

WINCHESTER CITY COUNCIL

**REPORT PREPARED FOR THE PRINCIPAL SCRUTINY COMMITTEE
MEETING 17 OCTOBER 2005**

DRAFT

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17 October 2005

Dear Sir

Winchester Alliance for Mental Health (WAMH)

We set out in the attached report our findings from our investigation which has been undertaken in accordance with the terms of our engagement letter dated 26 September 2005 and attached to this letter.

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Yours faithfully

PricewaterhouseCoopers LLP

Introduction

- 1 At the Principal Scrutiny Committee (PSC) meeting held on 12 September 2005, the report produced by us on the debt owed to the Council by the Winchester Alliance for Mental Health (WAMH) was considered. The Committee raised a number of issues and requested that an additional piece of work be undertaken by PricewaterhouseCoopers LLP (PwC).
- 2 The issues raised were included in a PSC resolution and incorporated into an engagement letter dated 26 September 2005. A copy of this engagement letter is appended to this report. We recommend that this report is considered alongside our original report dated 3 August 2005.
- 3 The PSC resolution contained five specific areas for additional enquiry as follows:
 - a) The Portfolio Holder for Finance and the Leader to be interviewed about their roles in the decision-making processes.
 - b) Councillor Hollingbery to be interviewed, to the extent that he is able to comment, taking account of any duty of confidentiality he owed to WAMH in respect of the period when he was a trustee of the charity.
 - c) In relation to the meeting of the Central Services Performance Improvement Committee held on 28 October 2003 why was no recommendation made to suspend or cease to provide further payroll services, given that the Director of Finance had previously written to WAMH to indicate that this approach would be recommended to the Committee.
 - d) An analysis of what issues should have been considered in the period between 28 October 2003 and 27 January 2004 when the debt rose from £201,903 to £385,000.
 - e) During the period between 28 October 2003 to 27 January 2004 who authorised the continuation of the payroll payments, and who was consulted as a part of that authorisation.
- 4 In accordance with our terms of reference we interviewed the three serving members identified in the PSC resolution. These were the Leader, (Councillor Campbell), the Portfolio Holder for Finance, (Councillor Learney), and Councillor Hollingbery, a former director of WAMH.

The role of the Portfolio Holder for Finance and the Leader in the decision making process.

- 5 Our discussions with the Leader and the Portfolio holder for Finance confirmed that the work of WAMH was considered valuable and that Members were aware that if the Council was to call in the WAMH debt, WAMH could no longer continue. In addition, the fact that WAMH had little in the way of assets meant that if WAMH could not trade its way out of its financial difficulties, the Council would lose all (or at least a substantial proportion) of its existing WAMH debt. Therefore, if WAMH was facing a short term cashflow issue, for the sake of risking potentially a relatively small additional sum over and above the existing debt, the Council would lose both the existing debt and cause the provision of a valuable community service to end.

- 6 In our first report dated 3 August 2005, we reported upon how one of the lessons to be learned was the need to undertake fuller and more robust risk assessments when exposing Council assets/funds to risk of loss. Clearly this does not mean that the Council should try and eliminate risk. Rather, in similar circumstances, there is a need to assess the scale of the risk being taken. In this context, it is evident that in October 2003 when the WAMH debt was in excess of £200,000, but well below its peak of nearly £400,000, a more explicit analysis of the amount by which the debt could increase would have helped to enable the decision to continue support to be placed in context. In addition, a clearer understanding of the amount of time that the Council was prepared to allow to WAMH and the additional financial exposure that would create would have added rigour to the assessment process.
- 7 In terms of information, the Cabinet routinely received minutes of various scrutiny and performance improvement committees and was aware of the scale of the debt. For example, the minutes of the 27 October 2003 meeting of the Central Services Performance Improvement Committee (CSPIC) were considered at the Cabinet meeting of 18 November 2003. We were informed that Cabinet members placed reliance on the views of these cross-party Member discussions when considering the debt. The two Cabinet members we interviewed attended and were involved in the Cabinet meetings which discussed the debt and indicated that this constituted the main formal part of their involvement in the decision making process.
- 8 We understand that in addition to the formal contact between officers and members that took place in the period between October 2003 and January 2004, additional informal contact did take place in this intervening period between the Council's Director of Finance and the Cabinet Portfolio Holder for Finance. However, details of the communication were not minuted although both parties do recall that discussion about the WAMH debt did take place on a number of occasions.

Councillor Hollingbery to be interviewed, to the extent that he is able to comment, taking account of any duty of confidentiality he owed to WAMH in respect of the period when he was a trustee of the charity.

- 9 In accordance with our terms of engagement we interviewed Councillor Hollingbery who confirmed that he had acted as a director of WAMH in the period 15 December 1999 to 9 October 2003. Councillor Hollingbery confirmed that he had regularly attended formal meetings of the WAMH Board and had a full understanding of his legal responsibilities as a director.
- 10 In the context of this debt, Councillor Hollingbery believed that the key issue related to the Cabinet and in this context, believed that there was a potential source of confusion of the roles of Cabinet and Scrutiny, particularly where a scrutiny committee attempts to become too involved in the detail of individual circumstances of individual cases such as the WAMH debt.
- 11 Councillor Hollingbery was aware that WAMH was in financial difficulty and was concerned about the adequacy of WAMH's arrangements for financial administration as well as its capacity to generate sufficient income to meet immediate costs and repay the outstanding debt. We understand that these concerns were raised at the CSPIC meeting of 28 October 2003 which was the first meeting of this committee after Councillor Hollingbery had resigned as a director of WAMH on 9 October 2003. The minutes of the meeting do not reflect any dissenting views on the resolution passed at the meeting.

In relation to the meeting of the Central Services Performance Improvement Committee held on 28 October 2003 why was no recommendation made to suspend or cease to provide further payroll services, given that the Director of Finance had previously written to WAMH to indicate that this approach would be recommended to the Committee.

- 12 The Council's Director of Finance wrote to Duncan Murray, WAMH's Chief Executive, on 16 October 2003. In her letter she set out details of the debt and her concerns and stated:

"I am reporting to members on the matter on 28th October and shall be recommending that, after the October run, no further payments be processed."

The letter therefore contained a clear indication that the Director of Finance was going to make a recommendation to the CSPIC at the 28 October 2003 meeting. The CSPIC considered the Director of Finance's paper (CEN33 Appendix N – Appendix 1) and paragraph 6 of that paper informed members that she had written to WAMH "indicating that she will be recommending to Members that the Council discontinues the payroll service."

- 13 At the 28 October 2003 CSPIC there was significant discussion about the debt but the Director of Finance did not make any recommendation to terminate the payroll service. The CSPIC also made no recommendation to terminate the payroll service. From our discussions we understand that the Director of Finance had spoken to WAMH's auditors and to senior individuals at WAMH, including the Chairman of the Trustees, and received assurances that the Charity was taking steps to strengthen its financial administration. These steps included forming a finance committee.

- 14 The Director of Finance had prepared a paper for the CSPIC 28 October 2003 meeting (CEN33 Appendix N – see Appendix 1) that referred to the issues surrounding the debt and gave a verbal update. This paper set out the details of the debt but did not make any specific recommendation.

- 15 In terms of scenario planning, the Council was at this stage owed more than £200,000 and therefore if the Charity could trade its way out of its financial difficulties it could possibly eventually repay the debt. However, for WAMH to achieve this strategy, the Council would need to continue to not call in its debt. Terminating the payroll service was an option open to the Council and it is evident that sufficient members were aware that implementing this course of action would have meant that WAMH could no longer continue.

- 16 Therefore it was reasonable for the Council's Director of Finance to threaten to withdraw the service to make absolutely sure that the Charity was aware of how seriously the Council viewed the debt. In terms of actioning this threat and making the recommendation stated in the letter, clearly the Council's Director of Finance is free to choose to make no recommendation to a later meeting of members especially given that WAMH had responded positively to this threat and members were known to be supportive of WAMH. In this context we note that the Cabinet discussed the matter at its meetings of 18 November 2003 and 11 February 2004 and the minutes of these meetings form Appendices 2 and 3. We note that the Cabinet minutes for the meeting of 18 November 2003 indicate that the Director of Finance believed that in the context of WAMH strengthening its arrangements for financial administration

".there was a realistic prospect that the debt would be met, but within the cash flow expenditure had not been reduced to match reduced revenue."

- 17 We believe that main learning point from this experience is that a fuller risk assessment was required so that members could quantify the maximum exposure that they were prepared to take in managing this situation.

An analysis of what issues should have been considered in the period between 28 October 2003 and 27 January 2004 when the debt rose from £201,903 to £385,000.

- 18 The papers that were initially prepared for the 28 October 2003 CSPIC meeting referred to the arrears of WAMH rather than the total debt position. Appendix N which was considered at the meeting provided a more detailed analysis and recorded that the total debt i.e. inclusive of recent payments that were not technically “overdue” under the Council’s 30 days terms of trade was £283,000.
- 19 Detailed analysis of the debt reveals that arrears began to become evident in June 2001. Prior to that period although WAMH had been in arrears, these were usually only for a brief period and subsequently payments were made to the Council to clear the debt. However, with effect from 8 June 2001 although payments were received, WAMH’s debt was never cleared. WAMH therefore had a history of indebtedness prior to the meeting in October 2003 and for all of the previous year the debt had not reduced below the level of £125,000.
- 20 In this context, it might have been reasonable to have put more pressure on the directors of WAMH to explain the situation. Legally the WAMH directors had a number of responsibilities particularly when they became aware (or reasonably ought to have been aware) that the financial circumstances of WAMH were potentially difficult. For example, under company law directors have a statutory responsibility to ensure that the company maintains accounting records and that the records disclose the financial position of the company with reasonable accuracy at any time.
- 21 Therefore, given the responsibilities that directors have, in conjunction with the fact that the debt had remained at a significant level for more than one year (with no sign of any reduction), one possible course of action would have been to obtain representation from the WAMH Board about how the debt would be repaid. We note, however, that the Director of Finance had communicated with WAMH on a number of occasions and the 16 October 2003 letter requested that the matter be brought to the Board’s attention. The Council could also have sought an undertaking for repayment from the directors that could be formally minuted in the records of the company and this would also have helped to ensure that the directors of WAMH were fully aware of and understood their legal responsibilities.
- 22 In addition, placing the onus on the directors to explain how they would ensure that WAMH would provide information to help the Council to determine how much longer it would support WAMH. In addition, if WAMH had provided a more detailed financial plan rather than simply the cashflow forecast, it could have been tested by the Council’s internal auditors to help ensure that income and expenditure projections were realistic.
- 23 In terms of issues to be considered the first issue relates to gathering information to perform a risk assessment. It is evident that WAMH did not begin the task of actually paying serious attention to managing the debt until the Trustees (who are the directors) became more directly involved. This involvement came after an email from the Director of Finance to two trustees and the recommendation of the CSPIC at its meeting of 28 October 2003 that the Council’s Chief Executive and Director of Finance meet with WAMH’s Chief Executive and Chairman of the Trustees, the

meeting taking place prior to 18 November 2003. However, given the responsibilities of all company directors, this more significant involvement by the trustees could have been instigated at an earlier stage.

During the period between 28 October 2003 to 27 January 2004 who authorised the continuation of the payroll payments, and who was consulted as part of that authorisation.

- 24 The Council has met the payroll costs of WAMH employees since they were transferred from WACA to the newly formed WAMH in 1997. The authority for the release of all payments came from the Council's Director of Finance following a well established policy of the Council administering payroll services in this manner to charities that it supports financially. The provision of payroll services of this nature to local voluntary sector organisations has been in place at the Council for many years prior to 1997.
- 25 The provision of this service is not covered by the Council's budget process because there should be no expenditure implications (other than the reduced investment income caused by the negative impact on the Council's cashflow) as each payroll payment made by the Council is invoiced to the third party and should be recovered. Therefore, once the arrangement is set up, the Council's Director of Finance might not be expected to terminate or suspend the service unless specifically instructed by a formal resolution made by members although this action could have been taken, for example by using emergency powers.
- 26 In the context of WAMH no such resolution was made until the recommendation made by the CSPIC at its meeting of 27 January 2004 to "...pay the January 2004 salaries, but thereafter no salaries should be paid without funds covering the monthly amount being received in advance." The minutes of the 27 January 2004 CSPIC meeting were considered at the 11 February 2004 Cabinet and the approach set out by the CSPIC was approved and adopted. Until these meetings, no resolution to terminate, or to identify conditions that would lead to the termination of the service, had been passed.
- 27 The recommendation to only pay WAMH's future payroll costs after the receipt of sufficient funds from WAMH to meet the cost therefore effectively capped the Council's exposure to the amount of the debt at February 2004. This amounted to slightly less than £393,000. Thereafter the actions taken by WAMH did begin to reduce the debt and at the point that WAMH determined that it could no longer continue trading in December 2004, the debt had been reduced by around £40,000 to £353,000.
- 28 The Cabinet considered the WAMH debt issue at its meetings of 18 November 2003 and 11 February 2004 (see Appendices 2 and 3). In the period between 18 November 2003 and 11 February 2004 there were four other meetings of the Cabinet (3 and 17 December 2003 and 7 and 14 January 2004) but the WAMH debt was not an item on the agendas for these meetings. The minutes of the CSPIC meeting held on 28 October 2003 were also considered by the Principal Scrutiny Committee at its meeting held on 8 December 2003 and there was also a full Council on 7 January 2004 that also received these minutes.

- 29 In terms of consultation in the period from the Cabinet meeting held on 18 November 2003 to the end of January 2004, based upon the results of our interviews, it is evident that informal meetings and conversations between the Council's Director of Finance and the Portfolio Holder for Finance about the WAMH debt did take place. No minutes of the meetings/discussions were prepared.
- 30 In this context, if a fuller risk assessment of the WAMH debt had been performed in late October or early November 2003, it would have been possible to clarify the precise form and level of continued support for WAMH. It would then also have been the case that the actions expected of the Director of Finance would have been clear. For example, if a maximum upper limit of financial support had been identified the Director of Finance and members would have clearly known the maximum amount of funds that the Council was prepared to risk in trying to help WAMH trade its way out of its difficulties. Without this assessment the risk of unclear expectations in terms of communicating the situation to members was inevitable.

Conclusion

- 31 The additional work that has been performed does not change our view expressed in our report of 3 August 2005 and particularly the benefits that a fuller risk assessment would have delivered. Had this been performed, the amount of funds that the Council was prepared to risk would have been quantified and members could have made this assessment by comparing the benefits of the work of WAMH against the potential cost implications.
- 32 In terms of lessons learned, any possible shortcomings of the directors of WAMH are clearly outside the remit of the Council to address. However, internally, there is a need to ensure that the roles of Scrutiny and Cabinet are clarified so that the danger of a scrutiny committee becoming too involved in detailed cases is addressed. In the case of the WAMH debt it is clear that significant discussion took place at CSPIC and this might have prompted Cabinet to give less prominence to this item although clearly the debt did get considered and was discussed at Cabinet. To illustrate, the minutes of the 18 November 2003 Cabinet which considered the CSPIC minutes of 28 October 2003 contain the resolution "That the current situation with regard to the debt owed to the Council by the Winchester alliance for Mental Health be noted." Given that a significant discussion took place, the resolution possibly suggests that it was the CSPIC that was leading on this issue although clearly Cabinet was ultimately responsible.
- 33 It remains our view that no single individual was responsible for the decisions made on the WAMH debt although clearly some individuals were more involved in the detail. It would also have been helpful if the reservations that some officers and members had about the ability of WAMH to repay the debt were recorded more explicitly to demonstrate more transparently the considerations of the relevant meeting.
- 34 In terms of other lessons, the Council does contribute to a wide range of charitable and voluntary sector organisations covering areas such as arts and leisure as well as community services such as those provided by WAMH. Whilst these organisations are outside of the Council's control, the Council does need to be satisfied that the governance of these third party organisations is acceptable. In addition, the provision of grants to third party organisations is likely to play an increasing role in the overall delivery of services via partnerships and also direct assistance. Therefore it may be appropriate for the Council to consider how it can monitor these third party organisations.

- 35 We are aware of another organisation to whom the Council provides payroll services that is currently in financial difficulty where the Council has agreed to make an emergency grant to allow them to meet their short term costs, including payroll costs incurred by the Council. We are reviewing this matter but it reinforces the need for the Council to clarify its responsibilities in relation to these organisations.
- 36 Clearly the Council would not wish to introduce a bureaucratic regime to monitor these organisations but should consider reviewing the monitoring arrangements for assessing how well the expenditure contributes towards meeting Council priorities. This area is likely to feature more prominently in future CPA assessments and also is a discipline that is useful to follow in identifying how resources are to be applied.