Grant Thornton

Nottingham City Council

Interim VFM Report

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Contents

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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Introduction

We have produced this report to formally update the Council's Audit Committee to place on record the areas which are of most concern to us.

One specific reason for producing this report is in order to comply with the guidance issued by the National Audit Office (NAO) in relation to the new approach to Value for Money (VfM) work for audit years from 2020/21 onwards: this guidance requires that where auditors have significant concerns about a council's arrangements, they should report them promptly, rather than waiting for all of the audit work for the particular year to be completed. Please refer to Appendix A for more details about the scope of our VFM assessment and types of recommendations we can raise.

Due the delays in the accounts audit, we have not completed our Value for Money (VFM) work for 2019-20 onwards. We have previously indicated that our VFM conclusion for 2019/20 would be likely to be qualified as the Council had not yet addressed the issues which led to the 2018/19 qualification.

We presented a report to Nottingham City Council's Audit Committee in February 2022. This report highlighted three areas of concern about significant weaknesses in the Council's Value for Money (VFM) arrangements:

- Financial Sustainability;
- Company Governance; and
- Delays to Annual Accounts Production and Finalisation.

The purpose of this report is to provide the Audit Committee with an update on our work in reviewing the Council's arrangements to secure best value. It provides our view of progress on the three areas of concern previously reported in February 2022. It also sets out five new areas of concern identified by our work during 2022 relating to:

- Failure to secure improvements in Children's Services
- Significant movements between budget and final outturn in 2021-22
- Unlawful transfer from the Housing Revenue Account to the General Fund
- Lack of management capacity due to recruitment and retention issues
- Failure to demonstrate best value through procurement.

We are not at this stage, however, seeking to comment on all of the issues which the Council faces, which are primarily being addressed through the Recovery and Improvement Plan. The Plan represents a very challenging agenda for the Council, which it is working hard to address, and it is clear that significant improvements have been made. However, there is still considerable further effort required and some aspects of the Plan were always intended to have longer timescales. We will continue to monitor progress and liaise with the Council and the Improvement and Assurance Board and consider the implications for our VFM reporting.

We will report on any further areas which we consider to be significant weaknesses once we have completed our wider audit work on the 2020/21 accounts, while at the same time providing our commentary on your VFM arrangements as required by the new approach.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Financial sustainability
Key recommendation	As part of its continuing efforts to achieve financial sustainability, the Council should ensure that: • Additional savings schemes are identified to bridge remaining gaps in the MTFS • The current work to build up and assess the business cases for savings proposals is continued at pace • The reasons for wide variations in in-year performance in 2021/22 are investigated and actions taken to improve forecasting in the relevant areas and prevent recurrence.
Follow up findings	The final version of the Medium-Term Financial Strategy (MTFS) for 2022-23 to 2025-26 as put forward by the Council in February 2022 represented a significant improvement on the scope and sustainability of plans prepared in previous years. Having benefitted from two years of reported and forecast underspends in the General Fund (£18M in 2020-21 and £13.9M in 2021-22), the final version of the MTFS for 2022-23 to 2025-26 (Figure 1) was balanced for all four years of the life of the plan, although this assumed that significant transformation and savings could be achieved in each of the four years. There are some positive points to note around recent financial performance: • For 2021-22, the Council elected not to draw-down the remaining £15M of capitalisation direction it had requested. The sum had been intended to fund transformation projects. However, with a risk assessed asset disposal programme of £53M having been introduced, the Council assessed that transformation could be funded from capital receipts rather than from additional central government support. • For 2022-23, "Business as Usual" Savings of £13.473M and Transformation Savings of £1.465M were shown as required in the MTFS. Quarter 1 reporting in 2022-23 recorded that only £0.67M of the "Business as Usual" savings has been assessed as undeliverable, with the remainder of Savings and Transformations for the year staying on track to be delivered. However, Quarter 1 reporting for 2022-23 also showed a forecast overspend of £13.2M opening-up on the underlying core portfolio costs for 2022-23. This was in addition to other areas of known risk within the MTFS for 2022-23 to 2025-26: Wave 3 transformation efficiencies; and required historic General Fund/ Housing Revenue Account corrections. For wave 3 transformation efficiencies, we note that Business as Usual Savings of £44.995M and Transformation Savings of £36.11M were shown as required within the MTFS. The Council is monitoring granular costed plans for most of this amount. However, £4.7M of "Wave 3" Transformation efficiencies in 2024-25 and 2025-26 have not yet been supported by business cases, although the Council has appointed a Strategic Delivery Partner to assist with preparing business cases going forward.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Financial sustainability
Follow up findings	For the General Fund and Housing Revenue Account corrections, we noted in February 2022 that an earlier iteration of the MTFS for 2022-23 to 2025-26 had factored in the need to repay £14M of HRA monies wrongly misappropriated by the General Fund. As already discussed, in April 2022, CIPFA informed the Council that historic amounts misappropriated by the General Fund from the Housing Revenue Account had a value of more than £40M, with £27M now covered by a Ministerial Direction and £16M planned as cash and asset adjustments. Further incorrect regeneration fee charges of between £4m and £5m are also expected to require an additional Ministerial Direction. The accounting treatment for these corrections is not yet fully agreed. Funding proposals put forward may require February's Medium Term Financial Strategy to be revisited. The other issue that requires the MTFS to be revisited are the significant inflationary pressures, which are the impacting the whole of the UK economy. Management have estimated that inflation is creating a £51.7m cost pressure. At the time of carrying out our work, we were also informed that after mitigations an estimated budget gap of £12m was being forecast for 2023-24 and that a total budget gap of £17.9m was being forecast for the period 2023-24 to 2026-27. Debt and Reserves There are some positive points to note around the Council's approach to debt and reserves. Max Caller CBE completed a Non-Statutory Review of Nottingham City Council in November 2020 and commented on the fragility of the Council's position – highlighting that debt stood at £1.1BN and that Earmarked Reserves had fallen (from repeated drawdowns) to a level not sustainable for supporting any more budget shortfalls. Since an Improvement and Recovery Plan was agreed in January 2021, the Council has worked diligently to reduce debt and re-build the resilience of the General Fund and Earmarked Reserves balances. A Voluntary Debt Reduction Policy was adopted and as a result, when the Council published its Treasury Annual Report in July 2022, it was able to show that total loan debts had fallen from £1.1BN on 31 March 2020 to £900M on 31 March 2022. During 2021-22, some £35M was transferred out of the General Fund and into Earmarked Reserves, including a financial resilience earmarked reserve. A new quarterly process was introduced by the Council in 2021-22 for the s151 Officer to review, approve and report to the Executive Board on all transfers OUT of reserves. All drawdown requests now need justifications as to why they could not be met from existing balances.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Financial sustainability
Follow up findings	The overall level of General Fund and Earmarked Reserves remained stable during 2021-22, with a combined balance of just over £200M at the end of both years. In February 2022, the Council announced a plan to increase the General Fund by £1M per annum for the next four years. The first Quarter of 2022-23 saw the Earmarked Reserves fall by £7.2M, however this masked off-setting movements. Covid related timing differences for Business Rates Reliefs of some £11M were reversed out of the Earmarked Reserves, but this was off-set by a welcome replenishment of £3.8M to the Reserves from the General Fund.
Conclusion	The Medium-Term Financial Plan for 2022-23 to 2025-26 as put forward by the Council in February 2022 represented a significant improvement on the scope and sustainability of plans prepared in previous years. Furthermore, the clear steps taken to bring discipline to the Council's management of debt and use of reserves are positive. However, historic issues surrounding misappropriation to the General Fund over previous years which now needs to be corrected, means there remain significant gaps in the Plan. There are £4.7M of Transformation savings within the latest MTFS which were unsupported by business cases; there are new overspends forecast for 2022-23; and, looking forward, there are new emerging budget gaps which could threaten delivery from 2023-24 to 2026-27. The extent of unaddressed budget gaps continue to represent a significant weakness in the Council's financial planning arrangements.
Key recommendation	The Medium Term Financial Plan should be revisited at the earliest opportunity. Business cases should be developed to support additional savings plans to fully address the budget gaps in the medium term.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Companies governance arrangements
Key recommendation	The Council should maintain the momentum it has now achieved in rationalising its company arrangements and improving governance. As part of this, it should: • Ensure that the planned increase in resources in this area, particularly in the form of the shareholder team, is effective and sufficient. • Continue efforts to ensure that the Council is appropriately represented on the boards of its subsidiaries and associates and that its representatives fully understand their role as directors and their responsibilities towards the company. • Put in place an overall strategy for its involvement in companies, building on the guiding principles which have recently come into use.
Follow up findings	Since February 2022, the Council has continued to strengthen its governance arrangements for companies. Active steps have been taken to de-risk and rationalise the Council's company portfolio – with one subsidiary being put into Voluntary Members Liquidation in April 2022 and another being sold in July 2022. Additionally, to improve monitoring and oversight of the Council's interests, funding for a new Shareholder Unit was agreed in March 2022 and active recruitment of three roles to operate the Unit is underway. The Companies Governance Executive Committee met seven times between February and September 2022 and a financial update for companies was provided to the Committee at every meeting. A Member's Handbook (a consolidated guide to the Councils approach to companies governance) was presented to the Companies' Governance Executive Committee in September 2022 and subsequently approved. The Council still has five wholly owned subsidiaries, two joint ventures where is has significant control, and numerous minority interests. The Council is undertaking a review of the strategic and commercial longer term aims of each company it has control over. Those companies most affected by the pandemic and inflation are being monitored in detail with regular analysis of the cash projections and mitigations against inflation. Risks within the group are communicated to the Council's Audit Committee and are also reported to the Companies Executive Governance Committee.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Companies governance arrangements
Follow up findings	NCH Ltd Notwithstanding the good progress observed with strengthening arrangements since February 2022, details surrounding the high value (£40M+) historic charges levied by the Council on the individual subsidiary NCH Ltd mean there remain company governance issues still be addressed. Mr. Penn and CIPFA have both reported since February 2022 that the illegal misappropriation of Housing Revenue Account monies dating back to 2014-15 reflected poor governance over the period not only at the Council but within the subsidiary and its' group as well. Richard Penn's report recommended amending the Nottingham City Homes Ltd's Articles of Association to give the Council better control over its' subsidiary and CIPFA recommended that the Council serve its subsidiary with a 12-month notice to terminate its functions. The Council has taken an executive decision to take Nottingham City Homes Ltd's housing functions back in-house. A structured approach for managing, closing or disposing of the residual company and its' subsidiaries is under review. Arrangements should be clarified at the earliest opportunity. Continued monitoring over period of inflation Even if there is a full disposal of Nottingham City Homes Ltd and its subsidiaries, the Council's portfolio of group holdings will remain large. With inflation a significant issue for much of the UK economy at the time of writing this report, a strong central Council finance function will be needed for continued monitoring of solvency across what will still be a relatively complicated group structure. As already noted, enhanced monitoring has been introduced since February 2022. Our understanding is that this will be assisted in future by the Shareholder Unit and that there is the intention to provide a dedicated finance business partner engaging with each company Board and finance team. However, the Council's finance function has at times been carrying a 30% vacancy rate and is heavily dependent on interim posts. The labour market in the UK finance sector remains under pressure. In the sixth Quarterly Report of the Improvement and Assurance Board, published in September 2022, we note that the Board estimated "It is expected to take until Spring 2023 to complete a review of subsidiaries and until late 2023 to complete a review of non-subsidiaries".

Follow-up on previously reported significant weaknesses

Area of significant weakness	Companies governance arrangements
Conclusion	We have seen positive steps taken to strengthen the Council's governance arrangements over companies since February 2022. However, governance failings and £40M+ historic accounting errors have been uncovered with one subsidiary. At a time when rising inflation poses risks for subsidiaries, the Council expects it to take well into 2023 to complete strategic reviews of the other companies. This issue continues to represent a significant weakness in the Council's governance arrangements over its companies.
Key recommendation	Efforts to review the strategic purpose and financial needs of Companies should be continued. The Council should be mindful that risk within subsidiaries could increase with coming inflation and that skilled accountants are required as business partners for companies as well as for core Council financial reporting roles.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Delays to Annual Accounts Production and Finalisation
Key recommendation	The Council should ensure that sufficient resources and priority are given to the accounts preparation process, commensurate with a council of Nottingham's complexity and challenges. Officers should strengthen arrangements to ensure that there can be no repeat of the loss of crucial valuation records, which resulted in delays to the accounts and the incurring of significant sums on a repeat valuation process.
Follow up findings	Work on the audit of 2019-20 financial statements is still ongoing. In addition to the valuations and Robin Hood Energy accounting issues identified in February 2022, in May 2022, we reported to the Audit Committee new accounting and audit risks on infrastructure assets, related party transactions, and management override of control. The accounting issues around the Council's General Fund needing to repay misappropriated funds to the HRA and Nottingham City Homes Ltd have not yet been resolved. Treatment on the Council, group and subsidiary income accounts and balance sheets needs to be clarified. In September 2022, the Board's Sixth Quarterly Progress report highlighted "serious concern about the level of key vacancies in the finance function" and reliance on "interim appointments in key positions". The vacancies in the finance function were having a significant impact on the ability of the Council to respond to audit issues and queries in a timely manner. Inevitably the vacancies in finance have led to audit timescales being pushed back further. In October 2022, new interim Finance team members have joined the team in October 2022, which has had an immediate and positive effect. It is essential that this renewed focus and effort from the Council in finalising the 2019-20 accounts audit is continued. A revised timeline has been agreed for the finalisation and audit of 2019-20 and for the preparation and audit of accounts for 2020-21 and 2021-22 accounts. The 2019-20 accounts and audit cycle is expected to conclude by in Q1 of 2023. It is expected that it will take 12 to 24 months to catch up for 2020-21 and 2021-22.

Follow-up on previously reported significant weaknesses

Area of significant weakness	Delays to Annual Accounts Production and Finalisation
Conclusion	The continued delays to the finalisation of the 2019/20 accounts and production of a full set of 2020/21 accounts represent a significant weakness in the Council's arrangements.
Key recommendation	External audit queries and issues should be resolved at the earliest opportunity. The Council should then ensure that sufficient resources and priority are given to the accounts preparation process, commensurate with a council of Nottingham's complexity and challenges.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Failure to secure improvements in Children's Services
Findings	On 5 September 2022, Ofsted published the findings from an unannounced July 2022 inspection of Nottingham City Council's Children's Services. Ofsted awarded the services an "Inadequate" grade for "Overall effectiveness". Ofsted's report stated that: *"Services for children who need help and protection are inadequate because there are serious failures, leaving children at continued risk of harm when they are first presented as in need of support"* The report also stated that the impact of leaders on social work practice with children and families "Requires Improvement to be Good" and that the experiences and progress of children in care and care leavers "Requires Improvement to be Good" . Weaknesses within the Council's Children's Services were first highlighted by Ofsted in January 2019, when the overall effectiveness of the service had been graded as "Requires Improvement". Since then, focused visits by Ofsted in February 2020 and June 2021 had highlighted slow progress with Improvement, driven by staff turnover; inconsistent management oversight and supervision; financial challenges; and the sad passing of the Director of Children's Integrated Services. In 2019-20, the Council's Children's Service net spend was valued at around £70M, but (in common with many English Authorities), costs have been rising rapidly – with latest growth forecast at around £11M in one year. The urgent need to drive through lasting improvement was highlighted by the Council in February 2022 when the Medium-Term Financial Plan for 2022-23 to 2025-26 noted that a "poor inspection outcome would have material additional financial implications for the council". The Plan had already put forward a proposed multi-year Change Programme, aimed at procuring specialist support to redesign the service; improving outcomes for children and families; and making a net saving £50.8M over eight years, with £40M occurring in the first four years (2022-23 to 2025-26). A transformation partner (external consultant) had already been appointed by the Council and an Improvement Plan was already in the process of being agreed at the time of Ofsted's July visit. The September 2022 Ofsted report recognised that a new senior management team had been established for the Children's Services; that oversight had been strengthened; and that recruitment and retention of workers was being appropriately prioritised. Nevertheless, Ofsted also noted that practice and supervision and management oversight remained inconsistent and that in some areas, services had deteriorated. Since the Ofsted visit, an Improvement Advisor has been appointed to the Council by the Department for Education and an Improvement Board has been put in place, meeting monthly. The Council's Improvement Plan, incorporating many of the service changes already embedded into the service's transformation plans, is still in the process of being finalised.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Failure to secure improvements in Children's Services
Conclusion	Ofsted first identified weaknesses in service performance in 2019. The "Inadequate" rating in September 2022 represents a failure to take appropriate action where an inspectorate has identified weaknesses in terms of service performance.
Key recommendations	The Council's Improvement Plan and associated actions for Children's Services should now be agreed at the earliest opportunity. Working with the Improvement and Assurance Board and other appointed partners will be essential now for securing better outcomes for children going forward.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Significant inconsistencies between budgetary information and the final outturn
Findings	In our February 2022 report, we noted a considerable swing in projected outturn for 2021-22 - reducing from an expected £10.9M overspend as at 30 June 2021 to an expected £2M overspend as at 30 September 2021. We reported that the high value of the swing raised questions about the forecasting approaches across different departments. By the end of 2021-22, significant inconsistencies in budgetary information continued and the "swing" in outturn had increased. Whereas a £2M overspend was forecast in September 2021, a £13.9M underspend was reported for March 2022. The trend of reporting high variances has continued in 2022-23 although may be explained by external pressures. Quarter 1 Budget Monitoring data for 2022-23 showed that by June 2022, although Savings and Transformation efficiencies planned for the year were still assessed as achievable, core portfolios costs were, three months into the year, forecast to result in overspends. The 2022-23 Budget allowed for Portfolio costs of £227.6M in the year. By the end of the first Quarter, total Portfolio costs for the year were forecast as £240.9M. The forecast £13.2M overspend was partly a reflection of pay awards, rising energy prices and other inflationary pressures. However, in their September 2022 Sixth Quarterly Report, the Improvement and Assurance Board reported that, as we found for 2021-22, "Budget Integrity and Planning" was an area of weakness and that the "level of understanding of base budget variation to actuals remains a concern". The swings in forecasts and high variances between budget and actual indicate, in short, that data underpinning original budgets and forecasts may not always be reliable. At the time of writing our report, the Council had engaged external consultants to review staff establishment data; income and grant forecasting and accounting; and purchase order to invoice arrangements. It is intended that the actions taken on the back of the review will feed through to stronger forecasting in future periods. However, the Council was also facing a 30% vacancy rate within its' Finance function when we carried out our work. An internal review by the Council of its' finance function in August 2022 identified a pattern of management accounting resources having been systematically removed to make budget savings since 2016-17; key activities (such as journals) having been performed wholly by budget holders without central accounting oversight since 2016-17; and the financial training function having been largely removed to make savings. Better arrangements recommended by the external consultants now engaged will only be impactful if an appropriate complement of skilled, confident and empowered staff is recruited to discharge them.
Conclusion	There are often significant inconsistencies in budgetary information due to weak underling processes. Strong technical accounting skills are required to address the Council's budgeting and planning issues. Consultants have been engaged and recruitment is underway but a longstanding history of under-resourcing the Finance function means the challenges the Council now faces are considerable. Significant inconsistencies between budgetary information and the final outturn represent a significant weakness in the Council's financial management arrangements.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Significant inconsistencies between budgetary information and the final outturn
Key recommendations	The Council needs to review budgets across the Council. Ideally adopting a zero-based budgeting approach to rebase and justify all expenditure. Efforts to recruit and engage skilled Finance resources should be continued. To resolve the management accounting weaknesses which have led to inconsistencies in budgetary information, the Council should be mindful that skilled accountants are required as business partners for services lines and companies as well as for core financial reporting roles.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Unlawful transfer between the General Fund and the Housing Revenue Account
Findings	On 15 December 2021, the Council's Section 151 Officer issued a report under Section 114(2) of the Local Government and Finance Act 1988. At the same time, the Monitoring Officer elected to issue a further report under Section 5 of the Local Government and Housing Act 1989. Both reports were issued in respect of acts of unlawfulness by the Council in respect of 'management fee rebates' made to the Council by its wholly owned and controlled company Nottingham City Homes (NCH) Ltd over the period 2014/15/ to 2020/21 inclusive. A CIPFA review commissioned by the Council had identified £15.85M of unlawful payments from the HRA to the General Fund, dating back to 2014-15. At an Extraordinary Meeting on 4 January 2022, the Council unanimously agreed to correct the financial wrongdoing and Richard Penn was commissioned as an independent investigator to report on: • The chronology of payments; • Who conceived of, who authorised and who knew about the payments; • How the payments were accounted for; and • How challenges to legitimacy were dealt with. Richard Penn's Key Findings were presented in a report to the Council in March 2022. Broadly, Mr Penn's report noted that the management fee rebate arrangements had been devised by Council budget holders in 2014-15 as a savings scheme and had been "no secret". Whilst affordability of the rebate had been challenged at various stages over the years, no questions around legality had been raised until CIPFA reviewed the scheme in 2021. Mr Penn concluded that the unlawful transfer of £15.85M arose because of *"poor governance practice, principally at (the Council) but also at NCH Ltd – this included officers being expected to understand complex legal issues; culture that mitigated against speaking-up; and unfit for purpose arrangements for controlling strategy and ensuring accountability between (the Council) and its' wholly owned subsidiary"*. The Report noted that whilst the Council Monitoring Officer had been invited to all relevant meetings since 2014-15, they had not always attended. Mr Penn concluded with the following recommendations: • Urgent consideration be given to bringing back in house the management of housing stock and functions; • Amend NCH Ltd Articles of Association to give the Council the necessary close control over NCH Ltd; and • Project plan for the return of Council housing management to the Council.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Unlawful transfer between the General Fund and the Housing Revenue Account
Findings	CIPFA, April 2022 – Housing Revenue Account (HRA) Review Phase 2 – Workstreams A & B In April 2022, CIPFA reported to the Council that additional work had uncovered a further sum of up to £25.759M of detected and assessed incorrect payments, taking the overall scale of the issue of up to £40.126m. The additional amounts were reported by CIPFA as comprising: • Historical decisions taken by the Council without full consideration of the HRA ring-fence totaling £8.503M; and • HRA monies spent by NCH Ltd on non-HRA activities between 2014-15 and 2020-21 totaling £17.158M. The CIPFA Phase 2 report recommended a wider review by the Council, stating that "work should be undertaken in relation to all charges to the HRA from the General Fund to provide a sound basis for the calculation of such charges combined with Service Level Agreements that have sufficient granularity to support these charges and any changes over time". At the time of our writing this update report, a wider review was ongoing at the Council and is understood to have identified additional incorrect payments. A Ministerial Direction to repay £27.7M in aggregate from the General Fund to the HRA has been sought and obtained by the Council. However, there are also cash and working capital adjustments of £16M expected and the impact on the Council's Medium Term Financial Strategy for 2022-23 to 2025-26 and accounting entries between the Council and NCH Ltd are not yet fully agreed. For the wider review, which is still ongoing, the Council is aware that a second Ministerial Direction may also be needed for between £4M and £5M to correct wrongly charged regeneration costs. The CIPFA Phase 2 Report also noted in April 2022 that "We have not been able to adequately confirm the number of properties managed on behalf of the Council as specified in NCH's financial statements for 2020-21. Regular reconciliations are not undertaken and there is a discrepancy of 65 properties that has not yet been resolved". The completeness and accuracy of NCH Ltd's asset base may therefore require review. Minister of State for Equalities, Local Government, Faith and Communities, Letter, June 2022 Considering the findings from Mr Penn and CIPFA, the Minister of State for Equalities, Local Government, Faith and Communities wrote to the Chair of the Nottingham City Council's Improvement and Assurance Board in June 2022 - formally recognising the hard work of the Board but notifying him that Nottingham City Council is failing to comply with Best Value Duty. The Minister outlined that the Secretary of State was minded to intervene and appoint commissioners. In September 2022, rather than appoint commissioners, the Secretary of State for Levelling Up, Housing and Communities, instead gave the Improvement and Assurance Board (IAB) more powers in overseeing improvements being made at the Council. The Chair of the IAB has given the Council a list of 67 things to do by the end of November to avoid further Government intervention.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Unlawful transfer between the General Fund and the Housing Revenue Account
Conclusion	Decision-making that is unlawful represents a significant weakness in the Council's governance arrangements.
Key recommendations	Arrangements for returning misappropriated funds to the HRA should be finalised and accounted for. The Council should continue its work to bring Nottingham City Homes Ltd's housing functions back in-house. A structured approach for managing, closing or disposing of the residual company and its subsidiaries is required. In-house housing functions arrangements need to be clarified at the earliest opportunity.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Lack of management capacity due to recruitment and retention corporate and key services
Findings	A recurring finding across the areas examined as part of our VFM assessment work is that a shortage of professional technical skills and staff capacity underpinned many of the significant weaknesses observed. For the Finance function, this is particularly striking – routine financial training; financial reporting and cost control knowledge; budget holder support; and expertise in accounting for companies have all been lacking for many years. However, we observed capacity issues critically impacting on other areas of the Council's operations as well, including: • Major regeneration pieces depending on contractors for leadership (putting continuity at risk); and • Vacancies within most central functions, including legal, IT, project managers and valuers (putting compliance at risk); • Staff sickness slowing the Asset disposal programme (leading to fall in asset disposal receipts); and • Gaps within Children's Services leadership and staffing (highlighted by Ofsted). A new Management Structure was proposed in July 2022 – with higher investment in finance, procurement and human resource functions. However, the Council is facing challenges in recruiting into vacant posts. At the time of writing our report, new interim Finance team members have joined the team in October 2022, which has had a positive effect. Nevertheless, the Council has relied heavily in the past on procured-in expertise and continues to do so. Professional services procurements planned or underway at the time of completing our work included the external consultant's review of staff establishment, income and expenditure cycles; a partnership for Strategic Transformation; support for a historic review of General Fund and HRA transactions; the ongoing detailed review of companies; and a review of the effectiveness of controls to prevent management override. Furthermore, at least two key posts within the Council's Senior Leadership were filled by interim staff at the time of our work, with little certainty in train beyond March 2023.
Conclusion	The ongoing high levels of staff vacancy in key professional roles makes it difficult for the Council to make progress against its Improvement Plan at a sufficient pace. The lack of management capacity represents a significant weakness in the Council's governance and management arrangements.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Lack of management capacity due to recruitment and retention corporate and key services
Key recommendations	The Council should continue to prioritise recruitment and should seek longer term certainty where interim posts are shortly to expire. The Council needs to review its pay policy to ensure it is able to recruit and retain talent.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Council not able to demonstrate best value through procurement
Findings	A member brought a matter to our attention regarding compliance with procurement regulations. We reviewed the specific contracts in question to consider whether contract and procurement regulations had been followed. Our review found that the Council has not been able to always demonstrate that it has achieved best value through procurement. Dispensations / exemptions had been applied but these may not have been appropriate and in some cases this was done retrospectively. Last year, in November 2021, the internal audit department also criticised the authority's procurement processes, after financial regulations were waived on more than 20 occasions. The internal audit team found that of the 15 procurement notices allowing dispensation that it reviewed, 60% did not have any approval for funding prior to the decision being made. In a couple of cases, goods and services were purchased without any approval, and dispensations of financial regulations were requested retrospectively, leaving no opportunity for these decisions to be rejected. Internal auditors also found that almost three quarters (73%) of dispensations did not indicate that obtaining value for money for the council was considered. It said that none of the decisions reviewed included any critical advice despite clear failings, adding that a "significant number of cultural inadequacies have been allowed to develop". The report said that the approved dispensations were due to three factors – poor planning by services areas, a lack of communication between procurement and departments, and a lack of challenge. The auditors said: "We do not consider the majority of decisions were in reaction to an emergency or due to operational issues of justifiable reason and in the majority of cases we believe dispensations of financial regulations could have been avoided or should not have been approved." This review raises concerns that contract procurement regulations are waived on a regular basis and in some cases this may not be appropriate. This creates a risk that the Council is not achieving best value through procurement. We identified other root causes including lack of interface between service areas and procurement, low procurement thresholds relative to the size of the Council's spend, outdated procurement systems and a lack of capacity due to vacancies within procurement. The Council recognised that weaknesses existed in its procurement arrangements. As a result, in late 2021, management commissioned an independent review of its procurement function. This review was completed in May 2022. A series of recommendations were made as to what a future operating model should look like. The Council now needs to implement the recommendations.
Conclusion	The Council has not been able to always demonstrate that it has achieved best value through procurement because it may not have complied with its own regulations. This represents a significant weakness in the Council's arrangements when procuring outsourced contracts/services.

Newly identified significant weaknesses in value for money arrangements

Area of significant weakness	Council not able to demonstrate best value through procurement
Key recommendations	The Council needs to implement the recommendations from the independent review of its procurement function, which aims to develop a new operating model, as soon as possible. The Council needs to put a combination of measures, including education, filling vacancies within procurement, tightening of procedures, stricter review and approval of dispensations and increased personal consequences for non-compliance. It will be important that the levels of compliance continue to be closely monitored and these measures be enhanced if necessary.

Appendix A: The scope of the auditor's work on value for money arrangements

2019-20

Auditors are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to be satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its' use of resources.

2020-21 and 2021-22

On 1 April 2020, the National Audit Office introduced a new Code of Audit Practice which comes into effect from audit year 2020/21. The Code introduced a revised approach to the audit of value for money.

There are three main changes arising from the NAO's new approach:

- A new set of key criteria, covering financial sustainability, governance and improvements in economy, efficiency and effectiveness
- More extensive reporting, with a requirement on the auditor to produce a commentary on arrangements across all of the key criteria
- Auditors undertaking sufficient analysis on the Authority's value for money arrangements to arrive at far more sophisticated judgements on performance, as well as key recommendations on any significant weaknesses in arrangements identified during the audit.

The Code requires auditors to consider whether the body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. When reporting on these arrangements, the Code requires auditors to structure their commentary on arrangements under the three specified reporting criteria.

Improving economy, efficiency and effectiveness

Arrangements for improving the way the body delivers its services. This includes arrangements for understanding costs and delivering efficiencies and improving outcomes for service users.

Financial Sustainability

Arrangements for ensuring the body can continue to deliver services. This includes planning resources to ensure adequate finances and maintain sustainable levels of spending over the medium term (3-5 years)

Governance

Arrangements for ensuring that the body makes appropriate decisions in the right way. This includes arrangements for budget setting and management, risk management, and ensuring the body makes decisions based on appropriate information

Potential types of recommendations

A range of different recommendations could be made following the completion of work on the body's arrangements to secure economy, efficiency and effectiveness in its use of resources, which are as follows:

Statutory recommendation

Written recommendations to the body under Section 24 (Schedule 7) of the Local Audit and Accountability Act 2014. A recommendation under schedule 7 requires the body to discuss and respond publicly to the report.

Key recommendation

The Code of Audit Practice requires that where auditors identify significant weaknesses in arrangements to secure value for money they should make recommendations setting out the actions that should be taken by the body. We have defined these recommendations as 'key recommendations'.

Improvement recommendation

These recommendations, if implemented should improve the arrangements in place at the body, but are not made as a result of identifying significant weaknesses in the body's arrangements

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