

Improving council governance

A slow burner



2012 highlights

Grant Thornton surveyed 64 local government leaders and analysed 153 council annual governance statements (AGS) and explanatory forewords. We found that:

Accounts are often difficult to understand, too technical and overlong. Only one third of survey respondents feel they are aimed at the public

The explanatory foreword is regarded as a vital introduction to the accounts, yet is often not written in plain English, nor focused on the issues most important to stakeholders

Confidence has fallen in audit committee ability to respond to risks and to annually evidence the value it brings to council governance

The average number of significant governance issues raised per council is 5.2, up from 4.3, reflective of a more challenging operating environment

AGS often fail to engage and do not always focus on key governance processes, assurances and significant issues. There are, however, some encouraging signs of councils beginning to do things differently

The effect of government policies is the most common risk identified by councils, generating more than twice as many significant governance issues in the AGS as last year

The scrutiny function scores poorly: 40% of council leaders do not believe it demonstrates added value

There is concern that not all members have the skills – or profile – to help drive effective governance

Councils are placing increasing reliance on external providers to deliver services. Yet, 21% of council leaders do not believe that roles and responsibilities are clear when working in partnership, up from 11%

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Methodology

This report is based on a desktop review of the annual governance statements (AGS) and explanatory forewords of 153 county councils, London boroughs, metropolitan borough councils and unitary councils in England.

We reviewed the AGS against our best practice criteria based on the CIPFA/SOLACE framework and guidance notes. We also included additional questions about the type and level of assurances that can be provided by the governance framework.

Our review of explanatory forewords was conducted against the criteria set out in chapter three of the 2011/12 Code of Practice on Local Authority Accounting produced by CIPFA. There were also additional questions relating

to clarity and consistency with other documents, such as the accounts and AGS, as well as some relating to best practice from other sectors.

We scored each AGS and explanatory foreword using a five-point scale:

- 1 – Missing
- 2 – Part missing
- 3 – Minimum
- 4 – Enhanced
- 5 – Standard-setting

The desktop review findings are supplemented by responses to our survey from 64 senior council officers and members, referred to collectively in this report as 'council leaders'. The survey included questions on governance reporting and supporting governance processes.

Executive summary

Welcome to Grant Thornton's annual review of governance in local government. This report is part of our wider analysis of UK governance practice and complements reviews on corporates in the FTSE 350, the NHS and charities. Within this suite of reports, we aim to help organisations improve their governance by learning from other sectors and their peers.

Local government is enduring a period of sustained pressure from such issues as:

- the largest reduction in public spending since the 1920s, for the four-year 2010 Spending Review (SR10) period (2011–12 to 2014–15)
- demographic changes and recessionary pressures which are increasing demand for the more costly-to-run services
- a reduction in demand for paid-for services, such as planning and car parking
- the government's policy agendas – such as those relating to localism and open public services – which could see a significant shift in the way services are provided.

Effective, embedded governance frameworks will be essential if councils are to meet these challenges while retaining the support of all their stakeholders.

Good governance is essential to both council leaders and the public. It supports leaders in making the right decisions, reduces the likelihood of things going wrong and protects them when problems do occur. It inspires confidence in the public that decisions are being taken for the right reasons, that the quality of service is protected and that public money is being wisely spent.

In this review, we have focused on both the public face of governance (the documents that local authorities publish, in print and online) and behind the scenes of governance (as demonstrated by council people and processes). Both are essential to effective governance.

Council annual accounts and associated documents are, by nature, not user-friendly. We suggest ways that these communication vehicles can be improved, including some encouraging examples of where councils have started to do things differently. Above all, we believe there is a compelling case for councils to produce annual reports.

Council governance arrangements are well established and largely well regarded from within the organisation. When funding reductions and other demands are placing increased pressure on governance systems, councils should shift emphasis from ensuring compliance to facilitating effectiveness to get more value from their arrangements. Elected member and senior officer leadership is the catalyst for a more rapid governance reaction.





The public face of governance

Councils present information to stakeholders in many ways: public meetings, websites, accounts, annual governance statements (AGS) and explanatory forewords being the most prominent. A small number of councils also produce annual reports.

However, despite these conduits, there remains considerable scope for improvement in communication with local people and other stakeholders.

Council media can be opaque, hard to navigate, inward facing and not aligned to the pursuit of and risks to councils' strategic goals. For example we found that:

- one third of survey respondents do not consider that council accounts are aimed at the public and the length and technical complexity makes them difficult to understand
- many council AGS follow too rigidly the example from the text in the CIPFA/SOLACE guidance, rather than reflecting the unique features and challenges of their individual council
- explanatory forewords are often far from 'explanatory', being hard to read and not focused on key messages for stakeholders.

Yet, many council leader respondents to our survey are unwaveringly positive about their governance arrangements. For example:

- 96% feel their accounts are made available to the public in a 'timely and accessible way' and 71% say they are easy to understand
- 9 out of 10 say their AGS enables the public to 'understand clearly' the governance arrangements the council has in place
- 94% believe their explanatory foreword provides a 'clear and concise introduction' to council accounts.

Good council governance is much more than publishing statements of compliance: it is about ensuring an entire organisation is aligned to achieving its strategic goals, effectively and ethically.

Councils need to reflect on this apparent contradiction. This would be helpfully informed by seeking the opinions of a wide mix of their officers, considering best practice from both local government and other sectors. Most importantly, councils should be surveying users and other stakeholders – who really need to know how they are doing.

Modern, web-enabled annual reports offer a possible solution to boost transparency and accountability.

Behind the scenes of governance: people and processes

Good council governance is much more than publishing statements of compliance: it is about ensuring an entire organisation is aligned to achieving its strategic goals, effectively and ethically.

Recognised good practice is for leaders to set the right tone from the top, embedding core values and principles throughout the organisation. Where culture is misaligned they need to have the skills to bring about lasting change. Employees should be familiar with, and working exclusively towards, the council's strategic goals. Governance frameworks, particularly risk management, scrutiny and audit, need to complement each other and, especially in financially challenging times, efforts need to be directed to establishing and assuring key controls that protect the council from failing to achieve its strategic objectives.

Embedding good governance throughout an organisation is never easy, nor quickly achieved: risks change, people move on and 'unknown unknowns' will always arise. Councils must ensure governance frameworks are fit for purpose and limited resources are focused on areas of greatest risk.

In looking at people and processes, we found significant disparities between the positivity of survey responses and our desk research. According to respondents:

- 100% review their governance arrangements annually and 92% ensure they comply with best practice
- 82% say they have 'robust' development mechanisms for officers
- 97% feel their audit committee responds effectively to changing risks.



The best councils will prioritise, directing finite governance resource to the areas of most significant risk.

In contrast, we found that:

- on-going governance processes and year-end statements are commonly two distinct exercises. This results in inefficiency in gathering assurances, makes it difficult for stakeholders to understand the ultimate purpose of these processes, thereby diminishing engagement
- despite members' pivotal role in setting the tone, they do not make the top four in council leaders' perceived 'top posts for driving governance'
- one third of respondents admit that they do not have robust arrangements for developing members
- worryingly, although external alliances are increasingly seen as a key part of the solution to more efficient delivery, 21% of survey respondents are not clear about council roles and responsibilities when working in partnerships.

These and our other findings suggest that there is still much that councils can do to truly embed effective governance processes. Throughout this report we suggest ways that councils might achieve this important aim. At a time of intense budgetary pressure and increasingly complex governance challenges, the best councils will prioritise, directing finite governance resource to the areas of most significant risk.

Public-facing governance

Councils use a range of mechanisms to communicate with stakeholders, from annual accounts to public meetings. However, despite signs of emerging good practice from certain local authorities, we found much published content remains opaque and non-strategic.

Councils showcase their governance arrangements through various mechanisms, including:

- published annual statements – the accounts, explanatory foreword and AGS (and an annual report, if produced)
- council website content, including agendas, papers and minutes
- open public meetings.

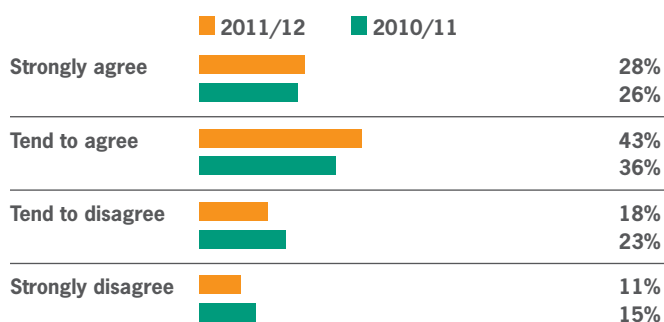
The general public, and other stakeholders, typically find out about an organisation and its governance by reading its annual report, accounts and associated statements. This also holds true in respect of council activities, as many people cannot attend council meetings and, based on collating our research, it is often hard to get information from council websites.



Accounts

The introduction of International Financial Reporting Standards (IFRS) to local government in 2010/11 increased the length and complexity of council accounts. Council leaders routinely tell us that the accounts are impenetrable to all but the most dedicated technicians. It is therefore surprising that our survey showed an increase in those who said they found the accounts easy to understand, up from 62% to 71%.

I FIND THE ACCOUNTS EASY TO UNDERSTAND

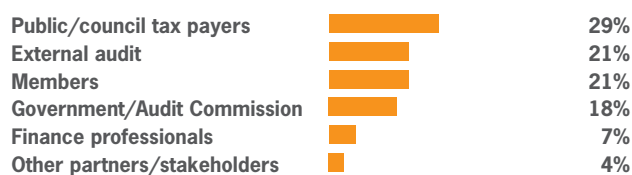


For the 29% who find the accounts difficult to follow, the most common reasons given were that they were over-complicated, used jargon or technical language or were too long.

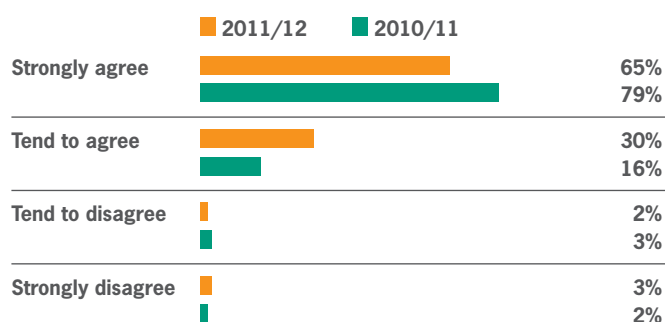
Councils are publicly-funded bodies, serving every sector of society. Publications should be accessible to a wide range of stakeholders with varying degrees of knowledge and understanding of council activities, responsibilities and objectives. Engaging with these individuals is critical in helping them to understand council performance and give feedback. However, our survey indicates that only one third of respondents consider the accounts to be provided for members of the public and one fifth believe they are prepared mainly for external audit – both suggesting a mismatch between purpose and practice.

Despite 95% of respondents saying their accounts are made available to the public in a ‘timely and easily accessible way’, our average score for ease of access and transparency was 3.3 (out of a possible top score of five), down from 3.6. The lower ease of access score reflects the fact that it is often difficult to get hold of the accounts before the end of September, six months after the reporting period. The NHS requires audits to be complete by early June, just over two months after the end of the financial year.

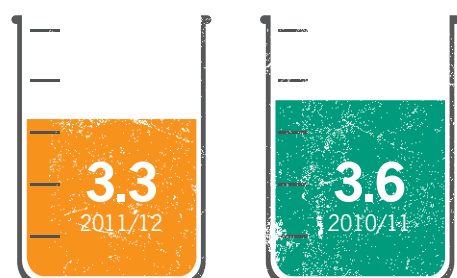
WHO ARE THE MAIN STAKEHOLDERS THE ACCOUNTS ARE PROVIDED FOR?



THE ANNUAL ACCOUNTS ARE MADE AVAILABLE TO THE PUBLIC IN A TIMELY AND EASILY ACCESSIBLE WAY



EASE OF ACCESS (SCORED OUT OF FIVE)



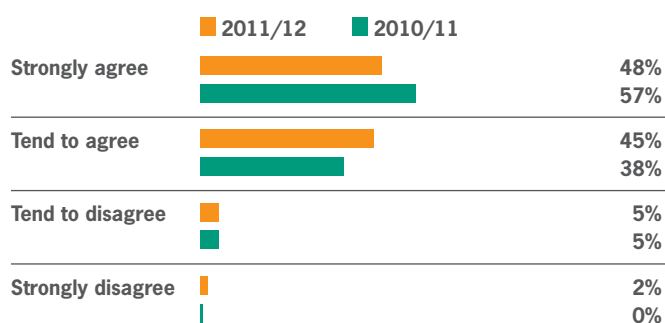
Explanatory foreword

The requirements for the explanatory foreword remain unchanged. As set out in the third chapter of CIPFA’s 2011/12 Code of Practice on Local Authority Accounting: “The purpose of the foreword is to offer interested parties an easily understandable guide to the most significant matters reported in the accounts. It shall provide an explanation in overall terms of the authority’s financial position and assist in the interpretation of the accounting statements, including Group accounts”.

The foreword should provide an overview of the council’s financial position. While it should not conflict with the audited accounts, it provides a valuable opportunity for councils to present financial information in an engaging way. In doing so they should be mindful to make the document accessible by steering clear of technical jargon.

The survey shows that confidence in the foreword for giving a useful insight into council finances is falling, with those agreeing strongly that it provides a ‘clear and concise introduction’ declining from 57% to 48%. However, with only 7% disagreeing, sentiment remains very positive.





THE EXPLANATORY FOREWORD TO THE ANNUAL ACCOUNTS SERVES AS A CLEAR AND CONCISE INTRODUCTION TO THE ACCOUNTS AND OVERVIEW OF THE FINANCIAL POSITION OF THE COUNCIL



Confidence in the foreword as a useful insight into council finances has fallen, with those agreeing strongly that it provides a ‘clear and concise introduction’ declining from 57% to 48%.

Respondents said that focusing on outcomes is a key way to improve the explanatory foreword. We agree that this would help illustrate how financial performance links to a council's strategic goals.

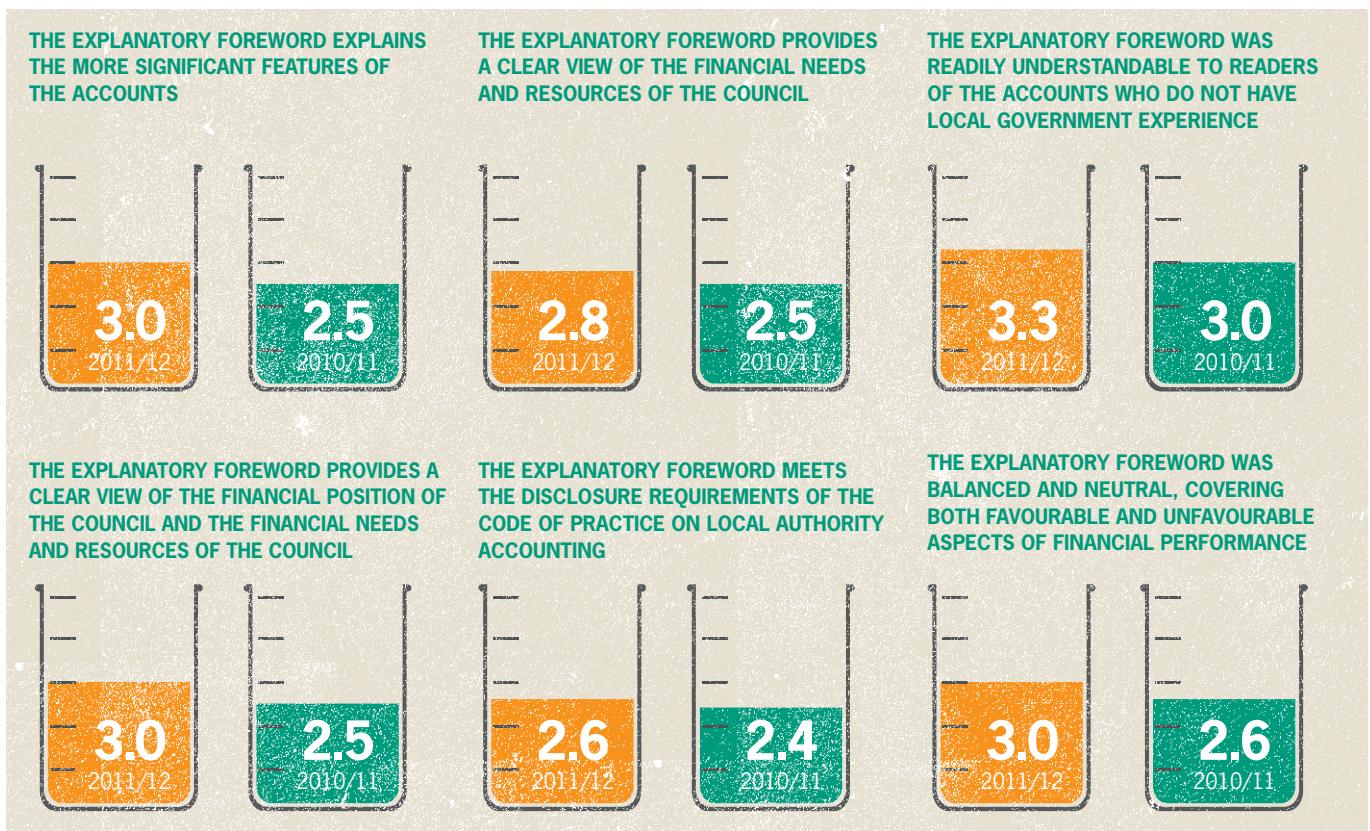
WHAT WOULD IMPROVE THE EXPLANATORY FOREWORD TO THE ACCOUNTS?

-  Use of plain English to explain financial information in non-financial terms
-  Use of graphs/charts to make it easier to understand
-  Focus on outcomes
-  Less technical and more rounded context

Our review of 153 explanatory forewords demonstrated a positive improvement in quality. However, on average, councils are just meeting minimum standards and there is some way to go to provide real insight.

The average length of explanatory forewords remains unchanged from 2010/11 at nine pages. However, the longest was 63 pages. This underlines the widely varying approaches taken by councils – and the scope for improvement.

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Annual governance statement

The AGS explains a council's governance arrangements and the controls it employs to manage the risks of failure to achieve strategic objectives. In the past, local government has delivered, within its financial framework, the changes required by central government. However, we believe that the sector's resilience over the medium term is less certain. In this context, councils' arrangements for governance are ever more critical, with clear reporting fundamental to transparency.

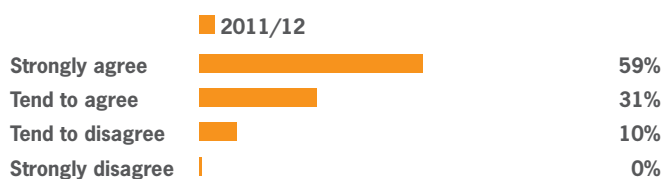
This year, 74% of AGS are included within councils' published accounts (75% in 2010/11). CIPFA/SOLACE suggests that publication of the AGS should happen alongside the financial results to give readers a comprehensive picture of council performance during the year.

Fifty-four per cent of AGS were signed or re-signed at the date of the audit opinion, a real improvement from 20% in 2010/11. However, if the AGS is prepared before the approval of the accounts, the guidance also notes the importance of ensuring that the statement remains up to date. It is encouraging to see this rise, but we would like to see all councils demonstrating compliance in this regard.

"As the governance statement provides a commentary on all aspects of the organisation's performance, it would be appropriate for it to be incorporated, either in full or in summarised form, into the annual report, where one is published."

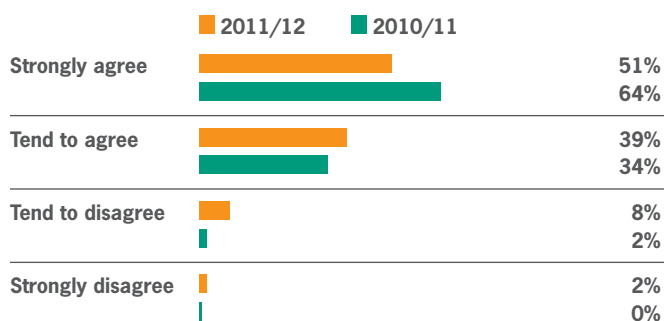
CIPFA/SOLACE 'Delivering Good Governance in Local Government Framework' 2007

MEMBERS HAVE SUFFICIENT OPPORTUNITY TO INFLUENCE THE CONTENT OF THE AGS



In signing the AGS, many council leaders will seek assurance from the audit committee that it is an appropriate reflection of the council's year. The survey results indicate a high degree of confidence from the sector in members' ability to influence the AGS. While, in many cases, AGS are presented to members at a June meeting of the audit committee, our experience suggests that this is often the first time in the year it is considered by members. At this late stage, member input is often restricted to the superficial. In promoting better understanding of the purpose of the AGS and facilitating greater member input throughout the year, councils will gain stronger engagement with the AGS and the important governance messages it contains.

OUR AGS ENABLES ALL STAKEHOLDERS, INCLUDING THE PUBLIC, TO UNDERSTAND CLEARLY THE GOVERNANCE ARRANGEMENTS THAT THE COUNCIL HAS IN PLACE, INCLUDING WHAT IS BEING DONE TO ADDRESS ANY AREAS OF WEAKNESS



Respondents felt the helpfulness and clarity of the AGS had reduced, with the ratio of those who agree strongly that it helps stakeholders understand governance arrangements falling from 64% to 51%.

Our findings indicate that, in many cases, council AGS stick too rigidly to the example format and content included in the CIPFA/SOLACE guidance. This approach means it is often difficult to distinguish between different council AGS. We believe the example should be treated as guidance only and that each council (while ensuring its AGS remains compliant) should capture its own priorities and achievements, so local residents can recognise their council in the statement.

Scores for the AGS remained static, around three out of five, with councils continuing to comply with the CIPFA/SOLACE framework. Consistent with last year, councils appear to be struggling with providing helpful, informative disclosures in the areas of:

- the level of assurance needed for the year (2.6)
- resolution of prior year issues (2.6)
- actions resulting from this year's significant issues (2.8).

We believe that councils could significantly improve their documents by focusing on the key governance controls and processes linked to their own strategic objectives.

Our survey shows the strong belief, of 84% of respondents, that senior management take shared responsibility for the AGS. This is appropriate as the statement should cover all aspects of council governance. However, our experience of working with local government suggests the AGS is most often written by the chief internal auditor, although it is sometimes completed by finance, legal or performance officers. It is rarely a genuinely shared effort. To make the document more rounded and readable, we suggest councils ensure wider input, at the very least those outside the finance and audit function.

SENIOR MANAGEMENT TAKE SHARED OWNERSHIP OF THE AGS



WHAT WOULD IMPROVE THE AGS?

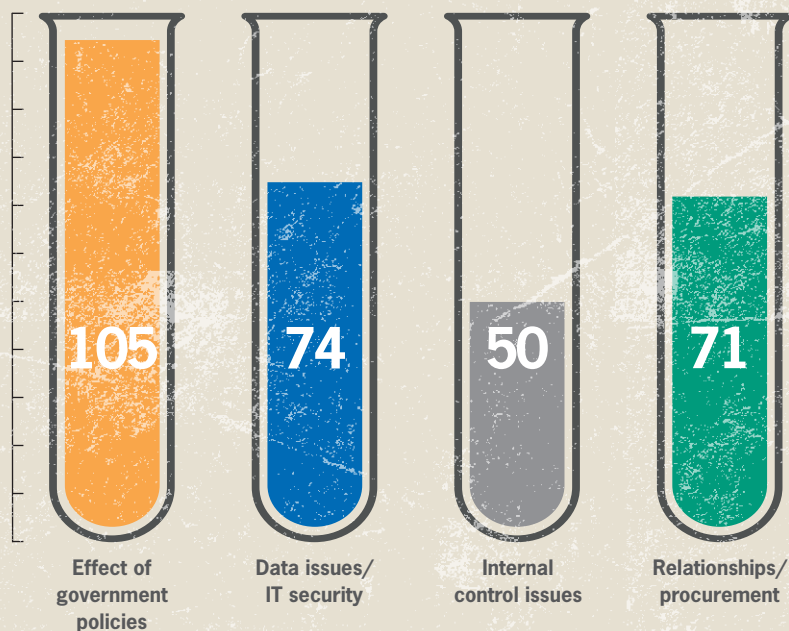
- ❄ More focused/less descriptive
- ❄ Outcome focused
- ❄ More visual/use of plain English

Councils are required to detail significant issues about their governance arrangements in their AGS. The average number of issues reported rose to 5.2 from 4.3, with only 28 councils reporting no issues in 2011/12 (45 in 2010/11). The results appear to reflect the uncertainty in the sector. The sheer volume of government changes is creating governance concerns for many councils. As indicated in the chart overleaf, the 'effect of government policies' was, by far, the major issue of concern. Indeed, it generated more than twice the number of issues than the linked area 'savings programmes/transformation issues' did last year.



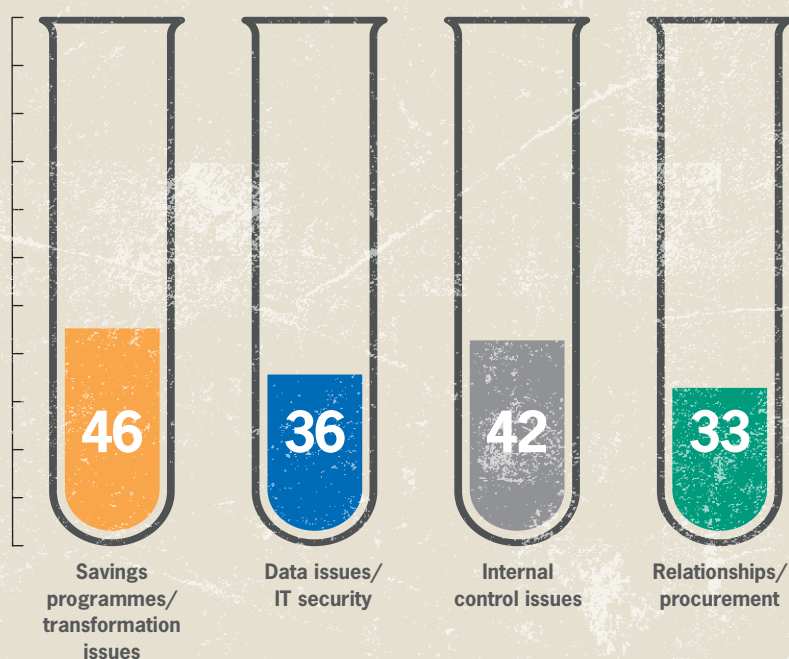
TOP GOVERNANCE ISSUES IDENTIFIED

2011/12



The number of reported issues in the top four areas have increased. This suggests councils have real concerns that need to be addressed by their governance arrangements. We believe this supports the need for a focused governance agenda where assurances are sought for key areas that could jeopardise strategic goals.

2010/11

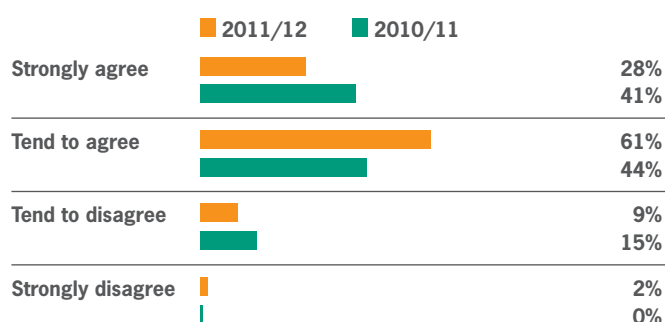


Annual reports

Very few councils produce annual reports. Local government is unusual in this respect, as virtually all other sectors (public, commercial and voluntary) produce end-of-year annual reports and accounts. These publications include summarised audited financial data and supporting commentary to provide context for readers, combined with key performance indicators (KPIs) and other information to give a rounded view of performance, focused on outcomes.

Some local government commentators say annual reports are unnecessary, due to the wide variety of ways of engaging with the public, as noted above. The confident response to our survey question on public accountability, with 89% of respondents reporting their ‘good arrangements’, appears to support this.

WE HAVE GOOD ARRANGEMENTS FOR ENGAGING WITH LOCAL PEOPLE AND OTHER STAKEHOLDERS TO ENSURE ROBUST PUBLIC ACCOUNTABILITY



Our analysis of council accounts, explanatory forewords and AGS suggests that many of the key elements of public engagement, upon which councils rely, are not fulfilling this need.

However, our analysis of council accounts, explanatory forewords and AGS suggests that many of the key elements of public engagement, upon which councils rely, are not fulfilling this need. Ironically, the very documents that should demonstrate council transparency and accountability often have the opposite effect. This opacity is further exacerbated by few councils having annual reports to communicate their key messages.

These findings echo last year's and, once again, there is often a discrepancy between council leaders' assessment of their own statements and our analysis of their quality.

We think councils should take a step back and conduct a critical review of their year-end published documents, asking the question: “Do we truly believe that our statements communicate effectively our governance practices to our stakeholders?”.

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The winner of the 2012 Local Government Chronicle Corporate Governance Award, Copeland Borough Council, asked a similar question of its wider governance arrangements. Officer and cross-party member recognition that there had to be a better way galvanised the council into a co-ordinated programme of governance improvement.

Some other councils are also recognising that their governance statements are not as effective as they would wish. As part of our aim to help raise the bar in governance reporting, we recently set up a small working group of councils interested in improving their AGS and in considering what an effective local government annual report could look like. Key messages from the group are included on the following pages.

Improving the AGS

Members of the recently formed governance working group agreed that it was time for the sector to take a fresh look at the AGS. The box below right shows some of the improvements suggested.

While there is no best practice AGS example in the sector, there are some useful examples of where councils have begun to do things differently.

AGS: key questions councils should ask themselves

- Who is responsible for producing the AGS – the head of audit, head of performance, legal, corporate governance group? Is this the right person? Is there a conflict of interest if it is done by audit?
- How many issues are raised by processes such as directors' assurance statements and how many of these should/do make it to the AGS (or are many managed 'off-line')?
- How honest and clear are the issues set out in the AGS?
- How well are AGS assurances gathered throughout the year (rather than at year-end)?
- How well are the identified significant internal control issues monitored and reported on during the year?
- How well understood is the AGS by the senior management team and members?

Working group suggestions for a better AGS

- **Content and style of document**
Less process and repetition of what is already in the local code of governance; more focus on key governance mechanisms and description of what assurances were received on these in the year; more user-friendly language and layout; greater emphasis on significant governance or control issues that flow from the earlier sections of the document.
- **Ownership**
Performance officers to be more involved in the document's production, to emphasise that the AGS is about assurances received on risks to the achievement of strategic objectives; a small corporate governance group (including audit and performance) should be formed as a forum for owning and producing the AGS; this, in turn, would aid senior management involvement.
- **Linking document with year-round assurance processes**
AGS to be used as an end point to shape audit committee work plans; assurances to be compiled for AGS during the year; regular monitoring by officer governance group; clarity to audit committee of assurances being received against plan; AGS to form part of quarterly performance report to cabinet.
- **Education**
Underpinning, but facilitated by the above, on-going training and communication with officers and members to ensure a wider and better understanding of the governance framework and the AGS.

COUNCILS MAKING PROGRESS

While there is no best practice AGS example in the sector, there are some useful instances of where councils have begun to do things differently.



BATH AND NORTH EAST SOMERSET COUNCIL

This council offers a good description of how it reviews the effectiveness of its governance framework, including sources of assurance and a list of those involved.



LINCOLNSHIRE COUNTY COUNCIL

This council provides SMART (specific, measurable, achievable, realistic and timed) action planning for identified governance issues.



LONDON BOROUGH OF BARNET

This council produces an AGS with an engaging overall layout and a helpful overview of the assurance cycle. It also offers clear updates on issues from the preceding year and SMART action planning.



NEWCASTLE CITY COUNCIL

This council describes its process for reviewing the effectiveness of its governance framework and delivers a conclusion on its effectiveness for the year.



NOTTINGHAM CITY COUNCIL

This council uses graphics to break up the text, as well as including examples of CIPFA guidance to determine whether identified issues are significant.

Improving the accounts and explanatory foreword

IFRS-compliant accounts will always be lengthy and complex, but the opportunity still exists for councils to make significant improvements to the quality of presentation. The use of an independent review of the accounts from a user's perspective will allow councils to identify areas where information could be presented differently to aid clarity. The box opposite shows our top tips for simplifying accounts.

We believe that one of the best ways to help users understand the accounts is to improve the explanatory foreword. As a guide when drafting a foreword, councils should describe, interpret and explain first, and then tick off the compliance requirements second. This will make the foreword easier to read and understand.

Suggestions to make explanatory forewords a better read:

✓ Explain the significant features:

- Link service expenditure closely to the figures in the directorate analysis in the accounts
- Tie figures to those included in the accounts
- Clearly set out the council's borrowing requirements
- Explain clearly movements in usable and unusable reserves
- Outline unusual charges and credits in the accounts

✓ Provide a clear view on the financial position:

- Ensure all information is consistent with the accounts
- Explain clearly where further information can be found in the accounts including relevant details on group accounts

✓ Give a clear and open view of the council's financial needs and resources:

- Outline major risks and uncertainties
- Describe major changes in statutory functions that will have a financial impact
- Discuss the likely effect of the economic climate on the council and its services

De-cluttering accounts

1 Start early

Begin by reviewing last year's accounts and remove unnecessary information before adding new requirements for the current year.

2 Officer review

Ensure deadlines allow enough time for council officers to review the accounts before the draft is submitted to the auditors. Consider involving members of staff outside the finance team to check the accounts make sense.

3 Highlight significant matters

Consider whether disclosures on significant matters are stated clearly and concisely. This could include new developments or areas where judgements are made, such as accounting for schools.

4 Is it necessary?

Ensure accounting policies and disclosure notes relate only to matters that are relevant and material to the council.

5 Is it up to date?

Review disclosures to ensure they are relevant to the current accounting period and are not references to historical matters. Ask yourself the question: are these still applicable?

6 Remove duplication

Do new disclosures supersede others that can now be removed? Are any issues duplicated in more than one note: if so, can these be merged?

7 Use of pro-forma/template accounts

Use these carefully, as they are intended for illustrative purposes. Tailor your disclosures to meet your specific requirements using templates as a guide only.

8 Remove nil entries

Remove lines and tables with zero entries that have been carried forward as a 'just in case'.

9 Use a glossary

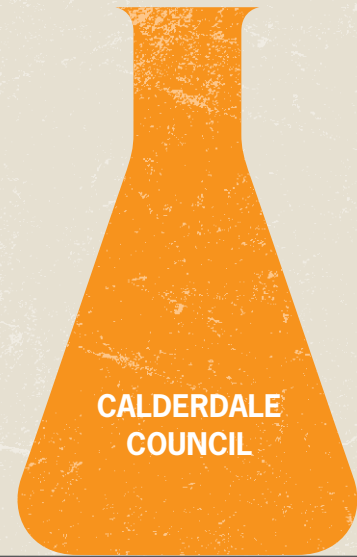
Consider providing a glossary at the end of the accounts rather than cluttering the notes with detailed explanations.

**EXPLANATORY FOREWORDS
WITH POSITIVE FEATURES**

A small number of councils have taken a fresh look at the explanatory foreword. There are elements of emerging good practice within different forewords.

**BUCKINGHAMSHIRE
COUNTY COUNCIL**

This council describes changes in statutory functions that had a significant impact on the accounts and summarises current-year and projected borrowing against the Capital Financing Requirement and authorised level of borrowing.

**CALDERDALE
COUNCIL**

This council explains what each statement means and summarises the council's performance, alongside a discussion of macro factors and their impact on the budget.

**LIVERPOOL CITY
COUNCIL**

This council discloses significant changes in accounting policies and their impact on the accounts; reconciles budget underspend to total deficit on the comprehensive income and expenditure statement (CIES); gives a comprehensive account of financial performance and details the council's activities and organisational structure.

**MANCHESTER CITY
COUNCIL**

This council summarises fixed asset acquisitions and disposals, outlines funding of capital expenditure and Private Finance Initiative and Public Private Partnership commitments and gives various KPIs, for example in relation to transport, crime and education.

Considering annual reports

The governance working group cited transparency and accountability as two compelling reasons for publishing annual reports. However, the benefits have to be balanced against the costs of producing annual reports.

The working group members agreed that a lavish, lengthy printed document is not what is needed. They supported something more concise, user friendly and perhaps published on the website as a ‘front end’ to summarise key information and provide hyperlinks to more detail. As well as being less costly, this is consistent with developing practice in some large corporates that are part of the International Integrated Reporting Council (IIRC) pilot scheme, which CIPFA is currently considering for the public sector.

While annual accounts are often not ready until the end of June, our working group members thought enough information would be available, of sufficient robustness, to support summarised financial content in a draft annual report. Surrey County Council produces a timely, user-friendly annual report containing pre-audit summarised financial information.

It is possible, therefore, that annual reports could be produced earlier in the year, containing high-level draft figures, significant AGS and explanatory foreword content, key risk and performance information, plus anything else fundamental to council strategy. A web-based annual report could be a live document, updated after the audit of the accounts.

The box below suggests possible content for a modern local government annual report, based on the working group’s suggestions of the key questions the public are likely to want answered.

As with any annual report, councils should follow established best practice principles including clarity of language, balance and neutrality.

Through our governance working group and wider discussions with the sector and CIPFA, we will continue to discuss annual reports with councils and publish examples of emerging good practice.

User-focused annual reports

A local government annual report could answer the following questions:

Backward looking

- What has the money been spent on?
- Was it within budget?
- Were the finances well managed this year?
- What was achieved for the local population?
- How well did the council perform (compared to before/others)?

Forward looking

- Is the council financially sustainable?
- What are the key risks?
- How are the key risks being managed?
- How is the council likely to perform (compared to now/others)?
- What changes will the public see in service provision?

“The annual report is absolutely vital for public accountability.”

Governance working group member

Behind the scenes of governance: people and processes

Published statements are the visible, high profile face of council governance. As crucial to effective governance, however, are a council's people, culture and processes.

People, culture and behaviour

A positive governance culture, where people understand and live the values, drives robust decision-making and, in turn, strong performance. If councils do not have the right people, behaving in the right way within a culture that is supportive of good governance, organisational effectiveness will be seriously impaired.

This is borne out by our survey results, where respondents rightly focus on the importance of senior management ownership and member involvement, as well as communication, as being key ingredients in establishing a sound governance environment.

Our survey shows the sector considers that senior officers and internal audit hold the four 'top posts for driving governance'. It is perhaps surprising that members do not feature, and yet the contribution that they can make in creating and maintaining a positive governance culture should not be underestimated.

The importance of the member role in setting the tone for governance was recognised by CIPFA in last year's addendum to the framework. Our survey respondents also said that member involvement was key to improving governance.

WHAT WOULD IMPROVE GOVERNANCE AT THE COUNCIL?



Senior management ownership

Reinforcement/wider awareness of key messages

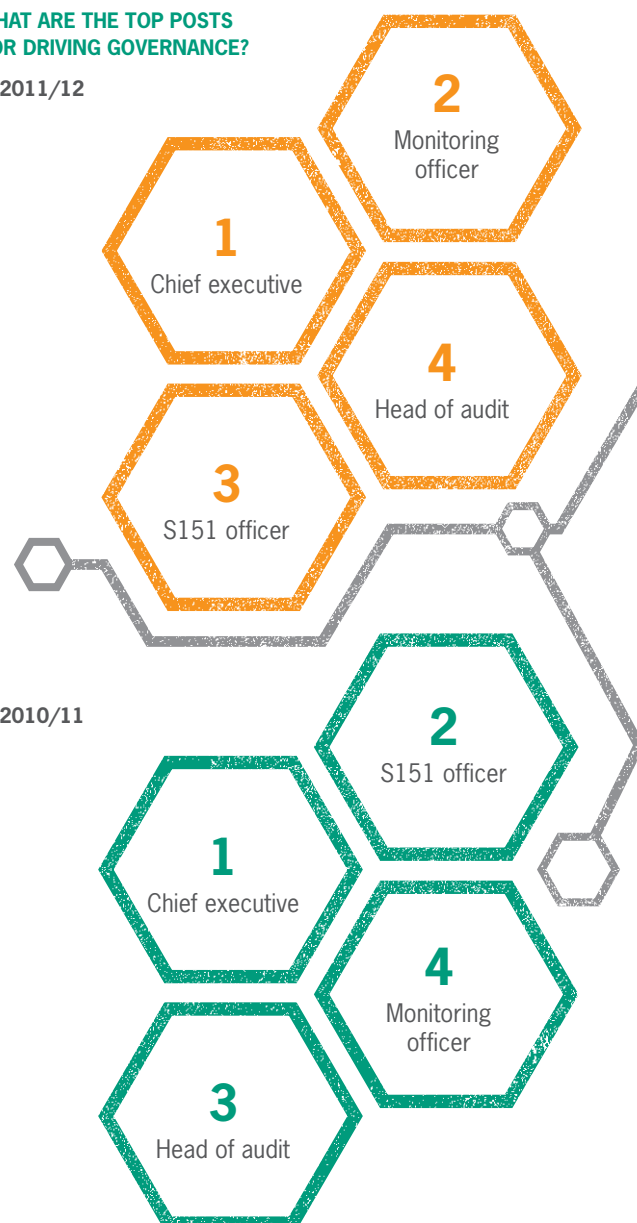
Member involvement

"The Framework ... puts high standards of conduct and leadership at the heart of good governance, placing responsibility on members and officers to demonstrate leadership by behaving in ways that exemplify high standards of conduct, and so set the tone for the rest of the organisation."

Addendum to Delivering Good Governance in Local Government: a framework, CIPFA, August 2012

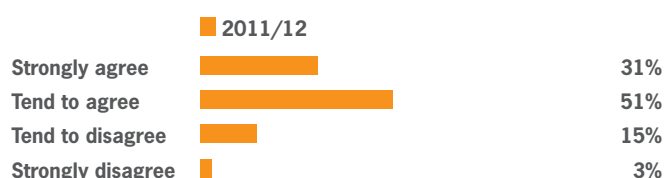
WHAT ARE THE TOP POSTS FOR DRIVING GOVERNANCE?

■ 2011/12

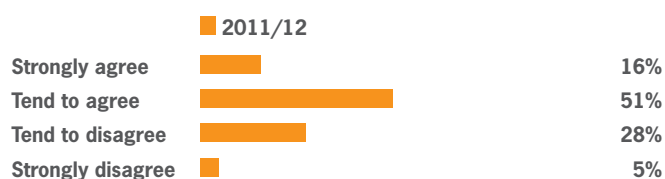


■ 2010/11

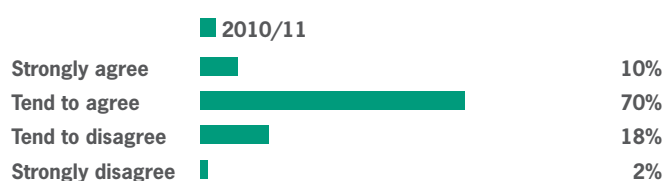
WE HAVE ROBUST ARRANGEMENTS TO DEVELOP THE CAPACITY AND CAPABILITY OF OFFICERS



WE HAVE ROBUST ARRANGEMENTS TO DEVELOP THE CAPACITY AND CAPABILITY OF MEMBERS



WE HAVE ROBUST ARRANGEMENTS TO DEVELOP THE CAPACITY AND CAPABILITY OF OFFICERS AND MEMBERS



Council leaders continue to rate highly their development mechanisms for officers, with 82% agreeing that they have ‘robust arrangements’ to build their capacity and capability. They are less confident about the equivalent for members, with one third feeling they do not have such robust arrangements for them. This is a significant issue and councils should consider how well they support members in their pivotal leadership role in governance.

We believe the key to changing views and approaches to governance is through strong principled leadership setting the right ‘tone from the top’. We explore this theme in our reports ‘The chemistry of governance’¹, which reviews governance in the UK’s FTSE 350, and ‘The tone of governance’². The core principle applies as well to local government, where the leader and chief executive have a vital role in determining how councils should be run, as it does to the corporate arena.

In considering behaviour and culture, the ‘Seven Principles of Public Life’ remain as relevant as when Lord Nolan’s Committee on Standards in Public Life first published them in 1995.

The seven principles of public life

1 Selflessness

Holders of public office should act solely in terms of the public interest. They should not do so in order to gain financial or other material benefits for themselves, their family, or their friends.

2 Integrity

Holders of public office should not place themselves under any financial or other obligation to outside individuals or organisations that might seek to influence them in the performance of their official duties.

3 Objectivity

In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit.

4 Accountability

Holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.

5 Openness

Holders of public office should be as open as possible about all the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

6 Honesty

Holders of public office have a duty to declare any private interests relating to their public duties and to take steps to resolve any conflicts arising in a way that protects the public interest.

7 Leadership

Holders of public office should promote and support these principles by leadership and example.

Committee on Standards in Public Life, January 2013

¹The chemistry of governance: a catalyst for change, Grant Thornton, January 2013

²Governance insights: the tone of governance, Grant Thornton, September 2012

Some recent work by the Institute of Risk Management (IRM) is also relevant.

“The culture of a group arises from the repeated behaviours of its members. The behaviour of the group and its constituent individuals is shaped by their underlying attitudes. Both behaviour and attitudes are influenced by the prevailing culture of the group.”

Risk Culture, Resources for Practitioners, The Institute of Risk Management, 2012

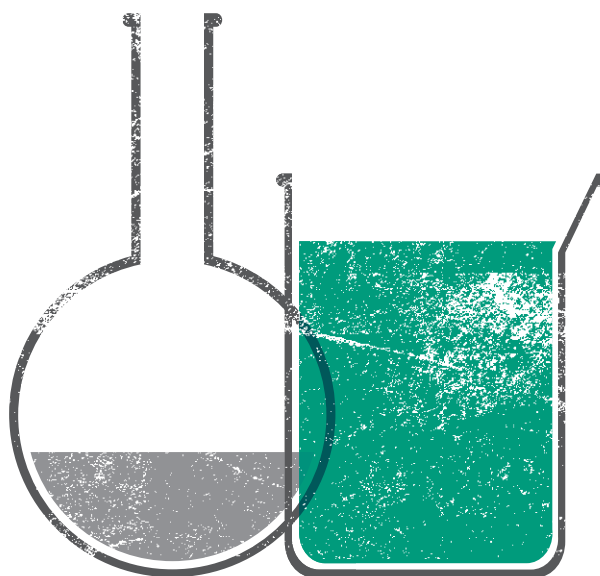
It suggests organisations ask themselves three questions about their culture and develop appropriate action plans:

- 1 What is the current culture in our organisation?
- 2 How do we want to change that culture?
- 3 How do we move from where we are to where we want to be?

While many tools and techniques for managing cultural change exist, it is never easy. Yet many organisations, including councils, give insufficient regard to addressing cultural issues when implementing change. When considering how to improve governance, councils need to think wider than systems and processes. If the culture isn't supportive of good governance, no amount of process redesign will fix it. We set out opposite some suggestions for driving improvement in the governance culture.

Improving your governance culture

- Invest time in understanding your governance culture. Don't just assume solutions will work
- Involve all those responsible for effective governance: elected members, statutory officers, senior leaders and departmental management
- Gain buy-in by reinforcing the basic principle: good governance = good decision making = good performance
- Spend time with stakeholders to demystify governance and spread understanding that it is the way that everyone should work – not just something for audit and finance
- Accept that cultural change takes time, resources and carefully planned and executed structured and unstructured interventions with stakeholders
- Focus on real behavioural change, not box ticking
- Identify and support those who are not showing the desired behaviours
- Share stories and reward those who exemplify the desired cultural change.

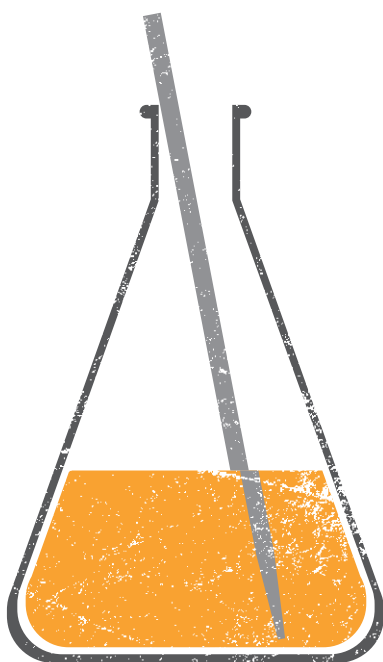


Process

The governance statements described above, from AGS to accounts, may be the most visible council governance vehicles but they are, of course, designed to be the culmination of 12 months of continuous processes.

However, too often on-going governance processes and year-end statements are treated as two distinct exercises. This makes it difficult for stakeholders to understand the purpose of these processes and diminishes engagement with the council's governance arrangements, potentially leading to gaps in assurance, or inefficiency.

Our recent report on local government financial resilience, 'Towards a tipping point?' highlights a sector perception that a critical juncture is approaching, but that its form is unclear. Recent reports from the Audit Commission and National Audit Office provide a similar message. Working in such an uncertain environment makes it even more critical that councils ensure governance frameworks are fit for purpose and resources are focused to address the most significant risks.



Possible 'tipping point' scenarios for councils

Statutory

Where a council can no longer meet its statutory responsibilities to deliver a broad range of services within the funding available, leading to legal challenges and protests from stakeholders.

Financial

Where the Section 151 Officer cannot set a balanced budget, leading in the first instance to an unbalanced budget report to members in line with Section 114 of the Local Government Finance Act 1988 (England and Wales); or where increased uncertainty leads to budget overspends of a size that reduces reserves to unacceptably low levels; or where a council demonstrates characteristics of an insolvent organisation, such as failure to pay creditors.

Industrial

Where, as a consequence of pay restraints, changes to terms and conditions and job losses, employees and trade unions undertake prolonged strike action, leading to major service disruption and long-term industrial relations disputes.

External

Where a major supplier fails, leading to significant service disruption and reputational damage to the council.

Incremental

Where multiple, smaller tipping points relating to individual service areas occur, developing over time and leading to an eventual critical mass.

Decision paralysis

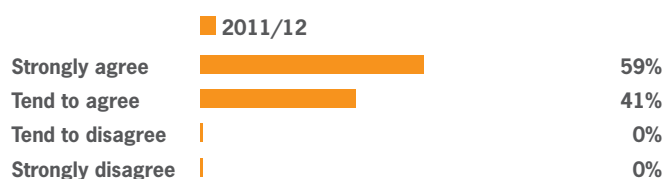
Where there is a failure to make the difficult decisions required to manage financial and other challenges.

'Towards a tipping point?', Grant Thornton, December 2012

The governance framework

Council leaders remain very positive about their governance frameworks, as our survey results show they do on their published annual statements. They all report undertaking annual reviews of governance arrangements and 92% say they ensure compliance with best practice.

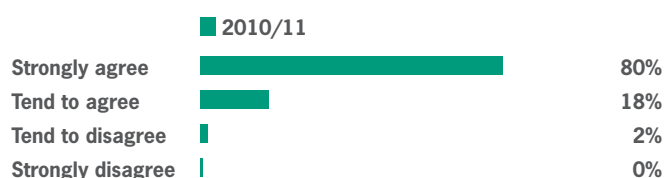
WE UNDERTAKE AT LEAST ANNUAL REVIEWS OF OUR GOVERNANCE ARRANGEMENTS



WE ENSURE COMPLIANCE WITH BEST PRACTICE IN OUR GOVERNANCE ARRANGEMENTS



WE UNDERTAKE AT LEAST ANNUAL REVIEWS OF OUR GOVERNANCE ARRANGEMENTS TO ENSURE THAT WE COMPLY WITH BEST PRACTICE



However, when we interview councils directly they are far less sanguine about how governance arrangements are working in practice. We believe that there is often a lack of understanding as the purpose of the governance framework and how it links to strategy.

In times of tight resources, governance processes should be focused on key controls, namely those considered critical to achieving the council's strategic goals. Once key controls have been identified, assurance plans should be developed to ensure these are operating effectively by the end of the year.

Internal auditors are also feeling the pressure on resourcing. The Grant Thornton/CIPFA survey of heads of audit³ found that three quarters had reduced coverage and depth of audit work. This comes as new public sector internal audit standards are being introduced from April 2013.

Clarity of purpose and better understanding of the elements of the governance framework would help councils to focus their efforts and potentially save on governance and assurance spending. Like all other aspects of council life, the challenge is how to get more for less.

There are many aspects to council governance frameworks. The findings set out in the remainder of this report focus on some of the main elements.

In times of tight resources, governance processes should be focused on key controls, namely those considered critical to achieving the council's strategic goals.

³The developing internal audit agenda, Grant Thornton/CIPFA, May 2012

Audit committees

The unprecedented issues facing local government – including funding reductions, loss of officer capacity, transparency requirements, organisational reconfiguration and outsourcing – all make the audit committee agenda more challenging.

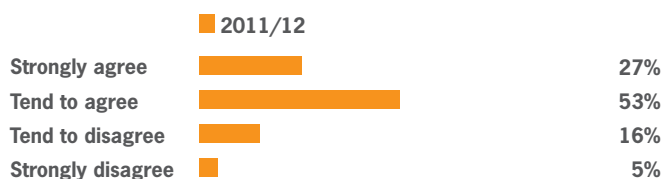
Our survey shows that audit and audit committees are seen as one of the key strengths of council governance. However, hidden in the detail, respondents are far less inclined to ‘strongly agree’ that their audit committee responds effectively to changing risks or demonstrates added value.

Ample guidance exists to support audit committee effectiveness and routinely council audit committees complete self-assessment checklists to assess compliance with requirements. However, from our work with councils across the country, we find that the sheer size and complexity of the agenda can hinder audit committee effectiveness. We set out opposite our suggestions for how council audit committees should manage the existing and emerging risks to effective operation.

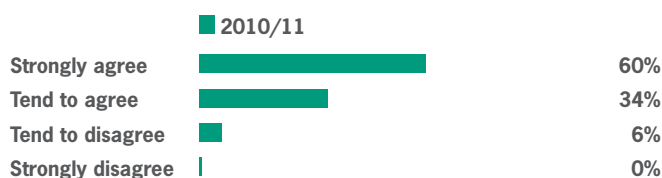
OUR AUDIT COMMITTEE IS EFFECTIVELY RESPONDING TO THE CHANGING RISKS FACING THE COUNCIL



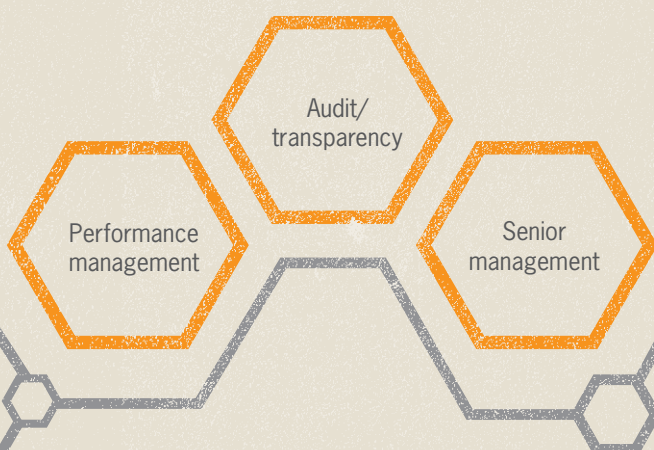
OUR AUDIT COMMITTEE FUNCTION ANNUALLY DEMONSTRATES THE VALUE IT ADDS



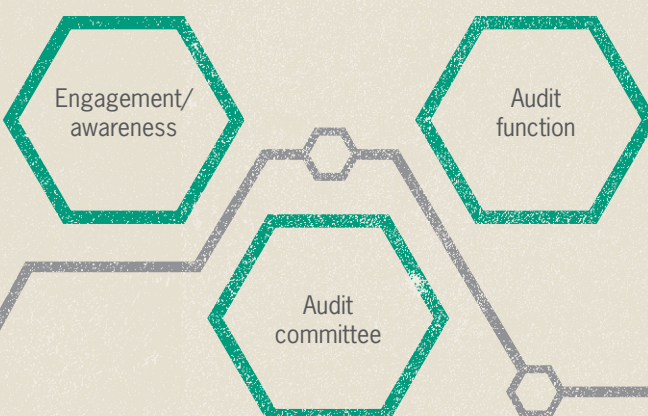
WE HAVE AN AUDIT COMMITTEE FUNCTION THAT IS EFFECTIVELY RESPONDING TO THE CHANGING RISKS FACING THE COUNCIL AND CAN ANNUALLY DEMONSTRATE THE VALUE IT ADDS



TOP STRENGTHS IN COUNCIL GOVERNANCE IN SURVEY 2011/12



TOP STRENGTHS IN COUNCIL GOVERNANCE IN SURVEY 2010/11



Membership is key. We believe it is critically important to have a skilled chair who can keep the work of the committee on track. It is vital that, as a group, members have the right skills, expertise (including financial), independence of mind and political neutrality to fulfil their role. If all of these criteria are met, then an audit committee is far more likely to be effective.

It is also vital to plan and manage the work of the committee throughout the year. At the start of the year the committee should set out how it will use its limited time most effectively. It should be clear about what assurances are needed in relation to the key risks to the council's strategic objectives and schedule how, and from what source, it wants to receive them.

Maintaining focus throughout the year on the content of the AGS is the best way of achieving such clarity. Agreement about what constitutes 'reasonable assurance' will help the committee judge when it has the required information and can move on.

There are many other levers for ensuring effectiveness, including member briefings, shorter reports, better agenda-sharing with scrutiny to avoid potential gaps or duplication, and preparation of an annual chair's report on the work and impact of the committee. Committees should constantly ask themselves: "Are we achieving our objectives in the most effective way possible and adding value to the governance of the council?" and be prepared to adapt and improve when necessary.

In particular, they should ensure they align their key controls – and assurance activity – towards the council's strategic goals. Whatever the member composition of the audit committee, it is this focus on what really matters that will ensure its effectiveness and enable it to demonstrate its value.

Scrutiny

This year, scrutiny was again one of the lowest-scoring areas of our survey: 40% of council leaders say their scrutiny function does not demonstrate the value it adds.

Councils' scrutiny functions are becoming increasingly important. They are also being challenged more frequently, due to the difficult decisions councils have to make in the current political and socio-economic climate. Council scrutiny should be robust, must explore all options thoroughly and should not be afraid to make difficult choices. As illustrated by recent government commentary on the excessive use of judicial review and its impact on innovation and growth, it is crucial that council decision-making and scrutiny is transparent so the public can be assured that proper processes are followed. Most importantly, they should focus on decision-making allied to their council's strategic goals.

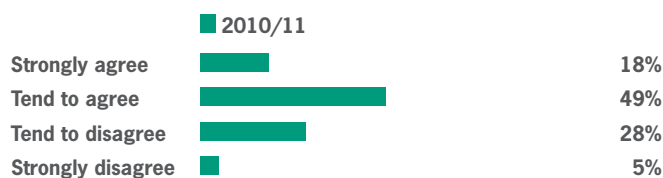
OUR SCRUTINY FUNCTION IS EFFECTIVELY RESPONDING TO THE CHANGING RISKS FACING THE COUNCIL



OUR SCRUTINY FUNCTION ANNUALLY DEMONSTRATES THE VALUE IT ADDS



WE HAVE A SCRUTINY FUNCTION THAT IS EFFECTIVELY RESPONDING TO THE CHANGING RISKS FACING THE COUNCIL AND CAN ANNUALLY DEMONSTRATE THE VALUE IT ADDS



Survey respondents were asked what would improve scrutiny in their council. The top three responses were:

- **improved clarity on role**
- **more strategic view and focus on key information**
- **training for members.**

The Centre for Public Scrutiny's (CfPS) 2012 survey⁴, which found that funding cuts had reduced both the numbers of reviews undertaken and of committees, supports our observation that scrutiny should focus on strategic issues.

The CfPS work found a positive outlook on what scrutiny could achieve. More than half of councils already focus (or are planning to do so) on priority issues that will make the biggest difference. This message chimes with our recommendations to audit committees to be focused. In difficult times, councils should seek to harness the potential that scrutiny can bring to the decision-making process.

Promoting effective scrutiny

- Demonstrate impact from your work
- Take the stakeholder perspective
- Focus on what really matters

Council scrutiny should be robust, must explore all options thoroughly and should not be afraid to make difficult choices.

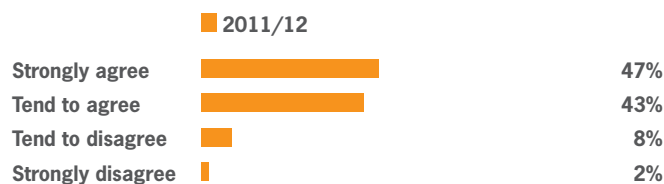
Risk management

The current local government environment means that now, more than ever, risks need to be identified effectively and managed carefully to mitigate adverse effects. Our survey results show that while confidence in identifying risk remains high, at 87%, this fell from 98% in last year's survey.

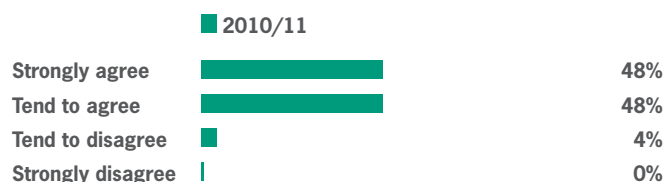
When asked whether risk management is effective in managing key risks, respondents continue to feel confident, although the figure has again fallen – from 96% to 90%. Our 'Towards a tipping point?' report suggests that, in terms of managing financial risk, embedding effective risk management awareness is key.

Yet, while councils report their governance arrangements are effective, they indicate some hesitancy as to whether risk management is truly embedded.

OUR GOVERNANCE ARRANGEMENTS ARE CURRENTLY EFFECTIVE IN ENSURING THAT KEY RISKS ARE APPROPRIATELY MANAGED

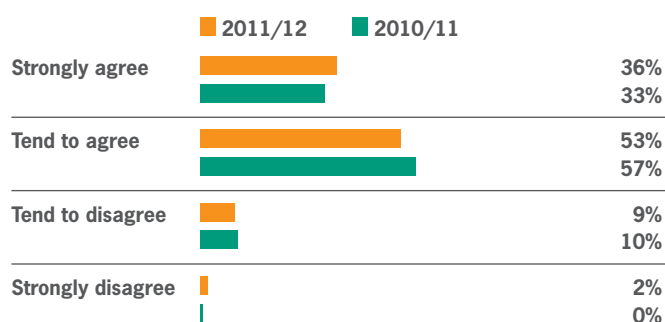


OUR GOVERNANCE ARRANGEMENTS ARE EFFECTIVE IN ENSURING THAT KEY RISKS ARE APPROPRIATELY MANAGED



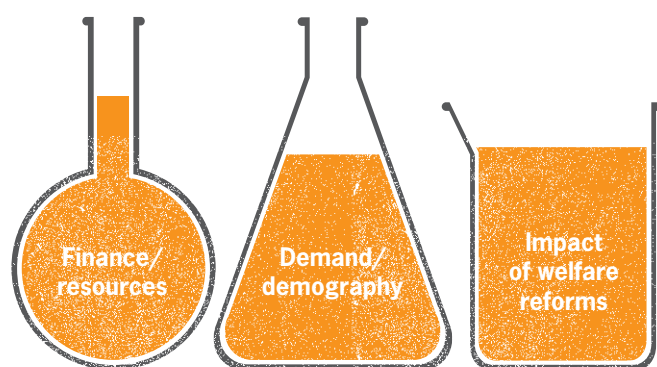
⁴Annual survey of overview and scrutiny in local government 2011/12, Centre for Public Scrutiny, October 2012

RISK MANAGEMENT IS EMBEDDED INTO THE CULTURE OF THE COUNCIL

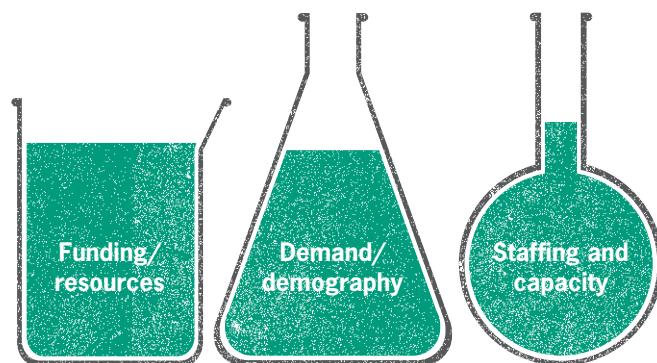


TOP THREE STRATEGIC RISKS IDENTIFIED BY SURVEY RESPONDENTS

2011/12



2010/11



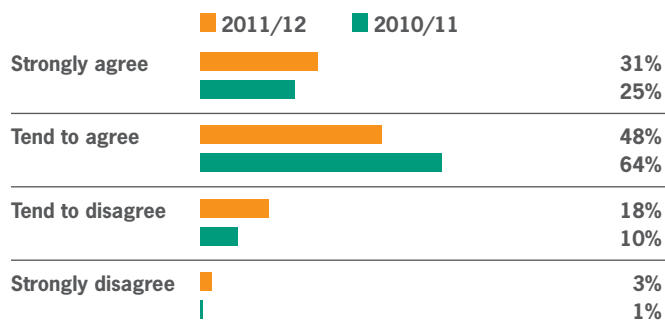
This year, unlike last, staffing and capacity was not cited as one of the top three risks: however, it was a popular choice, together with concerns around new service arrangements, legislative change and the impact of wider economic factors. A key emerging risk relates to the implementation of welfare reforms, a trend consistent with that of national policies being the most common governance risk identified in council AGS.

A prevailing thread throughout our survey and our review of AGS is of the risks created by change: whether that change pertains to legislation, funding, demography or service delivery. Risk associated with increased partnership activity is also a particular concern.

Tighter resources require councils to look differently at how they provide services to their populations. A number of councils are exploring commissioning structures, contracting out, shared service arrangements and other joint operations to provide more with less. This approach to service delivery is a key policy of central government and a central plank of its localism agenda. As well as opportunities, those vehicles carry different risks.

Many councils are placing increasing reliance on providers' quality standards and financial reputation. In this context, it is disturbing that 21% of council leaders do not believe that roles and responsibilities are clear when working in partnership, up from 11% last year.

WHEN WORKING IN PARTNERSHIP, MEMBERS AND OFFICERS ARE CLEAR ABOUT THEIR ROLES AND RESPONSIBILITIES INDIVIDUALLY AND COLLECTIVELY IN RELATION TO THE PARTNERSHIP AND THE COUNCIL



To address these risks, structured collaboration between different bodies has been promoted. At a time of increasing partnership working, we believe it is essential to understand the costs, benefits and outcomes of collaboration and then to establish an effective arrangement for oversight and governance, before entering into formal arrangements that can prove difficult to step back from.

Key commissioning cycle stages



Analyse

The analysis of need, capacity, assets and resources and of the capability of the market. Agreeing priority needs with partners. Defining the outcomes to meet those needs.



Plan

Gap analysis, stakeholder engagement, the design of services and service pathways, developing a joint commissioning strategy.



Do

Implementing the commissioning plan, facilitating the market, building capacity, sourcing the providers capable of meeting a specification and contracting for the new services. Delivering to users.



Review

Contract monitoring and reviewing the effectiveness of the strategy. Reviewing and learning from delivery and feedback from users.

Guide to commissioning and sourcing, SOLACE, 2012

Our survey shows that 89% of respondents feel risk management is embedded into the day-to-day activities of their council, consistent with last year. Our observations on the sector suggest that effective risk management is often driven by a well-established corporate risk management function.

However, funding pressures mean councils may no longer be able to maintain internal risk management resource levels – just when they are facing increased risk due to factors such as service transformation, outsourcing and localism. In this environment it remains important for councils to ensure principles of good risk management, and an effective risk culture, are spread throughout the organisation.

The Institute of Risk Management document on risk culture mentioned on page 19 provides a good summary of the ways organisations can understand and change their risk cultures. It includes 10 questions (shown opposite) boards should ask: these questions are equally applicable to council leaders and councils should consider what actions they need to take based on their answers.

Five risk management questions to ask departmental managers

- 1 Can you explain how risk management works in your department?
- 2 How is the risk management process and register used in day-to-day management?
- 3 Is the risk management process and register regarded as useful – or bureaucratic?
- 4 How do you escalate risks from your department to the corporate risk register?
- 5 Are the things that worry those at the front line consistent with what appears on the risk register?



Ten questions boards should ask on risk culture

- 1 What tone do we set from the top? Are we providing consistent, coherent, sustained and visible leadership in terms of how we expect our people to behave and respond when dealing with risk?
- 2 How do we establish sufficiently clear accountabilities for those managing risks and hold them to their accountabilities?
- 3 What risks does our current corporate culture create for the organisation, and what risk culture is needed to ensure achievement of our corporate goals? Can people talk openly without fear of consequences or being ignored?
- 4 How do we acknowledge and live our stated corporate values when addressing and resolving risk dilemmas? Do we regularly discuss issues in these terms and has it influenced our decisions?
- 5 How do the organisation's structure, process and reward systems support or detract from the development of our desired risk culture?
- 6 How do we actively seek out information on risk events and near misses – both our own and those of others – and ensure key lessons are learnt? Do we have sufficient organisational humility to look at ourselves from the perspective of stakeholders and not just assume we're getting it right?
- 7 How do we respond to whistle-blowers and others raising genuine concerns? When was the last time this happened?
- 8 How do we reward and encourage appropriate risk-taking behaviours and challenge unbalanced risk behaviours (either overly risk averse or risk seeking)?
- 9 How do we satisfy ourselves that new joiners will quickly absorb our desired cultural values and that established staff continue to demonstrate attitudes and behaviours consistent with our expectations?
- 10 How do we support learning and development associated with raising awareness and competence in managing risk at all levels? What training have we as a board had in risk?

Adapted from *Risk culture; under the microscope guidance for boards*, Institute of Risk Management, 2012

A positive governance culture, where people understand and live the values, drives robust decision-making and, in turn, strong performance.

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We service 40% of the public sector audit market, so our clients know that they can draw on a breadth of sector experience which spans local and central government and the NHS. This means we can truly appreciate the wider issues facing our clients, as well as provide solutions and services that are grounded in reality. We also bring best practice from across the sector for the benefit of our clients.

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Governance matters



**Corporate Governance
Review 2012**



**NHS Governance
Review 2013**



**Local Government
Governance Review
2013**



**Charities Governance
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