Corporate governance

Improvement and trust in local public services
The Audit Commission is an independent body responsible for ensuring that public money is spent economically, efficiently and effectively, to achieve high-quality local and national services for the public. Our work covers local government, housing, health and criminal justice services.

As an independent watchdog, we provide important information on the quality of public services. As a driving force for improvement in those services, we provide practical recommendations and spread best practice. As an independent auditor, we monitor spending to ensure public services are good value for money.

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Introduction

What is this report about?

This report is about the contribution that corporate governance makes to the quality of public services, for better or worse. It builds on the interest in the private sector in investigating the positive contribution that corporate governance arrangements make to profit and greater trust. Poor public sector corporate governance is at the heart of many public service failures. We need a greater level of understanding of how good corporate governance can contribute to high-quality, appropriate services and greater community cohesion, health, safety and economic well-being.

This study describes some of the strengths in current governance arrangements in the public sector and some of the areas that are most in need of attention. Many of these themes have been visited before, but this report brings together elements of Audit Commission and others’ work to show how good governance can provide both the means for public services to strengthen themselves and for regulators to ensure that regulation is proportionate to risk.

Research for this study

The principal aim of this study is to investigate the relationship between the quality of corporate governance arrangements in public sector organisations and the quality of the services that they provide. Given the enormous scope of research activity this question potentially involves, this study focuses on three areas of the public sector where the Audit Commission has audit responsibilities: health, local government, and police and probation in the criminal justice system. The study drew on audit and inspection data from the Commission and from other inspectorates, as well as on original research involving executives and non-executives in the public sector. The full list of participating organisations is given in Appendix 1.

As part of this project, we commissioned MORI to undertake original qualitative and quantitative research into what affects trust in public services and organisations. Some of the key findings from this research are included in this report. The research (Ref. 1) has been separately published and can be obtained from the Commission’s website at www.audit-commission.gov.uk

Three organisations participated in more detailed case study research involving in-depth interviews with senior personnel, to explore the contribution that corporate governance arrangements make to organisational decline and recovery. They were the Royal United Hospital in Bath, Sheffield City Council and the Northumbria Probation Board. The last two organisations (or predecessor body) had received critical inspection or audit reports in the past, but were now judged to be performing well. In the case of the Royal United Hospital, serious shortcomings had been
revealed and reported on by the Commission for Health Improvement (CHI) and subsequently in a report by Professor Robert Tinston. The Audit Commission is particularly grateful to these organisations – their chief executives, chairs and leader, and to other senior staff – for their willingness to take part in this research.

This study was conducted by Mark Wardman and Ingrid Koehler under the direction of Irene Payne and Joanna Webb. The Commission is grateful to Angela Watson, Elizabeta Petrova and MORI for additional research.

Structure of this report

- **Understanding corporate governance**
  Chapter 1 outlines the Audit Commission’s understanding of corporate governance, who is responsible for delivering it and its relationship with service quality and public trust in public bodies.

- **The shape of corporate governance in the public sector**
  Chapter 2 looks at the main governance issues affecting the parts of the public sector in this study, and addresses the role of regulators, inspectors and auditors in promoting good governance.

- **Auditors’ views on the quality of corporate governance in the public sector**
  Chapter 3 presents auditors’ cross-sector assessments of the governance-related risks that determine the focus of their work.

- **How corporate governance contributes to the quality of local public services**
  Chapter 4 examines the relationship between corporate governance arrangements in public bodies and the quality of the services they provide, drawing on an analysis of local government data from comprehensive performance assessments (CPA) and from other sources.

- **Achieving good corporate governance**
  Chapter 5 outlines the lessons from our analysis and details what leads to effective and well-governed organisations.

- **Key recommendations**
Understanding corporate governance

1 Corporate governance is understood differently across the public sector. This chapter sets out the Audit Commission’s definition of corporate governance and introduces some of the associated key themes that we explore further throughout the report.

2 The development of a common understanding of corporate governance is generally agreed to have started with the Cadbury report (Ref. 2), which identified the principles of good governance as integrity, openness and accountability. The report was the first of several on corporate governance in the private sector, the most recent contributions being the Higgs report on non-executive directors (Ref. 3) and the Smith report on audit committees (Ref. 4). In the public sector, the Nolan Report (Ref. 5) was particularly important in setting out the principles of public life. Appendix 2 contains a list of relevant reports on corporate governance.

3 The Audit Commission has developed its understanding and in this report defines corporate governance as:

The framework of accountability to users, stakeholders and the wider community, within which organisations take decisions, and lead and control their functions, to achieve their objectives.

4 Good corporate governance combines the ‘hard’ factors – robust systems and processes – with the ‘softer’ characteristics of effective leadership and high standards of behaviour. It incorporates both strong internal characteristics and the ability to scan and work effectively in the external environment. The internal combination of ‘hard’ and ‘soft’ characteristics involves:

- **leadership** that establishes a vision for organisations, generates clarity about strategy and objectives, roles and responsibilities, and fosters professional relationships;
- **culture** based on openness and honesty, in which decisions and behaviours can be challenged and accountability is clear;
- supporting accountability through **systems and processes**, such as risk management, financial management, performance management and internal controls. They must be robust and produce reliable information to enable better decisions to be reached about what needs to be done in order to achieve objectives; and
- **external focus** on the needs of service users and the public, reflecting diverse views in decision making, producing greater ownership among stakeholders and maintaining clarity of purpose.
5 Externally, an effective and **strategic regulatory regime** can promote better corporate governance, with appropriate targets and freedoms and flexibilities for organisations based on comprehensive information about their performance and capacity.

6 How well the internal characteristics are balanced is important; public sector organisations operate in complex legislative, political and local contexts, in which they have to make difficult decisions. Well-governed organisations balance their different responsibilities and use information to decide where to allocate effort and resources to meet competing demands. Good governance supports **effective decision making**; poor governance is often seen (in hindsight) as creating the climate, structures and processes that lead to poor decisions.

7 Decision making always involves risk, but this risk is reduced when an open culture exists in which challenge is accepted and supported. This challenge and openness must be underpinned by robust performance, financial and information management systems, the effective use of risk management and an accountability framework that is based on a clear communication and understanding across the organisation of roles and responsibilities.

8 The importance of effective leadership in ensuring good governance is clear from inspection reports and from other reports generated across the public sector. Ultimately, leaders are responsible for achieving the right balance of hard and soft factors and are accountable for the decisions they take, or fail to take. They set the strategy for organisations and give it a sense of direction and purpose. The relationships between those carrying out executive and non-executive roles are fundamental to setting the tone for the cultural aspects of organisations that can never be codified or set out in detailed guidance, but which are immediately recognisable to those who work in or deal with them (Exhibit 1, overleaf).

9 The Audit Commission, in conjunction with the Improvement and Development Agency (IDeA) is currently investigating the topic of leadership and will report later in 2003.
Effective decision making

Organisations must bring together both the ‘hard’ elements of governance, the systems and processes, and the ‘softer’ cultural elements, such as integrity, openness and accountability, to provide a robust basis for decision making.

Source: Audit Commission
How far does ‘corporate’ governance extend?

Increasingly, public sector services are delivered through contracts between public, private and voluntary sector organisations, and through more informal collaborations with a range of partners across all sectors.

Organisations are unlikely to be able to ensure that partnerships and contracts are effective unless their corporate governance is effective. How corporate governance affects the quality of partnership outcomes and how partnerships affect organisations’ own governance arrangements are both important issues that this report does not address in detail. The Audit Commission plans to carry out further work to specifically address the issues relating to governance of partnerships and multi-agency alliances.

Who is responsible for corporate governance?

In this report, the key governance roles are described in terms of the responsibilities of executive directors and non-executive directors (or NEDs), following terminology used in the NHS and in the private sector. These terms are understood differently across public sector organisations, particularly in local government, reflecting the democratic foundations of local authorities.

To avoid confusion, the terms ‘executive’ or ‘executive director’ should be taken to mean the corporate management team in local authorities – that is, the chief executive and senior service directors. The term ‘non-executive’ or ‘non-executive director’ should be taken to mean those roles carried out by elected councillors. In policing, executives are the chief constable and his or her senior management team; the non-executive function is filled by members of the police authority. In probation, all board members except the chief officer are non-executives; the chief officer and his or her senior management team are the executives.

Why is corporate governance important?

Organisations with good corporate governance have the capacity to maintain high-quality services and to deliver improvement. Poor corporate governance has contributed to serious service and financial failures. The growing debate about corporate social responsibility and corporate manslaughter bring this issue into stark perspective.
The quality of governance also affects levels of trust in public services:

*Trust is at the heart of the relationship between citizens and government. It is particularly important in relation to services which influence life and liberty – health and policing. But it also matters for many other services – including social services and education. In these cases, even if formal service and outcome targets are met, a failure of trust will effectively destroy public value.*


Corporate failures in the private sector can have a catastrophic effect on public trust, leading to falls in share values, investor confidence and in the general public’s trust in the stewardship and state of the economy. MORI’s research for this study shows that public sector corporate failures also undermine trust. Nearly two-thirds of those asked (64 per cent) said that high-profile incidents, such as the death of Victoria Climbie or the Alder Hey organ retention scandal, had adversely affected their level of trust in public services.

Loss of trust will damage the Government’s aim of modernising public services. The public and service users can disengage, either by choosing other service options (where feasible), or by not wanting to participate in public service delivery. They might decide not to vote, fail to respond to consultation, or, more significantly, withhold information or participation that enables public services to be delivered effectively for the wider common good.

Trust in public bodies is principally affected by two things: the quality of services that individuals and their families receive; and how open and honest organisations are about their performance, including their willingness to admit to and learn from their mistakes. The public does not generally rate public bodies highly on the second of these attributes: only one in eight (13 per cent) believes that their local hospital, council or police service always admits when it makes a mistake; and only one in four (22 per cent) believes that such organisations learn from the mistakes that they make.

Research for this study shows that public bodies fare badly on the ‘negative’ drivers of trust: having poor leaders and managers, and being uninterested in peoples’ views. Poor leadership and management is associated with poor communication, echoing research previously carried out for the Audit Commission[^1] that showed that the public believe: it is in the interest of the service provider to present figures and spending in a positive light (Exhibit 2).

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[^1]: Qualitative research among users of local services (2001) Craig Ross Dawson.
Exhibit 2
The key drivers of trust
There are both positive and negative drivers of trust. Public bodies fare badly on the ‘negative’ drivers.

Conclusion
20 The quality of corporate governance is often reflected in the quality of decision making. Public sector bodies must combine reliable information produced by ‘hard’ systems and processes with the ‘softer’ issues of openness and integrity to inform their judgement on key decisions. The more open and honest organisations are with themselves about their performance, the more open and honest they can be with service users and the public. This honesty is the foundation for deciding appropriate action to remedy poor performance. Better quality services are then more likely; improved performance and being more open will increase public trust.

21 The next chapter looks at the quality of some of these aspects of corporate governance across the public sector and at the particular constraints and opportunities that different public bodies face when seeking to improve them.
The shape of corporate governance in the public sector

This chapter outlines the context within which organisations in different parts of the public sector address corporate governance, drawing on information from inspectorates in each area to identify key issues. It also considers how regulation, inspection and audit contribute to the quality of the corporate governance of individual public sector bodies, addressing information management, decision making and user involvement in particular.

Local government

The governance of local authorities has improved following the Local Government Act 2000. Councils now have constitutions that set out their standing orders and codes of conduct, appointed monitoring officers and established Standards Committees and introduce new forms of executive arrangements that aim to streamline decision making and improve accountability.

It takes time for new arrangements to become effective. Many councillors involved in scrutiny are less clear about their roles than those in the cabinet. Many believe that scrutiny is less effective than the previous system and are concerned about the effect that this may have on the quality of decisions made.

Non-executive councillors are struggling with their role in ‘scrutiny’, whereby they hold their executive colleagues and other organisations to account, develop policy proposals and review services. There are examples of good practice, but 97 councils had a need to develop their work on scrutiny.

Patterns for Improvement, Audit Commission, 2003

The most distinctive feature of the governance of local authorities is that decision makers are directly accountable to the local electorate: in this sense, decision making in local government is considerably more transparent than in any other sector considered in this study. But a combative party political environment can highlight poor performance or mistakes not in ways that allow organisations to learn, but in ways that denigrate the organisation in the public’s mind.

Paradoxically, a higher level of mistrust may accompany greater openness in the same way that a higher level of complaints will accompany clear complaints procedures and an organisational culture that encourages them. The CPA of single tier and county councils rated around one-half (51 per cent) as excellent or good and only one-quarter (23 per cent) as poor or weak. However, research carried out for this study by MORI shows that councils are particularly poorly rated by the public in terms of their willingness to admit to mistakes and to learn from them; some of the key

[1] Of the 150 single tier and county councils that received a CPA.
drivers of trust. In addition, the public particularly perceives councils to have poor-quality leaders and managers.

27 Councils have a community leadership role, but the public tends to be more satisfied with individual services than with the organisation as a whole. Although CPA judgements encouragingly show that community leadership is developing well in over two-thirds of councils, this lack of trust in councils as corporate entities could jeopardise some councils’ ability to be effective community leaders.

28 Auditors recently judged local authorities against five key dimensions of corporate governance based on the guidance developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives and Senior Managers (SOLACE) (Exhibit 3). A majority rate local councils as very or fairly good performers in most areas. The exceptions are risk management and internal control. These issues are explored further in chapter 3.

Exhibit 3
The quality of corporate governance in local authorities
The majority of auditors rate local councils as very or fairly good performers.

Auditor judgements of local authorities’ performance on key dimensions of corporate governance

Source: Audit Commission
The Department of Health (DH) has been concerned to promote effective corporate governance of NHS trusts for many years. It has issued intricately prescribed codes of governance and conduct and has rolled out a programme of controls assurance. The term ‘corporate governance’, however, has a narrower focus than is understood in other sectors. Current attention focuses on providing high-quality information for decision making, enhancing the role of non-executives and communicating effectively with service users and the public.

With a structure that emulates, but pre-dates the Higgs report recommendations, NHS trusts are governed by unitary boards with an equal number (five) of executive and non-executive directors, plus a chair. These unitary boards bring together clinicians and managers, as well as NEDs. But the committee structures beneath board level generally reflect a clear separation of ‘corporate governance’ and ‘clinical governance’.

The existence of these governance ‘streams’ is a distinguishing feature of the NHS and a legacy of the historical autonomy that consultants have had when taking clinical decisions. The introduction of clinical governance (which has no equivalent elsewhere in public sector governance) began the process of integrating consideration of clinical matters within a corporate framework for decision making and accountability.

Clinical care is the core business of the NHS and clinical governance has achieved much in terms of promoting better care for patients. But chairs and chief executives who contributed to our research are concerned about some consultants’ unwillingness to be held to account by managers and non-executives for professional decisions. One chief executive from a primary care trust said ‘You tread on clinicians’ toes at your peril’. The consequences of this are that the clinical arm of the organisation wants to, and often does, deliver excellent clinical care to some individual patients, but not always with due regard for equity, finance and the bigger community picture.

The DH and the NHS Confederation are encouraging the combination of these two streams in order to achieve more effective governance in the NHS, but there remains some way to go. The Commission for Health Improvement (CHI) found that – ‘A third of the organisations CHI has reviewed have a lack of connection between the policies that the board has agreed and what actually happens in wards, clinics, surgeries and people’s homes’ (Ref. 6).

The NHS has been seeking ways to improve dialogue with patients, but CHI has found that nearly all trusts could be better at involving the people who use their services in planning developments. CHI also reports that even where good practice exists it is rarely shared: ‘More trusts are enlisting user groups and people’s panels to get people involved, but some NHS leaders appear to remain resistant to the idea of involving the people who use their services at all’ (Ref. 6).
The poor quality of information, both about finances and about clinical practice and patient care, remains one of the key governance risks that the NHS faces. The Audit Commission’s recent reports on the quality of data in the NHS show that, while it has improved, data quality still has some way to go before it can be said to provide a robust basis on which decisions can be taken (Ref. 7). In the NHS, it is not always clear that the board asks the right questions and this, in part, is because the NHS collects a vast array of data that is not always presented in a context that is meaningful to the organisation as a whole. The new Commission for Health Audit and Inspection will review the effectiveness with which providers use information in clinical and managerial decision making.

Inadequate information in the NHS reduces the clarity behind decision making that is necessary to achieve effective accountability. This creates the conditions in which severe malpractice can occur, including the deliberate falsification of waiting list information. The Audit Commission’s work suggests that this occurs rarely, but at the same time, most auditors report a lack of confidence in the reliability and accuracy of reported information. The effect of both on public trust and confidence should not be underestimated.

CHI has urged that action is taken on information management in all but 5 of the 203 published clinical governance inspections published to December 2002. They found:

- half of boards often did not receive information from clinical governance and service activities;
- recording systems for clinical governance for tracking complaints and monitoring incidents were a cause for concern; and
- in at least two-thirds of organisations clinicians and managers did not have ready access to information, including trust policies.

Chief executives and boards have a clear responsibility for maintaining and reporting accurate information. The National Programme for Information Technology is intended to produce information for governance purposes, through the production of information to support the delivery of patient care. Other planned or recent national information initiatives, such as health informatics and the national patient record analysis service, should also play an important role in enhancing the quality of the information that boards receive, once fully established. But national IT systems and programmes bring with them the risk that they will constrain the ability of boards to have appropriate local information, or require boards to structure their activities to meet national targets in ways that might not be appropriate for their local circumstances.

Decision making in the NHS would also be improved if the status of NEDs were enhanced. Although the non-executive role is generally difficult to fulfil in most organisations, it appears to be a particular problem in the NHS. Many non-executives in health complain of a lack of status and a feeling of disempowerment and CHI has raised concerns about how clear non-executives are about their roles. The Secretary of State could encourage change in this area: recognising more the contribution that...
non-executives make; developing their existing skills and experience; and looking more to them, as well as to executives, to deliver improvement.

The criminal justice system

A key feature of the criminal justice system is the interdependence of the agencies in achieving successful outcomes from the public’s perspective. Eleven agencies are overseen by three government departments and all must work together in some capacity. Additionally, outcomes are often influenced by the effectiveness of social services, health and education. The move towards multi-agency public protection panels to oversee high-risk offenders and the advent of local criminal justice boards are evidence of the recognition of the importance of effective systemic collaboration.

Police

Uniquely in this study, the local governing body for policing – the police authority – is not an integral part of the organisation that delivers services. No salaried police staff sit on the board. Police authorities include councillors, independent members and magistrates. They are responsible for budgeting and for setting strategic direction and policing priorities after consultation with local communities, and with due regard to the framework of the National Policing Plan, and with due regard to the framework of the National Policing Plan.

Chief constables are appointed by and accountable to the Police Authority. The introduction of the National Policing Plan is a good example of a set of national priorities that need to be carefully balanced and delivered together with the local priorities identified in the local consultation process.

To complicate matters, chief constables enjoy operational independence, which means that police authorities may not set operational policy. It has not always been easy for chief constables and police authorities to agree about what is strategic and what is operational. The critical point here is that robust governance and scrutiny arrangements are key to ensuring that Police Authorities carry out their function in the most well-informed and effective manner.

Police authorities set strategic objectives, but are largely reliant on forces to provide information on performance. In order to have robust and transparent performance management arrangements, the Police Authority must set clear reporting and scrutiny standards. Performance should be monitored and improvement driven across the piece, including operational, financial and human resources performance. The challenge for Police Authorities is to make sure that they have the competence and infrastructure to deliver this duty in a highly complex and challenging environment. As with the NHS, therefore, the issue of who is in control, and who is accountable to whom is critical. The role of police authority members as non-executives is similarly compromised.
Even where there is effective information sharing between force and authority, doubts remain about how good the data are. In the 17 triennial Her Majesty’s Inspectorate of Constabulary (HMIC) force inspections between 2001/02 and 2003 of local police forces in England, nearly two-thirds received recommendations or suggestions about improving their use or collection of operational intelligence or information. Recommendations included improving the way that crime data was collected, ensuring that information was exchanged effectively between operational units and ensuring that senior officers had adequate information about the level of crime in their areas.

Performance management generally is a concern. Over one-half of recent HMIC force inspections included a recommendation or suggestion about improving performance management. The Home Office recently introduced a new national framework for performance monitoring in policing. It has also introduced (or will shortly introduce) a number of measures to standardise and improve the way that the police collect and use information. This should help police authorities to hold chief constables to account for performance and will assist all those involved to use information more strategically. A number of forces already use similar approaches with locally developed information systems, but few are successfully integrating the use of this information with effective police authority scrutiny of force efficiency and effectiveness.

Although high-ranking police officers involved in this study said that they feel accountable to the local population, in just over one-half of HMIC force inspections, it was recommended that police improve aspects of their community engagement, communication or consultation arrangements.

Another striking feature of the governance of policing has been the concentration on maintaining high standards of conduct. In line with the Police Reform Act, from April 2004 complaints against the police will be overseen by the Independent Police Complaints Commission, which has independent investigatory powers. HMIC is charged with reviewing the way that forces deal with standards of conduct in every force-level inspection. While HMIC has generally found that the enforcement of standards of conduct have improved, it has also found that many professional standards units are not taking a sufficiently proactive approach to promoting high standards or to capturing learning about ‘organisational’ complaints as opposed to dealing with complaints against individual officers.

Probation services were amalgamated into the National Probation Service (NPS) just over two years ago. Local probation boards comprise 14 non-executives and the chief officer of the probation area. The chief officer is accountable to the board, but is also directly accountable to the director of the NPS.

Probation boards are responsible for delivering an efficient and effective service locally. However, a number of key services are procured nationally, such as IT and facilities management. There remains a tension for board members in influencing local
priorities and delivering challenging performance targets within a nationally determined structure and framework.

During the development of the new structure, corporate governance has been taken seriously. The Probation Boards’ Association and the National Probation Directorate both have posts specifically addressing governance. Her Majesty’s Inspectorate of Probation (HMIP) recently completed thematic inspections of the governance of probation boards, which found that boards were generally functioning well, but attributed poor performance in part to lack of clarity about how local boards fit into the national service (Ref. 8).

In addressing governance, the NPS has focused on developing effective systems and processes, particularly those used to monitor and manage performance. The NPS is largely able to monitor how effectively these systems are working, as well as having information systems that promote national and board-level scrutiny, but they rely on these systems being applied locally by effective boards.

The NPS has yet to develop all key areas of policies, particularly relating to communication and consultation with the public. The probation service has found it particularly difficult to engage with the public effectively. Local boards have struggled to develop a more open dialogue with a largely unaware public. Research carried out for the NPS in 2002, for example, found that only 7 per cent of the public surveyed felt that they knew much about what the probation service does, which alone presents a key challenge for the NPS (Ref. 9). New communication opportunities exist for probation within the context of local criminal justice boards and through participation with Crime and Disorder Reduction Partnerships, setting probation within the context of wider community safety issues.

The role of targets, regulation, inspection and audit in promoting better corporate governance

Targets

Reactions to national targets vary, often according to how long organisations have existed and the relationship they have with communities. Organisations with greater accountability to the local community, that is, local government and the police are more resistant to national targets on the grounds that they constrain their independence and conflict with local priorities. Notably, however, CPA showed that the 22 excellent councils, and some others, were able to reconcile both national targets and local priorities.

On the other hand, those organisations that are locally administered within a national service, such as primary care trusts (PCTs), healthcare trusts and the newly re-structured probation service, are more likely to welcome national frameworks and
targets. Research conducted for this study shows that, while board members and executives would like national policy frameworks to be simplified and clarified, many believe that national priorities per se are not inherently in conflict with local priorities, such as mental health, cancer or reducing re-offending. However, they do point to the need for greater freedom in how they deliver improvement against the targets. The way that trusts need to deal with cancer, for example, can differ in different areas. Targets should focus effort on outcomes; the way in which the outcomes are achieved should be more a matter for local discretion.

Despite national frameworks, some respondents from new organisations report that they are uncertain which targets to focus on, or believe that pressure to conform to health and safety or catering regulations, for example, will prevent them from paying appropriate attention to areas that will decide critical inspection judgements. Tensions and even conflicts can arise as organisations attempt to meet too many national targets and targets addressing the wrong areas. Many respondents from every service area say that they are troubled by the challenging scale and pace of the targets set by government, and are sometimes worried that they might have to cut corners to achieve them.

Respondents from all sectors are aware of the growing need to co-operate with other organisations in order to meet targets over which they may not have complete control. One PCT chief executive described how he is accountable for a reduction in road traffic accidents – a major cost area for health – but has to rely on help from organisations over which he has no direct control: local authorities are responsible for road condition and traffic planning; and the police are responsible for enforcement. He had to ‘approach a table where those with real control were sitting and persuade them’.

The danger is that, if persuasion and influence do not work, then some targets that require joint action may simply be dropped down the list of priorities. It is also possible that organisations will be held responsible for failing to meet targets when circumstances are beyond their control (as some probation board respondents felt was the case when the Crown Prosecution Service fails to provide the case information for pre-sentencing reports in time to meet a 14-day target).

Regulation through audit and inspection

Regulation either from central government or independent regulators provides the framework, through statute or guidance, within which public sector organisations operate. It helps to ensure that minimum acceptable standards of service are met. Inspection is an important part of the accountability framework, providing information on levels of performance and improvement progress to both policymakers and the public. External audit is an essential element in the process of accountability for public money. It can also make an important contribution to the stewardship of public resources and make recommendations about how some aspects of corporate governance could be improved.
The public supports the idea of independent ‘watchdogs’ but are not always aware of the regulators and inspectorates that hold public sector bodies to account. Effective regulation should result in a better way of communicating organisational performance to citizens and service users. This is particularly important, given the public’s disinclination to trust what organisations say about themselves.

Despite the public’s lack of awareness, public sector bodies themselves often complain about the burden of audit and inspection, and particularly about being subject to scrutiny by numerous agencies (some counts include more than 40 each for local government, criminal justice and health). This can generate confusion and a lack of clarity, particularly for newer organisations.

**Strategic Regulation**

Multiple regulation causes confusion and makes accountability less clear for both organisations and the public. Accountability would be improved if the interdependence of organisations were recognised within a more coherent regulatory framework. A more systemic approach to inspection and audit would encourage a systemic approach to governance, since governance arrangements are shaped to produce accountability for performance.

The Audit Commission accepts that regulation, including its own inspection and audit activities, needs to be streamlined. Centralist command and control supported by a plethora of targets is counterproductive. But at the same time, complete delegation of responsibility to the front line is not realistic. The Commission is increasingly working to apply the principles of Strategic Regulation across all of its work.

Strategic Regulation starts from a shared expectation that people should experience high-quality public services. Strategic Regulation is centred on governance and provides basic assurance to the taxpayer. It facilitates a lighter regulatory regime for high performers and allows the Commission and other regulators to focus their efforts on helping poorer performers to improve. CPA in local government is a good example of this approach.

CPA shows the value of an assessment of organisations ‘in the round’; how the different strands of governance fit together and link to service quality and the achievement of organisational objectives. Such assessments will become even more important as new organisations, such as foundation hospitals and children’s trusts, are created and new public-private partnership arrangements entered into. Such bodies will be allocated substantial public resources, but their governance and capacity are as yet untested.
Strategic Regulation will contribute to improved accountability by clearly communicating which organisations and services are at the highest risk of failure and how these areas will be monitored in addition to providing clear recommendations for improvement. Fewer, clearer, more meaningful targets will help organisations to focus and will provide the breathing space within which they can respond to local needs. Strategic Regulation requires regulators to work across professional boundaries and in close collaboration. The challenge for regulators, and for central government, is to ensure that the balance of regulation and autonomy is struck appropriately for each individual public body.

Conclusion

Many public sector organisations face common governance challenges relating to the role and importance of non-executives, the effective use of information, engaging users and the public, and the balance between local and national priorities.

The role of regulation, audit and inspection needs to be rationalised within a more coherent framework in order to bring clearer accountability to organisations and greater assurance to the public. Auditors’ judgements across the public sector are a good foundation for such rationalisation. The next chapter outlines the key governance risks that auditors have identified across public sector organisations.
Auditors’ views on the quality of corporate governance in the public sector

The role of audit is to alert organisations and stakeholders to problems and risks. The Audit Commission has adopted a risk-based approach to governance, assessing which systems and processes need to be improved or introduced in organisations. Each year, auditors return opinions on the quality of systems and processes that underpin corporate governance and their assessment of the related risks for each public body they audit.

The evaluation of risks to governance is based not just on immediate past performance but on those areas that need the most attention in order to meet the priorities ahead. Taking into account auditor opinions and other Audit Commission analysis, Exhibit 4 is a forward-looking assessment of the focus required on governance building blocks for each sector. Risks to the quality of governance in individual organisations will vary from the sector-wide position, but where sector risks are high, organisations should be particularly vigilant in ensuring that the quality of their systems and processes are sufficient to deal with both the likelihood and the impact of problems occurring.

Financial management and financial standing

The proper management of resources and a sound financial standing enables organisations to achieve their aims and objectives. Overall, most of the public sector organisations within the Audit Commission’s remit are in reasonable financial health and the majority present a fair and accurate picture of their financial position in their public accounts, although the financial position of the NHS is the area of greatest risk. Across the public sector, there is growing concern about the quality and timeliness of accounts (particularly in local government) and auditors continue to be concerned about the poor links between financial planning and management and service planning across all four service areas.

The constitutional purpose of a budget is to make government responsive to public opinion and responsible for its acts.

William Howard Taft, Presidential address to US Congress
Exhibit 4

The risk to health, local government, police and probation based on the quality of key corporate governance systems and processes

A needle swing to the right indicates that the current quality of these structures and systems represents a greater risk to governance, a needle swing to the left means systems are generally adequate and thus, lower risk.

### NHS
- **Financial Management**: High demand services and a failure to understand and address underlying deficits.
- **Risk Management & Internal Controls**: Making strong progress embedding internal controls. Risk identified, but not always managed.
- **Standards of Conduct**: Structures in place, but separate accountabilities for professionals and managers make corporate standards difficult.
- **Internal Audit**: Starting to develop a wider remit, some risk as services develop.

### LOCAL GOVERNMENT
- **Financial Management**: Some services demand led, financial planning not linked to service planning.
- **Risk Management & Internal Controls**: Almost universally poor, not integrated with decision making. Limited use of recommended practice.
- **Standards of Conduct**: Structures in place.
- **Internal Audit**: Adequate, but some areas need improvement.

### POLICE
- **Financial Management**: Service and strategic planning not sufficiently linked to financial planning and high pensions commitments.
- **Risk Management & Internal Controls**: Few have comprehensive risk management strategies. Limited use of recommended practice.
- **Standards of Conduct**: Most structures in place, and ethics highly regulated.
- **Internal Audit**: Generally adequate.

### PROBATION
- **Financial Management**: Immediate risk is transition to centralised accounts and appropriate grant distribution.
- **Risk Management & Internal Controls**: Internal controls developing and board members involved in reviewing risk, but not all areas have risk strategy.
- **Standards of Conduct**: Code of conduct for board members, staff codes an area for development.
- **Internal Audit**: Starting to develop a wider remit, some risk as services develop.

*Source: Audit Commission*
Risk management and internal controls

70 In contrast to Machiavelli’s perfect republic, organisations cannot entirely eliminate problems. Risk management, therefore, is critical to effective decision making. As part of setting priorities and objectives, organisations need to understand what could happen to prevent them from achieving their aims and how they will deal with such an eventuality should it arise. Even well-run organisations experience fires, floods, malign intent, an episode of poor judgement or simply changes in the external environment that mean that a chosen course is no longer feasible or appropriate. Too often risk management is associated with bureaucratic processes concerning only matters such as health and safety and insurable risk.

71 Internal controls are the systems that organisations put in place to ensure effective and efficient operations and compliance with laws, regulations and internal policies. Together, risk management and internal control provide assurance to leaders and decision makers that their objectives will be achieved. In the NHS and probation service, most organisations are making good progress in meeting the internal controls requirements set out by the DH and Treasury respectively. But far fewer bodies in the police service and in local government are complying with the recommended practice for internal controls, which will become a requirement in 2004.

72 Only around one-half of councils and probation boards (51 per cent and 49 per cent respectively) and one-third (35 per cent) of police authorities have a corporate risk management strategy in place. Of those organisations with a strategy, only in probation did a majority (78 per cent) identify the key risks, according to auditors. This figure fell to 29 per cent of police authorities and 24 per cent of councils.

73 Of particular note, however, is the effect that the involvement of elected members has in improving risk management in councils. In over one-third of councils (36 per cent), elected members are involved in ensuring that risk management arrangements are reviewed and monitored regularly, usually by the executive, or the overview and scrutiny committee, or where it exists, by the audit committee. Higher levels of involvement by councillors are associated with other characteristics; approaches to risk management are more likely to be judged by auditors to be corporate and comprehensive and less likely to be patchy or service-based and to have a higher degree of staff awareness of risk. Auditors are more likely in these councils to consider risk management to be good.

74 A similar picture emerges for police authorities and probation boards. In NHS trusts, where board-level responsibility for infection control was clearly defined and where clear lines of accountability existed throughout the organisation, there were lower levels of infection rates (Ref. 10).
Internal audit and audit committees

75 The traditional role of internal audit has been to provide assurance on the adequacy and effectiveness of systems of internal control that are designed to promote the effective use of resources. In recent years, the role has developed to embrace assurance about the management of business risks (financial and operational), corporate governance and the entire internal control framework. Given due consideration and resources, it can alert the organisation to problems in controls, thus allowing it to take timely steps to prevent a decline in the quality of services it provides or its financial position.

76 Most internal audit services are adequate, but very few were described as good. In a very small, but increasing number of NHS bodies, the standard of internal audit work falls below the threshold that external auditors consider appropriate. Internal audit is adequate in nearly all councils, although nearly one-third had some weaknesses in coverage. The picture is better in the criminal justice system. In all but one case, auditors felt that internal audit functions were adequate and effective during the transition from a local to a national service, and 95 per cent of the aims contained in internal audit plans were achieved. All police authorities maintained an adequate and effective internal audit, and 90 per cent achieved their 2001/02 audit plan.

77 Audit committees are a statutory requirement in the NHS and in probation boards. The most recent data available to the Audit Commission suggests that less than a quarter (23 per cent) of local and police authorities have a separate audit committee, although others have alternative arrangements that fulfil the same or broadly similar functions, for example, through a finance and general purpose committee or scrutiny committee.

78 The Audit Commission believes that audit committees are an important feature of good corporate governance and an effective way for local authorities to receive assurance about the adequacy of internal controls, compliance with statutory and other guidance, monitoring the performance of internal audit and agreeing the external audit plan. Where audit committees do not exist, authorities need to ensure that there are suitable alternative arrangements in place to ensure that the functions of an audit committee are carried out.
Standards of conduct

79 Auditors traditionally assess organisations’ compliance with relevant legislation, rather than the standards they achieve. But where standards of conduct have degraded to the point where behaviours are having a significant impact on working relationships, or where behaviour flouts the standards of probity and integrity expected in public life, auditors have issued Public Interest Reports.

80 In line with the Local Government Act 2000, all councils have now established a standards committee and many have adopted a members’ code of conduct, as recommended, rather than having the model code imposed upon them (Ref. 11). Police authorities are also required to set up standards committees and adopt members’ codes of conduct.

81 Two-thirds of councils (66 per cent) and three in five police authorities (58 per cent) had allowed their standards committees to address a wider remit, which might include a role in complaints procedures, addressing breaches of the officer code of conduct or dealing with matters that arise under the 1998 Public Interest Disclosures Act (better known as whistleblowing). Nearly two in five councils and one in four police authority standards committees had reported, or intended to report on, its work to members and/or the public. Where reporting was a duty of the standards committee they were more likely to have developed a broader remit and a work programme.

82 The National Probation Directorate has required all probation board members to adopt a code of conduct, but it has yet to develop a single code of conduct for employees. Although it is a legal requirement to have ‘whistleblowing’ arrangements, one-quarter of probation areas did not have them in place in time for the 2002 audit.

83 Structures and processes to improve standards of conduct, including registers of interest and hospitality, aim to prevent corruption and maladministration. Their existence alone, however, does not provide the information that really counts: namely, the extent of these phenomena in public life. The Audit Commission is discussing how best to tackle this issue in conjunction with the Standards Board for England and the Local Government Ombudsman.
Although we do not currently have adequate and comparable information from auditors about the quality of performance management systems in the public sector, auditors have identified this as a priority area through the National Risk Assessment Tool (the mechanism for planning auditors’ work in local public bodies). Performance management was identified as a relevant risk for more than four in five health bodies (83 per cent) and councils (86 per cent) respectively. In police and probation, auditors defined performance management as a relevant and significant risk in 87 per cent of police and in 33 per cent of probation areas.

Corporate assessments for the CPA in single tier and county councils found that performance management was weak in nearly two-thirds of councils. In these councils, there was no comprehensive system, or the systems that did exist were not consistently applied. Through CPA, councils have recognised this as an area that needs to be strengthened; 72 per cent have prioritised performance management in their improvement planning following CPA.

Each public service provider faces its own challenges to providing effective governance and improving services. But across the public sector each organisation must have assurance that both executives and non-executives can rely on the information provided through the core systems and processes and can ensure that the objectives set will be achieved. The analysis in this chapter shows that public bodies across the public sector have some way to go before they can be assured that their systems and processes are sufficiently robust. These are a means to the real end which is high-quality, appropriate services and better social outcomes. The next chapter will explore the relationship between corporate governance arrangements and the quality of services.

The characteristic virtue of Englishmen is power of sustained practical activity and their characteristic vice: a reluctance to test the quality of that activity.

R H Tawney, The Acquisitive Society
This chapter looks at the relationship between corporate governance and the quality of services. We use statistical analysis of data collected through the CPA of single-tier and county councils. We also look at inquiries into serious public failures in order to examine the relationship between governance and service failings.

CPA pulls together for the first time in a single framework the existing information on council performance held by councils, government departments, auditors and inspectors, including an assessment of how councils function as corporate entities. This comprehensive framework allows us to explore the link between the quality of governance and services in single-tier and county councils (district councils have yet to complete their CPA).

Our analysis shows that corporate assessment inspection judgements correlate positively and significantly with service scores (Exhibit 5).

A similar picture emerges for the relationship between CPA service scores and auditor judgements on the financial aspects of corporate governance. A positive and statistically significant correlation is present for all services except benefits (Spearman’s Rho), but in no case is it particularly strong. The correlations are strongest for services whose national profile and perceived importance ensures that the corporate body pays more attention to them like housing, social services and education (all at 0.3). Although housing benefit accounts for the majority of payments made by most councils, the Commission reported in 2001 (Ref. 12) that housing benefit was sometimes seen as a ‘Cinderella’ service often not managed directly by the finance directorate. This lack of connection to the corporate centre helps to explain why the correlation with benefits is not significant.

Other research suggests a similar relationship between some aspects of corporate governance and service quality. In the NHS, the Audit Commission’s recent report on the implementation of the NHS Plan concluded that there is a statistically significant relationship between managerial adequacy – including core systems and processes – and performance (Ref. 13).

But this analysis also shows that these measures do not tell the whole story about what determines the quality of services and what drives improvement in the public sector. While they are necessary for effective governance, they are not enough on their own.
Correlation between corporate assessment inspection judgments and service inspection scores

Plotting CPA service block scores against corporate assessment scores shows that there is a statistically significant relationship, albeit not a perfect correlation, between corporate capacity and the quality of services. As corporate functioning improves, so generally does the quality of services. The two are associated.\(^1\)

This suggests that the whole of corporate governance is greater than the sum of its parts. No one participating in this study suggested high service quality could be achieved and maintained without a strong governance foundation in areas like risk management, financial control and codes of behaviour. Nonetheless, not all believe that these or others are necessarily the determinant of quality and some felt that they might not even be the major factor in driving up service quality, or failing to protect the organisation from failure.

\(^{1}\) Average corporate assessment scores exclude the ‘Achievement’ theme to preserve independence between variables. Average service block scores include social services, libraries and recreation, environment, education, housing and benefits. County council average scores do not include housing or benefits – services which they do not provide.
Lessons from failures

Sometimes public sector services fail, resulting in wasted public money and poor experiences for users. Occasionally organisations fail badly, resulting in serious tragedies like the deaths of children, such as Victoria Climbie and the babies undergoing heart surgery at Bristol Royal Infirmary. Corporate failures can result in the collapse of public dialogue, which can contribute to civil unrest, such as the disturbances in Oldham. Such high-profile problems and failures are often followed by a public inquiry to identify the root causes and remedies.

This study has analysed a number of recent inquiries to see what contribution governance arrangements made to organisational failure. This section explores the lessons from previous failures and provides warning signs for other organisations.

Each of the national inquiry reports shows that there is an evident relationship between corporate governance and service quality. Poor governance arrangements set the framework within which organisational systems and processes failed to detect or anticipate serious service failures. There was never a single failure or shortcoming in corporate governance that was solely responsible for service failure. Rather, where there were serious and tragic outcomes, it was due to a combination of factors and an accumulation of governance failures.

A number of common themes were brought to light by each inquiry:

- the poor quality or absence of leadership;
- poor decision making and decision-making processes;
- inadequate systems and processes, such as performance management;
- lack of clarity in roles, responsibilities and activities creating poor accountability;
- poor working relationships and dysfunctional behaviours;
- an insular organisational culture and poor focus on community and user needs; and
- inadequate contingency plans or risk management strategies to deal with worst-case scenarios.

Some combination of these factors was present at each failing organisation. These characteristics are also present to some degree in organisations that are experiencing difficulties, but that have not yet suffered the serious consequences of service failures (Exhibit 6).
Exhibit 6
The seven warning signs of service failure
Analysis of public inquiries shows these common problems contributed to serious service failures.

The contribution of leadership

99 Leaders set the tone and culture within which governance is effective or serious problems are allowed to occur. The wrong tone can create the environment where ‘club cultures’ can thrive. A small, elite power base where people were either in or out of favour and a punitive climate of fear, meant that staff were unable to ‘speak out’ to challenge the behaviour and thinking of those in more senior roles.

100 Poor leaders can also create a culture of self-delusion and deliberate misrepresentation of information. Apparently high-performing organisations with dynamic and entrepreneurial managerial leadership can flatter to deceive. Sometimes...
severe organisational problems and even malpractice can be brought to light once ‘dynamic’ leaders leave, as the absence of effective systems and processes to support governance becomes apparent. This was described memorably by respondents at the Royal United Hospital in Bath as ‘all icing and no cake’.

Poor decisions based on inadequate information and a failure to challenge

101 Flawed decision making was often characterised by a failure to challenge: information was accepted at face value and decision-making forums had a lack of rigour.

102 Organisations failed fully to recognise, assess or review the impact of policy decisions. Sometimes this made a direct contribution to service failure, as in the policy on resolving firearms incidents that was often not followed, or the housing allocation policy in Oldham.

103 In some cases decision makers, particularly non-executive directors in the health service, were not properly informed about the true state of affairs or the full consequences of decisions by a powerful senior management team. Because of this they were never aware of the extent of the problems.

104 Even where there was no intent to mislead, decisions were often based on wrong or out-of-date information. Basic information systems were of poor quality and were unlikely to produce accurate or timely information. Sometimes this was because IT infrastructure was poor, but some organisations had ‘oral cultures’, where record-keeping and information management were undervalued.

Lack of clarity of roles, responsibilities and accountabilities within and between organisations

105 Within organisations, staff were sometimes unclear about what their job was or were allowed to shirk responsibility because no one else knew what it should have been, and accountability arrangements were unclear or weak. Activities, services and responsibilities were not covered by job descriptions, sometimes leaving numerous gaps in processes or levels of service. Without effective systems and processes, poor performance, unprofessional practice and/or misconduct went unchecked and were allowed to persist, and there was insufficient control of frontline services. This was exemplified by:

• poor staff and performance management practice, particularly supervision and performance review, which meant that senior managers were unaware of what frontline staff were doing;
• failure to ensure appropriate numbers of competent staff, through inadequate procedures for recruitment and retention (including over-reliance on temporary staff), for induction and training, or for allocating tasks; and
• failure to ensure that correct and up-to-date policies, procedures and guidelines were in place, were known and understood by staff and adhered to.

This lack of clarity internally also limited organisations’ ability to deal effectively with partner organisations. There were flawed and misunderstood guidelines and protocols between differing agencies. Partner agencies lacked a sense of a shared agenda, which was a feature of social services and police involvement in the Victoria Climbie report, and of local authorities and police in the Ritchie/Cantle reports.

Organisations failed to address known problems in working relationships

Working relationships, as well as systems and processes, broke down in these organisations, sometimes creating a toxic environment. Inquiries found ineffective communication between professional groups, sometimes as a result of actual or assumed hierarchies within professional groups and across organisations, hampering effective multidisciplinary, interagency and team working. These problems were often exacerbated by poor organisational structures. Ineffective relationships between councillors and officers or non-executives and senior managers were also a common feature.

Insular organisational culture with poor customer focus or community engagement

Failing organisations were focused inward, with weak or even hostile relationships with external agencies. They did not keep up with developments elsewhere or adopt new ideas and modern practices. Procedures and services were designed for the organisation’s convenience rather than supporting the best interests of the public.

Many organisations did not sufficiently prioritise the need to overcome the effect of poor services on the user, and often failed to involve or engage members of the public. Where serious service failings occurred, senior managers often failed to recognise their responsibility and there was generally poor communication between them and the public, exemplified by:

• the lack of an effective communications strategy to counteract myth and misunderstanding, an absence of forums for debate, a dependence on a network of community leaders lacking authority and credibility, and an ineffective engagement of key players (in the Ritchie Report);
Corporate governance contributes to the quality of local public services

Conclusion

Often, poor governance becomes visible after a service or organisational problem comes to light, but it may be hidden or masked for a while by otherwise reasonable service quality. The quality of clinical care at the Royal United Hospital in Bath, for example, has, so far, remained generally good despite the governance failures highlighted in the Tinston report. Oldham Council provided many satisfactory services, but failed crucially to fulfil its community leadership role and to improve community relations. But, ultimately, these failings can and will have an effect on individual service quality. Year-on-year budget deficits mean that less money is available for upgrading equipment and for general maintenance, and failures of community leadership mean that users and the public may be unwilling to come forward when councils need their contributions.

Corporate governance has sometimes been analogously described as the brain of an organisation. But a better analogy is that of a brain and nervous system, which, when working well, provides clear direction, anticipation of danger, communication, movement and action, all the while transmitting and receiving information to enable remedial action and changes of course.

Poorly governed organisations have poor internal ‘nervous systems’. They are not always able to identify where problems are likely to occur, or have occurred, nor are they able to scan their environment or take account of the messages provided by those who use their services. Well-governed organisations are able to rely on their systems and processes and are able to anticipate and manage risks and challenges. They are able to learn from their own challenges and failures as well as learning from others the steps to take to avert poor performance and potential disaster.
Achieving good governance

Chapter 1 argued that good governance can be seen in the quality of decisions and that effective decision making is based on ‘hard’ information from robust systems and processes that are used effectively by leaders in a culture that supports challenge and scrutiny. This chapter explores these ‘softer’ issues further, describing how good governance can support the decision-making process from policy setting to execution and review, by:

- achieving balance;
- maintaining an outward focus;
- sustaining a culture of accountability; and
- encouraging effective relationships between those in key governance positions.

A focus on decision making and these softer, more cultural attributes will enable discussions about governance to move on from a focus on compliance and preventing failure towards improvement.

Achieving balance

Reaching difficult decisions is often a matter of balancing priorities and different styles of leadership. The appropriate point of balance varies depending on the particular issue, the severity of the problems faced and, to an extent, the degree of central direction and control over targets and activities (Exhibit 7, overleaf).

- **Direction and negotiation.** Effective leaders win support for their strategies and objectives and for the structures that support them. But some standards must be upheld and some objectives are non-negotiable.
- **Rigidity and flexibility.** There are some things that are ‘must dos’ in any organisation. Organisations that are relatively new or poor performers may need to pay close attention to controlling organisational processes. More established or high-performing organisations are often able to focus more on outcomes than processes and outputs, knowing that basic systems and processes are sound.
- **Central direction and local autonomy.** Different parts of the public sector are subject to varying amounts of central direction, but all have some capacity to set the timescale for achieving national targets, if not to prioritise. All are also required to reflect the needs of users in decision making.
- **Key priorities and diverse responsibilities.** Some objectives and areas of activity require immediate attention and focused resources. But all organisations have a range of other responsibilities that must be attended to.
• **Compliance and creativity.** Organisations must balance the need for improvement with the need for assurance. Well-governed organisations review practices and procedures to see what works and what does not in order to develop new approaches. Decisions to innovate and change should be based on a robust assessment of risk, and rely on the ability to capture learning. Some organisations are focused on compliance, others on creativity. The right balance will depend on local circumstances.

• **Caution and ambition.** Having ambition is important, but it needs to be realistic and balanced with the capacity of the organisation if it is to be achievable.

• **Support and sanctions.** Accountability for actions is critical to good governance for assurance and improvement. But whether the account shows good or poor performance and consequent rewards or punishment, organisations need to learn from their experiences. An unbalanced organisation will focus too much on one area to the detriment of the other and in each case the opportunity for learning will be lost.

• **Short- and longer-term actions.** All decisions taken at board or cabinet level are within a time frame. Some will be imposed, such as the electoral cycle in local government, or are a result of statute and regulation, others adopted. Leaders must be as clear about the pace of action as they are about objectives.

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**Exhibit 7**

**A balancing act**

Finding the right point of balance on each dimension is crucial to making progress at the appropriate speed.

*Source: Audit Commission*
Organisations will need to tilt towards one or the other end of these continuums depending on their assessment of their position in any one area. This requires knowing where they are as much as where they want to go. Balance does not imply lack of movement; all organisations change and work towards multiple objectives. A balanced organisation proceeds at the appropriate speed; going too quickly or too slowly will result in loss of stability.

In the end, decisions have to be made between these and many other conflicting and competing approaches and demands. Even organisations with good leaders, robust systems and processes, and those that are aware of the public’s need, can still take wrong decisions, or be knocked off kilter by external forces. But with the right balance, they are both less likely to do so, and to be able to recover more quickly if they do. Their sense of direction and their ability to perceive the changing demands of the outside environment will help them to regain lost ground.

Outward focus

Public sector organisations have to respond to the desire of communities to have a greater say in the design and delivery of their local services.

Reforming our Public Services, Office of Public Services Reform, 2002.

Well-governed organisations understand what the public needs and wants. They use consultation and research to inform decisions and to communicate clearly and honestly about their performance.

Involving users in service planning and delivery is a key plank in the Government’s strategy to modernise public services, but much of the local public sector has been reaching out to the communities it serves for some time. This has been a focus in local government and the NHS for many years, while the Home Secretary’s focus on fear of crime and public confidence in the criminal justice system (CJS) is making many CJS agencies look at the issue afresh (Ref. 14).

Two challenges exist for both the government and for local public bodies. The first is that a substantial proportion of the public neither feels informed about public services, nor is it convinced that public sector organisations are interested in listening to them (Exhibit 8 and 9, overleaf). The second is that only a minority of the public appear to wish to become involved (see para 124).
‘The (local public body) does not keep me informed about the services they provide’

The public, on balance, wants more information from local public bodies about their services.

Effective communication with the public needs to mirror effective internal communication within an organisation. It should be based on an honest appraisal of performance – both good and bad. It should reflect accurately the prospects for improvements and should not over-promise. It should be open about errors, apologising where necessary and, as importantly, showing how the organisation is learning from its experiences.

‘The (local public body) is not interested in my views’

Despite comprehensive consultation by some local public bodies, the public requires more convincing.
Most public bodies now regularly hold open board or equivalent meetings where few if any members of the public attend, with the exception of controversial issues. Many others struggle to make the results of consultation play a real role in priority setting. Involving and communicating with the public adds significantly to the time and resources required to reach a decision. Not all the public will ever understand why a school, hospital or library is being closed, nor is it always possible to persuade them that it is the best decision to site a new unit for offenders or for people with learning disabilities in their locality.

But some public bodies have engaged in intensive, deliberative work with members of the public who get fully briefed about options. These can work, albeit with a small and interested section of the public. For example, many housing associations involve tenants in the governance of their organisations. This happens directly by including tenants as board members, where they will contribute to strategic decision making about asset management or corporate policy on borrowing, for example. It also happens indirectly via focus groups and monitoring panels where tenants’ views on their services/houses are accessed. Similarly, partnership boards that oversee the implementation of regeneration schemes, such as Single Regeneration Budget partnerships or New Deal for Communities are usually made up of one-third public, one-third private sector and one-third local residents. Such models are not without their difficulties, but involving users more directly can often create a greater sense of ownership in the outcomes. The Audit Commission has published examples of good practice in this area (Ref. 15).

There is, however, a challenge for local public bodies: our research shows no great unmet desire on the part of the public to involve themselves in the planning or delivery of key public services. Only around one in five would like to get involved in helping their council or NHS hospital to plan and deliver services (17 per cent and 22 per cent respectively). But as the above examples show, smaller-scale, targeted initiatives can work.

Realism is important. Reaching out to and involving people in decisions affecting services is undoubtedly difficult. Not everyone wants to be informed by public bodies, or by regulators. But this does not remove the need for organisations to conduct research among key groups of users and non-users. Targeted research among people affected by decisions may not lead to feelings of being involved, but it will help to ensure that decisions are based on better information. Communicating this properly to communities will help to reduce scepticism and to improve trust and confidence on the part of those who pay for and receive services in those who deliver them.

Now we are looking at what people really value. For example, when someone has been the victim of a crime, what people seem to value is being updated about the progress of their case. In the past, we only measured certain things, like speed of response, detection rates, etc. Now we are beginning to value and measure things like proactive updating on case progress.

Senior police officer
More importantly this creates a relationship that results in members of the public being willing to play their part when they are needed. The CJS relies on members of the public for information and co-operation, for example, while health professionals complain about the impact of patients failing to turn up for appointments. These issues of co-production relate to the way that organisations are governed. Public behaviour can affect how effectively organisations operate, as well as itself be influenced by how organisations work. Even if consultation can be difficult, the best organisations use intelligence from the public to shape the way that they deliver their services and report performance.

Creating clearer accountability

Organisations that are striving to achieve good corporate governance rely on robust systems and processes to let them know where they are, how they are performing and how likely it is that their objectives will be met. They use information from internal and external audit, inspection and stakeholders and partners to provide challenge to and confirm their own systems and processes. But they also create the right internal environment, using the softer issues of openness and integrity and emphasise learning over blame. These things generate the right balance between providing challenge and, where necessary, sanctions for poor performance and the chance to use problems as an opportunity for learning.

Openness and honesty create the right internal environment for making better decisions. An organisation that is aware of the current position, its deficiencies and options and is honest in its discussions on how to deal with them will have a strong foundation for good governance and the basis of future improvement or sustained good performance.

How can boards or councillors support an open culture, given that they need to know about poor performance or problems and be assured that, once any are identified, they will be tackled? Some organisations are better at producing clarity of responsibility within a framework that sets clear boundaries for staff and details what support they can expect: Box A shows how some local authorities have created more effective internal accountability, but the lessons are applicable to all sectors.
Box A

Establishing effective internal accountability

Councils that have established effective internal accountability have used systems and processes to provide accurate and timely information for decision making. They use those same systems and processes to ensure accountability for carrying out decisions.

In Kent, Liverpool and in Wandsworth accountability is identified and incorporated in action plans, service plans or standing orders. This has engendered a clear understanding of roles and responsibilities for both officers and members. Members outline vision, set direction and monitor performance, but officers are responsible for taking major decisions and are often allowed a great deal of discretion in how they do so.

- In Liverpool this has led to an ‘accountability’ culture, where shortfalls in the standard or quality of frontline services are now openly discussed. This has led to the implementation of more effective corrective measures.
- Wandsworth has also developed greater clarity about performance expectations, both internally and with its partners and contractors. Robust risk management, information and procurement systems have all been factors in securing improvement.
- Kent has focused on developing a strong performance management culture and has improved financial management and HR systems to support this approach.

Source: Audit Commission

Fostering effective relationships

There are many leaders within organisations at different levels and in different professional groups and subcultures. But these different, often competing groups and leaders need to act corporately. Leaders at the top of organisations enable this by setting a clear direction and framework for accountability for decisions and performance. This clarity of direction and understanding of purpose is set by the key relationship between the chief executive and the chair or leader.

The quality of this relationship is an indicator of how well governed organisations are. A dysfunctional relationship between these two key post holders will adversely affect other relationships at senior levels in organisations. If this relationship is good, however, then the quality of the wider relationships at governance level is likely to be good also, based on mutual trust and appropriate challenge, within clear boundaries. As with governance itself, though, there is no single model for effective chair/chief officer relationships. Roles and responsibilities may be defined by statute, but are generally left for individuals to work out.

Police authority member
Effective challenge and scrutiny is perhaps the most important contribution that non-executives can make to good corporate governance. Higgs showed that the critical factor determining how effective non-executive directors could be on boards is how well they establish proactive relationships (Ref. 3):

It is important to establish a spirit of partnership and mutual respect on the unitary board. This requires the non-executive directors to build recognition by executives of their contribution in order to promote openness and trust. Only then can non-executive directors contribute effectively. The key to non-executive director effectiveness lies as much in behaviours and relationships as in structures and processes. (paragraph 63)

This quote from the Higgs Report suggests that the private sector will, or should, move away from the ‘principal-agent’ model, in which non-executive directors hold executives to account on behalf of shareholders. Most people involved in the governance of public sector organisations believe that it is already based on the partnership approach Higgs identifies. But this raises a further question: how do executive and non-executive personnel ensure that they establish a professional and productive relationship that enables them to work together in partnership, but also allows them to hold, or be held, to account? The key is that intangible asset, trust:

In order to play a full role in governance, non-executive directors or councillors must have the right skills and the right knowledge and be properly resourced to carry out their role. Where there is an independent appointments process, it is important to get the right mix of skills on a governing body. In local government, successful councils enable and support opposition councillors and controlling party ‘back-benchers’ to serve on scrutiny committees, or on licensing committees (for example), thus involving them in decision making. Successful unitary board structures ensure that those exercising the non-executive role to have the capacity and enough service-specific knowledge to perform their role effectively. Competition for places helps in both local government and elsewhere, but then induction and training, along with time for developing relationships is vital for both councillors and non-executive directors (they can of course often fulfil both roles in different organisations).
Conclusions

135 Good governance is more than making sure that things do not go wrong or fixing them if they do. Good governance adds value; it ensures effectiveness in ever changing circumstances. It achieves more than meeting performance targets; it balances the need for compliance with the benefits of being creative about what the organisation does and how it does it.

136 Ensuring that good governance is in place is difficult, but important. Well-governed organisations will be well placed to achieve and sustain high-quality services. They will be alert to problems at an early stage, and be able to take remedial action to prevent them becoming significant drains on organisational resources, whether financial or managerial. We believe the features that help to bring about good governance in organisations – openness, clarity and honest accountability – are also the characteristics that enhance the public’s trust in public bodies.

137 Ensuring good governance and promoting public trust is not just the responsibility of local public bodies. Central government, its regulators and agencies like the Audit Commission also have a part to play. Our recommendations apply to all those who can affect the governance of organisations.
Recommendations

For public bodies

1. Chief executives and the chair/elected leaders should regularly and proactively review their organisations’ corporate governance arrangements.

- Local government does this within the CPA process and there is also a dedicated and detailed self-assessment tool based on the CIPFA/SOLACE corporate governance guidance, which can be found on the Audit Commission website.
- Other organisations should undertake a self-assessment of their governance arrangements, addressing both the hard and soft indicators of good governance outlined in this report. Appendix 3 gives the questions we recommend should form the basis of this initial review.
- In order to achieve honest and complete answers to these questions, organisations should arrange for their own assessments to be contributed to and challenged by key stakeholders or partners (for example, unions, service users) and regulators.

2. Public sector organisations should review the quality of their external communication about their performance in order to promote open and honest communication of the true performance, rather than ‘spin’. This will help them to build trust with the public in the longer term and help them to reduce the impact of negative events on their relationship with users and citizens.

For central government

4. Central government should work with CJS regulators support the integration of local and national governance arrangements in police and probation:

- In police, the government should take steps to ensure that the role of Police Authorities is recognised in new arrangements and guidance relating to the Police Reform Act.
• In probation, the government needs to act to improve the relationship between probation boards and the national probation directorate by clarifying their respective roles and functions.

5. Central government should encourage the assessment of organisations’ performance and capacity ‘in the round’, including the quality of corporate governance arrangements. CPA is one example of this from local government. It could be adapted to cover other sectors.

• These assessments set a basis for proportionate support, freedoms and flexibilities, and public accountability.

• It is particularly important that new organisations, such as foundation hospitals and children’s trusts, should have such a comprehensive assessment.

For auditors/inspectors/regulators

7. The Audit Commission and other inspectorates and regulators should work together to deliver Strategic Regulation.

• In particular, they should share their knowledge about the governance of local public bodies operating within different local and national frameworks, to maximise the prospects of improvements in services.

8. Auditors should give checks on data quality a high priority in their work plans. This will:

• Encourage organisations to make sure that the information that they need for management and decision-making purposes is accurate, and discourage those organisations and individuals tempted by data manipulation and worse.

• Increase confidence that data quality is good enough to ensure that the judgements about organisations’ performance within Strategic Regulation are sound.

9. Inspectors and auditors should report information to local public bodies on their corporate governance arrangements in ways that demonstrate how improvement can be obtained.
Appendix 1: acknowledgements

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Hampshire County Council
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National Probation Directorate
National Probation Service, London probation area
National Probation Service, Northumbria probation area
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Police Standards Unit
Probation Boards Association
Social Services Inspectorate
Trades Union Congress
Appendix 2: influential reports in the development of corporate governance in the UK


Other references


Appendix 3: self-assessment questions for governance reviews

1. How clear are strategy, aims and objectives? How effectively can those in executive and officer roles, and those in non-executive and scrutiny roles, contribute appropriately to their development?

2. How widely known and understood are the aims and objectives throughout the organisation and stakeholders?
   - Has an independent staff survey been conducted to show how effective two-way communication, information and management are in the organisation, or whether harassment/bullying is a problem?

3. Does the organisation focus on the right things? How well does the organisation balance the issues identified in chapter 5?
   - Direction and negotiation
   - Rigidity and flexibility
   - Central direction and local autonomy
   - Key priorities and diverse responsibilities
   - Compliance and creativity
   - Caution and ambition
   - Support and sanctions
   - Short- and longer-term actions

4. How effective is the decision-making process?
   - How clear are the boundaries between executive/officer and non-executive roles and functions? How effective is the training provided to non-executives to enable them to fulfil their roles properly?
   - How well does the organisation’s culture support open and honest discussion about performance and strategy? How well are non-executives or their equivalents effectively supported in scrutiny and providing challenge?
   - How good is the information that is used to make decisions? How confident are organisations that the quality of the data produced by systems and processes like performance management, risk management and financial management is robust and reliable?
   - How well do the views of service users and the wider public inform decisions about key strategic objectives? How effectively are users and stakeholders involved in decision making where appropriate?
   - How clear is it when decisions are taken? Are schemes of delegation clear and widely understood?
   - How well are the risks attached to decisions understood? How effective are the internal controls to monitor performance and alert the organisation to problems?
   - How effectively and honestly is performance and strategy communicated within the organisation, to stakeholders, to service users and to the general public?
References


A Force for Change: Central Government Intervention in Failing Local Government Services
The current Government has made the improvement of public services one of its key objectives, and has committed itself to stepping in to ‘intervene’ in failing services at a local level. The aim of this study is to make recommendations to the Government about the future framework for intervention.


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This management paper reviews the experiences of local authorities to show how performance indicators can be used to improve public services. It aims to help organisations make performance measurement an everyday activity, generating good quality information that can be effectively monitored and acted on.


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