

Nottingham City Council

**Initial follow up independent investigation into
officer and councillor actions, decision making
and culture in response to the HRA Review
undertaken by CIPFA**

Key Findings Report

Richard Penn

Independent Investigator

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1 Background and methodology

I was commissioned in December 2021 through the Local Government Association, of which I am a Senior Associate, to conduct an initial and independent investigation following the Chartered Institute of Public Finance review into the Council's Housing Revenue Account (HRA) commissioned by the Interim s151s Officer, supported by the Chief Executive in consultation with the Leader of the Council. The CIPFA report concluded that the payments could reasonably be argued to be:

'a mechanism conceived to divert HRA funds to the GF'

and that if so, in CIPFA's view, this was:

'an illegitimate use of HRA funds and a clear breach of the HRA ringfence which is potentially unlawful'.

- 1.2 Subsequently, the s151 Officer's report concluded that illegitimate payments had been made from the HRA to the General Fund (GF) since 2014/15 and that payments made by NCH to NCC have been accounted for by NCC to the benefit of the GF rather than to the HRA. The Council commissioned advice from a leading QC who advised that the payments were unlawful and that the s114 Notice served by the Interim s151 Officer and the s5 Notice served by the Director of Legal and Governance were both appropriate and had underlined the serious way in which the Council was dealing with the issue.
- 1.3 I was commissioned by the City Council Chief Executive and this report on my investigation is for him for appropriate consideration and consequential action. I have regularly needed to make clear during my investigation that I am an independent consultant and that the LGA has had no involvement whatsoever in the investigation. My investigation has examined in detail the chronology of events in relation to the payments NCH made to NCC including who conceived the payments, who authorised them, the accounting transaction details, who knew about this, how challenges to the legitimacy of the payments were dealt with and by whom and any other facts that provide insight into how the situation came to be.
- 1.4 I was provided initially with a copy of the CIPFA review and other relevant documentation, but my investigation included a review of other documents in the public domain together with formal interviews with individuals both inside and outside the Council including representatives of Nottingham City Homes (NCH). I have interviewed 30 individuals including a number of current members of the Council, senior officers at the Council, the former Chief Executive, the former Director of Finance and the former Monitoring Officer, the Chair of NCH, the Chief Executive of NCH. Each person I interviewed was told that I would be taking a note of the key points that emerged from the discussion, and a draft record was then provided as a draft to each interviewee for comment and, if appropriate, correction. Agreed records of each interview were then finalised. I advised all of those that I interviewed that I would draw on the agreed record in compiling my report on the investigation.

- 1.5 I also received written submissions from a number of former Council employees including the former Chief Executive, a former Deputy s151 Officer, a former Strategic Director of Finance, the former Corporate Director Growth and City Development and a former Interim Chief Executive. The Chief Executive of NCH provided me with a comprehensive account of the events leading up to and subsequent to the initial payment from the HRA to the GF in 2014/15. I also met with the author of the CIPFA report and with the Chair of the Nottingham City Council Improvement and Assurance Board.

2 My investigation and findings

- 2.1 The payments made by NCH to NCC since 2014/5 resulted in the GF benefitting from these payments to a total of £15,858,500 in the period from 2014/15 to 2020/21. The CIPFA review concluded that these payments seemed to be a breach of the HRA ring-fence which is, potentially, unlawful. Furthermore, the Council has had confirmation from leading Counsel that the payments NCH has made to NCC are prohibited ‘*distributions of surpluses*’ and are unlawful. CIPFA had concluded that the payments could reasonably be argued to be:

‘a mechanism conceived to divert HRA funds to the GF’

and that if so, in CIPFA’s view, this is:

‘an illegitimate use of HRA funds and a clear breach of the HRA ringfence which is potentially unlawful’.

- 2.2 I was required through my investigation to examine in detail the chronology of events in relation to these payments and to answer four questions:

- *who conceived the payments, who authorised them and the accounting transaction details?*
- *who knew about the payments?*
- *how challenges to the legitimacy of the payments were dealt with and by whom*
- *and any other facts that may provide insight into how the situation came to be*

This investigation and the report will result in two important outcomes:

- the first outcome will be to inform the understanding of how and why the Council has arrived in this situation
- and the second outcome will be to demonstrate the seriousness of the Council’s intent to establish an organisational culture that has learning and accountability at its heart.

- 2.3 This Key Findings Report on my investigation and the findings, conclusions and recommendations set out in the Report are based on the detailed evidence that I gathered through my investigation.

3 The chronology of events

- in 2012 NCC and NCH began looking at efficiencies from joint working which could release ‘savings’. The Council’s budget setting for 2013/14 included ‘*Big Ticket*’ savings which did not include anything related to NCH’s budget setting for that year and it is understood that NCC delivered the 2013/14 saving through its own accountancy and management of the HRA.
- the Council then established an ‘*NCC and NCH Common Services Big Ticket Programme*’ and the payment had formed part of wider ‘*Big Ticket*’ savings from the HRA to the benefit of the GF.
- the payment from NCH to NCC was proposed the following year during the budget setting process for 2014/15, and was initially set at £750k based on ‘*efficiencies from improved joint working*’ between NCC and NCH and NCH that would deliver an HRA trading surplus.
- there was no serious challenge to the proposal at that time and assurance was given to anyone who questioned the proposal that it was ‘*legitimate*’ and allowable under the NCH Articles of Association and the Partnership Agreement.
- the repayment expected from NCH grew year on year at the direction of NCC to meet continuing GF shortfalls in budget setting, and these payments were no longer evidenced by efficiencies from ‘*joint working*’ or a ‘*trading surplus*’. Rather, NCH was required by NCC to make annual savings from its operating costs to deliver the increased return.
- NCH raised concerns in 2016 with senior NCC officers and councillors about the inappropriate use of HRA finances which were noted. An internal NCH email raised concerns over possible inappropriate use of the HRA when it reported that ‘*there is also a drive from some NCC officers to substitute HRA funding for GF funding of services.*’ NCH advised the City Council that the Communities and Local Government Department was taking a closer look at use of the HRA around the country, which led to the Big Ticket Programme Board asking for assurance about what was proposed.
- NCC continued to expect an annual increase in the return leading to the NCH Board formally stating its concerns at the Partnership Forum in 2017. The expected return increased again to reach £4.125m in 2018/19 despite the concerns raised by NCH officers and the NCH Board.
- in 2018 it was acknowledged that the level of return was unjustifiable and steps were put in place to significantly reduce the level of annual return in subsequent years
- in 2021 the NCC Interim s151 Officer, supported by the Chief Executive in consultation with the Leader of the Council, commissioned the CIPFA review.

- the CIPFA review concluded that however the payments made by NCH to NCC since 2014/5 are defined or described, the GF has benefited from these payments totalling £15,858,500 in the period from 2014/15 to 2020/21. This seemed to be a breach of the HRA ring-fence which is, potentially, unlawful. Furthermore, if it was determined, on the basis of legal advice, that the payments NCH had made to NCC were prohibited ‘distributions of surpluses’ these were also, potentially, unlawful.
- inter alia, CIPFA recommended that given the potentially serious implications for both NCC and NCH, NCC should commission legal advice on the issues of lawfulness and should examine in detail the chronology of events in relation to the budgeting for and payments NCH had made to NCC including who conceived the initial payment, who authorised it, the accounting transaction detail, who knew about it, how challenges to the legitimacy of the payment were dealt with and by who and any other facts that could provide insight into how the situation came to be.
- in December 2021 an independent investigation was commissioned by the NCC Chief Executive
- on 15 December 2021 the Council’s Interim s151 Officer served a s114 Notice on the Council relating to the treatment by the City Council of annual ‘*management fee rebates*’ from NCH since 2014/15 (funds derived from the Housing Revenue Account (HRA)) as General Fund (GF) income in breach of the HRA ‘Ring Fence’ under the Housing Act 1989 (S74) and the receipt by NCC since 2014/15 of annual ‘*management fee rebates*’ paid by NCH Limited (a wholly owned and controlled company of NCC), in breach of its Articles of Association. The Interim s151 Officer was not requiring the cessation of spending by NCC but rather bringing to members’ attention acts of unlawfulness. He imposed a management action prohibiting NCC entering into new agreements and spending commitments with NCH unless expressly approved in writing by himself in consultation with the Chief Executive and Monitoring Officer as appropriate.
- the same day the Council’s Monitoring Officer served a s5 Notice on the Council to report that he was satisfied that the relevant information had been brought to the attention of all members of the authority as required by s5 LGHA 1989, by virtue of the s114 report.
- the Council has received advice commissioned by the Interim s151 Officer and the Director of Legal and Governance from leading Counsel confirming that the payments were unlawful and that the s114 and s5 Notices were appropriate.
- in March 2022 this Key Findings Report on the independent investigation was submitted to the Council’s Chief Executive.

4 My findings

4.1 I was required by Nottingham City Council (NCC) through this investigation to examine in detail the chronology of events in relation to the payments that had been made from the Housing Revenue Account (HRA) to the General Fund (GF) since 2014/15 and then to answer four questions:

- *who conceived the payments, who authorised them and the accounting transaction details?*

The answer to this question is straightforward. In July 2013 indicative savings targets were allocated to each Corporate Director (in this case the then Corporate Director of Development) based on the budget share for their Directorate. The process for generating potential savings for the Council's 2014/15 budget against these targets consisted of a number of elements: traditional savings, income generation, increases in charges, and the '*Big Tickets*' exercise. The clear political directive was to find the savings from efficiencies before cuts in spending wherever possible. '*Big Tickets*' were ideas generated in Directorates through Working Groups of officers and councillors to find large-scale (over £1 million) savings. Proposers had to provide assurance of the robustness of the saving for it to be approved in the Council's budget process. Proposals were considered by the Leadership Group (the former Leader, the former Deputy Leader, the former Chief Executive and the former Deputy Chief Executive/s151 Officer) and then agreed at budget meetings with the Executive. Throughout the process, checks and balances were built in to allow for the robustness and deliverability of proposals to be assured before being presented to councillors. This included requiring sign-off from officers with relevant technical or finance knowledge/expertise. Sessions with the whole Executive allowed for a political '*lens*' to be applied to the savings proposals and open and robust discussions took place on each and every savings proposal. The item referred to as the '*HRA saving proposal*' in the CIPFA report was developed as part of the 2014/15 budget process during the autumn of 2013. This proposal was one of many that were made by the then Corporate Director of Development as a result of the '*Big Ticket*' initiative. There was a clear expectation that only robust and legitimate proposals would be fully considered, and that all proposals were legitimate and deliverable. No concerns were raised about the long-term viability of this Nottingham City Homes (NCH) '*Big Ticket*', and assurance was clearly given as to the viability and legitimacy of this saving from officers from the Finance team and those who managed the NCC relationship with NCH. As well as officers with the responsibility for managing the Housing functions, the s151 Officer, the Director of Finance and the HRA Finance expert were all sighted on the proposal and none of them raised concerns about its legitimacy. After the in-principle agreement to this proposal no further concerns were raised by officers later in the process, including the Monitoring Officer or any of the Legal team.

- *who knew about the payments?*

Again, the answer to this question is straightforward. All those at NCC and NCH who were involved in the NCH '*Big Ticket*' process were fully aware of this proposal, and those officers and members who were directly involved in finalising the 2014/15 revenue budget potentially

knew about it. It was no secret – at p. 257 of the Budget Report for 2014/15 under ‘*Joint working/cost saving initiatives*’ it was stated that:

‘the City Council and NCH has embarked on a review of services to be delivered in partnership to deliver General Fund savings whilst ensuring that the HRA is charged a proportionate share of the costs. Page 256 Annex 4 – Appendix A17/02/2014 It is proposed elsewhere in this report that the City Council will require NCH to return a proportion of any surplus generated from trading activity (£0.750m in 2014/15). This proposal has no direct impact upon the HRA.’

so anyone who had looked at the 2014/15 Budget report – and that presumably includes all members of the Council, senior Council officers, representatives of partner and stakeholder organisations, the Council’s external auditors as well as the local media and the Nottingham public – potentially could have been aware of this proposal at the time. The former Corporate Director of Development who sponsored the proposal has said that Finance and Legal officers were closely involved at all stages and the proposal had been deemed legitimate by the two statutory officers - the s151 Officer and the Monitoring Officer - at the time.

- *how challenges to the legitimacy of the payments were dealt with and by whom*

The evidence is clear that at the time of its conception the proposal was not challenged except by the Finance officer who managed the HRA. As time went on there were more concerns expressed by NCC councillors and a former NCC Director of Finance who were appointed to the NCH Board about what had become annual payments from NCC to the Council, but the concern was only about the increasing quantum of the payments and the detrimental impact on tenants and not about the principle of the payments or their lawfulness. The first formal challenge came from the newly appointed NCH Chair who in April 2017 wrote to the Deputy Leader and Portfolio Holder for Finance at the City Council to raise his concerns that the £3.625m return planned for that year was not based on any legitimate trading surplus and that there was a lack of transparency about what the HRA money was being used for by the City Council. His concerns were then dealt with at meetings of the NCC/NCH Partnership Forum. And that seems to have been the case – that it was finance officers who reassured anyone who queried the appropriateness or the legitimacy of the payments that everything was ‘*ok*’. The Council’s legal team was neither asked for nor offered advice about the lawfulness or otherwise of these payments. When the report of the CIPFA review concluded that these payments seemed to be a breach of the HRA ‘*ring-fence*’ which is, potentially, unlawful and that, if it is determined on the basis of legal advice, that the payments NCH has made to NCC are prohibited distributions of surpluses these are also potentially unlawful, this took everyone by surprise both at NCC and NCH as the focus of any concerns had been on the amounts of the payments not their lawfulness. I was not required as part of my investigation to determine whether the payments were or were not ‘*lawful*’ – in any case, as someone who is neither a solicitor nor an HRA finance expert this would not have been possible for me – but it has been interesting to discover that the legal advice obtained by NCC and the legal advice obtained by NCH is contradictory. The legal advice to NCH in summary was that:

1. the annual refund made to NCC was consistent with both the Partnership Agreement and the Articles of the Company
2. surpluses retained by NCH can be used in furtherance of any of its Objects
3. Board members had not breached any other fiduciary or statutory duties

whereas the legal advice to NCC has been in summary that the payments were in contravention of NCH's Articles of Association and the 2011 and 2020 Partnership Agreements between NCC and NCH. NCH's Articles prohibit the distribution by NCH of profit to NCC by way of a dividend, bonus or profit. There is a conflict between the Articles and the Partnership Agreements but the Articles prevail, and not only do the Articles take precedence over the Partnership Agreement and prohibit the return of surpluses to NCC, this is any event prohibited by the overriding legislative ring-fencing protecting the HRA and any such treatment constitutes an unlawful use of HRA money

- *and any other facts that may provide insight into how the situation came to be*

Based on this wide-ranging review of relevant documentation and meetings with the NCC senior officers and elected members involved with the decision to transfer '*surpluses*' from the HRA to the General Fund in the 2014/15 Council budget, the available evidence clearly indicates that this proposal originated from the former Corporate Director of Development (who had responsibility for housing in at the time) as part of his response to need to identify so called '*Big Ticket*' items that would reduce the need for savings that may have led to service cuts and/or job losses. Assurance was given by him and by the Finance staff involved to anyone who questioned whether this proposal was '*legitimate*', and when junior officers associated with the management of the HRA questioned this and other HRA '*adjustments*' that it was all ok, there was backing from the political leadership and not to '*rock the boat*'. The Finance team ran the budgeting process and no legal advice was either sought from or offered by the Council's legal team about the lawfulness of the proposal. Legal staff generally, and the Monitoring Officer at the time specifically, were not engaged with the '*Big Ticket*' process or in the meetings where these matters were being considered by elected members and decisions were being made in relation to the 2014/15 budget. The Monitoring Officer was entitled to attend CLT and the Executive Panel but did not always choose to do so.

- 4.2 Notwithstanding the nature of the HRA ring-fence and the wholly-owned company that had been established to deliver services through HRA funding, there was no evidence of professional or intellectual curiosity from NCC officers as to the ability to do this - to make payments from the HRA to contribute to GF savings - notwithstanding the increasing amounts required over the years. The performance of those senior NCC officers with responsibility for Housing and Finance at that time fell well below what could reasonably be expected in terms of knowledge of the law in relation to HRA ring fence and providing advice to councillors. The general view of those councillors involved appears to have been that the issue was either not raised as a concern, or alternatively assurance was provided by the former Corporate Director of Development and Finance officers that it was legitimate and appropriate. No contrition or apologies have been offered by those involved.

- 4.3 Any concerns on the part of NCH appear to have been mainly centred on the increasing quantum of the payments and the financial strain they were putting the company under, rather than putting steps in place to stop the payments being made because they were considered unlawful or inappropriate. At both NCC and NCH the prevailing attitude appears to have been ‘*go along to get along*’.
- 4.4 However, I have not concluded that the payments were initially ‘*a mechanism conceived to divert HRA funds to the GF*’ as suggested in the report of the CIPFA review. The evidence indicates that the payment in the 2014/15 budget process was an officer-driven proposal, not a political instruction, in an environment where there were many proposals to reduce expenditure or increase income in order to meet the political imperative to maintain services and avoid cutting jobs. However, the annual payment then continued and the amount of the payment differed from year to year as did the description of the payment, and this increases the likelihood that it did become an accepted mechanism to divert funds from the HRA to the GF. That this was allowed to happen and continued for so long was down to poor governance practice, principally at NCC but also at NCH. Senior officers at NCC responsible for the Housing, Finance and Legal functions were expected to understand the GF rules and law around the HRA ring-fence, and to enquire and to challenge robustly any proposals that could potentially breach the ring fence. Notwithstanding that the historic culture at the time was that challenge of members or speaking ‘*truth to power*’ was not welcomed, that is the role of senior professional officers and it is the responsibility of councillors to ask for and take any such advice into careful consideration in decision making.
- 4.5 There has also been a serious failure of governance at NCH where the NCH Chief Executive and others had a sufficient knowledge of the HRA ringfence to know that returning surpluses back to the Council to help with General Fund budget pressures could not be justified but they went along with it. Whilst NCH is a wholly owned NCC company the relationship does not appear to be one that reflects that ownership reality, with little evidence of NCC setting strategic priorities for NCH and of NCH delivering against those. Rather, the evidence shows a lack of accountability with NCH seeking to pursue its own agenda with very weak effective client management from NCC. This appears to have been allowed to happen as a result of the ‘*hollowing-out*’ of the strategic local housing authority function at NCC in the belief that large parts of this could be carried out by NCH. This has led to NCC being exposed to significant risk in terms of having little or no control over significant housing functions for which it is responsible. Put simply, the governance arrangements between NCC and NCH are not ‘*fit for purpose*’. Even though it is a wholly owned subsidiary, NCC does not have the right to appoint or remove the Chair, nor does it have the right to appoint or remove the Chief Executive. NCC will need to take steps to reduce the risk associated with the management of its council housing and the performance of its local housing authority function.
- 4.6 My investigation was expected to result in two important outcomes that:
- **the first outcome** would be to inform the understanding of how and why the Council has arrived in this situation. Based on the evidence that I have been able to gather the organisational environment in which these payments were conceived and authorised in 2013 -2014 was remarkably similar to the organisational environment described in the Rapid Review report seven years later. There was a ‘strong Leader’ model in operation at the time, and a number of former NCC senior managers that I met with commented on a

political and managerial leadership that had failed and was not capable of listening and acting. However, although the picture painted by this evidence could have led to the City Council acting inappropriately and potentially unlawfully in its decision to make annual payments since 2014/5 that resulted in the GF benefiting from these payments to a total of £15,858,500 in the period up to 2020/21, I have not concluded that the payments were ‘*a mechanism conceived to divert HRA funds to the GF*’ as suggested in the CIPFA Report.

- the Council has acted unlawfully and, furthermore, resources have been systematically taken away from some of its most vulnerable citizens – as by definition citizens need to demonstrate significant need to qualify for social housing in the first place. The Council has been undertaking a very significant recovery and improvement journey in the last year. However, on the evidence of the CIPFA Report and this investigation this is not the case with its wholly-owned company, NCH. Moreover, the overriding original rationale for establishing an ALMO, to access ‘*Decent Homes Funding*’ for the upgrading of council housing, no longer exists. The evidence shows clearly that the Council’s existing relationship with NCH is problematic, not ‘*fit for purpose*’ and adds risk and complexity to the Council in the delivery of its statutory obligations and policy priorities. The Council needs to be clear, purposeful and swift in its response. I have therefore recommended that urgent consideration is given to bringing back ‘*in house*’ the management of the Council’s housing stock and related functions. Ordinarily not less than 12 months’ notice would be required to achieve this to allow sufficient time for the necessary project planning and implementation to take place in relation to the TUPE of staff to the Council, where they will become council employees, and the necessary integration of financial and management systems. Between now and when the ‘*Notice to Terminate*’ is served, the Articles of Association, the rules governing how the company operates lodged at Companies House, need to be amended to give the Council the right to appoint and dismiss the Chair of the Board and the Chief Executive along with other changes to ensure that the Council has the necessary close control over the company. The Council’s Shareholder Unit function, supported by the Council’s Statutory Officers, will have far greater oversight over the operation of NCH and its subsidiaries. The Council is already significantly strengthening its local housing authority role, to include effective clienting arrangements of NCH. This should also include project planning for the return of council housing management to the Council.
- **the second outcome** would be to demonstrate the seriousness of the Council’s intent to establish an organisational culture that has learning and accountability at its heart. This episode has of course been a disappointing setback for the Council on its improvement journey which has centred on improving strategic financial management and governance – poor examples of both have been identified through this investigation. Notwithstanding that, that the issue has been identified and dealt with by the Council itself, clearly demonstrates that the improvement journey is very much on track, and that there has been a sufficient shift in organisational culture that NCC senior officers have exposed the issue, spoken ‘*truth to power*’, and elected members have responded positively with a resolve to put things right as evidenced by the recommendations unanimously passed at the

Extraordinary Full Council meeting held on 4 January 2022. The Council knows full well what '*good*' looks like and has been determined to not put itself in the position of requiring the Improvement and Assurance Board or Commissioners to identify any wrongdoing and then put it right.

5 Recommendations

1. that, having regard to the CIPFA Review and this investigation, urgent consideration is given by the Council to bringing back '*in house*' the management of the Council's housing stock and related functions. Between now and when a 'Notice to Terminate' is served, the Council to expedite the significant strengthening of the governance arrangements applied to NCH, to ensure that the Council can demonstrate and exert the required control over NCH as a wholly owned Teckal company, to provide the necessary assurance over the management of the Housing Revenue Account. This should include amending the Articles of Association, the rules governing how the company operates lodged at Companies House, to give the Council the right to appoint and dismiss the Chair of the Board and the Chief Executive.
2. that the ongoing strengthening of the Council's local housing authority role, to include effective clienting arrangements of NCH, together with the undertaking of project planning for the return of council housing management to the Council, with the necessary resources being allocated.
3. that arrangements should be made for additional advice, guidance and support for the Council's Finance Team including external support.
4. that the Monitoring Officer and the s151 Officer should be formally and more actively involved along with the Chief Executive as the Council's third statutory officer in fulfilling their statutory responsibilities for the provision of advice to elected members on any proposed action by the Council that could potentially be unlawful.
5. that any such advice from the Council's three statutory officers must be fully respected by both members and officers and given due weight in the Council's decision making processes.
6. that the Council's external auditors should be required to have a greater focus on how the Council is taking decisions and responding to the advice from the Council's statutory officers rather than relying on '*materiality*' to trigger potential intervention.
7. that whilst the operating environment may have been considered challenging or difficult, the investigation has found that a number of former NCC officers fell below the standard that could reasonably be expected in showing the necessary intellectual curiosity, and providing clear advice about the inappropriateness of action by the Council in this regard. The Council should seriously consider passing details of the CIPFA Report and this Report to relevant professional bodies, where relevant professional qualifications were and are held, for those professional bodies to determine whether they wish to consider any support, guidance or action in this matter. This would be a serious step and proper consideration needs to be given to the relevant evidence before any such action is taken to avoid potential litigation.
8. that the Council's Constitution - including the various Codes of Conduct - should be critically reviewed to ensure that the lessons learned from this experience have been fully encapsulated in the requirements set out in the Council's Constitution.