises they occupy, which is calculated according to how much rent the premises 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 1 April 2017 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 2015. 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 the DCLG. The multiplier for 2016/17 was:

- England = 47.9p in the pound
- small businesses in England = 46.6p in the pound.

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, however, government chose to delay the revaluation due in 2015 until 2017 to give certainty to ratepayers. The 1990 rating list was based on rental values in 1988. The 1995 rating list was based on rental values in 1993. The 2000 rating list was based on rental values as at April 1998 and the 2010 rating list was based on rental values as at April 2008. The current rating list that came into force on 1 April 2017 is based on rental values as at April 2015.

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, such as those relating to utilities (eg gas and electricity). The billing authority must put the local rating list on public display.

2017 revaluation

In September 2016, the draft rating list was published along with the high level impact of the 2017 revaluation, which took effect from 1 April 2017.

The overall rateable value across England rose by 9.1%. The North East, the North West and Yorkshire and the Humber saw a fall in their rateable value with all the rest of England seeing increases. The largest increase was in London with a 22.8% increase in rateable value.

2017 revaluation – local rating list percentage change in rateable value by region and sector

Area	Retail	Industry	Office	Other	All
England	**4.7%**	**4.0%**	**11.3%**	**15.5%**	**9.1%**
North East	-6.8%	0.0%	-12.5%	9.0%	-1.1%
North West	-5.5%	-3.1%	-4.8%	10.2%	-0.2%
Yorkshire and the Humber	-1.9%	0.4%	-13.0%	6.6%	-0.3%
East Midlands	4.7%	3.3%	7.8%	13.7%	7.2%
West Midlands	-1.2%	3.1%	-7.2%	12.0%	2.9%
East	-4.0%	2.3%	2.4%	13.2%	3.9%
London	26.2%	15.1%	21.2%	25.7%	22.8%
South East	1.4%	6.5%	7.7%	17.5%	8.6%
South West	-4.4%	5.4%	-0.7%	12.1%	3.8%

Source: VOA administrative data as at 1 August 2016

In addition to the increase on the local rating list there was also a significant increase on the central rating list.

The overall effect of revaluation in England was an increase of 10.6%. As revaluations are revenue neutral, the increase in rateable value was offset by a reduction in the standard multiplier from 49.7p in 2016/17 to 47.9p in 2017/18.

The effects of previous revaluations in England are shown below.

	RV £m	Increase in RV	Multiplier	Multiplier (previous year)
2000	29,337	29%	41.6p	48.9p
2005	39,715	17%	42.2p	45.6p
2010	46,934	20%	41.4p	48.5p

Source: Business Rates: The 2017 Revaluation, House of Commons library briefing paper 31 March 2017

Appeals

From 1 April 2017 a new appeal system, check, challenge, appeal, came into existence.

The Valuation Office Agency (VOA) deals with checks and challenges and the Valuation Tribunal handles appeals.

Where there are factual inaccuracies in the rating list the owner, occupier or authorised agent needs to advise the VOA, and this is known as a check.

They can also request a change to the property valuation even if there are no factual inaccuracies, and this is called a challenge; however, a check must have been completed first. Challenges arise where, for example, the valuation was wrong when the rating list entry was created, there has been a change to the property or the surrounding area, or the property should be shown as more than one entry in the rating list.

If agreement can't be reached then it is possible to appeal the decision with the Valuation Tribunal.

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 and Housing Act 1989 and the Non-Domestic Rating Act 1992.

Transitional arrangements – 2017 rating list

In September 2016, the DCLG published a consultation paper on the transitional arrangements for the 2017 revaluation. The government's response to consultees' comments on the proposed transitional arrangements for the non-domestic rating revaluation 2017 was published in November 2016.

The consultation sought views on how much transitional relief should be provided for properties, over what time period, and how this relief should be financed. For the first time since 1990 the government suggested adding an extra tier to the transition scheme, to give three classifications of property: small, medium and large. The consultation asked for views on two schemes; 173 consultation responses were received. The responses showed very little support for either option, with only 10% supporting option 1 and 24%, the majority of which were billing authorities, supporting option 2.

Despite the lack of support from the responses received, the government then proposed introducing a £3.6bn 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.

Transitional arrangements – 2017 rating list, England

Cap on increases and reductions before inflation

	Cap on increases – small properties	Cap on increases – medium properties	Cap on increases – large properties	Cap on reductions – small properties	Cap on reductions – medium properties	Cap on reductions – large properties
2017/18	5%	12.5%	42.0%	20.0%	10.0%	4.1%
2018/19	7.5%	17.5%	32.0%	30.0%	15.0%	4.6%
2019/20	10.0%	20.0%	49.0%	35.0%	20.0%	5.9%
2020/21	15.0%	25.0%	16.0%	55.0%	25.0%	5.8%
2021/22	15.0%	25.0%	6.0%	55.0%	25.0%	4.8%

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 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. Billing authorities have the discretion to award additional relief of up to 20%
- 100% relief where the property is unoccupied and it appears that, when next in use, it will be occupied for charitable purposes.

Small business rates relief

Section 61 of the Local Government Act 2003 gives the secretary of state 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 the DCLG to set two business rate multipliers for England from 1 April 2005:

- a small business rate multiplier
- a business rate multiplier.

The business rate 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 rate relief that will be sufficient to meet the cost of the relief given to small businesses.

From 1 April 2017 the level of relief available, for qualifying ratepayers, is:

- properties with rateable values not more than £12,000 – 100%
- properties with rateable values between £12,001 and £15,000 – 0% to 100% with relief reducing by 1% for every £30 of additional rateable value
- properties with a rateable value below £51,000 are subject to the small business multiplier.

There will be a number of ratepayers who, due to the impact of revaluation, will no longer qualify for small business rates relief, or qualify for a lower amount. The government has committed to protecting these ratepayers by limiting the maximum amount their business rates bill can increase to £600, £50 per month.

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.

Rates retention

From April 2013, local councils have been allowed to keep a proportion of the business rates they collect from businesses in their area. In most areas, half of business rates will have to be paid over to central government, with some piloting 100% business rates retention. Billing authorities will continue to collect all of the business rates in their area on behalf of the major precepting authorities and central government. The shares of total business rates each type of local authority is allowed to keep are 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 redistribute 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 authorities 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 authority 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 authority 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 and any precepting authorities.

Business rate income is paid into the collection fund, administered by the billing authority, as it is collected from businesses. The collection fund then makes payments out to the billing authority general fund, the major preceptors and government based on the NNDR1 estimate. If more income than estimated is received, 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

As has been explained, while the local government finance settlement is still announced annually to confirm the amount of funding local government will receive for the following year from central government, it also now provides provisional figures for future years. Once this overall settlement has been set it is necessary to determine the allocation to each individual local authority.

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.

Estimated business rates aggregate

To get to a starting position for the anticipated 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 authority'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 or 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 x 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.

All top-ups and tariffs were recalculated for 2017/18 to ensure the fiscal neutrality of the 2017 business rates revaluation. The figures for individual authorities are contained in the local government finance settlement.

LOCAL GOVERNMENT FUNDING IN 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. One response has been the move towards self-sufficiency within local government and consideration of 100% business rates retention local authorities, but at the time of writing political uncertainty makes the future direction of policy difficult to determine.

FURTHER READING

Balancing Local Authority Budgets, CIPFA, 2016

A Guide to Local Government Taxation and the Collection Fund, CIPFA, 2014

An Introductory Guide to Local Government Finance (2017 Edition), CIPFA, 2016

The Local Government Finance Report (England) 2016/2017, DCLG, 2016

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

More Medicine Needed, CIPFA, 2016

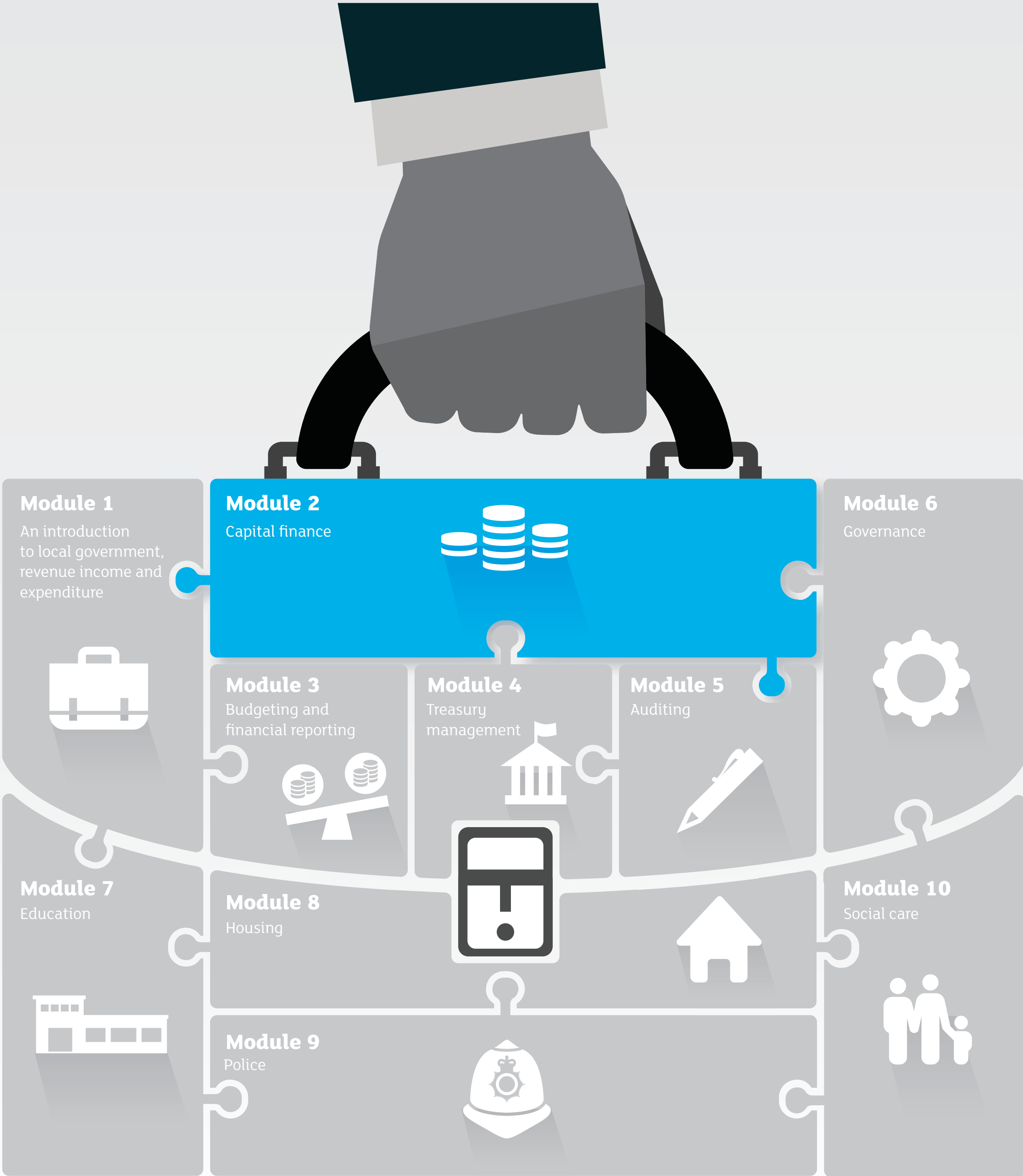
Raising the Capital: The Report of the London Finance Commission, London Finance Commission, 2010

Self-sufficient Local Government: 100% Business Rates Retention, DCLG, 2016

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

MODULE 2

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 system operates.

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 employment opportunities and a much-needed stimulus to the economy, and by 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.

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 includes the Code of Practice on Local Authority Accounting in the United Kingdom, which is updated annually. Its provisions relating to capitalisation are based on IAS 16 *Property, Plant and Equipment*. Costs associated with property, plant and equipment can 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 attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management
- the initial estimate of the costs 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 water supply and drainage systems and coastal defences, and community assets, such as open spaces or allotments.

Many authorities set a de minimis limit for capital expenditure. This means that any expenditure that is below the limit 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 the DCLG, 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.

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.

Guidance on capitalisation was issued alongside the 2016-2020 local government finance settlement. From 2016 to 2019, local authorities will be permitted to use capital receipts for a range of specified revenue spending purposes deemed 'qualifying expenditure'. 'Qualifying expenditure' is defined as:

expenditure on any project that is designed to generate ongoing revenue savings in the delivery of public services and/or transform service delivery to reduce costs and/or transform service delivery in a way that reduces costs or demand for services in future years for any of the public sector delivery partners. Within this definition, it is for individual local authorities to decide whether or not a project qualifies for the flexibility.

Examples include sharing of staff, joint procurement arrangements, joint arrangements regarding the management of public sector land, and establishing alternative models of service delivery. This guidance applies to the end of the 2018/19 financial year.

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
- 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

Capital expenditure by local authorities in England increased to £22.6bn in 2015/16 from £21.5bn in 2014/15, a year-on-year increase of 5.2%. Capital receipts have increased in 2015/16 to £3.6bn from £3.0bn in 2014/15, a year-on-year increase of 19.4%.

The graph below, taken from the DCLG's September 2016 statistical release (*Local Authority Capital Expenditure and Receipts in England: 2015 to 2016 Final Outturn* (DCLG, 2016)), shows the changes since 2011.

Capital expenditure and receipts, England, 2011/12 to 2015/16 forecast and outturn

The table below shows local authority capital expenditure by service in England. Increases in patterns of expenditure reflect a growth in regeneration projects.

Local authority capital expenditure by service: England: 2011/12 to 2015/16

					£m
	2011/12	2012/13	2013/14	2014/15	2015/16
Education [(a)]	5,495	4,528	3,741	3,480	3,196
Highways and transport	6,574	6,046	6,615	7,438	8,306
of which GLA	3,137	3,016	3,502	3,802	4,309
Social care	253	207	343	264	261
Public health [(b)]	...	...	10	7	10
Housing	3,274	3,731	3,964	4,807	4,604
of which GLA	0	652	414	676	259
Culture and related services	1,102	877	829	957	1,068
Environmental services	488	526	581	680	726
Planning and development services	653	879	1,131	1,467	1,686
Police	538	500	481	546	611
Fire and rescue	136	172	178	192	172
Central services [(c)]	1,160	1,264	1,325	1,375	1,489
Trading services [(d)]	358	201	463	323	518
Total capital expenditure	**20,032**	**18,931**	**19,661**	**21,536**	**22,647**

(a) *Expenditure on education services in 2015/16 onward is not comparable to previous years due to a number of schools changing their status to become academies which are centrally funded rather than funded by local authorities.*

(b) *Public Health Grant is being provided since 2013/14 to give local authorities the funding needed to discharge their new public health responsibilities.*

(c) *Central services include court costs, local tax collection, and other core council services costs.*

(d) *Trading services include the maintenance of direct labour and service organisations, such as civic halls and retail markets.*

Source: COR local authority returns 2011/12 to 2015/16

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. This bottom-up approach to devolution sees local areas bringing forward proposals to government for the devolution of powers, budgets, freedoms and flexibilities which are then considered on a bespoke basis.

City Deals were developed in 2012 to facilitate devolution. They are essentially a tailored agreement between a city region and government providing the region with the opportunity to gain powers through devolution from central government in return for fulfilling proposals to achieve growth.

The first City Deals were with the core cities, the eight largest economic cities outside of London: Bristol, Birmingham, Manchester, Leeds, Liverpool, Newcastle, Nottingham and Sheffield. The funding for City Deals is allocated to the local enterprise partnership (LEP) and held by the nominated accountable body, which can be the local authority.

City Deals were complemented by Growth Deals which also form a part of this devolution process.

In 2014, the government also announced the first instalment of plans to invest at least £12bn in local economies in a series of 'Growth Deals'. Growth Deals provide funds to LEPs (partnerships between local authorities and businesses) for projects that benefit the local area and economy with businesses and local authorities. Infrastructure, housing and other funding is brought together in a single pot, and put directly into the hands of local authorities and businesses to invest with their knowledge of what is needed in their area to maximise their potential economic growth.

Round One funding of £6bn was allocated towards providing support for local businesses to train young people, creating thousands of new jobs, building thousands of new homes and starting hundreds of infrastructure projects, including transport improvements and superfast broadband networks.

Round Two saw a further £1bn of Growth Deal projects announced in January 2015 and 2017 has seen a number of Round Three announcements including the Midlands, South-West and Northern Powerhouse.

THE PRUDENTIAL FRAMEWORK

CIPFA's *Prudential Code for Capital Finance in Local Authorities* 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 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.

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 and 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 and Cross-Sectoral Guidance Notes* (CIPFA, 2011)
  - 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.

Consultation

The Prudential Code was last updated in 2011. Since then the landscape for local government has changed significantly following the sustained period of reduced public spending and the developing localism agenda. In spring 2017, CIPFA considered it an appropriate time for the Prudential Code to be reviewed and sought views from stakeholders as to areas where it could be strengthened or amended. A further consultation on the proposed changes is anticipated in the summer of 2017, with the revised Codes being published in time for implementation in 2018/19.

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.

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 (RICS, 2012).

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.

In addition RICS has produced the RICS Public Sector Property Asset Management Quick Start Guide (RICS, 2012), 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 (RICS, 2012). 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.

ONE PUBLIC ESTATE

One Public Estate is an initiative delivered in partnership between the Government Property Unit and the Local Government Association that provides funding and support to local government for property-based projects in collaboration with government departments and wider public sector partners.

One Public Estate began as a pilot programme with 12 areas in 2013. The following year, a further 20 pilots joined the programme and demonstrated that with the right expertise, support and investment, shared approaches to the use of property can deliver benefits in both service transformation and efficiency savings.

By October 2016, 159 or half the councils in England had taken part in the scheme. These partnerships have resulted in a wide range of land and property-focused projects and expect to deliver, among other benefits, 16,500 new homes, 36,000 new jobs, £138m in capital receipts and savings of £56m in running costs over a period of five years.

HIGHWAYS NETWORK ASSET (FORMERLY HIGHWAYS INFRASTRUCTURE ASSETS)

The original Code of Practice on Transport Infrastructure Assets (the Transport Code) was published in 2010 and was used to provide information for the whole of government accounts (WGA) and to support asset management. It was 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. Subsequent editions of the Transport Code and the *Code of Practice on the Highways Network Asset* have maintained these principles.

The Transport Code was subsequently 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* (the Accounting Code) 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 historical 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 (the latest published WGA estimate is at least £244bn) is one of the WGA qualification issues.

The Transport Code was updated in 2016 and renamed the *Code of Practice on the Highways Network Asset* (the Highways Code) to describe the Highways Network Asset in a way which would be better understood by the users of local authority financial statements.

CIPFA/LASAAC (the board responsible for the development of the Accounting Code) were keen to measure the value of the local highways network in local authority accounts using the principles in the Transport Code. This had been scheduled for the 2017/18 financial statements, however, at its meeting in March 2017, CIPFA/LASAAC decided not to proceed and that it would only give further consideration to this issue if provided with clear evidence that benefits outweigh costs for local authorities.

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.

In October 2016 the first edition of Well-managed Highway Infrastructure: A Code of Practice (Well-managed Highway Infrastructure) was published by the UK Roads Legislation Group. It consolidated the three previous Codes of Practice: *Well-maintained Highways*, *Management of Highway Structures* and *Well-lit Highways* and is designed to promote the adoption of an integrated asset management approach to highway infrastructure based on the establishment of local levels of service through risk-based assessment. The delivery of a safe and well maintained highway network relies on good evidence and sound engineering judgement. The intention of *Well-managed Highway Infrastructure* is that local authorities will develop their own levels of service and it therefore provides guidance for authorities to consider when developing their approach in accordance with local needs, priorities and affordability.

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 Loan Board (PWLB), a statutory body operating within the UK 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. In 2015 Warrington Borough Council issued £150m of CPI-linked bonds to fund its capital programme which includes the £100m new town centre development. In 2016 Aberdeen City Council issued

£370m of bonds to help secure investment in the city to deliver its transformational capital and infrastructure programme.

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.

Municipal Bond Agency

The UK Municipal Bonds Agency Plc (Bonds Agency) is a public limited company, owned by local councils and the Local Government Association. The Bonds Agency aims to help local authorities to finance their investment in projects including infrastructure and housing, efficiently and cost effectively. The Bonds Agency is a first for the sector in the UK. It plans to issue bonds to finance local authority projects at a lower cost than the Public Works Loans Board. This aims to reduce financing costs, meaning more can be invested into local economies, infrastructure and housing projects. At the time of writing the Bonds Agency had yet to issue a bond.

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 for 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 would *"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.

Private Finance 2 aims to achieve, as set out in the foreword to A New Approach to Public Private Partnerships (HM Treasury, December 2012):

The realities of the private sector market place exert a powerful discipline on businesses to maximise efficiency and take full advantage of business opportunities. Successful Public Private Partnerships (PPP) enable the public sector to access the discipline, skills and expertise of the private sector.

The National Audit Office published a *Review of the VfM Assessment Process for PFI* (NAO, 2013) in 2013, requested by the Treasury. The review sets out an analysis of the Treasury's

quantitative and qualitative approach to value for money appraisal, and was submitted to the Treasury Committee as part of its inquiry into PF2.

In 2014 the Treasury Committee published its report into PF2, following an examination of key elements to determine whether they are likely to address the principal concerns the Committee has previously raised with regard to PFI.

Tax increment financing

Tax increment financing is very popular in the US, but is still at the relatively 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 is retained by the council in order to fund the development.

A second option involving borrowing against different elements of retained business rate income was initially referred to as TIF2, but was renamed 'New Development Deals'. Here, the secretary of state designates an area (and revenue stream) which is outside the business rates retention scheme. The 2012 budget set a limit of £150m on borrowing via 'New Development Deals' and they were only available to core cities.

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 to 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 of local authority capital expenditure: England: 2011/12 to 2015/16

	2011/12	2012/13	2013/14	2014/15	2015/16
	£m	£m	£m	£m	£m
Central government grants	7,170	8,481	7,483	8,520	9,302
EU structural funds grants	77	55	57	132	114
Grants and contributions from private developers and from leaseholders etc	747	693	750	727	1,069
Grants and contributions from NDPBs[(a)]	522	442	443	564	505
National lottery grants	121	67	49	53	47
Use of capital receipts	1,647	1,294	1,516	1,879	2,196
Revenue financing of capital expenditure	4,504	3,167	4,920	5,241	4,654
of which:					
Housing Revenue Account (CERA)	324	466	578	686	775
Major Repairs Reserve	1,160	1,259	1,491	1,526	1,815
General Fund (CERA)	3,020	1,442 [(b)]	2,851	3,029	2,065
Capital expenditure financed by borrowing/credit	18,819	4,842	4,454	4,422	4,759
of which:					
SCE(R) Single Capital Pot[(c)]	338	88	70	0	0
SCE(R) Separate Programme Element[(c)]	74	30	8	0	0
Other borrowing & credit arrangements not supported by central government[(d)]	18,406 [(e)]	4,724	4,376	4,422	4,759
Total	**33,606** [(e)]	**19,042**	**19,671**	**21,539**	**22,646**

(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 Natural England.*

(b) *This reflects reallocation of expenditure by TfL as part of year end process of reconciling funding to its subsidiaries.*

(c) *Supported capital expenditure (SCE) financed by borrowing that is attracting central government support has been discontinued as of 31 March 2011. This may have a bearing on the financing of capital expenditure. A residue of schemes in 2011/12 and 2012/13 will continue to be financed in reliance of supported borrowing from earlier years.*

(d) *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.*

(e) *It is estimated that approximately £13bn is associated with the financing of the HRA self-financing determination payment.*

Source: COR local authority returns 2011-12 to 2015-16

FURTHER READING

Budget 2016, HM Treasury, 2017

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

Code of Practice on the Highways Network Asset, CIPFA, 2016

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

Local Authority Capital Accounting: A Reference Manual for Practitioners, CIPFA, 2016

Local Authority Revenue Expenditure and Financing England: 2016 to 2017 Budget, June 2016

Local Government Act 2003

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

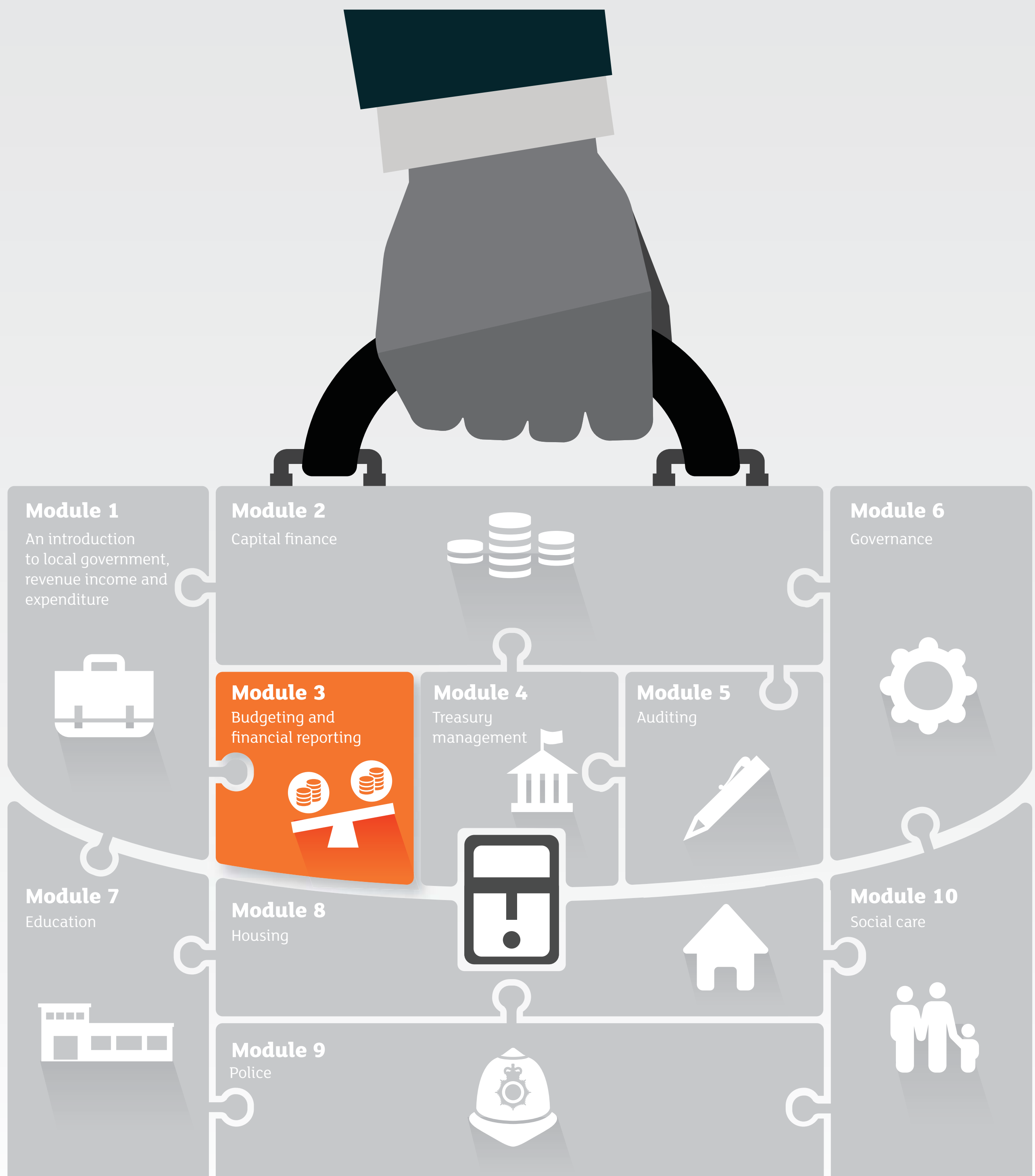
The Prudential Code for Capital Finance in Local Authorities (2011 Edition), CIPFA, 2011

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

MODULE 3

Budgeting and financial reporting



INTRODUCTION

Budgeting and financial planning have never been more important than in a period of austerity when the margins for error are reduced and the consequences of failure would be an inability to provide statutory services. Setting a balanced budget has becomes a bigger challenge than ever 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 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 virements.

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 enduring *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.

These enduring principles are supplemented by the legislative framework for the process contained in Part 2 of the Local Government Act 2003:

- Sections 25 to 29 place duties on local authorities – and their chief finance officers – in relation to 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 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.

In the current financial climate, chief finance officers may also have to consider Section 114 of the Local Government Finance Act 1988 if it is judged that the council is unable to set or maintain a balanced budget.

Financial planning

A council must have a sound financial planning system. This has always been the case, but recent 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, income and spending levels.

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 alone is of limited value as a policy document as it looks only one year ahead. The implementation of significant policy initiatives often takes longer than one financial year so local authorities will plan over a longer timescale – at least three to five years ahead – to reflect the likely effects of demographic and/or economic change, and the medium-term consequences of legislative changes. Longer-term forecasting is also essential for local authorities to establish that their capital programmes are prudent and sustainable. All these requirements are embodied 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 or other preceptor'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 (within four months from 31 March 2017 and future years), 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.

Recent practice has been to announce provisional details of the local government finance settlement usually 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 December of the preceding financial year. These were used to set provisional budgets although the final decisions on the local government finance settlement were not then usually taken until January or February for the year beginning on the following 1 April.

Before the 2017 election the government had considered ending the annual local government finance settlement, since with a move to the 100% redistribution of business rates local government as a whole would become financially self-sufficient. In these circumstances it would have still been necessary to consult periodically on the principles by which resources are re-distributed within the sector. It would also have remained necessary to consult on the principles used to distribute resources within local government, even though there would no longer be a local government finance settlement that distributes central grant to support local services. This reform was however overtaken by the 2017 election so its implementation will depend on the intentions of future governments.

Financial planning and control timetable – for the 2016/17 year

	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	
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 outturn fed into discussion of new budget	
March	Council sets council tax for year 1 with indicative figures for years 2 and 3		

** In England, for the 2017/18 financial year and future years, authorities must confirm that the statement of accounts presents a true and fair view of the financial position of the authority at the end of the relevant financial year and the authority's income and expenditure for that financial year, prior to the commencement of the period for the exercise of public rights (which includes the first 10 working days in June) and to approve and publish them by 31 July.*

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.

With greater emphasis on efficiency, performance outcomes and value for money and the move towards faster accounts closure, the budget and reporting cycle needs to adapt as a tool to support these developments.

Improving Budgeting: Modernising the Cycle (CIPFA, 2008), described practical ways to improve this process, the sentiments of which still hold true. 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 reforecasts 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.

However in the current climate, there is a need to perhaps look further ahead than ever before. Thinking Ahead: Developing a Financial Strategy (CIPFA, 2012), advocates that a short, medium and long-term financial planning approach are all essential to the success and survival of public sector organisations.

Strategic financial planning in public service organisations has recently been reinvigorated, since with the financial crisis of 2008 and its aftermath, many of the assumptions underpinning financial strategies were found to be untenable. The immediate pressure on budgets has joined with a stress on protecting frontline services to reduce planning horizons and undermine commitments to strategic planning. These short-term needs cannot be ignored, but they should not distract from creating a long-term vision embodied in a financial strategy. In this way public service organisations recapture the benefits of planning ahead.

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 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. The chief finance officer must also check to see if the assumptions in the annual budget are valid. Assumptions will include demand, risk and unavoidable future commitments. This challenge may show areas where services can be delivered differently, which can lead to savings. Any budget available, from any savings made during this process, will usually be prioritised towards the council's statutory services.

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 the following year, by late January (or early February) and forecast its non-domestic rates income available to support the forthcoming year's budget by 31 January.

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.

The council tax referendum arrangements of Section 72 of the Localism Act 2011 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

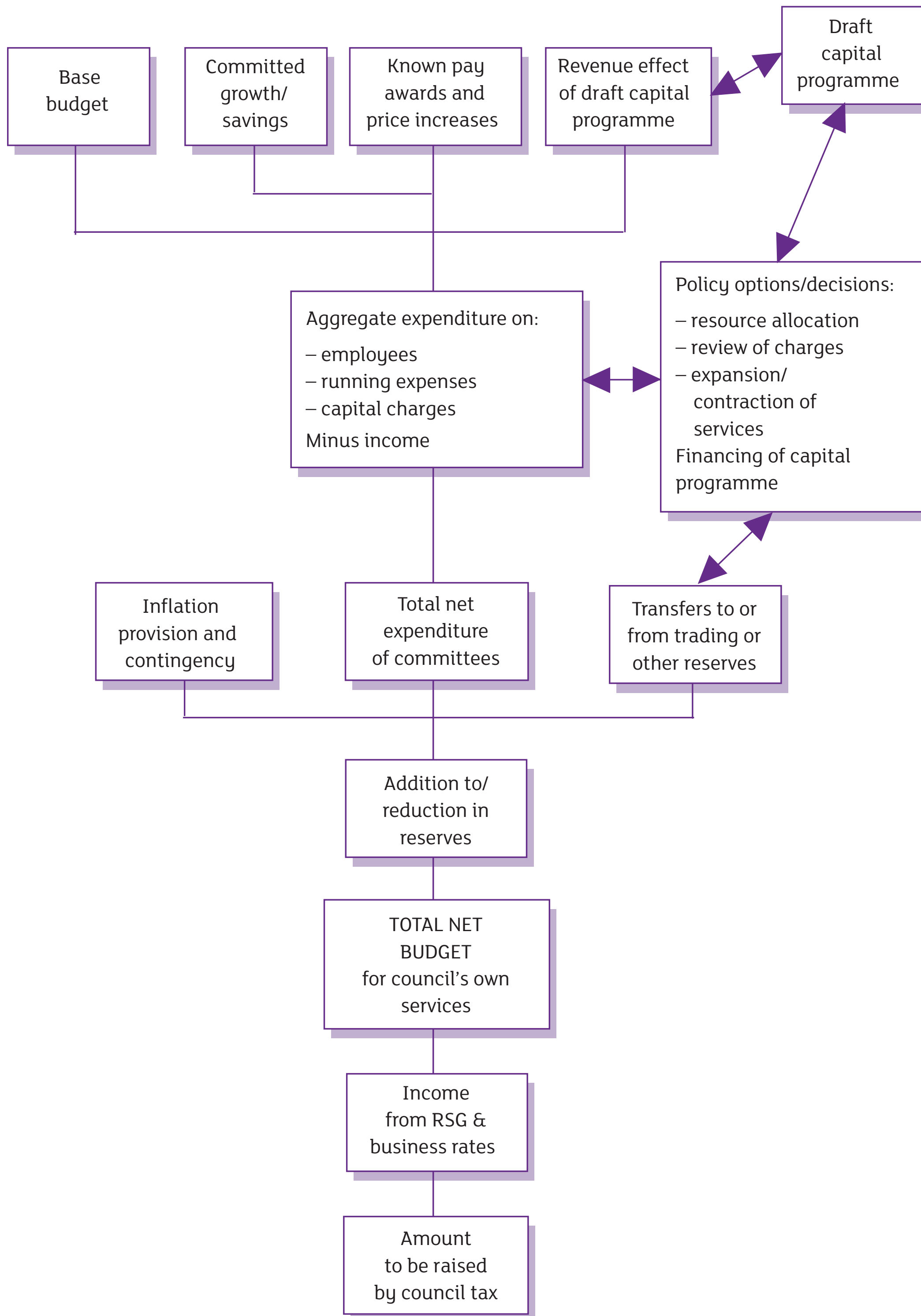
The lowest level of detail at which budgets are usually produced by officers is the individual line item (also known as the detail head). For example:

- 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 political and managerial culture of the authority and on the circumstances it faces. 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. Of particular importance in the current economic climate is for elected members to re-examine the policies that are implicit in the existing budget, with a view of focusing on what is important for the organisation rather than 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. ZBB has been used successfully by several authorities in more recent years as a tool for identifying savings in response to funding cuts.

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
- if applicable, 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, so this issue is likely to become more significant if the economy is moving towards an era of higher inflation. 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 (RSG). 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 DCLG 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 changes in the tax base along with any projected losses due to appeals and bad debts.

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. Before the 2017 election, RSG was expected to be phased out in the next three years.

More details about the funding of local government can be found in Module 1.

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 (CIPFA, 2011) 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. More detail on this can be found in Module 2.

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. The terms surplus or deficit are used instead of profit or loss in not-for-profit organisations such as local government.

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 is the responsibility of the chief finance officer to advise councils about the appropriate levels of reserves and to ensure that clear protocols are 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 the local level, and stresses 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 earlier years, including the collapse of Icelandic banks and the ensuing threat to council deposits with the banks. External factors such as extensive flooding, and the problems experienced by the global financial markets, have highlighted the importance for authorities of maintaining appropriate levels of reserves. LAAP Bulletin 99 provides guidance to council chief finance officers. 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 is required to 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 so 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, to meet known or predicted requirements; earmarked reserves are accounted for separately but remain legally part of the general fund.

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.
Transformation/invest-to-save project reserves	To fund expenditure on projects which will produce savings or generate income for the authority.
Insurance reserves	Self-insurance is a mechanism used by a number of councils. In the absence of any statutory basis, sums held to meet potential and contingent liabilities are reported as earmarked reserves where these liabilities do not meet the requirements of a provision under IAS 37.
Business rates volatility	Reserve set aside to manage additional risk from the business rates regime including uncertainty over appeals and to manage the timing differences between recognition of safety net and levy amounts compared to collection fund surpluses and deficits.
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 2016/17 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.

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.

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 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 local authorities in the Local Government 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 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, 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 Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2016) details an approach to giving assurance that risk, control and governance matters are being addressed in accordance with best practice.

The *Code of Audit Practice* makes 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, including:
  - 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 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. For example, 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 a 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.

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

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 and police bodies) 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, elected members 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 will 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 budgetary implications, especially where funding streams or budgets are pooled, and concerns have been expressed 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 (2017 Edition) looks at balance sheet management in the context of an authority's overall financial management framework. 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 (CIPFA, 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 (CIPFA, 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 (CIPFA, 2016) was initially launched in 2004 and is now in its fourth version.

The model offers a practical tool for improving organisational effectiveness. It presents the components of financial management in a structured framework based around three styles of financial management:

- Enabling transformation: the finance team have input into strategic and operational plans taking into account proactive risk management, clear strategic directions and focus-based outcomes.
- Supporting performance: finance teams are actively committed to continuous improvement focused on efficient and effective delivery and organisational performance.
- Delivering accountability: financial information is accurate, timely and focuses on controls, probity, compliance and accountability.

It looks for each style across four management dimensions:

- **Leadership** – which focuses on strategic direction and performance management, and the impact on financial management of the vision and involvement of the board and senior managers.
- **People** – which includes both the competencies and the engagement of staff. This aspect generally faces inward to the organisation.
- **Processes** – which examines the organisation's ability to design, manage, control and improve its financial processes to support its policy and strategy.
- **Stakeholders** – which deals with the relationships between the organisation and those with an interest in its financial health, whether government, inspectors, taxpayers, suppliers, customers or partners. It also deals with customer relationships inside the organisation, between finance services and their internal users.

The model is a matrix setting out statements of good practice, 30 in total.

Behind each statement lies a set of questions that invite users to explore the practical implications of the statements. By using the model, organisations can conduct a self-assessment of their financial management. They can score themselves and build up a profile of financial management effectiveness.

The methodology used in the model is also used in Aligning Local Public Services Framework: A Reference for Good Practice (CIPFA, 2015). This is a reference guide of good practice in working with local partners to deliver public services as economically, efficiently and effectively as possible, based on common strategies and high-quality financial and operational data.

Balancing Local Authority Budgets

In Balancing Local Authority Budgets (CIPFA, 2016), CIPFA reviews the current financial challenges faced by local authorities in balancing their budgets. This module so far has assumed that an authority can set a balanced budget, ie one where the budgeted expenditure is fully financed. However at this time of reducing grant and rising pressures, there will be a funding gap requiring savings strategies and CIPFA considers what an authority's response to this may be, such as:

- income generation such as introducing/increasing fees and charges
- efficiency measures
- reducing or stopping delivering non-statutory services
- reducing reliance on government grants
- longer-term savings such as reviewing capital projects
- operational implementation of a spending freeze.

It also considers the more serious response of issuing a Section 114 report if the budget fails to balance and considers what the implications are of doing so. A Section 114 report would only be issued in the gravest of circumstances and when all other options have been exhausted, but it is perhaps a case of when and not if an authority issues such a report, something not seen in nearly 20 years.

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 tax payers 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 DCLG, requiring councils to treat certain items in the accounts differently from the way specified in the accounting standards.

All the accounting requirements for councils are brought together each year 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. IFRS were developed for the private sector, but the impact of the vast majority of transactions is the same for all sectors. 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. (The use of adaptations in the Code is determined by reference to the guidance in Annex A of the Memorandum of Understanding.)

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, International Public Sector Accounting Standards (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.

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 exclusively with 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 to the accounts only need to be produced if they are material (information is material if omitting it or misstating it could influence decisions that users of the accounts make on the basis of the financial information about a specific council). For example, the accounts need to reflect the pension 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.

Annual statement of accounts

Until recently, each local council was required to produce an annual statement of accounts by 30 June immediately following the end of the financial year reported on. This timetable will change to 31 May for the financial year 2017/18 and onwards.

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 to 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:

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.
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.
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 the 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).

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 (receivables and payables) balances in the council's balance sheet.

Debtors (receivables) 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 (payables) 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 non-current assets (non-current meaning expected to still be held by the authority after 12 months from the balance sheet date); mainly buildings, infrastructure and pieces of equipment. There are two key elements to capital accounting:

- to ensure that the value of the council's assets is 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 as a minimum, or more frequently as necessary to keep the values up to date. 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	Current 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		
Infrastructure	For example roads, footpaths, bridges, tunnels, coastal defences, water supply and drainage systems	Depreciated historical 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		
Surplus assets	Assets not being used to deliver services but that are not investment properties or assets held for sale	Fair value	The price that would be received to sell the asset in an orderly transaction between market participants at the measurement date ie value in highest and best use.
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 obtained via 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	Fair value	The price that would be received to sell the asset in an orderly transaction between market participants at the measurement date ie value in highest and best use.

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 (current meaning expecting to be sold within 12 months of the balance sheet date) 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 usually 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 revaluation 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 consumed. 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 ten 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 spreads the £10,000 cost of owning the asset (the purchase cost of £20,000 less its final value of £10,000) over the ten 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 any 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 non-current assets.

Depreciation, impairment and revaluation losses have been described above. Gains and losses on the disposal of non-current assets reflect the difference between the balance sheet value of an asset at the point of disposal and the amount it is sold for. Because of the way councils are financed and the fact that money received for the sale of non-current assets is tied up in capital receipts, the government does not want these items to be charged to the general fund, and so has made regulations to adjust these items against the authority's surplus or deficit

on the provision of services 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 as described in the *Budgeting* section of this module. 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.

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 are covered in more detail in the *Budgeting* section of this module.

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 to the pension fund is reversed out of the accounts in the movement in reserves statement against the pension reserve.

Other accounts

Councils may use other 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 to show that 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. In recent years the Code has incrementally introduced requirements designed to ensure that the accounts are of more value for the non-expert reader while at the same time not eliminating local discretion about how this wider objective is achieved.

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.

The Accounts and Audit Regulations 2015 require authorities to include a narrative statement in the accounts. As such, the Code requires that there should be a narrative report to accompany the statement of accounts. The narrative report should provide information on the authority, its main objectives and strategies, the principal risks that it faces and how it has used its resources to achieve its desired outcomes in line with its objectives and strategies.

The 2017/18 Code has established that the narrative report must provide a fair, balanced and understandable analysis of the authority's performance and should highlight and explain the linkages between information presented in the narrative report and the information within the accounts and the information presented must be consistent with the information within the accounts.

The structure and presentation of the narrative report should meet the needs of the users of the authority's accounts and reflect the individual characteristics of the authority and the reporting period under review. The narrative report should focus on those elements that are material to an understanding of the financial position and performance of the authority.

Expenditure and funding analysis

The expenditure and funding analysis was introduced to the accounts for the first time in 2016/17 and usefully brings together local authority performance reported on the basis of expenditure measured under proper accounting practices with statutorily defined charges to the general fund.

Both the comprehensive income and expenditure statement and the expenditure and funding analysis include a segmental analysis which requires local authorities to report performance on the basis of how they are structured and how they operate, monitor and manage financial performance.

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, employers' pension contributions must be reported in addition to the remuneration.

The transparency agenda

Councils are required to publish all expenditure transactions over £500 to encourage 'armchair auditors', ie members of the public with an interest in council finances who are prepared to question councils over what they spend. In February 2015, the DCLG published its latest version of The Local Government Transparency Code (DCLG, 2015), 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 there is 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 have 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. These principles of effective communication in financial reporting are that it should be focused, open and honest, clear and understandable and finally interesting and engaging. The FRC has provided a detailed elaboration of how each of these principles can be satisfied.

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 underway 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 other statutory 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.
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.

The accounts include an expenditure and funding analysis to further link and explain the comprehensive income and expenditure statement and the movement in reserves statement. The objective of the expenditure and funding analysis is to demonstrate to council tax (and rent) payers how the funding available to the authority (ie government grants, rents, council tax and business rates) for the year has been used in providing services in comparison with those resources consumed or earned by authorities in accordance with accounting standards. The expenditure and funding analysis also shows how this expenditure is allocated for decision making purposes between the council's directorates (services or departments).

FURTHER READING

Aligning Local Public Services Framework: A Reference for Good Practice, CIPFA, 2015

Balance Sheet Management in the Public Services: A Framework for Good Practice (2017 Edition), CIPFA, 2017

Balancing Local Authority Budgets, CIPFA, 2016

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

Delivering Good Governance in Local Government: Framework 2016, CIPFA, 2016

A Guide to Local Government Taxation and the Collection Fund, CIPFA, 2014

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

The Local Government Transparency Code, DCLG, 2015

Narrative Reporting: A Public Services Perspective, CIPFA, 2009

Principles of Effective Communication in Financial Performance Reporting, CIPFA, 2012

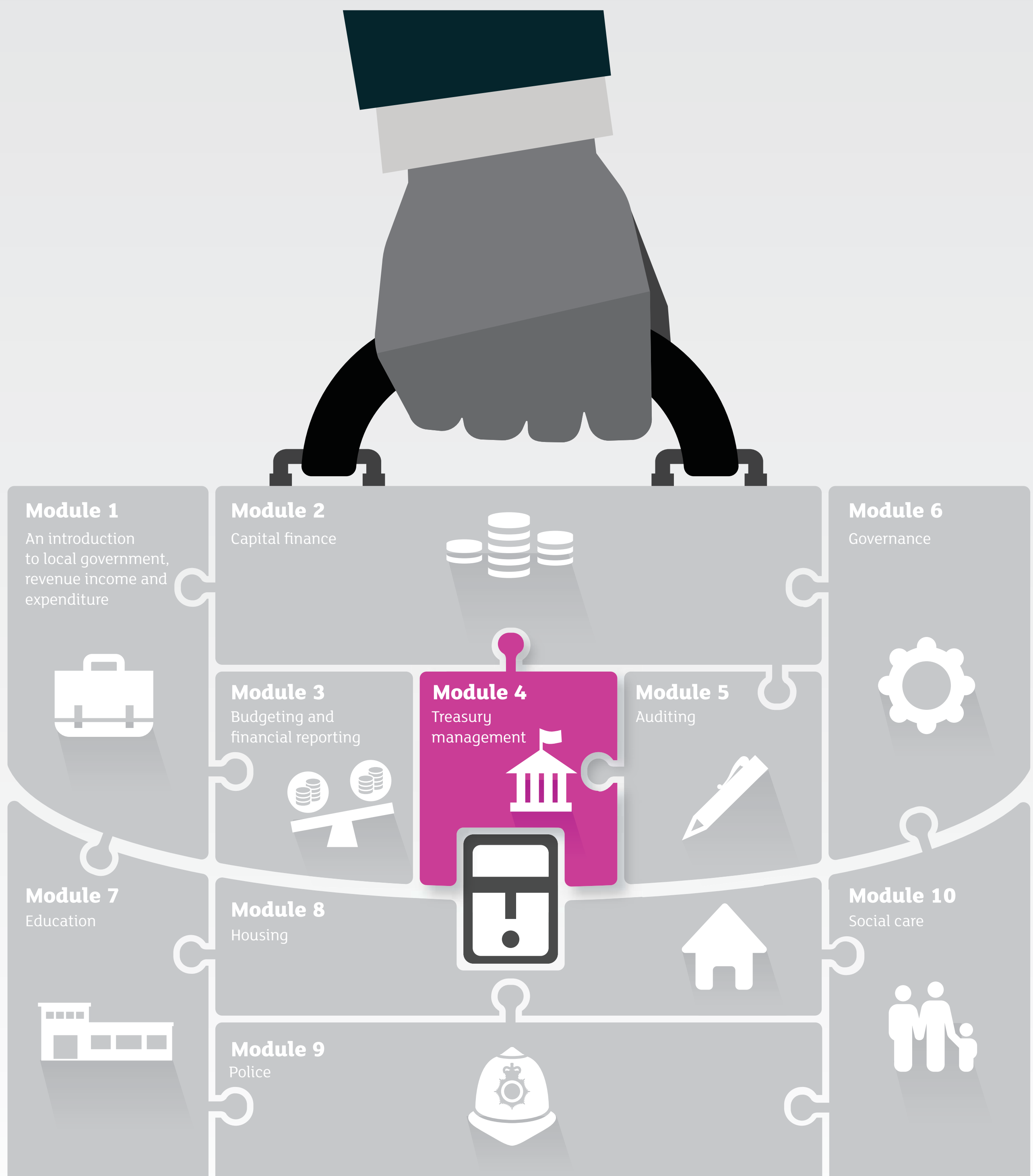
The Prudential Code for Capital Finance in Local Authorities (2011 Edition), CIPFA, 2011

Standards of Professional Practice, CIPFA, 2002

Thinking Ahead: Developing a Financial Strategy, CIPFA, 2012

MODULE 4

Treasury management



INTRODUCTION

Treasury management activities are defined in CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (CIPFA, 2011) (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.

According to the Local Government Financial Statistics England No 26 (DCLG, 2016) local authority gross external debt as at 31 March 2016 was £58.8bn and local authority investments on deposit were £30.8bn.

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 its *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 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 in the 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) supports the development of high quality international 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 by-laws.

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 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 risks, 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.

CONSULTATION ON CIPFA'S TREASURY MANAGEMENT CODE

Since the Treasury Management Code was last updated in 2011 the landscape for public services has changed significantly following the sustained period of reduced public spending and the developing localism agenda. In spring 2017, CIPFA considered it an appropriate time for the Treasury Management Code to be reviewed and sought views from stakeholders as to areas where it could be strengthened or amended. A further consultation on the proposed changes is anticipated in the summer of 2017, with the revised Codes being published in time for implementation in 2018/19.

INVESTMENT STRATEGY

The DCLG produces Guidance on Local Government Investments (DCLG, 2010), which councils in England are required to have regard to. 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 *"**S**ecurity – **L**iquidity – **Y**ield… 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 when it is 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 the 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 criterion 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 in the Public Services: 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:

Gross and net debt

This is set by the council for the forthcoming financial year and the following two financial years and sets upper limits on the proportion of net debt compared to gross debt. This highlights where an authority may be borrowing in advance of need.

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 Prudential Code for Capital Finance in Local Authorities (CIPFA, 2011). 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* (CIPFA, 2011).

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, 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
- estimate 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 Treasury Management 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* (DCLG, 2010) 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 before this change.

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 will 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.

In 2012, CIPFA’s Treasury and Capital Management Panel produced a *Treasury Risk Management Toolkit for Local Authorities* (CIPFA, 2012). 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. 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 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 (CIPFA, 2013). 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

Local Authority Investments Icelandic Bank Investments 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

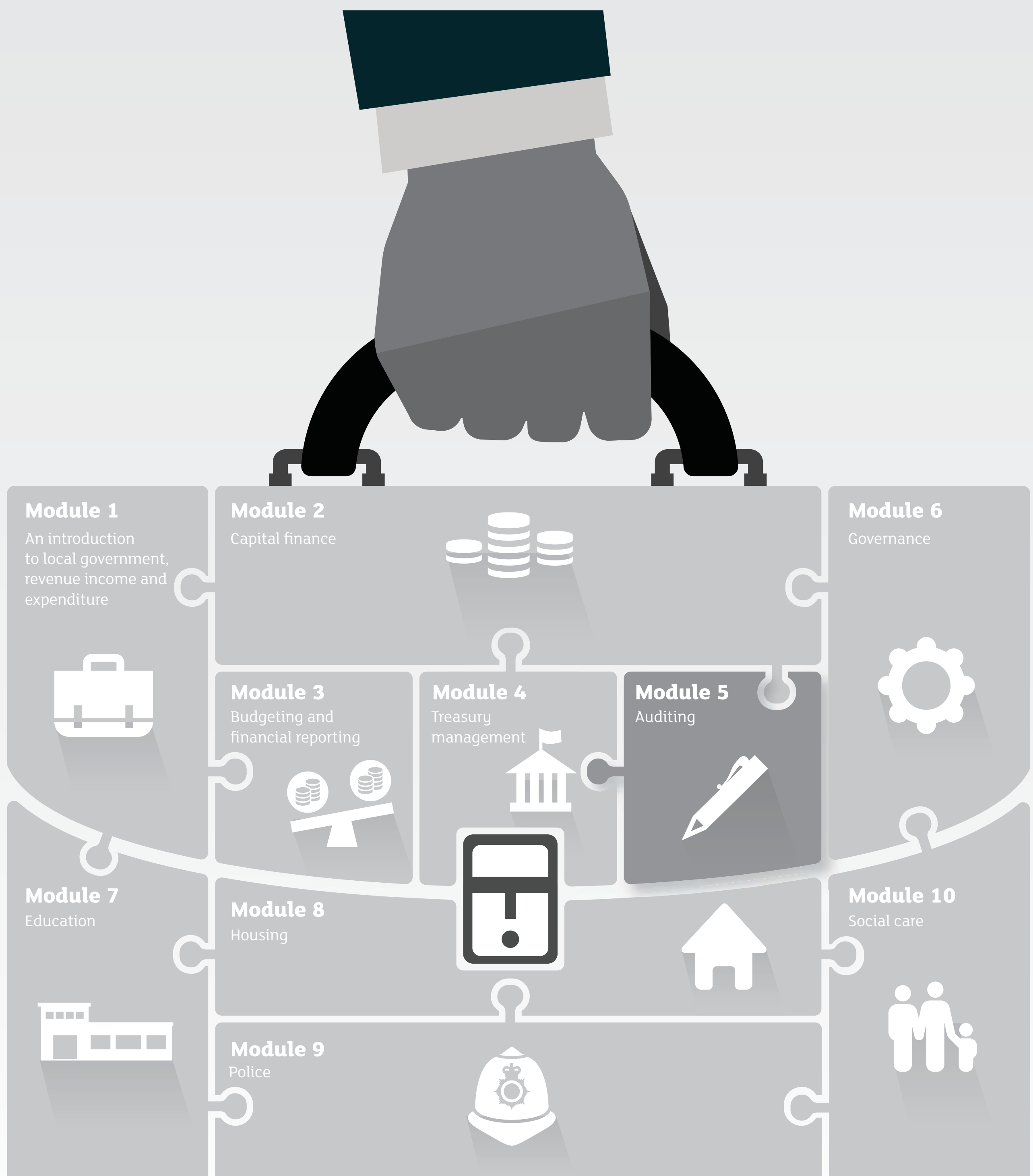
Standards of Professional Practice, CIPFA, 2002

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

In recent years there have been significant developments in 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 have been given the ability to appoint their own auditors from the 2017/18 financial year via 'auditor panels' that can be set up in different ways, including individually by councils or jointly between more than one authority. However, the majority of councils are expected to utilise the services of Public Sector Audit Appointments Ltd, the company responsible for appointing auditors to local government bodies.

Within internal audit, in 2013 the Relevant Internal Audit Standard Setters, of which CIPFA is the standard setter for local government, issued the first Public Sector Internal Audit Standards (PSIAS), 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 (CIPFA, 2013), which is mandatory for the local government sector.

The *Public Sector Internal Audit Standards* (CIPFA/IIA, 2017) were updated in 2016 to incorporate a new Mission of Internal Audit and ten Core Principles for the Professional Practice of Internal Auditing and in 2017 to include a number of new and revised Standards.

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.

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 their 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 – that is, knowing where the organisation wishes to be and being 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 authority 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".*

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, have adopted a common set of PSIAS from 1 April 2013; this was subsequently updated in 2016 and 2017. (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.) 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 (with additional requirements and interpretations as deemed necessary for the UK public sector).

The mandatory elements are:

- mission of internal audit
- definition of internal auditing
- core principles for the professional practice 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.

Mission of internal audit

To enhance and protect organisational value by providing risk-based and objective assurance, advice and insight.

Source: The Institute of Internal Auditors

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

Core principles for the professional practice of internal auditing

For an internal audit function to be considered effective, all principles should be present and operating effectively.

1. *Demonstrates integrity.*
2. *Demonstrates competence and due professional care.*
3. *Is objective and free from undue influence (independent).*
4. *Aligns with the strategies, objectives, and risks of the organisation.*
5. *Is appropriately positioned and adequately resourced.*
6. *Demonstrates quality and continuous improvement.*
7. *Communicates effectively.*
8. *Provides risk-based assurance.*
9. *Is insightful, proactive, and future-focused.*
10. *Promotes organisational improvement.*

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 require 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 include 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 (CIPFA, 2013) 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, among 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 head of internal audit 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 head of internal audit 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 head of internal audit 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.

Heads of internal audit 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 head of internal audit 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 objectives 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 head of internal audit 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 head of internal audit 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 head of internal audit opinion is the most important output from the head of internal audit. 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 head of internal audit 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 head of internal audit must express concerns where they exist.

Role and resources available to internal audit

Heads of internal audit face increasing challenges and higher expectations from stakeholders, especially in helping organisations look forward. The head of internal audit 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 position must be a senior manager.

The PSIAS require that the head of internal audit 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 head of internal audit 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 head of internal audit reporting to the chief executive or to the CFO.

The 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 head of internal audit should come from within the organisation or from the supplier of the audit service. In the latter case the relationship between the head of internal audit 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 head of internal audit should be the person who is responsible for drawing up the internal audit charter and plan and for issuing the annual internal audit opinion.

Where the level of resources available to the organisation means that the head of internal audit is required to take on additional roles and responsibilities outside of internal auditing, safeguards must be in place to limit impairments to independence or objectivity. The PSIAS say that safeguards are oversight activities, often undertaken by the audit committee, which may include such activities as periodically evaluating reporting lines and responsibilities and developing alternative processes to obtain assurance related to the areas of additional responsibility. The audit committee must approve and periodically review any safeguards put in place to limit impairments to independence and objectivity to ensure that they are appropriate and working effectively.

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 head of internal audit must also have a right of access to individual members of the leadership team and as a minimum, it is vital that they attend key meetings where they consider it necessary. The head of internal audit 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 head of internal audit'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 head of internal audit 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 head of internal audit.

The internal audit resources available must be proportionate to the size, complexity and risk profile of the organisation and must be enough for the head of internal audit 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 head of internal audit must ensure that all the work, including planning and individual assignments, is consistently of a high quality and in line with professional standards. They must also ensure that all staff demonstrate the highest ethical standards. The head of internal audit therefore has a responsibility to ensure that internal audit staff have appropriate qualifications, knowledge, skills and competencies and are continuously developed. They must assess the staffing needed to make sound judgements on the whole range of the organisation's governance arrangements and they are required by the PSIAS to inform the board if they believe 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 coalition government made transparency a key feature of its policies toward local government. We have had the requirement to publish all spending data above £500, increase disclosures on senior officer pay and promote 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 Audit and Accountability Act 2014 requires the publication of annual accounts. The Accounts and Audit Regulations 2015 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 Section 3 of the Local Audit and Accountability Act 2014 (2014 Act) (and via Section 32 of the Act in so much as this provides the powers to make regulations for the form and contents of accounts and the statements of accounts) and Section 21 of the Local Government Act 2003.

The Code of Practice on Local Authority Accounting in the United Kingdom (the Code) is defined as proper (accounting) practices under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, as amended. The Code has been based on International Financial Reporting Standards (IFRS), which was a significant development in local authority accounting from 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.

The *Service Reporting Code of Practice for Local Authorities* (S*e*RCOP) continues to be proper accounting practice under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. It defines proper practice in respect of financial reporting in government statistical and other statutory performance reporting purposes. But local authorities are no longer required to provide an analysis in the Comprehensive Income and Expenditure Statement according to the requirements of S*e*RCOP. Instead, as a consequence of the Telling the Story review of the presentation of local authority financial statements, authorities now report in their financial statements according to their operational structure.

The Accounts and Audit Regulations 2015

These regulations, made under the 2014 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. They apply to most local government organisations, including local authorities, joint authorities, police and crime commissioners and chief constables, parish and community councils, fire and rescue authorities, national parks authorities, probation committees, internal drainage boards, passenger transport executives, joint waste authorities and port health authorities. The full listing of relevant authorities that the regulations apply to is provided in Schedule 2 to the 2014 Act.

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 different depending on the size of the authority with many of the regulations split for category one and category two authorities. A category two authority is a smaller authority as defined by the 2014 Act (where the higher of the authority's gross income for the year and its gross expenditure for the year does not exceed £6.5m). A category one authority is not a smaller authority or is a smaller authority that chooses to follow a full audit under the Smaller Authorities Regulations. Accordingly, this section concentrates on the more stringent main provisions applying to category one authorities. The requirements

for parish and town councils are dealt with in the National Association of Local Councils publication Governance and Accountability for Smaller Authorities in England, last updated in March 2016.

Publication of the financial statements

The chief finance officer must prepare, sign, date and confirm that the accounts present a true and fair view of the financial position and income and expenditure of the authority at the end of the financial year. This confirmation must be provided prior to the commencement of the period of the exercise of public rights, which for 2017/18 must include the first 10 working days of June.

Following the conclusion of the period of the exercise of public rights, the signed statement of accounts then has to be considered and approved by a meeting of the authority, or one of its committees (and signed and dated by the person presiding at the committee where approval is given).

A category one authority must publish (which must include publication on an authority's website) 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.

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 period of inspection must include the first 10 working days of June. The accounts and other relevant documents are to be available for public inspection for 30 working days before the date appointed. 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 National Audit Office has prepared a note of guidance for those who wish to inspect the accounts of an authority, called Council Accounts: A Guide to Your Rights (NAO, 2015). 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 dates of the period for the exercise of public rights
- how electors can communicate to the council their wish to inspect the accounts and related documents

- the name and address of the auditor, and
- the relevant legislation that governs the inspection of accounts and objections.

If the authority does not make the accounts and supporting documents available for inspection or it does not comply with the provisions for notifying electors it risks frustrating the accounts and audit processes as defined by the regulations. 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 it wants to do so, it has to be able to prove that it is in the public interest to do so. It 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

- defining key decisions 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 the 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, 2011, 2015 and 2016), the Environmental Information Regulations 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 pre-defined 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 have also been approved by the information commissioner. 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 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.

Audit committees

Guidance from CIPFA in 2013, *Audit Committees: Practical Guidance for Local Authorities and Police Bodies* (CIPFA, 2013), 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. (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.) 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 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 independent process of commissioning of external auditors that was previously carried out by the Audit Commission. It also allows for an 'appointed person' to carry out the role on behalf of authorities themselves.

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 include parts of the NHS (for example clinical commissioning groups and special trustees for hospitals).

As existing audit contracts have been coming to an end, these local public bodies are becoming responsible for appointing their own local auditors. The first of these new contracts, for NHS bodies, began from the 2017/18 financial year; for local government, police and fire contracts will commence from the 2018/19 financial year.

Appointments must be made taking into account the advice of the authority's auditor panel. However, there is also the option for authorities to opt out of their statutory responsibility to appoint their own auditors and instead opt into the 'appointing persons approach', whereby Public Sector Audit Appointments Ltd (PSAA), as specified by the DCLG, has taken on the responsibility for sourcing and appointing auditors for those authorities who decide to use this service.

Auditor panels

In December 2015 CIPFA and the DCLG issued detailed, practical guidance on the topic of auditor panels, the Guide to Auditor Panels (CIPFA, 2015). The guide sets out the options available to local authorities in England for establishing an auditor panel; what form such a panel can take; the operation and functions of the panel; and the main task of the panel – that is, advising the authority in connection with the appointment of the local auditor.

The four main options set out in legislation for using an auditor panel are:

- Individual authorities may establish their own auditor panel.
- More than one authority may set up a joint auditor panel. This can be used to assist in procuring joint audit contracts for the authorities involved or for grouped or individual audit contracts for those authorities.
- An authority may use an existing auditor panel of another authority.
- An authority may use one of its own existing committees, such as the audit committee, to assume the role of the auditor panel.

For local authorities, and whichever auditor panel option is chosen, the Act requires at least the majority of the auditor panel members – and specifically including the chair – to be independent. 'Independence' is further defined in the Local Audit (Auditor Panel Independence) Regulations 2014 and 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
  - a partner in a firm, or
  - a 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 is included in the CIPFA/DCLG auditor panel guidance published in 2015.

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 subcommittee 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.

Auditor panels

The Local Audit and Accountability Act 2014 allows for an organisation to apply for and be specified as an 'appointing person'; that is, a body that will appoint auditors to principal local government authorities that choose to opt into its national scheme (PSAA). Invitations were sent to all principal local authorities to opt into the scheme in 2017 and, at the time of writing, 98% of eligible authorities have accepted that invitation, leaving 2% of authorities to appoint their auditors individually or jointly via an auditor panel.

PSAA has stated that it plans to award contracts to audit firms in the summer of 2017, providing six months to consult with authorities and confirm appointments before the 31 December 2017 deadline to appoint auditors for the 2018/19 financial year.

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* (NAO, 2015) published and maintained by the NAO. The Code specifies in further detail the external auditor's objectives when conducting an independent assessment of an authority.

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 NAO'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, and to help members of the public understand their rights to inspect, and 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
- 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 in England (CLA), also known as the Local Government Ombudsman (LGO), 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
- 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 Regulations 2015

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, 2016

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

Council Accounts: A Guide to Your Rights, National Audit Office, 2015

The Excellent Internal Auditor: A Good Practice Guide to Skills and Competencies, CIPFA, 2011

Guide to Auditor Panels, CIPFA and DCLG, 2015

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 Government Application Note for the United Kingdom Public Sector Internal Audit Standards, CIPFA, 2013

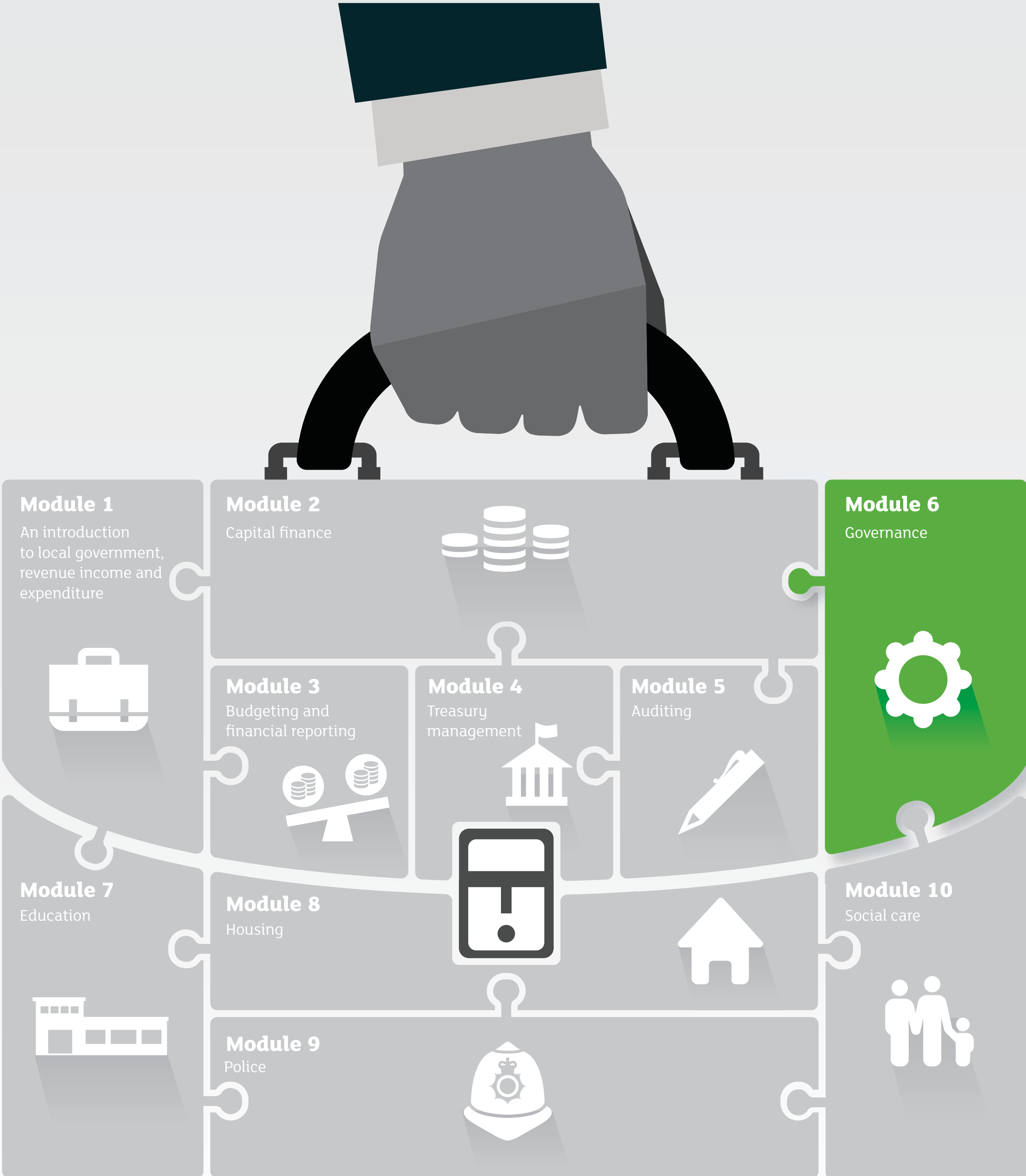
The Local Government Transparency Code, DCLG, 2015

Public Sector Internal Audit Standards, the Relevant Internal Audit Standard Setters, 2017

Service Reporting Code of Practice for Local Authorities, CIPFA, annual

MODULE 6

Governance



INTRODUCTION

Governance in public sector organisations is frequently 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 (CSPL, 2013), which gave the seven principles of public life 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.

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 association 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* (FRC, 2016) (formerly the Combined Code).

The *Good Governance Standard for Public Services* built 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.

International Framework: Good Governance in the Public Sector (CIPFA/IFAC, 2014)

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 *Good Governance Standard for the Public Services* (CIPFA/OPM, 2004) which provided the basis for all previous governance guidance, including the CIPFA/Solace Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2007).

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, and INTOSAI; 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

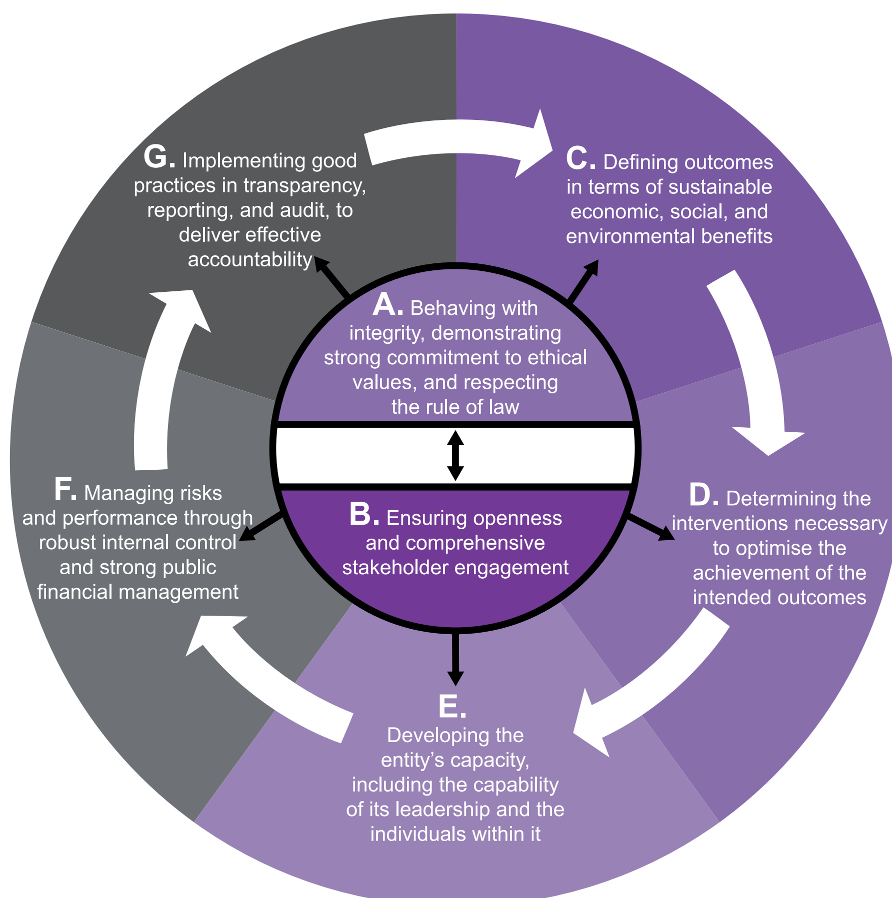
The International Framework notes that governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved. The fundamental function of good governance in the public sector is to ensure that entities achieve their intended outcomes while acting 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 diagram from the International Framework below illustrates seven core principles for good governance in the public sector and how they relate to each other. The International Framework notes that “principles A and B permeate implementation of principles C to G. The diagram also illustrates that good governance is dynamic, and that an entity as a whole should be committed to improving governance on a continuing basis through a process of evaluation and review.”

Achieving the intended outcomes while acting in the public interest at all times



Achieving the intended outcomes while acting in the public interest at all times

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, being 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.

The CIPFA/Solace *Delivering Good Governance in Local Government: Framework* and related guidance were reviewed in 2015 and revised editions were published in 2016. The International Framework formed the basis for this review (this is covered later in the module).

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 (CIPFA, 2009). 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* (2007).

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 can play in relation to good governance. It emphasises that heads of internal audit need to review the whole system of control, both financial and non-financial, and focus on the areas where assurance is most needed. The head of internal audit 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 looks at the Localism Act 2011 and how it has affected the way in which local government operates. It also briefly considers the impact of the Cities and Local Government Devolution Act 2016.

Context

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.

The Cities and Local Government Devolution Act 2016 is the latest government measure to implement the devolution programme in local government.

Local Government Act 2000

Prior to the Local Government Act 2000, local authorities could either take all decisions in full council or 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, 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.

Overview and scrutiny committees, the standards regime, code of conduct, standards committees and the regulation of standards are examined in more detail below.

Overview and scrutiny committees

The Local Government Act 2000 brought in 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 has the power to summon members of the executive and officers of the authority before it to answer questions, and is 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.

Overview and scrutiny committees may not include members of the executive and their membership should in general reflect the local authority's political balance. Each local authority must appoint a scrutiny officer although this does not have to be a dedicated post.

'External scrutiny' enables councillors to consider the influence of other bodies on policy areas of interest to the authority. Today, local authorities in England have specific powers 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 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 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
- 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.

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.

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. However 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 has 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.

Localism Act 2011

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.

The Cities and Local Government Devolution Act 2016 is the latest government measure to implement the devolution programme in local government.

Key areas

The provisions of the Localism Act 2011 relating to councils' governance include the following.

- The 'general power of competence' gives local authorities the legal capacity to do anything an individual can do that is not specifically prohibited. This general power gives local authorities greater freedom to work in partnership and develop more innovative ways of providing services.
- The government abolished the Standards Board regime in England but introduced a 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 England. 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.

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 (HM Government, 2010) 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 included in the Localism Act 2011 links with the first principle of the CIPFA/Solace Framework: “behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law”, and its supporting principles. Shared values that become integrated into the culture of an organisation and are reflected in behaviour and policy are hallmarks of good governance.

Although the Localism Act 2011 has enabled councils in England to put in place locally drawn-up codes of conduct for their elected members, the 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), 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.

Where a governance model (for example the mayor and cabinet model) has been adopted following a referendum, councils are only able to change it as a result of a further referendum supporting that change. Local people 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

The 2010 coalition government 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.

Currently, 16 local authorities have elected mayors, excluding the Mayor of London or the proposed mayors in Greater Manchester, the Liverpool City Region and other large urban areas, which are covered by separate legislation and have different powers from local authority mayors (see the section on the Cities and Local Government Devolution Act 2016 below).

Mayors do not have powers over and above those available to non-mayoral local authorities.

Power to instigate local referendums

The Local Government Act 2000 gave local electorates the right to petition for a referendum for the creation of a directly elected mayor. The Localism Act 2011 has also enabled electorates to petition to introduce a leader and cabinet system or committee system. The minimum threshold for a valid petition is 5% of the registered electorate in the local

authority's area. The referendum resulting from a valid petition must be held "no later than" the next "ordinary day of election".

Cities and Local Government Devolution Act 2016

The Local Democracy, Economic Development and Construction Act 2009 permits combined authorities to be established – a legal structure that may be set up by two or more local authorities in England. The Act permits the authorities to undertake functions related to economic development, regeneration or transport.

The Cities and Local Government Devolution Act 2016 gives combined authorities further powers to enable growth and public service reform in their areas. They are also permitted to have a directly elected mayor who will be able to exercise the functions of the police and crime commissioner for their area. The 2016 Act requires each combined authority to set up at least one overview and scrutiny committee.

The first 'devolution deal' was announced by the government and the Greater Manchester Combined Authority in November 2014, representing a new era for local government. This introduced powers for the authority to support business growth and join up budgets in health and social care and elect a metro mayor. Since then, deals with several other areas have been agreed.

Devolution deals negotiated to date have mostly involved transfer of powers over services such as business support, further education and skills funding, transport budgets and land management, with involvement in health and policing being less common.

Several directly elected mayors were established from May 2017, under 'devolution deals' agreed between the government and specific local areas. These directly elected mayors were introduced under Cities and Local Government Devolution Act 2016 orders and are distinct from mayors of local authorities in legal terms. They chair the 'combined authority' in each region and therefore cover a number of local authority areas.

The devolution agenda is driving new and rapidly evolving models of collaboration with a focus on place-based outcomes, bringing about specific challenges and issues for governance. For such arrangements, clarity of vision is crucial. It is also essential that at the negotiation stage, communities are able to understand what the objectives for devolution are and that they are consulted accordingly.

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 and 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.

The *Local Government Transparency Code* (DCLG, 2015) sets out the minimum data that local authorities should be publishing, the frequency with which 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 quarterly related to the following themes:

- expenditure over £500
- government procurement card transactions
- contract and tender information
- procurement information.

The Code also sets out information to be produced annually:

- local authority land and building assets
- social housing asset value
- grants to voluntary, community and social enterprise organisations
- organisation chart
- trade union facility time
- parking accounts and parking spaces
- senior salaries
- the constitution
- the pay multiple
- fraud
- waste contracts.

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. Local authorities often work with and through a range of organisations in order to deliver services.

Partnerships and the cross-cutting issues that they often deal with 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, and 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 authorities 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 counter fraud and corruption.

Audit committees

In 2013, CIPFA updated and published *Audit Committees: Practical Guidance for Local Authorities and Police* (CIPFA, 2013). 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.

Audit committees are a key component of an authority's governance framework. Their purpose is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance processes. By overseeing internal and external audit they make an important contribution to ensuring that effective assurance arrangements are in place.

Audit committees in local authorities satisfy the wider requirements for sound financial management. In England, under the Accounts and Audit (England) Regulations 2015 local authorities must ensure that they have a sound system of financial control and undertake an effective internal audit of risk management, control and governance processes. Section 151 of the Local Government Act 1972 requires every local authority to "make arrangements for the proper administration of [its] financial affairs".

The Cities and Local Government Devolution Act 2016 requires combined authorities to have an audit committee. Careful thought will be required regarding how they will fit with existing structures.

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 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.

CIPFA's guide to audit committees is being updated in 2017.

Local Audit and Accountability Act 2014

The Local Audit and Accountability Act 2014 requires that local authorities in England must appoint their own auditors from 2018 when their existing audit contracts expire. The new arrangements include the ability of authorities to appoint their own local public auditors on the advice of an auditor panel and this may be done either individually or jointly with one or more other authorities.

Authorities are permitted to share an auditor panel and are also able to designate an existing committee such as the audit committee or standards committee as an auditor panel. Authorities will need to consider carefully the advantages and disadvantages of the options available to them in setting up an independent auditor panel. Where an independent auditor panel is established and an audit committee already exists, the authority or authorities will need to look at the areas where the functions of an independent auditor panel and audit committee will overlap and how they will be managed.

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. Elections to councils are held on the first Thursday in May in any given 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.

The number of councillors for each council is decided by the independent Local Government Boundary Commission for England.

Community governance reviews

District councils and unitary councils in England have the power to carry out community governance reviews and establish or amend local community (parish) governance arrangements.

The Local Government Boundary Commission for England (LGBCE) has responsibility for making any related alterations to district ward or county division boundaries following a parish boundary change. A review can consider a number of issues, including:

- creation of a new parish
- alteration to the boundary of an existing parish
- grouping a number of parishes together in a grouped parish council.

Local people can petition a council to carry out a community governance review. The council must undertake a review if the relevant petition conditions are met. The principal authority sets the terms of reference for any review and must also consult when considering changes.

The LGBCE is responsible for changing the ward or division boundaries following a community governance review. These are called 'consequential changes'.

The LGBCE publishes relevant guidance.

GOOD GOVERNANCE IN LOCAL GOVERNMENT

This section looks at the CIPFA/Solace Delivering Good Governance in Local Government: Framework which sets the standard for governance in UK local authorities.

Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2007)

The main concept underpinning the development of the first CIPFA/Solace Framework, published in 2001, was that local government was shaping its own approach to good governance. This concept remained key to the revised Framework and guidance published in 2007. The Framework built on governance work in both the public and the private sector and in particular The Good Governance Standard for Public Services (CIPFA/OPM, 2004).

The six core principles from *The Good Governance Standard for Public Services* were adapted for the local government context. The principle of leadership was expanded to emphasise the role of authorities in 'leading' their communities and greater emphasis was placed on scrutiny and overview. The principles were also developed to take greater account of the political regime in which councils operate.

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.

For the purpose of the addendum, the example annual governance statement 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 (England) Regulations 2011, which requires all relevant bodies to prepare an annual governance statement rather than a statement on internal control. It also reflected other key changes including conformance with the *CIPFA Statement on the Role of the Chief Financial Officer in Local Government*. For further detail see the 'Role of the Chief Financial Officer' section below.

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 were incorporated into the revised guidance note.

Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2016)

The Framework and guidance were reviewed in 2015 and a new Framework and guidance were published in 2016.

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 core principles and sub-principles set out in the new Framework are taken from the International Framework: Good Governance in the Public Sector (CIPFA/IFAC, 2014). In turn, they have been interpreted for a local government context.

The core principles are as follows; full details and sub-principles are set out in the Framework.

- Acting in the public interest requires a commitment to and effective arrangements for:
  a) behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law
  b) ensuring openness and comprehensive stakeholder engagement.
- In addition to the overarching requirements for acting in the public interest in principles A and B, achieving good governance in local government also requires effective arrangements for:
  c) defining outcomes in terms of sustainable economic, social, and environmental benefits
  d) determining the interventions necessary to optimise the achievement of the intended outcomes
  e) developing the entity's capacity, including the capability of its leadership and the individuals within it
  f) managing risks and performance through robust internal control and strong public financial management
  g) implementing good practices in transparency, reporting, and audit to deliver effective accountability.

Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2016) positions the attainment of sustainable economic, societal and environmental outcomes as a key focus of governance processes and structures. Outcomes are what give the role of local government its meaning and importance, and it is fitting that they have this central role in the sector's governance.

Also, the focus on sustainability and the links between governance and public financial management are crucial – local authorities must recognise the need to focus on the long

term. They have responsibilities to more than their current electors; they must take account of the impact of current decisions and actions on future generations.

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.

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 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.

Politically restricted posts

Certain council employees in positions of seniority or influence, such as the chief executive and the chief financial officer, 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.

CIPFA Statement

CIPFA's *Statement on the Role of the CFO in Local Government* (CIPFA, 2016) describes the role and responsibilities of CFOs in local government. It builds heavily on CIPFA's *Statement on the Role of the CFO in Public Service Organisations* and applies the principles and roles set out in that document to local government.

The statement sets out five principles that define the core activities and behaviours of the role of the chief financial officer 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.

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 that 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. is 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, that 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, and 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
  - 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 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.
- Evaluating the financial implications of alternative delivery vehicles.
- Appraising and advising on commercial opportunities and financial targets.
- Developing and maintaining an effective resource allocation model to deliver business priorities.
- Developing an approach for the delivery of collaborative services within a structured framework.
- Leading on asset and balance sheet management to allow the authority to maximise its effective use of resources.
- Co-ordinating the planning and budgeting processes.
- Involvement in strategic asset management.

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 make 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 linked to related performance information and strategic objectives, which identifies any necessary corrective decisions.

- Preparing timely management accounts.
- Ensuring the reporting envelope reflects partnerships and other arrangements to give an overall picture.
- Monitoring the service impact of third party contacts on the delivery of organisational objectives.
- Monitoring the longer-term financial impact of third party contracts.

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.
- Ensuring effective monitoring of partnerships through monitoring and access to information.

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 or being clear on the reasons for alternative selection.
- 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.
- 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 Code of Practice on Local Authority Accounting in the United Kingdom.
- 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; and 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.
- Being alert to potential conflicts of interest and ensuring the authority has access to appropriate independent advice.

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, and that they meet the requirements of the law, financial reporting standards and professional standards as reflected in CIPFA's *Code of Practice.*
- 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.
- Managing partnership delivery.
- 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.
- Ensuring that finance staff, managers and the leadership team are equipped with the financial competencies and expertise needed to manage the business both currently and in the future whether directly or indirectly employed.
- 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.

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.

Qualifications

Section 113 of the Local Government Finance Act 1988 requires the officer appointed under Section 151 of the 1972 Act to be a member of one of six recognised chartered accountancy bodies in the UK 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 of the Local Government Finance Act 1988

The responsible officer under Section 151 of the 1972 Act had his or her duties significantly extended by Section 114 of the 1988 Act which requires a report to all the authority's

members to be made by that officer, in consultation with the council's monitoring officer, if there is, or is likely to be, unlawful expenditure or an unbalanced budget.

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.

A copy of that report must be sent to every member of the authority and to the authority's external auditor.

The council must meet to consider a report within 21 days after the report is dispatched and decide whether it agrees or disagrees with the view in the report and what action it proposes to take.

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.

Regulations under the Local Government Act 2000 amended Section 114 for authorities in England operating executive arrangements. In those cases such reports are submitted to full council in respect of non-executive functions and to the executive for executive functions. If the unlawful expenditure relates to actions undertaken by the executive then under Sections 114A and 115B, the CFO's report must be submitted to the executive. Copies must also be sent to all members of the authority and the external auditor.

No action should be carried out until the executive has considered the report. The executive must then provide a report to the authority, the CFO and the external auditor, explaining what action, if any, is to be taken and the reasons.

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.

Appendix A to the CIPFA *Statement on the Role of the Chief Financial Officer in Local Government* provides further detail on relevant legislation and contains a flowchart for Section 114 procedures under the Local Government Finance Act 1988.

Relationship of the CFO with elected members

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 *CIPFA Statement on the Role of the Chief Financial Officer in Local Government* says that councils should ensure that governance arrangements allow the CFO to report directly to the chief executive and that the CFO must work to develop strong and constructive working relationships with both the executive and non-executive members of the authority's leadership.

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.

The Local Authorities (Standing Orders) (England) (Amendment) Regulations 2015 set out key elements of the process for the dismissal of a head of paid service, monitoring officer or chief finance officer on the grounds of misconduct. Dismissal must be approved by a vote at a meeting of the authority, provided that they have considered:

- the advice and views of a panel established according to the Regulations
- the conclusions of any investigation into the proposed dismissal
- any representations from officers concerned.

Relationship of the CFO with other officers

Local authorities operate a number of different democratic models. In local authorities, therefore, the concept of the leadership team will include executive committees, elected mayors, portfolio holders with delegated powers and other key committees of the authority. The *CIPFA Statement on the Role of the Chief Financial Officer in Local Government* makes it clear that the CFO should play a key role within these leadership teams while balancing their responsibility to advise all members.

The governance requirements in the statement are that the CFO should be professionally qualified, report directly to the chief executive and be a member of the leadership team, with a status at least equivalent to other members. The statement requires that if different organisational arrangements are adopted the reasons should be explained publicly in the authority's annual governance statement, together with an explanation of how these arrangements deliver the same impact.

A close working relationship with the chief executive and all other chief officers is therefore necessary. The statutory guidance issued by the secretary of state under the Local Government Act 2000 advises that local authorities will need to ensure that the CFO and the monitoring officer have access as necessary to meetings and papers and that members must consult with him or her regularly. The CFO must be able to advise the leadership team directly, including elected representatives, in order to discharge responsibilities in relation to the authority's financial health and long-term viability.

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. The CFO has an important role in ensuring necessary financial information and advice is provided to the leadership team and decision makers at all levels across the authority.

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. CIPFA has issued standards covering:

- ethics (see the section on 'ethical standards' below)
- auditing
- financial reporting
- tax management
- treasury management
- budgetary planning and control
- financial transactions management
- suspected fraud and corruption
- continuing professional development (CPD).

Participation in CIPFA's CPD scheme is mandatory for all CIPFA qualified members. CPD guidelines are set out in Investing in Your Future: Continuing Professional Development (CIPFA, 2013). 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.

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 adopted its *Standard of Professional Practice on Ethics* (SoPP) in May 2006 with a further update in 2011. The SoPP applies to all CIPFA members and students. It 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:

- 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 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: A Guide to the CIPFA Standard of Professional Practice on Ethics (CIPFA, 2011).

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.

CIPFA is updating its SoPP in 2017.

FURTHER READING

Audit Committees: Practical Guidance for Local Authorities and Police, CIPFA, 2013

CIPFA Statement on the Role of the Chief Financial Officer in Local Government, CIPFA, 2016

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

Cities and Local Government Devolution Act 2016

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

Code of Practice on Managing the Risk of Fraud and Corruption, CIPFA, 2014

Delivering Good Governance in Local Government: Framework, CIPFA, 2016

Delivering Good Governance in Local Government: Guidance Notes for English Authorities, CIPFA, 2016

Ethics and You: A Guide to the CIPFA Standard of Professional Practice on Ethics, CIPFA, 2011

Guidance on Community Governance Reviews, DCLG/Local Government Boundary Commission for England, 2010

International Framework: Good Governance in the Public Sector, CIPFA/IFAC, 2014

Local Audit and Accountability Act 2014

Local Government Act 2000

Local Government Transparency Code, DCLG, regularly updated

Localism Act 2011

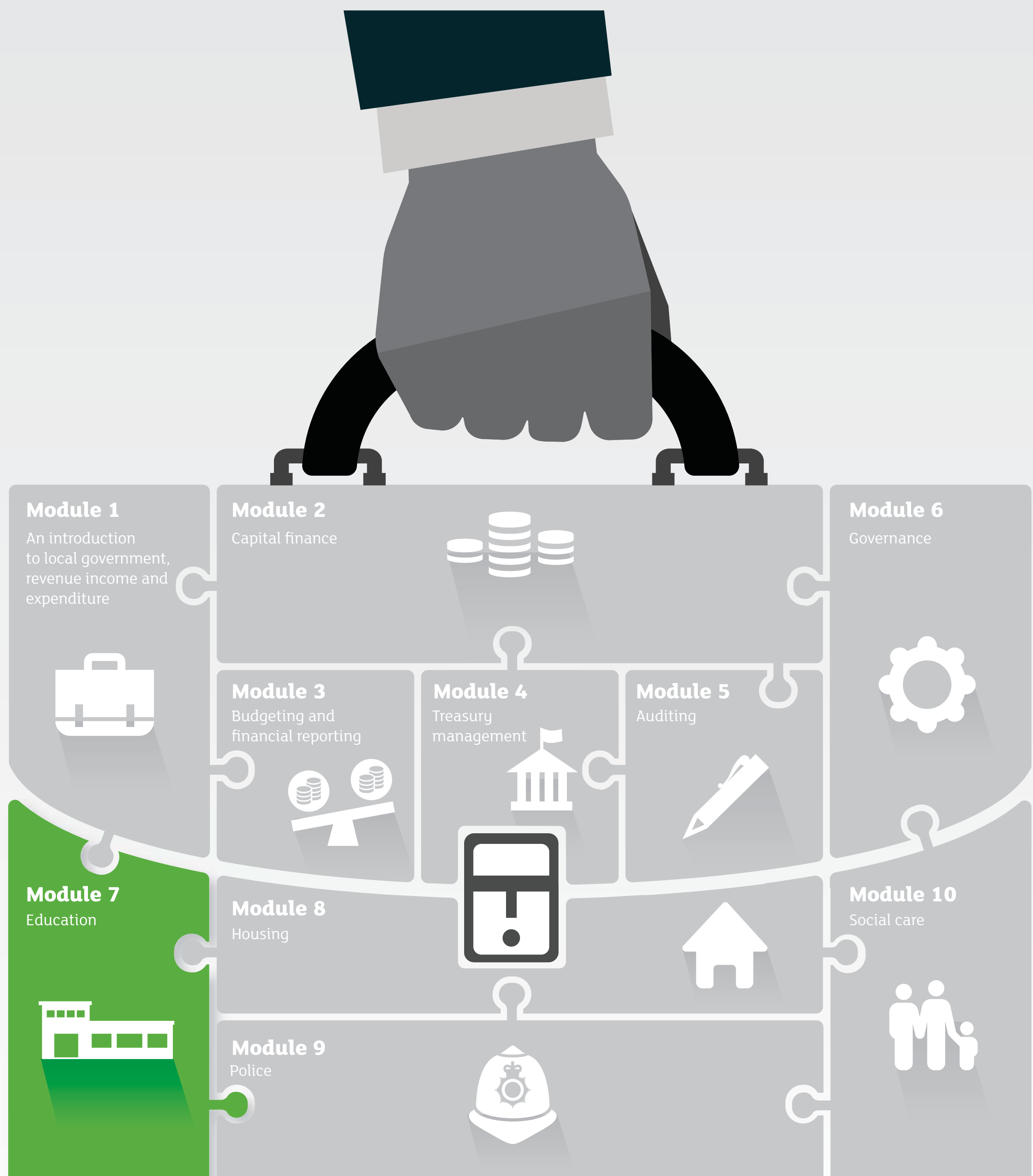
Overview and Scrutiny in Local Government, Briefing Paper Number 06520, House of Commons Library, 2016

Standard of Professional Practice on Ethics, CIPFA, 2011

Standards Matter: A Review of Best Practice in Promoting Behaviour in Public Life, Committee on Standards in Public Life, 2013

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 continued through and into the 2017 election with policy initiatives proposing a new funding formula. This module looks at education finance in the national context and describes the many significant changes that recent governments have put in place. The module also covers the legal framework and how schools are funded. 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 IN ENGLAND

Education is provided in England by the following:

Local authority funded schools

Local authorities fund four main types of school:

- community schools that are not influenced by religious or business groups
- voluntary aided schools
- voluntary controlled schools
- foundation schools.

In England in January 2016 (National Statistics – Schools, pupils and their characteristics: January 2016 (DfE)) numbers of primary schools were:

- 7,792 community schools
- 3,133 voluntary aided schools
- 2,152 voluntary controlled schools
- 693 foundation schools.

Numbers of secondary schools were:

- 594 community schools
- 282 voluntary aided schools
- 45 voluntary controlled schools
- 272 foundation schools.

Approximately 3.7 million primary school pupils and 1.1 million secondary school pupils were educated in these schools.

Academies

Many schools have converted or are considering converting to academy status.

Academies are funded directly by the government through the Education & Skills Funding Agency (ESFA), 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 2016, excluding free schools there were 2,891 primary, 1,994 secondary and 165 special academies; there were also 77 alternative provision academies – a total of 5,127 academies.

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.

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. They can be 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 January 2016 there were 117 primary free schools, 135 secondary free schools and 19 special free schools.

Free schools include university technical colleges and studio schools:

- In January 2016 there were 39 **university technical colleges (UTCs)**. These are technical schools for 14- to 19-year-olds working with employers and universities. The university supports the curriculum development of the UTC, provides professional development opportunities for teachers, and guides suitably qualified students to foundation and full degrees. The sponsor university appoints the majority of the UTC's governors and key members of staff.
- In January 2016 there were 37 **studio schools**. The studio school seeks to address the gap between the skills and knowledge that young people require to succeed, and those that the current education system provides. They pioneer an approach to learning which includes teaching through enterprise projects and real work.

In January 2016, 3,022,677 pupils attended academies, free schools, university technical colleges and studio schools.

EDUCATION SPENDING

Education remains a key priority for the government. Following the outcome of the spending review in November 2015, the government announced that the core schools budget would be protected in real terms over the course of the Parliament – protecting the cash per pupil funding within the Dedicated Schools Grant and pupil premium rates for the most disadvantaged children. £23bn would be invested in school buildings, creating 600,000 extra school places and 500 free schools. In the March 2017 Budget, the Chancellor confirmed a one-off payment of £320m for 140 new free schools, on top of the 500 already pledged to be created by 2020 and an additional £216m to rebuild and refurbish existing schools.

Education continues to be the biggest, but reducing, local government service, with budgeted revenue expenditure of £34bn in England in 2016/17. This figure excludes expenditure on academies, which are funded directly by the DfE via the ESFA. Education accounted

for around 31% of total spending on all local government services, comparable with the combined spending on social care and police. Within the total, the breakdown between categories of schools is as follows.

Education services: budgeted expenditure 2016/17

	Net current expenditure
Education services	**£m**
Early years	2,825
Primary schools	16,983
Secondary schools	7,601
Special schools and alternative provision	3,298
Post-16 provision	506
Other education and community budget	2,998
Total education services	34,211

Note: figures exclude academies as these are funded directly from central government

Source: Local Authority Revenue Expenditure and Financing: England 2016 to 2017 Budget (DCLG, June 2016)

LEGAL FRAMEWORK – KEY MILESTONES

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 are as follows:

- 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 [No. 2] Act 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 was to cover 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 was intended to cover functions such as home-to-school transport. 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'.

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 could successfully apply to convert to academy status. Academies are publicly funded independent schools. They are outside local authority control, can set their own pay and

conditions for staff, have freedoms around the delivery of the curriculum and 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 comply fully 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.

Currently, 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.

Education Act 2011

The Education Act 2011:

- provided for a new entitlement for disadvantaged two-year-olds to 15 hours' free early years education
- replaced independent appeals panels for exclusions with independent review panels
- removed the duty on councils to appoint a school improvement partner for every school
- gave 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
- extended the secretary of state's powers to intervene in underperforming schools
- provided 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 are now made to the secretary of state
- allowed for pilots of direct payments for SEN education services

- made changes to local authority powers over sixth form colleges
- provided 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).

Children and Families Act 2014

A Green Paper, Support and Aspiration: A New Approach to Special Educational Needs and Disability – A Consultation (DfE, 2011), was published in April 2011. The Green Paper made wide-ranging proposals to reform radically the 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 set out the next steps in taking forward the Green Paper reforms.

The Children and Families Act 2014 progressed the programme set out in the previous 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.

Educational Excellence Everywhere (DfE, March 2016)

The White Paper issued in March 2016 set out the government's plans for the next five years, building on and extending reforms aimed at achieving educational excellence everywhere. The main proposals included:

- investment to strengthen school leadership
- curriculum developments
- emphasis on the English Baccalaureate
- funding reform (national funding formula)
- changing the legal framework (ultimately all schools should become academies)
- extending the free schools programme
- recruiting more academy sponsors
- encouraging a greater volume of multi-academy trusts with ten to 15 schools
- capital funding to be made available for expansion of provision and for new schools
- speeding up of academy conversions with proposals for land transfer.

However, in October 2016, the government announced that it would then not attempt to implement measures announced in the Queen's Speech and outlined in the White Paper.

Schools that Work for Everyone

The government issued the consultation document Schools that Work for Everyone in September 2016. The proposals include:

- expecting independent schools to support existing state schools, open new state schools or offer funded places to children whose families can't afford to pay fees
- asking universities to commit to sponsoring or setting up new schools in exchange for the ability to charge higher fees
- allowing existing selective schools to expand and new selective schools to open, while making sure they support non-selective schools
- allowing new faith free schools to select up to 100% of pupils based on their faith, while making sure they include pupils from different backgrounds.

EDUCATION REVENUE EXPENDITURE AND REVENUE FUNDING

For councils, the main source of funding for revenue spending on education is formula grant from central government. There is also a smaller proportion of income from fees and charges.

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 Dedicated Schools Grant (DSG). DSG is paid to local authorities less deductions (recoupment) for academies and is subject to other adjustments. The grant must be used in support of the schools budget and the authority's chief financial officer is required to confirm at year end that this has happened.

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 (the largest block at 80% of DSG)
- high needs block (13% of DSG)
- early years block (7% of DSG).

Schools block

The schools block covers core education provided by mainstream primary and secondary schools up to age 16. 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 other costs is referred to as 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.

All delegated funding may be spent on anything required for the purposes of the school. Schools therefore make their own decisions on how much to spend on staff, premises maintenance, etc, in order to fulfil their duties to current and future pupils effectively. The ESFA calculates the academies' share of the individual schools budget and recoups this from the authority. This funding is then paid to academy trusts in the form of the general annual grant (GAG).

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 2017 to 2018 (EFA, 2016).

High needs block

High needs funding supports individuals with special educational needs (SEN) in a range of settings. It is also intended to provide support for pupils who cannot be educated in schools. The high needs funding system has two main components:

- core funding – included in school budgets
- top-up funding – reflecting the additional support costs relating to individual pupils and students, in excess of core funding.

Early years block

The early years block comprises:

- funding for the three and four year old entitlement to 15 hours of free education
- participation funding for disadvantaged two year olds
- the early years pupil premium.

Central expenditure

Authorities may deduct funds from their schools budget for purposes set out in regulations made by the secretary of state. The school finance regulations specify the kinds of activities a council can fund from, and the costs it can incur in, its central expenditure. The local authority, in consultation with the schools forum, determines any funding to be retained centrally. The schools forum is a statutory body and must have representatives from local schools as members.

Pupil premium

The pupil premium aims to provide significant funding for disadvantaged children to help close the attainment gap. 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.

For 2017/18 schools attract £1,320 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).

Review of school funding

Background

Reform of school funding has been on the government’s agenda for some time and key consultations are outlined below. Before the 2017 election the government was proposing the phased introduction of a new national funding formula from 2018/19. Owing to historical differences in funding, the average amount per pupil funding varied considerably between authorities. A key determinant of how much a local authority received per pupil in its schools block was how much it had received in previous years.

In addition, local authorities are responsible for allocating individual schools budget to individual schools in accordance with their local schools funding formula. The local authority

is required to maintain a single formula for funding both maintained schools and academies in its area taking account of their circumstances. Local funding formulae have to use certain factors such as minimum pupil amounts for primary and secondary pupils and deprivation and can use optional factors such as prior attainment. The formula must allocate at least 80% of funding through pupil-led factors (single per-pupil amount, social deprivation, prior attainment, English as an additional language, pupil mobility, looked after children, differential salaries of teachers near London). Overall this means that local authorities give different weights to different factors.

The local authority, in consultation with the local schools forum, determines the overall individual schools budget for schools.

The wider funding context

The NAO report Financial Sustainability of Schools (December 2016) noted that the DfE's overall schools budget, although protected in real terms, did not provide for funding per pupil to increase in line with inflation. Without additional funding, mainstream schools in England would therefore be required to make £3bn of savings by 2019/20 to withstand cost increases. This is partly because pupil numbers will rise significantly during this period, and partly because schools are facing major cost pressures from, for example, increased pension and national insurance contributions and inflation.

Consultations

In April 2011, the DfE published a consultation on reforming the funding formula, A Consultation on School Funding Reform: 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 fair 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 would work towards introducing a national funding formula in the next spending review period. As part of the 2013 spending round, 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 was 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 and allocated additional funding of £350m to the "least fairly funded" local authorities for 2015/16.

Approach for 2015/16 and 2016/17

Following the above consultation and the government's response, the DfE published Fairer Schools Funding: Arrangements for 2015 to 2016 in July 2014. This set out a number of reforms for the schools funding system for 2015/16. The main proposals included:

- all local authorities to be funded to at least the same cash level as in 2014/15
- an additional £390m (rather than £350m announced earlier) to fund schools in the least fairly funded authorities.

The additional funding meant that each local area's allocation of funding reflected a minimum basic per-pupil amount, and amounts reflecting other pupil and school characteristics.

For 2016/17, the 'fairer schools funding' was rolled forward. Allocations for the schools block have been calculated largely on the basis of how much an area received per pupil with some adjustments. The £390m fairer schools funding has been continued. The core schools budget has continued to be protected and per-pupil funding together with the pupil premium maintained in cash terms.

The school budget share is protected by a minimum funding guarantee. This means per-pupil funding will not fall by more than 1.5% compared with the previous year. The minimum funding guarantee calculation excludes funding for sixth forms and places in special units.

For 2016/17, as in previous years, a cash floor of minus 2% was applied to the DSG allocations, to protect local authorities with significant falling rolls. For 2016/17 there were 14 factors that local authorities could use in their local funding formulae.

Consultations in 2016 on schools national funding formula

In March 2016, the government issued a consultation document to start the process for introducing a national funding formula from 2017 to 2018 – Schools National Funding Formula: Government Consultation – Stage One.

This represented an important move towards a system where school funding is allocated on a consistent national formula. As part of this, local authorities would receive funding to help with their responsibilities towards young people with high-level special educational needs on a fair and formulaic basis, so that no pupil is disadvantaged simply by where they live.

The proposals were intended to ensure that:

- every school and local area is funded fairly according to need rather than on a historical basis, therefore areas with the highest need would attract the most funding
- funding goes straight to the front line – the current school funding system relies on local authorities determining how much funding schools are allocated. A single national funding formula for schools would remove the role of the local authority, so pupils with

similar needs will attract the same level of funding to their school, and this would also give headteachers far more certainty over future budgets.

The consultation proposed that several factors should be used to allocate core schools funding. They included:

- basic per-pupil funding – a core allocation for the costs of teaching all pupils
- funding for additional needs – including deprivation, low prior attainment and English as an additional language
- school costs – including fixed costs and costs relating to rural schools
- area costs – so that funding goes to areas facing the highest costs.

The government also announced that there would be a parallel consultation on a national funding formula for early years funding and this was issued in August 2016.

In December 2016 the government issued the next stage of consultation, National Funding Formula – Stage 2 Consultation, which looked at weighting factors and the impact of the funding formulae across schools and local authorities. The government confirmed its intention to introduce a 'soft' national funding formula from 2018/19 – the national funding formula would be used to calculate local authorities' allocations, but they would then apply their own local formula for distribution purposes to schools. A 'hard' formula would apply in 2019/20. This means the national formula will be used to allocate most of schools' funding. Also proposed was the intention to limit gains and losses in both years. It is envisaged that the factors included in the first consultation would be used with an additional one for mobility in response to comments.

The consultation also proposed the creation of a 'central school services block' within the DSG to support the ongoing role of local authorities in education. This will be created from two funding streams – the schools block and the Education Services Grant (ESG) (this is covered more fully below). The central school services block will fund services previously supported by ESG and those funded centrally through DSG.

Approach for 2017/18

For 2017/18, the government announced before the election that local authority funding will be maintained at 2016/17 levels (adjusted to reflect local authorities' most recent spending patterns) for the schools block and the high needs block. The minimum funding guarantee for schools would be retained so that no school can face a funding reduction of more than 1.5% per pupil in what it receives through the local authority funding formula.

The list of allowable funding factors remained the same for 2017/18 with the exception of the post-16 factor which has been removed. Local authorities were encouraged to move their local formulae towards the proposed national funding formula so that their schools allocations in 2018/19 were on a logical trajectory for the longer term.

High needs funding reform

In March 2016, the government also consulted on proposals for reform to high needs funding based on a core set of principles. The first stage covers high level principles, key proposals

and options to improve the way that high needs funding is allocated to local authorities. The proposals are aimed at ensuring the system:

- supports opportunity to help all pupils to achieve their potential
- is fair – allocating funding on the basis of objective measures regarding needs and pupil characteristics
- is efficient
- gets funding straight to schools, maximising the resources available for teaching and learning
- is transparent – easily understood and justified
- is simple
- is predictable to enable planning for year-on-year changes.

The high needs proposals are:

- to introduce a national funding formula for high needs
- to use factors in the formula including population, health, disability, low attainment and deprivation
- to continue to allocate funding to local authorities for high needs, but on a formula basis
- to ensure stability by retaining a significant element of funding based on what local authorities are currently spending, and capping the gains and losses of local authorities each year
- to provide financial and practical help to authorities to assist them in reshaping their provision, including capital funding for new specialist places and new special free schools.

The second stage of the consultation process in relation to high needs was also issued in December 2016. This consultation proposed that:

- around half of high needs funding will be allocated according to historic spending patterns
- the rest should be allocated according to a national formula
- funding floor should ensure that the implementation of the formula did not result in any authority losing funding.

Education Services Grant

The Education Services Grant (ESG) is paid to local authorities and to academies to fund education support services such as school improvement and welfare services. The November 2015 Spending Review announced that savings of around £600m would be made via cuts to the ESG. The ESG will be replaced from September 2017 by grant funding for local authorities' and academies' statutory education duties. Therefore, transitional 2017/18 ESG funding will be allocated to cover the period up to August 2017. This funding will then be removed and a smaller element of funding for ESG duties will be paid through the schools block of DSG.

Income from fees and charges

Income from fees and charges remains a very small proportion of total funding for children's services, but fees and charges can 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 group of clients that pay fees and charges for council services but academies can choose other suppliers if they wish. Academies themselves can provide services (such as behaviour support) which the council would normally provide to a maintained school. 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 market environment will bear.

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, Partnerships 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.

Priority School Building Programme

In response to the James review, the coalition government set up the Priority School Building Programme (PSBP) in 2011. The £4.4bn PSBP is a centrally managed programme set up to address the needs of the schools most in need of urgent repair.

Under the first phase, 260 schools are being rebuilt and refurbished. The first phase is scheduled for completion by the end of 2017. Under the second phase, known as PSBP2, 277 individual school blocks are being rebuilt and refurbished. This is a five year programme operating between 2015 and 2021.

Capital spending 2015 to 2018

On 9 February 2015, the DfE announced indicative allocations for school condition funding for the three-year period covering financial years 2015/16 to 2017/18. These allocations are based on a new approach involving:

- direct funding for individual institutions through **devolved formula capital**
- funding for those bodies responsible for individual institutions through the **school condition allocations**
- access to funding via the **Condition Improvement Fund** for those academies and sixth form colleges not eligible to receive direct school condition allocations.

Further detail on each element is set out below.

The devolved formula capital (DFC) budget is currently approximately £200m per year. 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, sixth form colleges and non-maintained special schools. It is also allocated to specialist post-16 institutions that have eligible state-funded pupils.

The calculation of DFC uses a per school sum of £4,000 and a per-pupil sum that varies. For example, 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 percent of the DFC allocation is provided by the DfE for voluntary aided schools; the governing body is required to raise the additional 10%.

School condition allocations are made to those bodies responsible for the maintenance of buildings – organisations responsible for large numbers of schools, such as local authorities and large multi-academy trusts (referred to as ‘responsible bodies’). The budget for school condition allocations is set at £1.2bn a year until 2017/18. Responsible bodies received a fixed allocation for 2015/16, which was indicative of their second and third year allocations.

There are three elements to these allocations:

- **core condition funding** based on pupil numbers
- **high condition needs funding** for those with disproportionately high needs
- **floor protections** to provide some stability in the transition to the new system.

Condition Improvement Fund

The DfE provides a Condition Improvement Fund for smaller multi-academy trusts, single academy trusts and sixth form colleges. This is a bid-based funding stream through which these institutions can access condition funding. The budget for the fund is approximately £458m for 2017/18.

Basic need capital funding for local school places

Local authorities receive basic need capital allocations to support the capital requirement for providing new pupil places by expanding existing maintained schools, free schools or academies, and by establishing new schools. Basic need funding helps local authorities to fulfil their duty to make sure there are enough school places for children in their local area.

The most recent allocations to local authorities were made in April 2017, covering allocations for 2019/20. This funding is aimed at allowing local authorities to create the new school places they will need by September 2020. £980m has been provided and is allocated mainly on data collected from local authorities in the 2016 School Capacity Survey (SCAP). The basis for this is a comparison of forecast pupil numbers with school capacity, with shortfalls in capacity attracting funding.

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.

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 for Capital Finance in Local Authorities* (CIPFA, 2011). 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

One of the most significant changes introduced by the coalition government and continued with the current government is the move to increase significantly the number of academy schools and encourage free schools. In January 2016 there were 5,127 academies and 271

free schools. 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 – changes 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.

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 raised the participation age to 18 in 2015.

The EFSA has responsibility for funding post-16 learning.

Raising the participation age does not mean young people must stay in school; they are 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.

For this to be successful, all sections of the education system need to play their part. Councils have a key role to play in championing the needs of young people in their areas and in working with local partners to achieve full participation.

Managing surplus school balances

Balance control arrangements for schools' balances are included within each council's scheme for financing schools. Issue 8 of statutory guidance from the DfE for local authorities on schemes for financing schools (December 2015) 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

The schools financial value standard (SFVS) helps schools in managing their finances and gives authorities 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 CRC Energy Efficiency Scheme

The CRC Energy Efficiency Scheme (formerly known as the Carbon Reduction Commitment Energy Efficiency Scheme) covers large non-energy intensive organisations such as local authorities and central government departments. It is a mandatory reporting and pricing 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.

Schools were removed from the main scheme following the Department of Energy and Climate Change's consultation in 2012. A deduction was made from each local authority's DSG allocation, based on the budget cost included on the 2013/14 Section 251 budget statement. As schools are not covered by the scheme from 2014/15, these figures will not be updated. For 2015/16, a deduction of £7.51 per pupil was made to DSG allocations. The overall deduction was £51m (the same as in 2014/15). This is a baselining operation and the government does not expect to make any further changes in subsequent years.

Schools forums

Schools forums are established by local authorities to represent schools' views to the council. The forum acts as a consultative body on some issues and a decision-making body on others. In March 2015 the government updated its operational and good practice guidance which supports schools forums in line with the provisions of the Schools Forums (England) Regulations 2012 (as amended). The schools forum is made up of representatives from schools and academies, but with some representation from other non-school organisations, such as early years private, voluntary and independent providers (PVIs) 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
- financial issues relating to arrangements for pupils with special educational needs, in pupil referral units and in early years provision.

The forum is responsible for decisions such as:

- 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 to be funded from the schools budget
- proposals to de-delegate funding from maintained primary and secondary schools (eg for staff supply cover)
- approving changes to the scheme of financial management (school members only).

Financial reporting requirements

Section 251 of the Apprenticeships, Skills, Children and Learning Act 2009 requires local authorities to submit statements about their planned and actual expenditure on education and children's social care to the DfE.

The Section 251 budget data statements are the primary means of informing schools and the public in general about local authority funding and expenditure plans. The statements provide detailed information on each authority's planned expenditure for its schools, including spending on early years, high needs and post-16. Authorities must also provide details of their children and young people's services budget. The format permits benchmarking by schools forums and authorities.

Authorities provide details of actual expenditure in the Section 251 outturn tables.

The consistent financial reporting (CFR) framework provides a standard template for schools to collect information about their income and expenditure by financial years. Maintained schools provide this information to their local authorities in a financial statement each year.

The Consistent Financial Reporting (England) Regulations 2012 set out the approved headings to be included in the financial statements and guidance provides definitions for each CFR code set out in the regulations.

Financial statements include:

- school resources received in a financial year, including any unspent at the end of the previous year
- the application of any school resources
- a summary of the school's financial position at the end of the year.

The information enables governors and local authorities to produce reports and can be used for benchmarking purposes.

FURTHER READING

Condition Funding Methodology for 2015 to 2018: Updated Explanatory Note for the 2017 to 2018 Allocations, DfE, 2017

The Consistent Financial Reporting (England) Regulations 2012

Consistent Financial Reporting Framework: 2017 to 2018 Guidance for Schools and Local Authorities, EFA, March 2017

A Consultation on School Funding Reform: Rationale and Principles, DfE, 2011

Dedicated Schools Grant: Technical Note for 2017 – 2018, EFA

Early Intervention: The Next Steps, DWP, 2011

An Early Years National Funding Formula: Government Consultation, DfE, 2016

Fairer School Funding: Arrangements for 2015 to 2016, DfE, 2014

Financial Sustainability of Schools, National Audit Office, 2016

Guidance: Priority School Building Programme Overview, DfE, 2016

High Needs Funding Formula and Other Reforms: Government Consultation – Stage One, DfE, 2016

Local Authority Revenue Expenditure and Financing England: 2016 to 2017 Budget, DCLG, 2016

A Practical Guide for Local Authorities on Income Generation (2015 Edition), CIPFA, 2015

Review of Education Capital, Sebastian James, 2011

Schemes for Financing Schools, Statutory Guidance for Local Authorities, DfE, 2015

School and Early Years Finance (England) Regulations 2014

School Buildings and Capital Funding (England), House of Commons Briefing Paper Number 07375, 2015

Schools Financial Value Standard (SFVS) Support Notes, EFA, 2017

Schools Forum Regulations 2012

Schools Forum: Operational and Good Practice Guide, EFA, 2015

Schools Forum Powers and Responsibilities 2015 to 2016, EFA, 2015

School Funding in England. Current System and Proposals for 'Fairer School Funding', House of Commons Briefing Paper Number 06702, 2016

Schools Funding Reform: Next Steps Towards a Fairer System, DfE, 2012

Schools National Funding Formula: Government Consultation – Stage One, DfE, 2016

Schools National Funding Formula – Stage 2, DfE, 2017

Schools, Pupils and their Characteristics, DfE, 2016

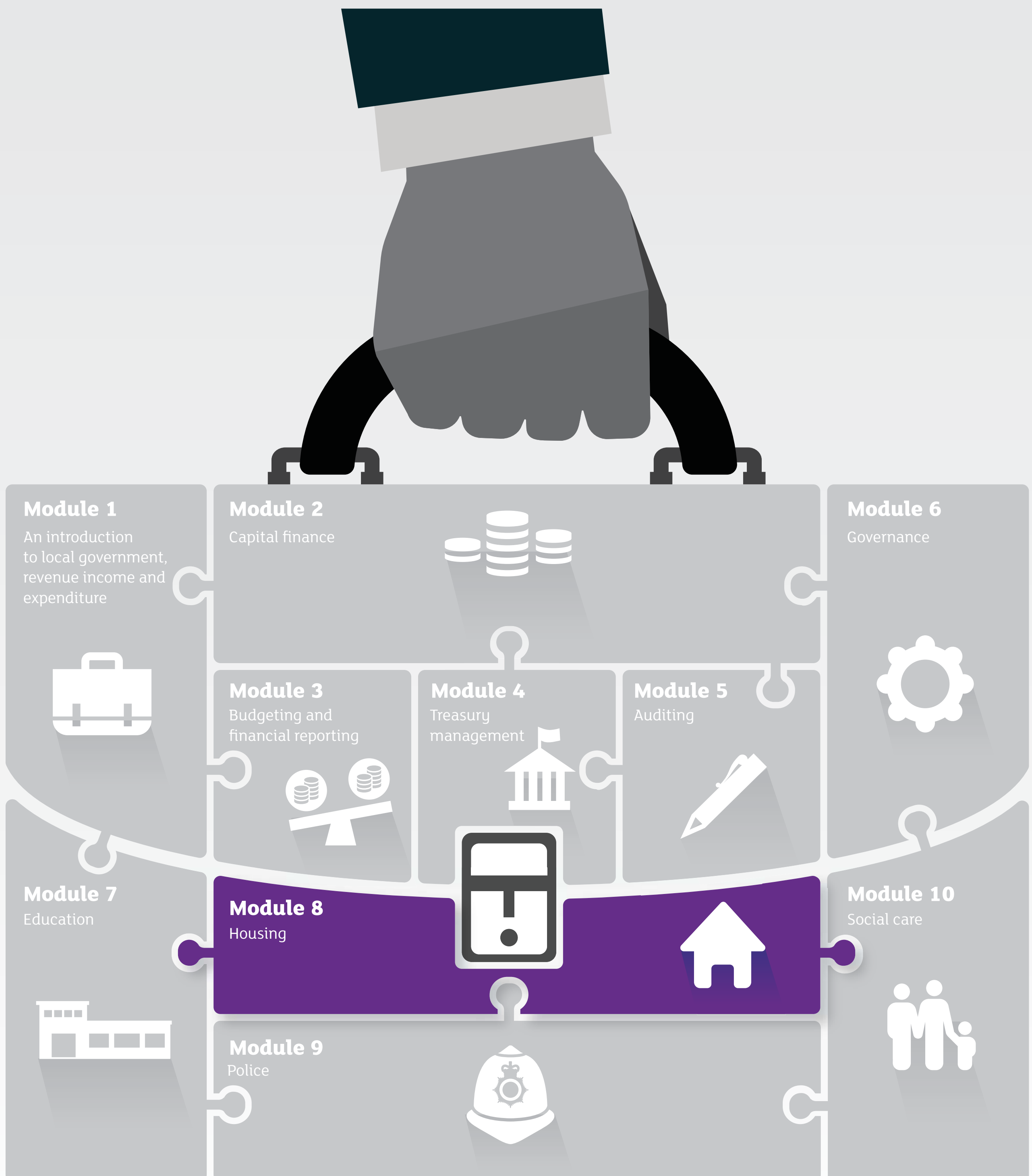
Schools that Work for Everyone: Government Consultation, DfE, 2016

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.

Much is being written about the problems faced by people seeking housing in the UK. Between 2002 and 2016 house prices in England have more than doubled (+120%). With an increase of 158% in London, the increase has been even starker in the capital. Over the same period, average earnings have increased by 38%, showing that changes in (nominal) earnings have by far not kept up with house prices. In fact, average house prices in England have increased more than three times (3.2x) as much as average earnings over this time period (See How Affordable is Housing for People in Lower-income Occupations? National Housing Federation, 2017).

By contrast, the local authority average weekly rent ranges from £74 to £147 per week, making this an option for many seeking accommodation, but supply often falls below demand. There were 1.18 million households on local authority waiting lists on 1 April 2016, a decrease over the 1.24 million on 1 April 2015.

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.

Investing in Council Housing (CIPFA and CIH, 2016) explored some of the implications of policy changes for the housing sector, particularly in relation to building and increasing stock. It concluded that cumulative changes had resulted in greater pressures on social rented housing stock.

The Housing and Planning Act 2016 contains a number of new provisions that will impact housing policy in the future. While much of the detail around these changes is still unclear the Act will bring in changes relating to starter homes, right to buy and the sale of high value local authority housing.

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 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 forthcoming 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 the new universal credit under welfare reform.

Increasing supply

Overall, the UK 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 average price of a property in the UK was £217,502 in February 2017 and the annual price change for a property in the UK was 5.8%.

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- to 30-year-old homeowners will almost halve, falling by 1.1 million to only 1.3 million. These findings were supported by the National Housing Federation report *Broken Market, Broken Dreams*.

In 2011, the government produced *Laying the Foundations: A Housing Strategy for England* (HM Government, 2011). The main points of the strategy included a focus on buying properties rather than rental.

The Elphicke–House Report (DCLG, 2015), 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. Policy decisions such as the introduction of income-based rents and the sale of high value assets combined with recent rent reductions increased the challenges to be faced by the social rented sector.

The Housing and Planning Act 2016 requires councils to sell higher value housing when it is no longer occupied. Local authorities will then be required to pay this income to central

government which will use it to subsidies the right to buy initiative for housing association tenants.

The Act also required that local authorities must charge a higher level of rent to those tenants whose income exceeds a certain threshold. This proposal proved extremely difficult to introduce and was highly unpopular such that it is no longer mandatory.

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 roughly £24bn (including both the administration and the payment of housing benefit and council tax benefit). The coalition government from 2010 identified it as a key area for spending reductions and is introducing major changes to housing benefit and 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 Department for Work and Pensions (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. However the project has been delayed and will not be completed by this date.

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 into 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.

Prior to the 2017 election the further key welfare reform changes impacting on housing that were to be introduced by March 2019 included:

- freeze of local housing allowance (LHA) rates for four years
- limiting backdating of housing benefit claims
- reduction in and removal of universal credit work allowances
- reduction in the household benefit cap

- removal of the housing benefit family premium
- extension of local housing allowance rates to homeless cases and removal of management allowances
- removal of housing support for young people
- extension of local housing allowance rates to the social rented sector.

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, the DCLG, though housing benefit is currently overseen by the DWP.

Local authorities in England owned 1.61 million dwellings on 1 April 2016, a decrease of 1.9% from the previous year. There has been a decrease 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 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

Local housing authorities must identify housing need and publish a strategy to address those needs.

Local housing authorities must ensure a free housing advice service is available.

Local housing authorities 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), local housing authorities 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).

Local housing authorities must pay disabled facilities grants for home improvements to those applicants who are eligible.

Local housing authorities 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.

Local housing authorities 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.

Local housing authorities must monitor the number of empty houses in their areas, and encourage owners to bring them back into use.

Local housing authorities must make appropriate housing provision for Gypsies and Travellers.

Local housing authorities must determine and pay applications for housing benefit in accordance with the national scheme. However, the government is moving to a national scheme of universal credit. An element for housing benefit will be included within the new universal credit.

Local housing authorities may provide housing-related support that encourages vulnerable people to achieve or maintain independent living.

Local housing authorities 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 and 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 modelling a fully functional replacement system took many years. Finally, the new self-financing system was introduced in April 2012.

Since April 2012 when the concept of self-financing HRA was introduced, each council is reliant on its own rent income to provide and manage council housing. The government calculated the amount of notional debt that each council's HRA could support utilising a 30-year future calculation of its rental income less the notional expenditure for that period. The debt that this sum could support was compared with the government's view of each council's housing debt and HRA debts were adjusted to this level. Some authorities took on extra debt and made an equivalent payment to the Treasury while others had their debt reduced by the Treasury. Overall the Treasury was paid a net £8bn. However, since this settlement the government has made a number of significant changes around rent policy, welfare benefits and right to buy that have materially affected the total rental income.

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 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 policy on rents for social housing for the ten years from April 2015 – Guidance on Rents for Social Housing (DCLG, 2014). 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 were expected to set their rents from April 2015 onwards. However this policy has been suspended for four years from 2016/17, with local authorities required to reduce rents by 1% annually.

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 the DCLG or the Homes and 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 as follows.

- 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 and Communities Agency. The Regulatory Framework for Social Housing in England from April 2012 (Homes and Communities Agency, 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 came 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).

New rules introduced in April 2017 allow local authorities to crack down on rogue landlords that flout the rules and improve safety and affordability for renters. Councils are now able to impose fines of up to £30,000 as an alternative to prosecution for a range of housing offences. They will be able to retain all of the income to make sure it is used for private sector housing enforcement purposes.

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.

HomeBuy

HomeBuy is a programme to promote affordable home ownership. The Homes and Communities Agency oversees the scheme and it is mainly operated by approved local agents. There are five schemes:

- equity loans
- mortgage guarantee
- shared ownership
- own your home
- Help to Buy ISA.

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 grant

Disabled facilities grant (DFG) is paid to enable property owners or tenants or their dependants to continue living in their own homes by adapting them to provide disabled facilities. Government grant for DFG was set at £394m for 2016/17 (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. There is a close financial link with health through this grant as part of the £5.9bn Better Care Fund, the disabled facilities grant being paid directly from the government to local authorities.

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.

Around 14,780 households in England were accepted as homeless and in priority need in the first quarter of 2016, a rise of approximately 9% on the figure for the first quarter of 2015. The reasons behind homelessness are complex and of those households, 31% had lost their previous home due to the end of an assured shorthold tenancy, 28% due to relatives or friends no longer being able or willing to provide accommodation, 11% due to a violent relationship breakdown, 3% due to rent arrears and 1% due to mortgage arrears (homeless.org.uk).

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 health bodies 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.

Supported housing

Supported housing covers a range of different housing types, including group homes, hostels, refuges, supported living complexes and sheltered housing. Rent levels in supported housing tend to be higher than those charged for similar accommodation in the private sector.

With the changes in welfare and rent this sector has called on central government to review its position. The government subsequently announced a one-year exemption for the supported housing sector from the 1% rent reduction and a one-year delay in applying local housing allowance caps to residents in supported housing. A consultation was undertaken by the Department for Communities and Local Government and the Department for Work and Pensions but the findings were not issued before the 2017 general election and a Parliamentary Committee looking at the Future of Supported Housing that was looking at this matter was also stopped by the dissolution of Parliament on 3 May 2017.

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 tax payer subsidising council housing. Councils must not budget for a deficit on their HRA after taking account of HRA balances.

Arm’s-length management organisations

Many housing authorities that retain stock have established ALMOs. These initially were introduced to enable authorities to borrow funds to bring their properties up to decent homes standards. 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 that are 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 originally be achieved within ten years of the start date, but it became clear because of the size of the gap and government rent policy over the intervening years that it could only be achieved by 2015/16 at the earliest, but government policy on rent setting has changed.

On 8 July 2015, in the summer Budget 2015, the chancellor announced that rents in social housing would be reduced by 1% a year for four years, resulting in a 12% reduction in average rents by 2020/21 compared to forecasts based on the previous system. The measure has the impact of reducing housing benefit expenditure and is forecast to save £1.4bn by 2020/21. However, this will cost local authorities around £2.6bn over five years. Around 1.2 million tenants not in receipt of housing benefit in the social rented sector are expected to benefit by £700 per year (current prices). This means that local authorities will have their business planned income reduced by between 12% and 15% over the life of the original 30 year business plan used at the time of establishing self-financing.

Local housing authority income includes service charges as 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, owner-occupation and leaseholders (mainly flats). 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.

The Social Landlords Mandatory Reduction of Service Charges (England) Directions 2014 (known as 'Florrie's Law' in reference to the high profile case of Florence Bourne) introduced a cap of £10,000 (£15,000 in London) on repair bills for local authority leaseholders in certain circumstances.

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.

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 2 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 (£100,000 in London), increasing annually with inflation, so now at £78,600 and £104,900 in London. With this increased level of discount there has been an increase in take up with around 50,000 sold in the first three years since the reinvigoration of right to buy.

The right to buy has been extended to housing associations under the Housing and Planning Act 2016, through voluntary agreements between the secretary of state and the registered housing provider.

Specialised properties such as sheltered accommodation are not eligible for the right to buy. There are also restrictions on resale for properties bought in designated rural areas.

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 have been 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 are voluntary bodies and vary in size from fewer than ten homes, to more than 50,000.

Altogether, housing associations provide about 2.5 million homes for more than 5 million people in England. Some are charitable trusts or companies; others, co-operative or community benefit 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 (IFRS), where it is helpful for both types of organisation to share and learn from their experiences.

The main challenges for housing associations, as 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 benefit and the implementation of the new universal credit under welfare reform

- the requirement to reduce rents by 1% per year for four years from 2016/17.

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 and Communities Agency through the Affordable Homes Programme, or by the Greater London Authority in London. 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.

FURTHER READING

Affordable Housing Capital Funding Guide, HCA, 2016

Broken Market, Broken Dreams, National Housing Federation, 2014

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

The Decent Homes Programme, NAO, 2010

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

Increasing the Number of Available Homes, DCLG Policy Paper, 2013

Investing in Council Housing, CIH/CIPFA, 2016

Laying the Foundations: A Housing Strategy for England, DCLG, 2011

Let's Get Building, National Federation of ALMOs, 2012

Live Tables on Social Housing Sales, DCLG, 2012

Local Growth Fund: Housing Revenue Account Borrowing Programme (2015 to 2016 and 2016 to 2017), DCLG, 2014

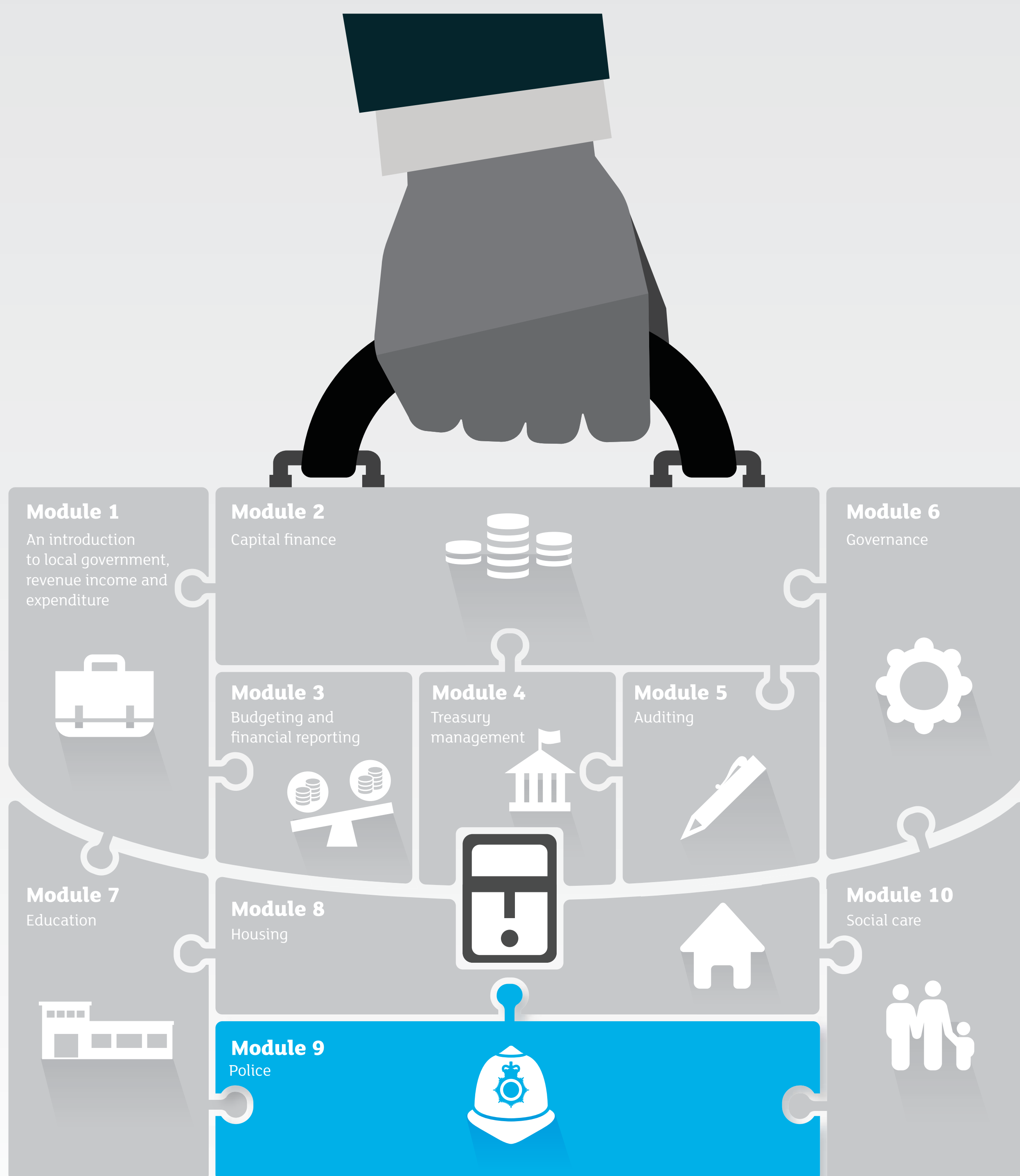
The Prudential Code for Capital Finance in Local Authorities (2011 Edition), CIPFA, 2011

Reinvigorating Right to Buy and One for One Replacement: Information for Local Authorities, DCLG, 2012

Service Reporting Code of Practice for Local Authorities, CIPFA, annual

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, and in Greater Manchester where the mayor is the PCC).

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.

More recently, the devolution agenda has led to the role of the PCC in Greater Manchester being abolished as a separate role and for the Mayor to become the PCC for Greater Manchester from May 2017 as part of the combined authority for Greater Manchester.

Also, the government's agenda on closer working between the emergency services has led to the Policing and Crime Act, which received Royal Assent in January 2017. This Act allows police and crime commissioners in England to take over the governance of local fire and rescue service(s) and allows them, at the same time or at a later date, to merge their local police force and fire and rescue service into a single employer. In either case, the PCC would need to put together a business case and put a proposal to the home secretary for the changes on the grounds of economy, efficiency and effectiveness or in the interests of public safety. The home secretary would decide on whether the proposal to take over the governance of the fire and rescue service, and potentially a combined organisation, could go ahead.

EXPENDITURE AND BUDGETS

Funding overview

Total funding for policing for 2016/17 was £10.4bn in England and £0.61bn in Wales, excluding national Home Office reallocations.

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 DCLG 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 following the 2013 spending review.

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. 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 (CIPFA/OPM, 2004). 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, 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 from 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

This Act provides the College of Policing with powers to set standards for police 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, Section 141 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. Section 142 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 Section 143 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.

Policing and Crime Act 2017

The Policing and Crime Act, which received Royal Assent in January 2017, is enabling legislation which allows police and crime commissioners in England to take over the governance of local fire and rescue service(s) and become a police, fire and crime commissioner. Where this is implemented, a third organisation of PCC-style fire and rescue authority (FRA) is established. The chief constable would still report to the PCC and chief fire officer would report to the PCC-style FRA. The police and crime panel would also be extended to be a police, fire and crime panel.

This legislation also allows PCCs, at the same time or at a later date, to merge their local police force and fire and rescue service into a single employer with a single chief officer reporting to the police, fire and crime commissioner. This part of the Policing and Crime Act applies to England only and has implications for finance, governance and financial reporting.

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 authorities and manages all income and expenditure and reserves that are the ultimate liability of the council tax payer).

- The chief constable cannot borrow money (other than temporary overdrafts set out in Section 141 of the Anti-social Behaviour, Crime and Policing Act 2014), 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 last issued in October 2013 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. It is currently being updated for publication in 2017.

The FMCP applies to all PCCs, and the police forces maintained by them, in England, 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 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.
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. Ensuring receipt and scrutiny of the statement of accounts of the chief constable and ensuring production of the group accounts.	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.
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 for Capital Finance in Local Authorities.

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 requires 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 as set out in Section 141 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 (CIPFA, 2011), and all borrowing should comply with the CIPFA Prudential Code for Capital Finance in Local Authorities (CIPFA, 2011).

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. They should also comply with the requirements of Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2016) and Delivering Good Governance: Guidance Notes for Policing Bodies in England and Wales (CIPFA, 2016).

Audit

The PCC and the chief constable are required to maintain effective internal audit of their affairs by the Accounts and Audit Regulations 2015. In fulfilling this requirement the PCC and the chief constable should have regard to the Public Sector Internal Audit Standards (CIPFA/IIA, 2016) published by CIPFA in April 2016 and associated Local Government Application Note (CIPFA, 2013). 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 Sections 1(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 forces 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 Reform 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 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 The Role of the Chief Financial Officer in Public Service Organisations. CIPFA also produced an accompanying document for CFOs of PCCs and chief constables, the 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 (March 2014). An updated version of this should be published by the end of 2017. The statement goes into much 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 establishes 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 holder 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 chief constable (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 tax payers 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 as there is a statutory division of police staff between the office of the PCC and the chief constable – in effect creating two separate bodies, or corporations sole. The existence of 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. The Anti-social Behaviour, Crime and Policing Act 2014 facilitated the finance elements of stage 2 transfers.

FURTHER READING

Accounting for the Impact of Police Reform (LAAP Bulletin 95), CIPFA, 2012

Accounts and Audit Regulations 2015

Anti-social Behaviour, Crime and Policing Act 2014

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 Financial Officer in Public Service Organisations, CIPFA, 2011

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: Framework, CIPFA/Solace, 2016

Delivering Good Governance in Local Government: Guidance Note for Policing Bodies in England and Wales (2016 Edition), CIPFA, 2016

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

Policing and Crime Act 2017

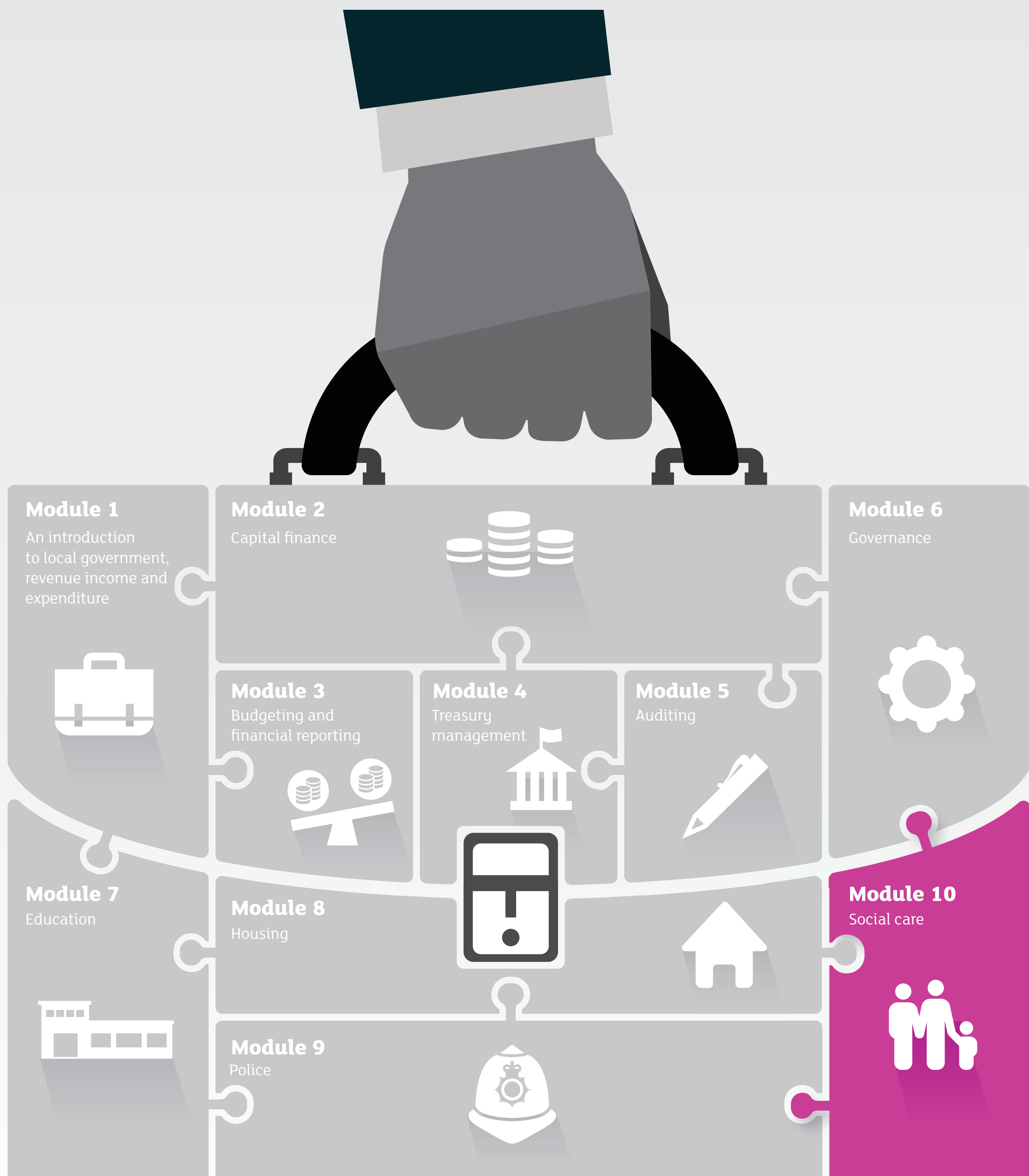
The Policing Protocol Order 2011

Practitioner Briefing Note on Asset and Liability (Including Employment) Recognition in Police and Crime Commissioner and Chief Constable Accounts, CIPFA, 2013

Public Sector Internal Audit Standards, CIPFA, 2016

MODULE 10

Social care



INTRODUCTION

Council expenditure on social care exceeds spending on all local government services other than education, and is the largest area of spend for which councils are directly responsible. 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 the implications of the Health and Social Care Act 2012 and the Care Act 2014, the Better Care Fund (introduced in 2015/16 to assist in the drive towards integrating health and social care) and the government's agenda for wider integration and for devolution. The module also covers the legal aspects of the children's social care system.

This chapter first considers the overall issues before considering adult social care and then children's social care in more detail. It concludes with suggestions for further reading.

OVERALL FUNDING AND LEVELS OF SPEND FOR SOCIAL CARE

As with most local government services, the bulk of funding comes via a combination of Revenue Support (formula) Grant, business rates and council tax – though this pattern is at present expected to change by 2020 if fully retained business rates replace all central government grants. There has been a move away from specific grants in recent years, though a small number remain. Most notably, the Better Care Fund and funding for new responsibilities under the Care Act take this form.

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, which can make planning very difficult. The population is ageing, meaning more people require services as they live for longer. In many cases the need for council support is exacerbated when elderly parents are no longer able to cope with the demands of their children with special needs. In addition, there is an increasing number of younger adults requiring support as medical advances lead to longer lifespans for service users with life-limiting conditions. These pressures make the service difficult to manage.

Services have historically been provided predominantly by councils directly. Over recent decades this focus has changed, with many services now being bought in from the independent or the third sectors. 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.

A key current challenge for the sector is to develop the integration agenda between health and social care, the government's aim being that service users experience seamless service provision and are unaffected by whether care is being provided by the NHS or social care. It is hoped that closer working, especially on preventative solutions and intermediate care, will lead to improved efficiencies across the whole system as hospital admissions are reduced and fewer people are placed in permanent residential care. The moves towards devolution are, in some areas at least, intended to facilitate the integration agenda. This module explores the challenges further.

The budgeted net current expenditure in relation to adult social care for 2016/17 was £14.4bn for England. For children's social care, the total was £7.8bn for England making the total budgeted net expenditure for social care for England £22.2bn. This reflects an ongoing real terms reduction in adult and children's social care spend (both at similar cash levels to 2014/15) and follows a period of reducing spend in adults' services and increasing spend on children's services.

The following table gives an analysis of budgeted net current expenditure for social care in England for 2016/17. It shows that services for older people consume over a third of money allocated to social care. Services for adults with learning disabilities are close behind, consuming 21%. The third major element is children looked after, with 15% of the budget.

Analysis of net estimated expenditure 2016/17

	England
	£m
Children's Social Care	
Sure Start children's centres/flying start and early years	550
Children looked after	3,585
Other children and family services	229
Family support services	971
Youth justice	208
Safeguarding children and young people's services	1,777
Asylum seekers	73
Services for young people	441
Total Children's Social Care	**7,835**
Adult Social Care	
Physical support – adults (18–64)	1,133
Physical support – older people (65+)	3,254
Sensory support – adults (18–64)	55
Sensory support – older people (65+)	128
Support with memory and cognition – adults (18–64)	46
Support with memory and cognition – older people (65+)	830
Learning disability support – adults (18–64)	4,390
Learning disability support – older people (65+)	519
Mental health support – adults (18–64)	635
Mental health support – older people (65+)	376
Social support – substance misuse support	29
Social support – asylum seeker support	25
Social support – support for carer	144

	England
	£m
Social support – social isolation	67
Assistive equipment and technology	158
Social care activities	1,461
Information and early intervention	196
Commissioning and service delivery	944
Total Adult Social Care	**14,390**
TOTAL SOCIAL CARE	**22,224**

Source: CIPFA Finance and General Statistics Estimates 2016/17

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 are given the funds to purchase their assessed care requirements directly themselves. The aim of direct payments is to allow services to be tailored more precisely to need to the needs of an individual and to promote independence.

The reporting categories in England changed from 2014/15 in line with a review undertaken by the Health and Social Care Information Centre, this is reflected in the analysis shown above.

INTEGRATION AND DEVOLUTION

Integration and devolution have together been the consistent elements in the incremental development of government policy on social care this century. Adult social care has received more attention than children's in these respects, but the principles are equally applicable to both.

Integration between health and social care

The number of people in England who have problems requiring both health and social care assistance 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 joined-up services, leaving them at increased risk of harm. Health and care staff may miss opportunities to provide optimum care for patients and service users, and taxpayers' money is not being used as effectively as possible.

It is, therefore, Department of Health policy to work towards ensuring that everybody who uses both health and social care services has integrated care – services that work together to give the best care response to a person's circumstances. It wants local authorities 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.

In 2016 the government announced that all local authority areas were to produce sustainability and transformation plans (STPs) by 2017, setting out how they would move to full integration by 2020. Exactly what is meant by 'full integration' in this context has not been spelled out in detail, and STPs are now the primary vehicle for integration planning, rather than a separate document. Nonetheless, the trend towards greater integration is clear.

It is also judged more efficient for people to have control over their own budgets 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 underway with national partners to remove barriers by:

- co-producing Integrated Care and Support: Our Shared Commitment (National Collaboration for Integrated Care and Support, 2013) – a document setting out how local areas can use existing structures for integrating care
- agreeing and publishing a definition of integrated care
- inviting local areas to act as pioneers and exemplars, to develop and demonstrate the use of innovative approaches to efficiently deliver integrated care.

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.

Devolution in the context of health and social care

The government is moving forward with the agenda of devolving powers in England. The developments in Manchester are well-publicised; Cornwall was granted the first of the county deals in July 2015; and 38 devolution deals were submitted in late 2015, leading to detailed

negotiation of deals, most of which remain ongoing as at spring 2017. The pace of progress has, therefore, been somewhat slower than was originally anticipated.

Devolution fits particularly well with health and social care as it provides more scope, scale and impetus to the collaborative working which is widely seen as key to improving the health outcomes obtainable from the limited resources available.

The key innovation of Manchester's arrangements is the formation of a £7bn budget which brings all non-acute health services into local decision making, and though that is not typical of the devolution deals proposed to date, it is apparent that it could be the long-term trend. Nonetheless, the devolution deals agreed to date have not typically included health spending: Manchester is something of an exception, and it remains to be seen whether that forms the future template or remains unusual.

ADULT SOCIAL CARE TRENDS AND PRESSURES

As has been explained, adult social care is a demand-led service: if a person is assessed as needing care and that care is within the eligibility range set by the national rules introduced by the Care Act 2014, then the person must receive that care. Historically, this has made it a difficult budget to manage.

Demand-led pressures

In the 15 years to 2009, local authority net spending on adult social care for all age groups increased by an average of almost 6% a year over and above inflation. But this trend has reversed sharply in recent years. Spending has dropped by an average of 2.2% a year since 2009. Moreover, demand is rising: the number of people over 85 is increasing by some 2.5% per year. Consequently adult social care spend per person over 85 has fallen, and this trend is projected to continue. While some of this reduction can be viewed as positive, resulting from preventative measures and reablement programmes which reduce demand, budgets are undoubtedly increasingly challenged to a point which could become unsustainable. The King's Fund/Health Foundation report Social Care for Older People: Home Truths (2016) provides a good summary of the issues.

The quantity of care provided has reduced, but local authorities have also improved their ability to control their costs in delivering core services. They have made substantial savings on the price paid by such measures as renegotiating contractual agreements, making below-inflation fee increases and constraining demand.

However, especially in the context of the introduction of the national living wage, paying low fees can put pressure on the financial sustainability of care providers, many of which are in the independent sector. Ensuring that proper consideration of the various factors in this area has become legally as well as prudentially critical, as the Care Act 2014 requires that local authorities ensure they have evidence that the fee levels they pay for care and support services enable the delivery of agreed care packages and support a sustainable market that offers people a diverse range of quality services.

Similarly, by 2014 almost all local authorities had raised the eligibility level they set for individual packages of care so as to arrange care services only for those with substantial

or critical needs. This was built into expectations by the Care Act 2014, which uses the equivalent level of service as the national minimum.

Pressure on social care can impact on other parts of the care and health systems. For example, informal carers now provide more hours of care per week than was historically the case and on average they are getting older. In addition, shortages in social care can lead to unnecessary emergency hospital admissions and/or delays in hospital discharge, both of which generate significant NHS costs.

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 on the ability for informal carers to provide support.

The challenge, consequently, is to move beyond the procurement squeeze and constraint of demand to generate more transformative methods of providing services and delivering savings. That might be through integrating services with the NHS, revision of care pathways, better use of telecare, or improving preventative programmes. The key actions are:

- to fund and encourage preventative support in the community to reduce the chances of people requiring individualised help
- where such support is needed, to intervene early enough in a client's care to prevent long-term admission to residential care, which is an expensive commitment
- to use short-term intensive reablement packages to return people to independence following hospitalisation, and so avoid long-term support where possible.

Concerns around the mounting pressure on social care budgets were encapsulated in the Local Government Association's autumn 2016 Budget submission, which assessed the pressure by 2019/20 as £3.5m on adults' services:

Adult social care – forward cost projection

2016/17	2017/18	2018/19	2019/20
£m	£m	£m	£m
14,380	15,444	16,629	17,833

Source: Local Government Association's autumn 2016 Budget submission

BUDGET SETTLEMENTS FROM 2017/18 ONWARDS

Recent spending reviews have seen a combination of:

- relative protection for the NHS, which has received inflationary increases – but not the growth in spending arguably required to deal with demographic and other cost pressures. Despite this relative protection NHS providers overspent by an unprecedented £2.45bn in 2015/16 and are expected to overspend again in 2016/17 despite additional funding of £4bn

- ough settlements for local government, and consequently for social care – with knock-on effects on health which threaten the efficacy of the NHS protection
- overnment recognition of the problems facing social care, triggering additional financial assistance.

For 2015/16, the extra help took the primary form of putting £3.8bn into pooled budgets for health and social care services to work more closely together in local areas, based on a plan agreed between clinical commissioning groups (CCGs) and councils. This shared pot, known as the Better Care Fund included, a £2bn transfer from the NHS, with the aim of benefiting the NHS in turn through more joined-up services for older and disabled people, to keep them out of hospital and to avoid long hospital stays.

The announcements made in October 2015 for 2016/17 onwards continued the trend:

- It was confirmed that the Better Care Fund (BCF), initially announced for one year only, would be extended; that contributions into it will increase in value by £1.5bn; and that the fund will act as a transition mechanism towards devolution of integrated health and social care.
- Added flexibility was introduced by giving authorities the ability to increase council tax by an extra 2% without a referendum in order to support adult social care.
- There was positive news on health, benefits, housing and police budgets, all of which gained increased spending power with positive indirect effects on social care.

These announcements provided some degree of improvement for social care, but on the other hand, the consensus was that the 2% extra on council tax would not solve the financial problems. The additional £1.5bn for the Better Care Fund is to be phased in slowly, with only £100m available in 2017/18 and £700m in 2018/19. Moreover, £800m of the increases in the BCF will come from the New Homes Bonus, meaning that only £700m is new money for local government; and the reductions (of 9% over the parliament) in public health budgets are unhelpful for social care.

Local government therefore welcomed the government's announcement of further measures in the autumn 2016 and spring 2017 Budget statements:

- The council tax precept for social care, while still required to average no more than 2% increase per year over the three -year period to 2019/20, can be frontloaded by being set at 3% increase in each of 2017/18 and 2018/19.
- Additional direct funding will be provided of £1.2bn in 2017/18, rising to £2bn by 2019/20 (after which the Improved Better Care Fund, as previously announced, will provide the mechanism for a similar level of funding). This additional funding is skewed towards those authorities with the lowest tax bases – which are both able to raise proportionately less money through the social care precept but are likely to face the sharpest increases in social care demand.
- Announcement of a Green Paper to be published in late 2017, designed to tackle the long-term underlying funding issues in the sector.

Significant concerns remain: will social services be given full benefit of the additional funding, or will there be rules requiring it to assist with delayed discharge rather than dealing with existing pressures? Will the Green Paper, if it is not delayed by the post-election

uncertainty, be followed by the same failure to act on its findings as has followed the last 20 years of similar enquiries? But the short term assistance and recognition of the issue has been widely welcomed.

BETTER CARE FUND

The Better Care Fund provided £3.8bn pooled funding in 2015/16, and this is to increase by inflation thereafter and by an additional £1.5bn by 2019/20. It requires health and social care services to work more closely together in local areas. The main purpose of the fund is to ensure that local authorities and clinical commissioning groups (CCGs) act as partners, alongside health and wellbeing boards and the rest of the health system. Plans to deliver this took effect in full from 1 April 2015, and were 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 2014
- 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' as a shared reference for individuals
- 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 includes plans to deliver a reduction in 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 had to be approved by the relevant health and wellbeing board and by NHS England in order to gain access to the Better Care Fund. 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 is required to sign off the plan for its constituent councils and CCGs. That plan is 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 standalone plan in accordance with a template requiring a wide range of service and financial performance indicators to be set out.

In 2015 it was announced that the Better Care Fund will run until at least until 2019/20. That is seen as very helpful, for even if the bureaucratic element of the fund is unpopular, the encouragement for joint working was welcome and the funding stream for the protection of social care is widely regarded as critical.

Moreover, the administrative burden of the Better Care Fund was somewhat reduced by the 2016/17 Better Care Fund Policy Framework and consequent changes in the rules for the fund. This featured:

- removal of the awkward and over-ambitious £1bn payment for performance framework, which didn't work as the government had hoped in 2015/16
- sensible new conditions focused on funding NHS commissioned out-of-hospital services and tackling delayed transfers of care
- appropriate requirements to demonstrate the joint nature of planning
- a reduced amount of finance and activity information to be collected
- flexibility for devolution sites, in line with the moves towards fuller integration by 2020.

Consistent with these improvements, CIPFA and HFMA's survey (*Better Care Fund: The Full Year Experience*, CIPFA and HFMA, 2016) of views at the end of the first year of the BCF indicated that those involved were broadly positive about its effects.

A further positive is that the minimum size of the Better Care Fund will increase from the current £3.8bn to £5.3bn by 2020 – an extra £1.5bn. And this increase will not be top-sliced from CCG budgets.

On the other hand, this is back-ended money, in the sense that there is no increase in 2016/17, £105m in 2017/18 and the increase reaches £1.5bn only in 2019/20. Given that the purpose of the fund is largely to invest up front to improve the longer-term position, the delayed timing of the increase was seen as unhelpful. So the spring 2017 Budget announcements were welcomed: they gave extra funding to social care, the effect of which was comparable to bringing forward that additional BCF funding.

ADULT SOCIAL CARE EFFICIENCY AND SAVINGS PROGRAMMES

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, which remains the most comprehensive recent look at the potential to improve efficiency in adult social care. The LGA Adult Social Care Efficiency Programme: The Final Report (LGA, 2014) acknowledged that since 2010, spending on adult social care had 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 had increased by 14%.

Over a third of upper-tier authorities participated in the three-year programme. Most of the participants 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 set out in more detail in the following sections.

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. This 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.

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 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.

The access point to social care has been the cause of much consideration, a specialist service (ie involving professional social workers at an early stage) is now more prevalent than generalist models (ie initial stage in administrative mode prior to onward allocation) 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 local authority funded provision is made.

Transformation

Those councils that have needed to achieve savings targets above 10% over the period of the programme looked at radically new service delivery models which, through offering less formality and bureaucracy, can engender a more innovative environment.

It is recognised that the most significant element in transforming services to make savings involves making significant changes in culture and behaviours. Councils recognise that it is not possible to bring about this culture change within a short timeframe 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

Many councils are moving to becoming commissioning organisations, developing new models of care which are separate from 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.

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 single magic solution to meet the funding challenge. Instead, a relentless focus on all the efficiency opportunities is required. Successful efficiency approaches have included the following:

- 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.

See the LGA website for more information, including *The LGA Adult Social Care Efficiency Programme: The Final Report*, which contains case studies of 54 councils, and highlights

the transformational approaches they took to improve outcomes for vulnerable adults while making the efficiency savings required to balance the books. The CIPFA/ADASS tool for assessing risk when setting social care budgets should also be considered in making these decisions.

The LGA's conclusions remain relevant, but recent value for money research has supplemented previous work by increasing the focus on integration as an opportunity, in line with the government's emphasis on this agenda. This has been shown in Delivering Sustainable Health and Social Care: How Integration Can Lead to Savings and Improved Outcomes (LHA and Newton, 2016).

The Recent Savings Record

In What Are the Opportunities and Threats for Further Savings in Adult Social Care? (Institute of Public Care, 2016) Professor John Bolton considers how councils in England have delivered savings over the past five years in adult social care and what options they might have in a period of continuing financial challenges.

Some local authorities managed to deliver savings of around 20% or more of their gross budgets in the four years to 2014/15. Savings have been made across the board with a strong focus on prioritising people with the greatest needs and deploying lower cost ways of meeting the needs of others. Earlier work suggests that councils have minimal room to deliver further savings without a major impact on what is offered or on meeting statutory obligations but some areas have been considered for potential further savings.

The report argues that there may still be scope among local authorities to introduce or refine the provision of care, seeking to avoid formal care where it is safe to do so and helping people in other ways, ensuring that opportunities for recovery and recuperation are consistently offered, and that an assessment of needs is not rushed when someone is in a crisis (eg at the point of hospital discharge), thus helping to avoid residential or other institutional solutions where possible. All such opportunities can be best achieved where the NHS adopts similar approaches and works in partnership with adult social care to deliver improved outcomes.

ADULT SOCIAL CARE STATUTORY AND POLICY FRAMEWORKS

There have been a number of policy frameworks that have impacted on adult social care this century. Valuing People (DH, 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. Putting People First: A Shared Vision and Commitment to the Transformation of Adult Social Care (DH, 2007) set out the basis for personalisation and community-based support. Living Well with Dementia: A National Dementia Strategy (2009) 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.

A Vision for Adult Social Care: Capable Communities and Active Citizens (DH, 2010) looked to achieve 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
- 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.

These various policies are now well-established in the way authorities aim to deliver services – but subject to the balancing act required by increasing financial pressures.

Director of adult social services

Each council with social services responsibilities must appoint a statutory chief officer to be known as the director of adult social services (other services, eg highways and leisure, tend not to have such a requirement). Originally, this requirement was linked to an expectation that children's and adults' social services would be managed separately, but in recent years it has become accepted practice – should the council wish – to combine the roles once again.

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:

- 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 per year
- 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 was incorporated in the Care Act 2014, but the critical recommendations about paying for care were deferred to 2020 due to the additional costs involved. Many believed that deferral would lead in due course to cancellation: it is now expected that the Green Paper due in late 2017 will clarify the timetable of any implementation.

Health and Social Care Act 2012

The Health and Social Care Act 2012 set out a new structure 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 intended implications and subsequent partial unravelling is critical to social care finance. It:

- established an independent NHS Commissioning Board to allocate resources and provide commissioning guidance (now renamed as NHS England)
- increased GPs' powers to commission services on behalf of their patients
- strengthened the role of the Care Quality Commission
- strengthened regulation within the NHS, setting up roles now carried out by NHS Improvement
- abolished primary care trusts and strategic health authorities.

New clinical commissioning groups (CCGs) led by GPs replaced primary care trusts and have taken on much of the commissioning of NHS services. The governing body of each CCG has to include at least one registered nurse and a hospital doctor. Competition for services is still possible where it will improve quality and efficiency for patients.

The Act established health and wellbeing boards with the emphasis being on local communities' needs, democratic involvement, and agreeing priorities for the community and commissioning in a more joined-up way. Each authority has its own health and wellbeing board which involves 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 (JSNAs) 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 authority to undertake a JSNA of the community and develop a joint strategy to meet 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.

The new NHS arrangements have proved complicated to manage in practice, and while it is rare to hear anyone commending them, there is also a strong consensus that there should be no further structural reform, so that CCGs remain in place. Health and wellbeing boards have not proved as influential as expected, and the NHS might be said to have started 'managing around' the new setup through the sustainability and transformation plans (STPs) introduced from 2016 (see NHS England: Sustainability and Transformation Plans) for 44 STP 'footprints'. STPs bring together NHS bodies and local councils responsible for social care provision to develop proposals and make improvements to health and care based on the needs of the local population. Submission of plans based on the STP areas began in October 2016, providing a basis for system-wide, place-based planning for 2016-2021. STPs are not statutory organisations, but rather partnerships that bring together the statutory bodies in the area. Social care is not necessarily covered directly, but is seen as a critical consultee and part of the overall picture. All 44 plans – as submitted in draft in October 2016 – are now publicly available for consultation and ongoing development.

The STP process reinstates some of the overall place-based planning which occurred under strategic health authorities prior to their abolition.

The Care Act 2014

The Care Act 2014 contains provisions relating to adult care and support, care standards, health education and research.

The Act gives effect to the policies requiring primary legislation that were set out in the White Paper Caring for Our Future: Reforming Care and Support (HM Government, 2012), 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 required primary legislation.

In February 2013, the government announced it would reform the funding of care and support in line with the Dilnot recommendations. Following a deferral, those changes are due to be implemented in 2020, but they are expensive and there is some scepticism over whether the government will in the end choose to prioritise this change given the extent of other financial pressures on the health and social care system.

Paying for care

In addition to an assessment of their needs, clients 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 the amount of capital held by the individual, 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* (DH, 2014). 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 these services will help to support the budget. The public must be consulted on charging policies and any proposed changes to them.

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 are due to change under the Care Act 2014 (see above) but the relevant provisions have been deferred to 2020 and many commentators doubt if the government will, if fact, move to implementation. This provides for a reformed system of funding whereby there will be a cap (of £72,000 at 2014/15 prices) on care costs incurred to limit what people pay for care over their lifetime.

Commission on the Future of Health and Social Care

There is a widespread view 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 King's 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 ringfenced, 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 society is committed to doing for healthcare costs).

The key recommendation was that a single, ringfenced budget for both health and social care, incorporating attendance allowance, should be managed by a single commissioner. 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.

The commission held that the costs of this new settlement could be met in a 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 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.

The King's Fund website provides both the report and for the commission's November 2015 statement of concern with the lack of progress in response to it. It had been hoped that these issues will be revisited in the planned 2017 Green Paper but the situation has been complicated by the 2017 election and its aftermath.

CHILDREN'S SOCIAL CARE TRENDS AND PRESSURES

Budgeted expenditure for children's social care for 2016/17 was £7.8bn for England, of which looked after children accounted for the largest proportion at 45%. Commissioning and social workers are the second largest element, 20%. Other services include youth justice work, family support and support for asylum seekers.

Directors of children's services may also have responsibility for broader functions such as home to school transport and school places planning; not covered here but an important interface with children's social care.

Children's social care is also demand led. If a child is placed into a local authority's care, then that child must be supported, with residential placements being the most expensive. As with adult social care, the policy focus is to intervene early in order to both prevent expensive admission into care and provide better outcomes for children in their own homes.

The LGA's autumn 2016 Budget submission assessed the pressure by 2019/20 as some £0.9bn over a somewhat broader definition of children's services, covering children's social care and education services.

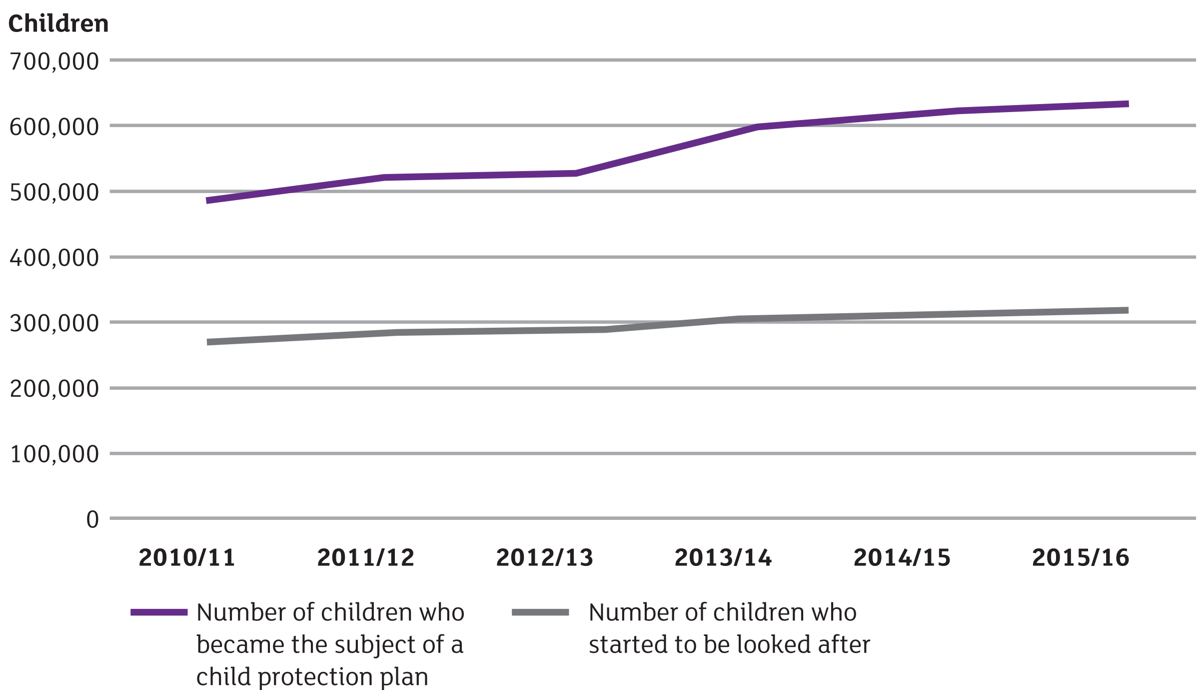
Children's services – forward cost projection

2016/17	2017/18	2018/19	2019/20
£m	£m	£m	£m
11,142	11,419	11,762	12,092

Source: Local Government Association's autumn 2016 Budget submission

The All Party Parliamentary Group for Children (APPGC) published the findings of its latest inquiry into children's social care services in England in March 2017. The report, *No Good Options*, identified the key trend leading to budgetary pressure is in the number of children classified as 'looked after', as follows:

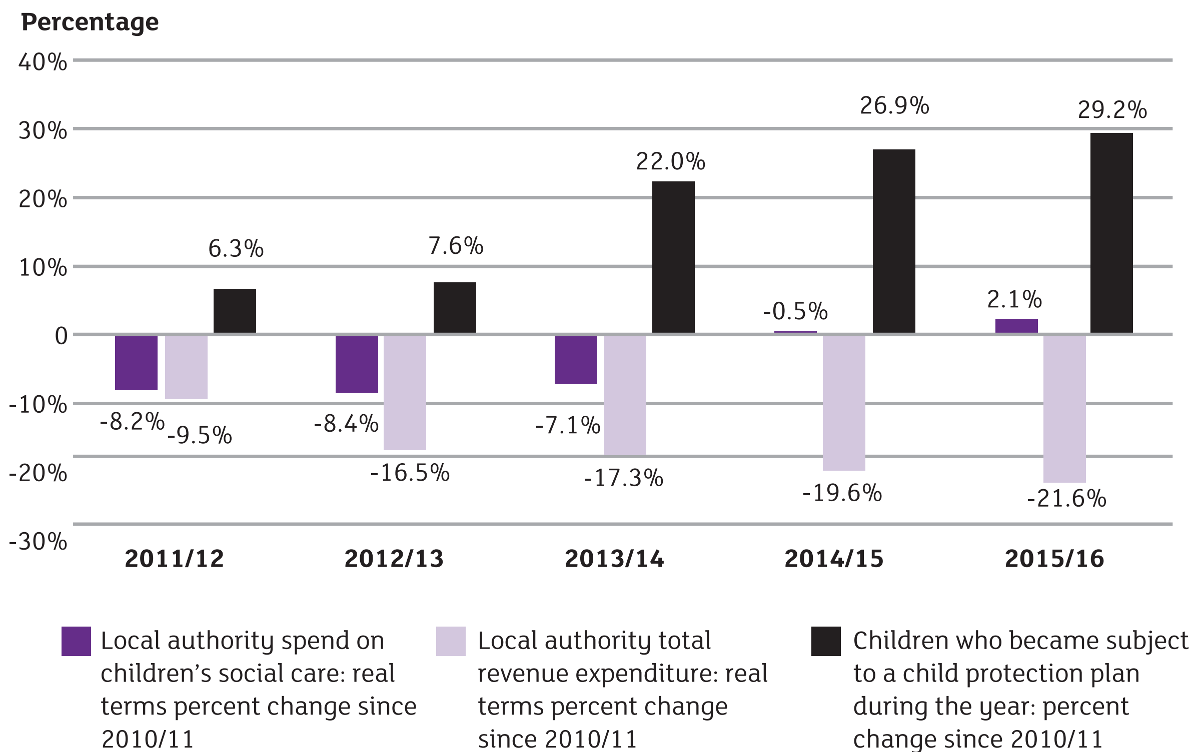
Children with a child protection plan, and looked after children



Source: All Party Parliamentary Group for Children (APPGC) No Good Options (March 2017) p9

This has led to pressure even though children's services have been relatively protected compared with local authority spending as a whole:

Change in local authority spend on children's social care since 2010/11



Source: All Party Parliamentary Group for Children (APPGC) No Good Options (March 2017) p12

The report also points out that spending on early intervention has typically reduced, though the picture is patchy, eg "Essex has invested significantly in children's centres whereas Oxford decommissioned all centres in their area and faced judicial review as a result".

CHILDREN'S SOCIAL CARE EFFICIENCY AND SAVINGS PROGRAMMES

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 (LGA, 2014) – 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.

CHILDREN'S SOCIAL CARE STATUTORY AND POLICY FRAMEWORKS

Director of children's services

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 its 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 and Fostering Payment Systems – Good Practice Guidance (DfES, 2006).

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 foster 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 inter-generational. 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 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 has 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.

Children's social care 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 wellbeing 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 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 and 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 ringfenced 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; and this offer should be 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 are more closely involved in the assessment. In addition, existing protections for parents and carers, including their right to directly request a local authority assessment of their child, have been maintained and extended.
- 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 with arrangements for parents/carers, children and young people to consider mediation but with an option for them to go straight to an appeal.
- The local authority is required to publish any comments made on its 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, these groups must also be included in any reviews of the local offer.
- 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 not in education, employment or training (NEET). 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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