BRIEFING PAPER
Number 08520, 27 May 2021

Local authority financial resilience

By Mark Sandford

Contents:

Contents

Summary

This briefing paper summarises concerns around local authority financial resilience, which rose in profile in the late 2010s. It begins by setting out the accountability framework within which local authorities operate, including the accountability system operated by the Ministry of Housing, Communities and Local Government (MHCLG), and statutory codes of practice: the Prudential Code, treasury management guidance, guidance on local authority investments, and guidance on minimum revenue provision.

The paper then provides brief details of the legal accountability structures faced by local authorities, and of the process that they must follow when developing their annual budgets. This includes the role of the head of finance (the 'section 151 officer') and the procedure surrounding the issue of 'section 114 reports' within local authorities.

The paper provides details of concerns expressed by the local government sector in recent years regarding the future funding of local authorities. These include analyses of falls in central government funding for local authorities; analyses of the 'funding gap' provided by the LGA's 'Future Funding Outlook' reports; and debates concerning whether English local authorities collectively have access to sufficient funding to continue to discharge their functions. The paper also covers some analysis of how local authorities have tackled the challenges caused by reductions in funding. Brief mention is made of local authority commercial property investments, an issue that has received some attention in the national media and from bodies such as the National Audit Office due to the large sums of money involved.

The paper provides some details of the high-profile difficulties experienced by Northamptonshire County Council in 2018, and subsequent events in the London Borough of Croydon in late 2020.

The paper includes a separate section on the financial challenges generated for local authorities by the coronavirus pandemic during 2020-21. This includes details of the various funding support packages provided by the Government to local authorities in that financial year; brief details of support grants for businesses, distributed via local authorities; and changes to the timing of some existing grant provision, in order to minimise cashflow difficulties.

The paper provides details of the Local Government Association's peer challenge system, and the monitoring framework for local authorities operated by the Ministry of Housing, Communities and Local Government (MHCLG). Lastly, it notes the 'financial resilience index' created in 2018 by CIPFA (the Chartered Institute of Public Finance and Accountability).

Local government is devolved to Scotland, Wales and Northern Ireland. Local authorities in those areas have not been subject to the level of funding reductions that their counterparts in England have faced since 2010. Accordingly, debates about local authorities' financial resilience have focused principally on England, and this briefing paper therefore principally covers England.

1. Local financial accountability: the legal framework

Local authorities' principal accountability for the services that they provide, and for their financial management, is to their electorates. Councils are independent bodies with legal responsibility for their own financial sustainability; they have ownership of assets, powers to borrow and to invest, and hold reserves which enable them to plan for and manage financial risk.

In England, the UK Ministry of Housing, Communities and Local Government maintains a monitoring framework for English local authorities. This locates financial accountability – and therefore concerns about resilience – within a broader governance framework, details of which can be found in the National Audit Office's 2019 report *Local authority governance*.

Local government is fully devolved to Scotland, Wales and Northern Ireland. In each devolved area, local authorities receive some of their funding in the form of grants from the devolved administrations. They are also subject to audit by Audit Scotland, the Wales Audit Office, and the Northern Ireland Audit Office respectively.

1.1 Accounting officers

All departments and public bodies have an accounting officer, who is normally the chief executive or another senior official. The accounting officer is accountable to Parliament, normally via the House of Commons' Public Accounts Committee, for the use of public funds by the department or public body.[1] This has been the case since 1872.[2] The accounting officer has a statutory duty to prepare the body's accounts for examination by the Comptroller and Auditor General.[3] A further exploration of the accounting officer role can be found in the Institute for Government's 2013 report *Following the Pound*.

The MHCLG's fundamental responsibilities in this regard are set out in its Accounting Officer System Statement, last updated in November 2020. The Permanent Secretary of MHCLG is *personally* accountable for ensuring accountability for public money spent by MHCLG:

1 See HM Treasury, *Managing public money*, 2013, pp15-17, for an explanation of the nature of this responsibility.
2 Treasury Minute, dated August 14, 1872. The National Archives, Public Record Office (PRO) BT 13/7/15
3 See the *Government Resources and Accounts Act 2000*, s 5(7)

> 2.2. As Principal Accounting Officer, I am personally responsible for safeguarding the public funds for which I have been given charge under the MHCLG Estimate and the Business Rates Retention and Non-Domestic Rates Trust Statement. …
>
> 2.3. This system statement covers the core department, its ALBs [Arm's Length Bodies] and other arm's length relationships such as local authorities and Local Enterprise Partnerships (LEPs). It describes accountability for all expenditure of public money through the Department's Estimate, all public money raised as income, and the management of shareholdings, financial investments and other publicly owned assets for which I am responsible. … [to] ensure that spending is carried out with regularity, propriety and achieves value for money.[4]

The MHCLG considers itself to have an overall responsibility for the local government finance system in England, not just for the grant funds that it distributes to local authorities. The 2019 NAO report *Local Authority Governance* said:

> In the Department's view, its responsibility is for the local governance system as a whole. The Department relies on this system to ensure that local authorities are accountable for acting with regularity, propriety, and value for money in the use of all their resources. The accounting officer is clear that she is responsible for ensuring that the local governance system as a whole contains the right checks and balances and is working.[5]

1.2 Statutory guidance and codes of practice

As MHCLG is responsible for the local government finance system as a whole, its accountability system statement includes two subsidiary accountability systems, which provide frameworks for the substantial amounts of revenue that it provides to other elected bodies within England. These are:

- the 'local government accountability system', covering local authorities;
- the Local Growth Fund accountability system, covering Local Enterprise Partnerships (LEPs). A further assurance framework document was published in January 2019 covering LEPs, and also covering Mayoral combined authorities where these manage LEP funds.

The following four codes of practice play a critical role within the financial framework applying to local authorities:

- Treasury management guidance, concerning the investment of local authority funds and cash holdings. In 2017 CIPFA (the Chartered Institute of Public Finance and Accountancy) published a guidance manual entitled Treasury Management in the Public Services: code of practice and cross-sectoral guidance notes, which applies to local authorities and other public bodies;
- Statutory guidance on local government investments and statutory guidance on minimum revenue provision. New editions of both of these were published on 2 February 2018, alongside a

---

4 MHCLG, *Accounting Officer System Statement*, November 2020, p6
5 NAO, *Local authority governance*, HC-1865 2017-19, 2019, p11

Government response to consultation. The guidance on investments covers the placing of short and long term deposits with financial institutions, and also the purchase of assets as a form of investment. The guidance on minimum revenue provision concerns the amount of cash local authorities should hold to service debt repayments in any given financial year;

- The *Prudential Code*, which governs local authority borrowing. Published by CIPFA, this document contains guidance on the management of local authorities' capital finance, in particular the setting of borrowing limits. The most recent version of the Code was published in December 2017. More detail is available in the Library briefing *Local government in England: capital finance*.

The revisions to these codes in the late 2010s took place in the context of substantial increases in local authority borrowing and investments (see section 3.4 below), and general concerns about local authority financial resilience. The National Audit Office stated in March 2020 that:

> The Department did not have clear measures to test the impact of the changes on risk from commercial property investment and did not carry out new quantitative analysis of commercial investment activity in the sector. The Department has told us it has subsequently decided this work will form a first phase of its review and that this work was scoped to provide an initial review of early progress. The Department will review trends in the sector in later phases of its review work.[6]

[6] NAO, *Local authority investment in commercial property*, HC-45 2019-21, March 2020, p11

2. Local authority budgeting

2.1 Legal requirements

Local authorities must, in normal times, set a balanced budget for each financial year. They must follow a procedure laid out in legislation in order to do this. They must also maintain a system of internal audit, and make arrangements for the external audit of their financial management and the value for money achieved in their provision of services.

In England, Wales and Scotland, local authorities are required to set their budgets before 11 March each year,[7] in advance of the start of the new financial year on 1 April**.** The date in Northern Ireland is 15 February.[8] There is no legal requirement for the Government, or any other higher-level authority, to approve or sign off a local authority's budget.

Local authorities in England and Wales are required to set a balanced budget for each financial year, following a specific process. They must calculate "the expenditure which the authority estimates it will incur in the year in performing its functions";[9] and then they must subtract "the sums which it estimates will be payable for the year into its general fund",[10] not including business rates, revenue support grant or other grant funding. This calculation leads to a local authority's 'budget requirement' for the financial year in question.

The local authority must then subtract the amount that they expect to receive in Government grants and business rates. The amount remaining is the total amount that they must raise in council tax.[11]

These provisions have the effect of obliging a local authority to set a balanced budget, by providing that its forecast expenditure must align with its forecast income. 'Income' may include transfers from the authority's reserves, but this must be specified in the calculations. The provisions also prevent a local authority from borrowing money to cover its annual revenue expenditure.[12]

Due to the Covid-19 pandemic, the Government made regulations in November 2020 permitting local authorities to balance their budgets over three years (2021-24) rather than one. This was done by permitting them to make provision for a deficit in their collection fund over three years rather than one. The 'collection fund' is the account in which a

---

7 *Local Government Finance Act 1992,* section 30 (6) (England and Wales); section 93 (Scotland). Precepting authorities must set their budgets by 1 March each year.

8 See the *Local Government (Capital Finance and Accounting) Regulations (Northern Ireland) 2011* (SI 2011/326), regulation 3

9 *Local Government Finance Act 1992* section 32 (2) (a)

10 Ibid,. s32 (3) (a)

11 For Scotland, see section 93 of the *Local Government Finance Act 1992*.

12 Local authorities follow the standard accounting distinction between capital and revenue expenditure. Capital funding is spent on assets that last for several years, and that may depreciate over time (see the Library briefing *Local government in England: capital finance*). Revenue expenditure refers to regular annual spending on matters such as service provision and staffing costs.

local authority places its council tax and business rates income.[13] The regulations apply only to budget shortfalls accumulated in 2020-21. Where authorities have such a deficit, the regulations state that they *must* spread it across the three years in question.[14] The Government has published guidance and a 'deficit spreading tool' to assist local authorities to calculate whether they are eligible for these provisions.[15]

Local authorities are required to undergo an annual external audit. This is governed by the 'local audit' regime. The authority's auditor must provide an opinion on a local authority's accounts, and also a conclusion on value for money. To this end, the auditor has various powers to ensure appropriate financial management. They may investigate items in the authority's account at the request of an elector; they may apply to the court to have an item of expenditure declared unlawful; they may make a statutory recommendation which is copied to the Secretary of State; and they may make a 'public interest report' on matters of concern within a council's accounts. Further details are available in the Library briefing *Local audit in England*.

Local authorities must also maintain a system of internal audit, as required by the *Accounts and Audit Regulations 2015* (SI 2015/234). These "require that elected members maintain a sound system of internal control including arrangements for the management of risk, an effective internal audit, and that local authorities prepare annual accounts".[16]

2.2 Section 114 reports

In England and Wales, each local authority's chief finance officer (the 'section 151 officer') has statutory status and is responsible for financial administration. The chief finance officer has a number of duties related to financial resilience, including a duty under section 25 of the Local Government Act 2003 to report on the robustness of the council's budget estimates and the adequacy of its reserves.[17]

The chief finance officer is also under a statutory duty to issue a formal report if s/he believes that the council is unable to set or maintain a balanced budget. This is often known as a 'section 114 report' or 'section 114 notice', after section 114 of the *Local Government Finance Act 1988*:

> 114 (3) The chief finance officer of a relevant authority shall make a report under this section if it appears to him that the

---

13 See the *Local Authorities (Collection Fund: Surplus and Deficit) (Coronavirus) (England) Regulations 2020* (SI 2020/1202)

14 MHCLG, letter to finance directors, 5 November 2020

15 See MHCLG, *Council Tax Information Letter 6/2020*, 15 December 2020

16 MHCLG, *Accounting Officer System Statement*, July 2018, p42. See also regulations 3-6 of the *Accounts and Audit Regulations 2015*. For Scotland, see regulation 7 of the *Local Authority Accounts (Scotland) Regulations 2014* (SI 2014/200); for Northern Ireland, see rule 6 of the *Local Government (Accounts and Audit) Regulations (Northern Ireland) 2015* (SI 2015/106)

17 Section 6 (2) of the *Local Government Finance Act (Northern Ireland) 2011* makes an equivalent provision to section 25 of the 2003 Act for England and Wales. However, there is no equivalent of the section 114 notice in Northern Ireland.

> expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed the resources (including sums borrowed) available to it to meet that expenditure.

After a section 114 report is issued, the local authority may not incur new expenditure commitments,[18] and the full council must meet within 21 days to discuss the report.[19] There is no legal provision regarding what action the council must take then. Although media reports may describe the issue of a section 114 report as indicating 'bankruptcy', there is no procedure in law for a UK local authority actually to become bankrupt, and none has ever done so.

The issue of a section 114 report is a statutory requirement upon the chief finance officer, but it only usually takes place when regular discussions have failed. The Chartered Institute for Public Finance and Accountancy (CIPFA) says:

> To be at the point where a Section 114 report is a real possibility would suggest that the organisation has failed to heed or act effectively on the warnings of the CFO about the seriousness of the budgetary position. Warnings and conversations that CIPFA would expect to have been taking place at the highest level of the organisation. Facing a difficult financial outlook is not a reason in itself to expect a rush of Section 114 reports.[20]

The chief finance officer of the London Borough of Croydon issued a section 114 report in November 2020, and Northamptonshire County Council issued two section 114 reports in 2018 (see section 4 below). Prior to these, the most recent issue of a section 114 report for an issue relating to a failure to balance the budget was by the London Borough of Hackney in October 2000.

[18] See section 115 (6) of the *Local Government Finance Act 1988*
[19] See section 115 (2-3) of the *Local Government Finance Act 1988*
[20] CIPFA, *Balancing local authority budgets*, 2016

3. Financial resilience concerns: England

3.1 Local authority financial resilience in the 2010s

Financial resilience became a significant issue in English local government in the late 2010s. This arose in the context of substantial reductions in grant funding for local authorities from the UK Government. Discussions of resilience generate discussion of governance issues – good planning, strong financial control, and audit – that apply to all local authorities in the UK. The profile of such issues is currently higher in England, generating a greater quantity of debate in Parliament and amongst stakeholders.

Central government grant funding for local authorities in England has fallen substantially since 2010. England-wide and regional figures can be found in the Library briefing *Local government finances*. Figures for individual local authorities can be found in the Library's interactive local authority finance data pages.

English local authorities have also experienced a fall in their 'spending power' since 2010. This is a UK Government calculation of their capacity to spend funds: in essence, it takes account of a local authority's grant funding, business rates revenue, and its capacity to raise council tax (not necessarily the actual rise in council tax). The Government has produced a note explaining how it calculates spending power.[21]

In 2018 the Public Accounts Committee stated that central government funding for local authorities fell by 49.1% in real terms between 2010 and 2018. This was equivalent to a real terms reduction in spending power of 28.6%.[22]

Financial difficulties have intensified during the Covid-19 pandemic. The *Local Government Chronicle* reported in August 2020 that a leaked Cabinet Office document suggested that 1 in 20 local authorities were at high risk of failure due to the financial pressures of responding to the pandemic.[23] A number of authorities have been reported as being at risk of issuing a section 114 notice during 2020 (see section 6 below). The Government has provided emergency financial support throughout the 2020-21 financial year (see section 6 below).

The *Local Government Chronicle* surveyed 145 chief executives and senior managers within local authorities in October 2018. 49% said they did not expect their council to make required savings in 2018-19, whereas 43% believed that they would. 42% expected their local authority to issue a section 114 notice within the following four years.

---

21 See MHCLG, *Core spending power: explanatory note*, January 2019
22 Public Accounts Committee, *Financial sustainability of local authorities*, HC-970 2017-19, 2018, p7
23 See Martin George, "Cabinet Office: 5% of councils 'at high risk of financial failure'", *Local Government Chronicle*, 24 Aug 2020

Confidence was higher amongst district and unitary authority staff, but low amongst metropolitan boroughs.[24]

The Local Government Information Unit and the Municipal Journal produce an annual State of Local Government Finance Survey. The latest, published in February 2020, found that 74% of respondents were not confident that local government finance was sustainable. 97% of respondent authorities planned to increase council tax and their fees and charges. 12% of authorities stated that they feared being unable to fulfil statutory duties in 2020-21.

3.2 The 'funding gap'

The Local Government Association has produced a series of reports in the 2010s entitled 'Future funding of local authorities'. Each of these identified a 'funding gap' that was forecast to arise by a particular date in the (then) future, based on the difference between Government figures for projected local authority income and projected demand for service spending at that point.

Although central funding of local authorities has fallen throughout the 2010s, the forecast 'funding gaps' vary in size: they have not become larger and larger over time. This is because they are based on comparing service provision at the point at which they are published with projected service provision at a future date.

For example, the first of these reports, published in 2012, was entitled *Funding outlook for councils from 2010-11 to 2019-20: preliminary modelling.* It estimated a £16.5 billion annual funding gap by 2019-20 compared with 2010-11. A further paper in 2015 revised the projected funding gap for 2019-20 to £9.5 billion.[25] This figure is lower because it uses local authority spending in 2015 – which had fallen from levels in 2010 - as its baseline. In a briefing published on 1 October 2018, the LGA estimated an annual funding gap of £3.85 billion in 2019-20, rising to £7.81 billion by 2024-25.[26]

All figures of this kind should be treated with caution. They compare funding at the time of writing with future funding projections. They should not be compared with one another, or used to draw conclusions about the health of local government finances at different points since 2010.

The LGA's projections take into account projected rises in demand and population in the relevant periods. This is also accounted for in other analyses. The National Audit Office's 2018 report *Financial sustainability of local authorities* stated that demand for certain services had risen.[27] The report stated that, between 2011 and 2018, the number of looked-after children had grown by 11%; the estimated population in need

---

[24] Jon Bunn, "Confidence slumps that savings targets can be met", *Local Government Chronicle*, 16 Oct 2018
[25] LGA, *Future funding outlook for councils 2019-20: interim 2015 update*, July 2015
[26] LGA, *Local services face further £1.3 billion government funding cut in 2019/20*, 1 October 2018
[27] National Audit Office, *Financial sustainability of local authorities 2018*, HC 834 2017-19, 2018, p19

aged 65 or over by 14%; and the number of unintentionally homeless people by 34%.

3.3 How much funding do local authorities need?

These concerns have led to debates on how much funding the local government sector as a whole should receive, and how this should relate to need. There exists no agreed, objective measure of 'need' for local authority services, nor is there a settled mechanism to translate 'need' into total levels of funding.

The NAO noted that the 2015 Spending Review assessed the need for local authority services via a high-level exercise involving several government departments.[28]

The local authority finance website *Room 151* reported in September 2018:

> Local authorities need to unite to make the case for overall greater funding, rather than argue over how the money is divided, heard delegates at the summit, which is being held alongside the Local Authority Treasury Investment Forum.
>
> Tony Kirkham, director of resources at Newcastle City Council, said: "The cake needs to be bigger. The question of who gets what out of the distribution is in some ways secondary for me – the cake isn't big enough."
>
> "The government has not validated that we have not got enough money in the first place. It hasn't assessed the 1400 statutory requirements placed on us and the amount needed to deliver them. And it doesn't allow us to raise council tax."
>
> Tony Travers, visiting professor at the London School of Economics, also speaking at the summit, said: "The truth is that national politicians in government and indeed at the top of the opposition are unwilling to face the fact that local government can't deliver £100 worth of services for £70."[29]

The outgoing Comptroller and Auditor General, Sir Amyas Morse, said in a blog post in September 2018:

> …During this progressive reduction in funding [since 2010], I have not seen any evidence-based effort to reconcile funding to local needs. In my view, the policy objectives for local government and the local government statutory duties have not been properly weighted against potential efficiency savings. The 2015 Spending Review made some headway here but it was not a comprehensive approach.[30]

---

28 National Audit Office, *Financial sustainability of local authorities 2018*, HC 834 2017-19, 2018, p57

29 Colin Marrs, "FDs' Summit 2018: Funding crisis poses 'existential threat' to public services", Room 151, 20 Sep 2018

30 Sir Amyas Morse, "When 'more for less' becomes 'less for less': the implications of central decision-making for the delivery of frontline services", LSE Politics and Policy, 21 September 2018

Sir Amyas also drew attention to a lack of local government sector-wide statistics to indicate changes in patterns of service use in response to the changes identified.

3.4 Responses to funding pressures

Local authorities have been required to respond to falling levels of funding, within the constraints of balancing their budgets annually. In a report in 2018, the NAO identified changes in their patterns of response to funding challenges throughout the 2010s:

> 1.23 Our modelling indicates a shift in the way that authorities have used these different options since 2010-11…. For the first three years of funding reductions, local authorities as a whole reduced service spending at a rate in excess of their income reductions. This allowed them to build up their reserves and also offset growth in other spending.
>
> 1.24 In the second three-year period, the scale of funding reductions was similar to the first period, but net reductions in service spend accounted for less than half of the required savings. Instead, at the aggregate level, local authorities have increasingly offset funding reductions by reducing other spending, reducing their net contributions to reserves or drawing them down, and growing alternative income such as commercial trading profits or external interest.
>
> 1.25 This suggests that authorities have moved from simply reducing service spend to looking for alternative savings and sources of income. However, a growing reliance on the use of reserves to offset funding reductions raises questions about the sustainability of the current model.[31]

Rishi Sunak, then minister for local government, said in an interview in December 2018:

> "Councils individually are quite rightly the ones making those decisions closely to those they represent; it is not for me to sit in Whitehall to dictate to people exactly how they should serve their constituents."
>
> "When it comes to funding, a combination of the Budget and the settlement shows an enormous vote of confidence and support for the sector."
>
> "In aggregate the resources available to councils are growing significantly ahead of inflation in this forthcoming year. It is the largest year over year cash increase in this four-year settlement period."[32]

In June 2019, the Housing, Communities and Local Government Committee published a report entitled Local government finance and the 2019 Spending Review. One of its conclusions was that "if HM Treasury wants local government to continue providing the services it currently does it needs to provide local government with a significant

[31] National Audit Office, *Financial sustainability of local authorities 2018*, HC 834 2017-19, 2018, p21

[32] Jon Bunn, "Sunak: no 'general clampdown' on local authority entrepreneurs", *Local Government Chronicle*, 13 December 2018. The entire quote is from Mr Sunak himself.

real-terms increase in its spending power".[33] Like the LGA and NAO reports cited above, it identified significant rises in demand for local government services during the 2010s, with which funding had not kept pace.[34]

3.5 Commercial property investment

During the 2010s, a number of English local authorities have made substantial investments in commercial property, many using sums of money borrowed from the Public Works Loan Board (PWLB). The aim is to bolster their income, and protect local services, by letting commercial properties at a net profit. More information on these developments can be found in the Library briefing paper *Local government: commercial property investment*.

Concerns have been expressed that borrowing and investing comparatively large sums of money could damage the resilience of local authorities. The National Audit Office reported on these developments in March 2020.

> There are inherent potential risks associated with the acquisition of commercial property. These include 'specific risk' associated with each individual property such as the length of the lease or the financial strength of the tenant. Local authorities also face 'systematic risk', which reflects movements in markets; in the last recession UK commercial property values and market rental values both fell.[35]

The NAO also noted a lack of centrally-held data on the investment decisions made by local authorities:

> The Department has data on local authority debt levels and costs and it has used these to support its work on the financial sustainability risks of commercial investments. However, there are a range of other areas such as trends in buying out of area, the contribution of commercial income to service expenditure, and the scale of contingency funds where the Department needs better and more timely data and analysis.[36]

Government concerns over the effects of large-scale borrowing led to the Government raising the PWLB interest rate by 100 basis points (1%) on 9 October 2019, and proposing to prevent local authorities that borrow money to purchase property for yield only from using the PWLB at all. A consultation on this proposal concluded in November 2020, and it came into effect on 26 November. The 1% increase was reversed on the same day.[37] The Government also published additional guidance on the lending terms of PWLB loans following this change.[38]

These changes will not affect local authorities' powers to invest in property for purposes other than purely for financial yield. The majority

33 Housing, Communities and Local Government Committee, *Local government finance and the 2019 Spending Review*, HC-2036 2017-19, 21 Aug 2019, p5
34 Ibid,. p.8-9
35 NAO, *Local authority investment in commercial property*, HC-45 2019-21, March 2020, p8
36 Ibid., p10
37 See PWLB, *Operational Circular 162*, 26 November 2020.
38 See PWLB, *Treasury guidance*, 26 November 2020.

of property investment by local authorities is directed towards their functional responsibilities, such as regeneration. Local authorities may still borrow from the PWLB if they are spending money on their functional responsibilities in a way that will *also* generate commercial income: the prohibition relates to transactions intended *solely* to generate income. This issue is discussed further in the Library briefing *Local government; commercial property investments*.

The Public Accounts Committee expressed concern in July 2020 that local authority commercial property investments constituted a severe financial risk in a small number of cases:

> The behaviour of these authorities not only means that they are highly exposed to risk, but it also alters the terms of the debate; the outlier authorities are viewed as behaving poorly, while other authorities borrowing for yield at relatively lower levels are now not necessarily seen as an issue. Extreme behaviour needs to be curtailed not only for the risk it represents for those specific cases, but also for the mixed messages it sends across the sector, normalising behaviour that may be relatively less risky but nonetheless is still not within the spirit of the framework.[39]

At the end of 2020, commercial property investment had not itself caused any English local authority to suffer severe financial difficulties. It was noted as a concern within the difficulties suffered by LB Croydon in late 2020 (see section 5.2 below). However, the auditors' Public Interest Report suggested that risky commercial property investments by Croydon were a secondary concern to poor treasury management practices and the running down of reserves.

It is possible that the Covid-19 pandemic could affect this model of commercial property investment. If large numbers of local authority-owned properties lose their tenants or businesses cannot pay rent, local authorities might struggle to repay the loans with which they purchased the property. At the time of writing, there have been no reports of local authorities suffering severe difficulties of this kind.

---

[39] Public Accounts Committee, *Local authority investment in commercial property*, 11th report, HC-312 2019-21, p6

4. Financial resilience concerns: Scotland and Wales

4.1 Scotland

Audit Scotland produces an annual 'financial overview' report on the local government sector in Scotland. The most recent covers the 2019-20 financial year. It states that Scottish government revenue funding for local authorities – in effect, grant – fell by 4.7% in real terms between 2013-14 and 2019-20.[40] The report identified a 'funding gap' of 3% in 2019-20, between planned and actual spending, equating to £500 million.[41] Scottish councils added £65 million to their reserves in 2019-20, in contrast to 2018-19 when they drew down £45 million of reserves.[42] There is no equivalent in Scotland (or Wales) of the concept of 'spending power' used by the UK Government with regard to English local authorities.

In a report in 2017, the Fraser of Allander Institute stated that local government funding in Scotland had fallen by 9.3% in real terms between 2010-11 and 2017-18. The Institute's report also notes that a number of new lines of funding in that period were provided to address 'new burdens' (i.e. additional responsibilities assigned to local government by the Scottish Government). This means that, on a like-for-like basis, the fall in grant funding is likely to be greater.

Unlike in England, local government grant funding in Scotland includes school education funding and business rates revenue, but it does not include fire and rescue or public health; thus these figures are not directly comparable with England.[43]

4.2 Wales

In Wales, local authority spending has fallen by £720 million (7.9%) between 2009-10 and 2019-20.[44] In the same timescale, the amount raised in council tax in Wales has risen from £1,257 million to £1,628 million, and the amount raised in business rates from £965 million to £1,079 million.[45] Revenue Support Grant has fallen from £3,741 million to £3,229 million.

The Wales Audit Office issued a report on 18 August 2016 on the financial resilience of local authorities in Wales. It stated that authorities had managed reductions in funding effectively, but that they needed to

---

40 Accounts Commission [Audit Scotland], *Local government in Scotland: Financial overview 2019/20*, January 2021, p11
41 Ibid., p14
42 Accounts Commission [Audit Scotland], *Local government in Scotland: Financial overview 2018/19*, December 2019, p18
43 Fraser of Allander Institute, *Fiscal issues facing local government in Scotland*, 2017, p.10-12
44 Wales Audit Office, *At your discretion: local authority discretionary services*, April 2021, p11
45 Ibid., p12. See also Joseph Ogle, Daria Luchinskaya and Michael Trickey, *Austerity and Local Government in Wales: an analysis of income and spending priorities, 2009-10 to 2016-17*, Wales Public Services 2025, 2017, p3

improve their capacity, strategic planning, and income generation plans in the medium term:

> Dealing with the impact of these budget decreases therefore requires local authorities to significantly change the way they manage and govern their finances. Financial management arrangements that were once good enough, are now unlikely to be fit for purpose to continue to deliver strong financial outcomes in the future. The scale of cost reduction required also means that local authorities have to look beyond immediate short-term savings and think more radically about how to reduce costs, and how to sustain this in the longer term whilst still maintaining or improving services.[46]

The report identified that several local authorities intended to cover unplanned budget gaps by using earmarked reserves; or by allowing underspending in one service area to mitigate overspending in another in any given financial year. It suggested that "as relatively easy savings have already been made, local authorities would need to develop longer-term transformational projects to address the significant budget pressures they face".[47]

A further report from the Wales Audit Office, in 2020, stated that the impact of Covid-19 on local authorities had been muted up to that point, noting that Welsh councils' levels of reserves had remained static in 2019-2020:

> …for 2020-21 additional funding from the Welsh Government has largely mitigated the financial impact of the pandemic on local councils. However should the impact of the pandemic continue into future years, it may be the case that councils will need to increasingly use their reserves to meet additional costs or supplement income losses.[48]

46 Wales Audit Office, *Financial resilience of local authorities 2015-16*, 2016, p6
47 Ibid,. p17
48 Audit Wales, *Financial Sustainability of Local Government as a Result of the COVID-19 Pandemic*, October 2020, p7

5. Financial stress: effects on individual authorities

During 2020, rumours circulated that several local authorities have been considering issuing section 114 notices (see section 2.2 above), and there have been a number of reports of authorities facing financial difficulties.[49] The subject of additional funding for local authorities was debated in Westminster Hall on 24 November 2020.[50]

Despite these concerns, only two councils to date have experienced financial difficulties of sufficient severity for a section 114 notice to be issued. This section outlines events in those two councils, and sets out actions that have been taken in respect of some other authorities in financial difficulties.

5.1 Northamptonshire County Council

During 2016, evidence became available of the potential for substantial financial failings at Northamptonshire County Council. In response to these concerns, on 9 January 2018 Sajid Javid, then Secretary of State for Housing, Communities and Local Government, commissioned a Best Value inspection by Max Caller, a former Boundary Commissioner and local authority chief executive. In a written statement, Mr Javid said:

> For some time there have been concerns about financial management and governance at Northamptonshire County Council, and in recent months a number of reports have been published which have led me to question whether the authority is failing to comply with its best value duty. Particular reports include the external auditor's (KPMG) "adverse" value for money opinion in relation to the 2015-16 and 2016-17 accounts, publicly available budget documents, and the September 2017 Local Government Association peer review into the council's financial planning and management.[51]

While the Best Value inspection was in progress, the county council's section 151 officer issued a section 114 report, on 2 February 2018. On 20 February 2018, KPMG issued an advisory notice, indicating that they believed that the council was about to set an unlawful budget.

The county council met to discuss the section 114 report on 22 February. It eventually passed a revised budget on 1 March 2018, which reduced spending for 2018-19 by a further £10 million.[52] This met the council's legal requirement to set a balanced budget.

---

[49] For example, Jim Pickard and George Hammond, "Croydon seeks government help amid crisis for councils", *Financial Times*, 26 Aug 2020; BBC, "Coronavirus: Luton borough council faced with 'stark' savings", 19 May 2020; Jessica Hill, "Peterborough faces uncertainty over setting legal budget", *Local Government Chronicle*, 16 Sep 2020; Sarah Calkin, "Unitary chief: 'We cannot achieve this level of savings and maintain statutory services'", *Local Government Chronicle*, 19 Nov 2020

[50] HCDeb 24 Nov 2020 c335WH

[51] HCWS 394 2017-19, 9 January 2018

[52] Colin Marrs, "Northamptonshire plans for £10m in cuts a week after 'unlawful' budget", *Room 151*, 1 Mar 2018

Mr Caller's report was published on 15 March 2018. It found that Northamptonshire had failed to exercise proper budgetary control since 2013-14. Earmarked reserves had fallen from £57.7 million in 2013-14 to £8.8 million by 1 April 2017. The council had "repeatedly under-assessed the level of spending pressures it will experience across the years within its medium-term financial plan".[53] The report also noted that the council had used capital receipts to compensate for overspending in its revenue budget, but that no strategy document directing this use was in existence, contravening statutory guidance.[54]

On 10 May 2018, the Government intervened formally in Northamptonshire, appointing two commissioners to run the council for the period up to March 2021.[55] However, the section 151 officer issued a second section 114 report on 24 July, in respect of the 2018-19 financial year, believing that the council was not on track to make necessary in-year savings. Further reductions in spending were subsequently voted through.[56]

The Government then agreed to allow Northamptonshire to use £70 million of capital receipts to bolster revenue expenditure (a 'capitalisation direction').[57] £42 million of this sum came from the sale and leaseback of the county council's headquarters, One Angel Square.[58] The council was subsequently also permitted an extra 2% of 'headroom' in the council tax referendum regime for 2019-20.[59]

Mr Caller's report also recommended that, in the medium term, the county council area should be restructured into two unitary authorities. A proposal to this effect was submitted to the Secretary of State in August 2018.[60] Two new unitary authorities, North Northamptonshire and West Northamptonshire, were established in April 2021 and will hold their first elections in May 2021 (postponed from 2020 due to the coronavirus pandemic).

In July 2020, the Government published a 'lessons learned' document written by the commissioners appointed to Northamptonshire.[61]

---

53 DCLG, *Northamptonshire County Council Best Value Report*, 2018, p23

54 See the Library briefing *Local government in England: capital finance* for an explanation of capital receipt use and 'capitalisation', and details of the current statutory guidance.

55 See HCWS673 2017-19, 10 May 2018; MHCLG, *Northamptonshire County Council: Directions and explanatory memorandum*, 10 May 2018

56 Robert Cusack, "Northants votes to 'significantly reduce spending'", *Local Government Chronicle*, 8 August 2018

57 MHCLG, *First progress report of commissioners at Northamptonshire county council published*, 29 November 2018. 'Capitalisation' is discussed in section 1.5 of the Library briefing *Local government in England: capital finance*.

58 See paragraphs 2.7 and 2.8 of the second section 114 notice, issued on 24 July 2018

59 In other words, Northamptonshire would be able to raise its basic rate of council tax by 5% - 2% more than all other county councils – without holding a referendum. See the Library briefing paper *Council tax: local referendums* for more information.

60 See MHCLG, *The proposed reorganisation of local government in Northamptonshire*, 25 November 2018

61 MHCLG, *Northamptonshire County Council: lessons learned from the first year of intervention*, July 2020

5.2 London Borough of Croydon

The London Borough of Croydon issued a section 114 notice on 11 November 2020. This followed the publication of a public interest report by the council's auditors, Grant Thornton, on 26 October 2020. The Government also ordered a rapid review into the council's governance structures on 29 October. The public interest report noted:

- a rapid running down of council reserves over a few years, in order to plug overspends on services. The report anticipated an overspend of £49.1 million in 2020-21;
- a lack of challenge by councillors of financial decision-making, through overview and scrutiny or audit committees;
- evidence that Government guidance around capitalisation had not been followed. Some £73 million had been capitalised – transferred from capital to revenue budgets – between 2017 and 2020. Capitalisation is permissible only for specific circumstances, defined by Government guidance, or with explicit permission from the Government;
- concerns being raised by auditors over more than one financial year, which were largely disregarded by officers and elected councillors;
- a lack of documentation surrounding companies established by the council, including Brick by Brick, a housing delivery company, and London Borough of Croydon Holdings, which was struck off by Companies House. Croydon had borrowed some £545 million to direct towards property investments since 2017.

David Simmonds MP led an adjournment debate on Croydon's financial difficulties on 9 December 2020. Responding to his points, Kelly Tolhurst, for the Government, said:

> On 29 October, my right hon. Friend the Secretary of State for Housing, Communities and Local Government announced a rapid, non-statutory review of the council to be conducted by an independent review team. …I am pleased to confirm that the independent review team has reported its findings to the Secretary of State. He is considering the report and will respond in due course. I can reassure Members that the Secretary of State will take a keen interest in the steps the council will need to take to address the governance and financial management issues that have been identified through the independent review, ensuring that the residents of Croydon receive the services they have every right to expect.[62]

An 'improvement and assurance panel' was appointed on 1 February 2021. This does not constitute a statutory Government intervention in the authority.

5.3 Other authorities

During 2020, reports suggested that a number of other local authorities were facing severe financial difficulties. No further section 114 notices have been issued as of April 2021. The Government announced a rapid

---

62 HCDeb 9 Dec 2020 c952

review of Nottingham City Council on 2 November 2020, following concerns over its wholly-owned company Robin Hood Energy. Max Caller, who led the investigation into Northamptonshire in 2018, is the lead reviewer.[63] Neither this, nor the review into LB Croydon, constitutes a statutory intervention by the Government.

The Government has instituted an 'exceptional support scheme' for councils that are encountering unmanageable financial pressures as a result of the Covid-19 pandemic. This has taken the form of individual authorities being granted a 'capitalisation direction' by the Government. A capitalisation direction consists of permission to use capital funding to fill gaps in revenue funding. This is normally not permitted: Northamptonshire's sale of its headquarters, noted above, is an example.

The Government made bilateral agreements with a number of authorities in the early months of 2021.[64] These took essentially the same form. The Government agreed to the authority transferring a specified sum from its capital to its revenue account, and using that sum to bolster its revenue spending. In return, the agreements made provisions for external assurance reviews of the local authority's spending, applied a higher interest rate to future PWLB loans, and determined how the authority should make its minimum revenue provision in its accounts (normally a matter of local discretion).

These capitalisation directions have been erroneously reported as 'bailouts' or 'loans' in many parts of the media. In reality they consist of permission for local authorities to use existing money in a different way. They do not provide local authorities with additional grant or loan funding that they did not previously possess. More information on capitalisation can be found in the Library briefing paper *Local government in England: capital finance*.

This policy is in line with Government practice when local authorities have encountered severe financial difficulties in the past: as a rule it does not provide any financial support or 'bailout'. This was true in two of the most recent large-scale threats to local government financial stability – interest rate swaps (in the late 1980s) and Icelandic banks (2008-09). More information on these episodes can be found in the Library briefing *Local government: commercial property investments*. Exceptionally, the Government loaned Western Isles Council (Comhairle nan Eilean Siar) £30 million after it lost £24 million following the collapse of the Bank of Credit and Commerce International (BCCI) in 1991.

Previously, a publication by the Bureau of Investigative Journalism in March 2018 suggested that a number of county councils faced financial stress in the short- to medium-term.[65] Pixel Financial Management

---

63 See MHCLG, *Government confirms rapid review into Nottingham City Council*, 2 Nov 2020
64 MHCLG, *Exceptional financial support for local authorities*, 7 April 2021
65 Gareth Davies, *County councils in crisis: three more named as showing signs of financial distress*, Bureau of Investigative Journalism, 8 Mar 2018. See also CIPFA, *Surrey County Council finance*, July 2018, p2

carried out some research on local authority reserve levels in 2018, which suggested that district councils too might face difficulties in the medium term owing to uncertainties over business rates income.[66]

[66] Adrian Jenkins, "Research: financial stresses remain despite stabilisation of reserves", *Local Government Chronicle*, 28 June 2018

6. Financial resilience and coronavirus

The coronavirus pandemic in 2020 presented a number of severe challenges to the financial resilience of local authorities. These include:

- Cashflow problems: local businesses and residents require urgent financial support, but local authorities could struggle to obtain enough revenue to pay for the support they give;
- Lost revenue arising from the restrictions on travel and economic activity mandated by the Government.

6.1 Cashflow and financial support

The Government has provided a number of sums of money to English local authorities to assist their cashflow and supplement their funding during the pandemic. These include the following, though this is *not* a comprehensive list of Covid-19 related extra funding for local government:

- **11 March 2020**: A £500 million 'hardship fund' for residents struggling to pay council tax bills. This funding is to be allocated to residents currently benefiting from local council tax support schemes. Government guidance was published on 24 March, and additional guidance on 16 April.
- **19 March 2020**: £1.6 billion additional funding made available to local authorities. £1.4 billion of this funding was allocated via the adult social care needs formula. The remaining £200 million was allocated in line with each councils' Settlement Funding Assessment. The Institute for Fiscal Studies has argued that the impact of the virus on different councils, "may not reflect historical differences in social care spending needs." As a result, the formulas used to allocate funding are "out of date."
- **25 March 2020**: £1.8 billion grants paid to local authorities in advance. This followed the Chancellor's announcement of widespread exemption from business rates for 2020-21. Normally, business rates relief would be applied first, and local authorities would seek reimbursement after it had been applied.
- **1 April 2020:** £12 billion funding for business rates grants transferred to local authorities. These funds were distributed under the Business Rates Grants schemes (see *Coronavirus: support for businesses*). BEIS published the total amounts distributed under this scheme on 12 November 2020;
- **16 April 2020**: Councils will be allowed to defer £2.6bn in business rates payments to central government from April to June 2020. This is in respect of the 'central share' of business rates.
- **16 April 2020:** £850m in central government social care grants for both children and adults, from April to June 2020. This was paid up front in April.

- **18 April 2020:** A second £1.6 billion of additional funding for local government. This was distributed on a different basis from the funding announced on 19 March, with district councils receiving a considerably larger share of the 18 April funds (though see also the entry below for 22 October 2020).
- **2 May 2020:** a further discretionary fund of £617 million to be made available for grants to businesses that do not qualify for the Small Business Grant scheme and the retail grant scheme.
- **15 May 2020:** £600 million made available to local authorities to support social care provision. 75% of the funding to be passed on direct to care homes, with the other 25% to "be used for infection control measures [which] … local authorities are able to allocate based on need";[67]
- **24 May 2020**: £50 million made available to councils via the Reopening High Streets Safely Fund. This funding was to cover planning and communications to assist the reopening of high street businesses, together with temporary changes to the public realm. This fund may not be used to provide grants to businesses or for capital spending. Grant funding agreements will be instituted between local authorities and the Government;
- **24 May 2020**: £150 million for new homes was allocated to local authorities on 29 October 2020. A further £105 million was made available to tackle homelessness on **24 June 2020**.
- **11 June 2020:** A 'local welfare assistance fund' of £63 million made available to councils to "support people struggling to secure food and other essentials". This funding is available to upper-tier authorities;[68]
- **11 June 2020**: A £300 million fund announced for local authorities to support the Government's test and trace service. 11 authorities will lead on sharing best practice;
- **2 July 2020**: A further £500 million of un-ringfenced funding for councils. The Government published allocation figures for this third round of funding, alongside figures for the rounds made available on 19 March and 18 April;
- **24 August 2020**: guidance issued on a fund to compensate local authorities for lost income from sales, fees and charges. In brief, the Government will compensate local authorities for 75% of income from these sources for which they had budgeted in 2020-21, with a 5% 'deductible' rate for which no compensation will be paid. This fund does **not** cover commercial income.
- **22 October 2020**: A further £919 million of un-ringfenced funding for councils. Funding allocations are based on the 'Covid Relative Needs Formula' and take into account the sums allocated on 16 March, 19 April and 2 July. An additional £100 million fund to support "council leisure centres most in need" was also

67 DHSC, *Care home support package backed by £600 million to help reduce coronavirus infections*, 15 May 2020
68 Sarah Calkin, "Districts hit out at decision to hand food poverty cash to counties", *Local Government Chronicle*, 7 Jul 2020

announced, with further details becoming available in mid-December.

- **4 November 2020**: The Local Restrictions Support Grant, Additional Restrictions Grant and Contain Outbreak Management Fund formalised and made available to all district and unitary councils in England. They are allocated on a rough formula of £20 per head and £8 per head respectively.

The following arrangements apply during the national lockdown beginning on 5 January 2021:

- The Local Restrictions Support Grant (Closed) scheme will be available to all businesses in England required to close. It will be accompanied by a 'Closed Businesses Lockdown Payment', an additional one-off support grant for businesses totalling £4.6 billion for England. Guidance for both these grants was published on 13 January 2021. The eligibility criteria for these two schemes are the same.

- The Additional Restrictions Grant will be increased by £500 million. Local authorities may make discretionary grants from this fund to businesses not eligible for the LRSG, or to other local businesses as they see fit;

- £1.55 billion in un-ringfenced funding for local authorities. This is to be distributed according to the 'Covid Relative Needs Formula'. In effect, it is a fifth tranche of the funding support summarised in the 22 October announcement. The Government guidance does not prescribe what use should be made of the funding, but recommends priority be given to:

  ….adult social care, children's services, public health services, household waste services, shielding the clinically extremely vulnerable, homelessness and rough sleeping, domestic abuse, managing excess deaths, support for re-opening the country and, in addition, the additional costs associated with the local elections in May 2021.[69]

- £670 million to be distributed to local authorities to support local council tax support schemes. These are expected to face increased pressure due to the economic effects of the pandemic.[70]

- A Government commitment to reimburse local authorities for 75% of irrecoverable council tax and business rates shortfalls in the 2020-21 financial year. Authorities must make claims for reimbursement based on their forecast income;

- Compensation for lost income from sales, fees and charges, originally announced on 24 August 2020, is to be extended to cover April, May and June 2021.

- A 'Restart Grant' scheme is available at the outset of the 2021-22 financial year, providing a one-off grant to retail, hospitality and leisure sector businesses. This is very similar to the Local Restrictions Support Grants available during 2020-21.

69 MHCLG, *COVID-19 funding for local government in 2021-22: consultative policy paper*, 11 Jan 2021, paragraph 20

70 Ibid.

Indicative allocations for a number of these support grants are available on the gov.uk website, via the links in the above list. In other cases, the allocations to individual local authorities will depend on the amount that local authorities apply for, or on data returns that are not available at the time of writing. In these cases, the allocation data is not yet available.

The £12 billion in business rate-related grants made available on 1 April 2020, the Local Restrictions Support Grant, the £4.6 billion announced on 5 January 2021, and the Restart Grants, are to be passed on directly to businesses. These amounts therefore do not constitute additional funding for local authority functions. The Library has published a dashboard summarising the various sums of funding made available since March 2020.

The amounts made available on 25 March and 16 April 2020 constitute already committed funding being made available on an earlier timescale. This reflects widespread concerns in local government about a cashflow crisis – the threat that councils would pay large amounts of money out in respect of various support programmes early in the 2020-21 financial year, then run out of money in advance of being reimbursed by central government.

6.2 Loss of revenue

Local authorities have also expressed strong concerns about broader losses of revenue arising from the coronavirus pandemic.[71] The main concerns include:

- **Council tax**: A number of local authorities permitted council tax-payers to pay their ten monthly instalments from June 2020 to March 2021, instead of the normal pattern of April to February.[72] Payments were rescheduled rather than cancelled. This practice has also generated tensions in two-tier areas, where district councils are responsible for council tax administration;[73]
- **Commercial property:** On 20 April 2020 the *Financial Times* reported that landlord and tenant representatives had jointly called for support from the Government for property that had "been furloughed". Businesses with little or no turnover will rapidly become unable to pay rent, with knock-on consequences for landlords dependent on rental income;
- **Other commercial income**: Local authority income from sources such as car parks and leisure centres has fallen dramatically since April 2020. This is a significant source of income for district councils in particular. The *Local Government Chronicle* conducted a survey in April 2020 that, if the figures were scaled up, suggested a shortfall of £9 billion for 2020-21 (though this was a very rough figure and did not take into account the additional

71 Sarah Calkin, "Revealed: the multi-billion pound Covid-19 funding shortfall", *Local Government Chronicle*, 17 Apr 2020

72 The law allows council tax instalments to be paid in ten consecutive months: see schedule 1 of the *Council Tax (Administration and Enforcement) Regulations 1992*.

73 See Mark Smulian, "Coronavirus council tax holidays spark county fear over cashflow", *Local Government Chronicle,* 7 April 2020

£1.6 billion of funding announced on 18 April).[74] In October 2020 the Government announced a £100 million fund to support leisure centres threatened with closure, but it has given no other indication that it will provide support for authorities that are struggling due to lost commercial income;

- **Lost grant / local income**: local authorities may have budgeted for income from New Homes Bonus or business rate retention, which cannot now be relied upon as property construction may be paused or abandoned;
- **Business rates**: the Chancellor has instituted schemes that have the effect of removing liability for business rates from many businesses. However, the Government has committed to reimbursing local authorities for any revenue lost as a result of those schemes (see the Library briefing paper *Business rates*).

Many local authorities responding to the LGC's April 2020 survey indicated that their reserves were not sufficient to compensate for forecast lost income. Results from a survey by the County Councils Network, published in November, suggested continued pessimism from finance officers regarding the 2020-21 financial year:

> More than half (56%) of the 35 two-tier and unitary counties that responded to the survey last month [October 2020] admitted they were planning to reduce access to care packages and/or introduce new charges for services in order to balance the books. Two fifths (42%) were also eyeing reductions to personal budgets and mental health services.
>
> There is less scope to reduce services in children's social services, with all respondents seeing a rise in vulnerable children. However, 27% said they will have to reduce services for children in council care and subject to safeguarding, and 33% planning reductions to early years and youth services.[75]

In August 2020, the Institute for Fiscal Studies compared the additional support that Government had provided at that point with local authorities' forecasts of financial need for the 2020-21 financial year. They estimated a shortfall of £2.0 billion for English local authorities, based on support provided at that point. This does not take into account the additional support announced on 24 October 2020 (see above); local authority forecasts of spending may also have changed since August 2020.[76]

6.3 Accounting requirements

Separately, changes have been made to the financial accounting requirements placed on local authorities. The deadline for publishing audited accounts was moved from 31 July to 30 November 2020.[77] Unaudited accounts must be published by 31 August, and authorities

[74] Sarah Calkin, "Revealed: the multi-billion pound Covid-19 funding shortfall", *Local Government Chronicle*, 17 Apr 2020

[75] Jessica Hill, "Counties warn of major cuts", *Local Government Chronicle*, 13 November 2020

[76] See Kate Ogden and David Phillips, *COVID-19 and English council funding: how are budgets being hit in 2020–21?*, Institute for Fiscal Studies, 19 August 2020

[77] See the *Accounts and Audit (Coronavirus) (Amendment) Regulations 2020* (SI 2020/404)

will have discretion on the period when they must make the accounts available to the public in advance of publication.[78] However, proposals to simplify the accounting requirements themselves were abandoned after resistance from auditors and regulatory bodies.[79]

78 Stephen Sheen, "Accounts simplification isn't happening. What next?", *Room 151*, 15 April 2020
79 Sarah Calkin, "Bid to relax accounts code 'not acceptable' to auditors and regulators", *Local Government Chronicle*, 7 April 2020

7. Monitoring financial resilience

7.1 Sector led improvement

The Audit Commission was the main body responsible for financial and performance oversight of local authorities in England, until its inspection powers were removed in 2010 and its responsibility for audit lapsed in 2015. The Commission's audit activities have been taken over by a range of different bodies: see the Library briefing paper *Local audit in England*.

The Local Government Association (LGA) runs a programme of self-improvement for local government known as Sector Led Improvement. MHCLG provided £20 million towards this programme in 2018-19.[80] Sector led improvement is available to all local authorities in England irrespective of whether they are members of the LGA.

Sector led improvement comprises a range of support programmes for councils that are set out on the LGA website. They are based on strong leadership, challenge from peers, comparative performance information and sharing good practice.

The LGA also publishes comparative data on local authority value for money and performance on its LG Inform website.[81] This includes the 'value for money profiles' previously published by the Audit Commission, and financial diagnostic reports available to councils.[82]

As part of sector led improvement, the LGA runs a programme of corporate peer challenges for local authorities in England. Participation by local authorities is voluntary. Any action to address issues identified is the responsibility of the council concerned: this has always been the case for peer challenges. (The Audit Commission itself had no formal powers of intervention, as these were reserved to the Secretary of State.)

The LGA publishes a description of the process of peer challenge. This is concerned with local government operations generally, though financial management will naturally feature frequently within it. In 2018 the LGA commissioned research to identify the outcomes and benefits of the peer review process. An interim report published in November 2018 identified a number of benefits (with named examples from local authorities and individuals). The research identified the following as key points:

- The input of local government peers;
- The need for formal vs. informal learning;
- The timing of sector-led improvement; and
- The value of the self-assessment process.[83]

---

80 DCLG / LGA, *Memorandum of Understanding: grant funding 2018-19*, 2018, p3
81 See https://lginform.local.gov.uk/
82 See https://vfm.lginform.local.gov.uk/
83 LGA, *Case study: the impact of sector-led improvement*, November 2018, p6

An annual report on the process states that 129 peer challenges were facilitated by the LGA in 2019-20. It states that:

> Whereas some peer challenges focus on a specific area, corporate peer challenges encompass multiple themes: understanding of place and priority setting; leadership of place; financial planning and viability; organisational leadership and governance; and capacity to deliver. This approach helps councils to improve across the board. The challenges are fully funded and there is an expectation that all councils (and fire and rescue authorities) will complete a corporate peer challenge or finance peer review every five years.[84]

The LGA has an ongoing programme to evaluate the impact and effectiveness of this sector led approach to improvement.[85] It has also published a memorandum of understanding with MHCLG, focusing on the use of the MHCLG's annual grant for improvement and development in the context of Covid-19.

In the debate on the provisional finance settlement for 2019-20, on 13 December 2018, the Secretary of State for Housing, Communities and Local Government, James Brokenshire, announced that the Government planned to launch a 'continuous improvement tool' in spring 2019:

> We are working with local authorities to promote efficiency, and we will use that work to develop a package of support to help councils become more efficient and get better service outcomes. We will launch a continuous improvement tool in spring 2019, and we are championing authorities that are putting communities at the heart of service delivery.[86]

The LGA also stated:

> We are working with MHCLG and councils to develop this self-assessment tool to help councils continuously improve. This will form part of a wider package of support easily accessible on-line and will build on all the improvement tools we already have in place including peer challenge, leadership development and LG Inform.[87]

7.2 Public Sector Audit Appointments

When the Audit Commission was closed, a voluntary mechanism was provided for the central appointment of auditors to local authorities. Most authorities' auditors are now appointed by Public Sector Audit Appointments (PSAA), a company established by the LGA. From 2015, PSAA managed residual audit contracts that had been let by the Audit Commission. The new process for appointment of local authority auditors came into full effect in the 2019-20 financial year: see the Library briefing *Local audit in England*.

---

84 LGA, *Sector-led improvement in 2019-20: end of year report*, 2020, p8
85 See LGA, *Evaluation of sector-led improvement: phase two interim summary report*: November 2018
86 HC Deb 13 Dec 2018 c413
87 LGA, *Provisional Local Government Finance Settlement: On the Day Briefing*, 13 December 2018

PSAA does not have any broader role to report on value for money or to produce 'studies', in the manner of the Audit Commission.[88] However, up to 2017-18 it collected data in an annual report on 'the results of auditors' work'. These reports set out information about authorities where qualified audit conclusions were reached, and details of any advisory notices issued.[89] Producing this report is no longer a statutory requirement from 2018-19 onwards. However, PSAA has stated that there is value in the data being published and it will liaise with other bodies on how to provide a comprehensive picture on the results of public audit.[90]

PSAA also established a Local Audit Quality Forum in April 2018, intended as a means of sharing good practice between auditors and audited bodies, and to improve practice within local authority audit committees. This forum met on a six-monthly basis until the outbreak of Covid-19. It also publishes annual audit quality reports, the most recent covering the 2018-19 financial year.

7.3 Government monitoring

The 2020 MHCLG accounting statement sets out how the Ministry monitors the financial sustainability of English local authorities. It collects financial data from local authorities and the Office for National Statistics, information on service provision, and 'soft intelligence'.[91] MHCLG has faced criticism previously for its oversight of the financial resilience of local authorities. This first appeared in the 2014 National Audit Office report *Financial sustainability of local authorities*:

> …the Department uses limited information to monitor financial and service pressures in the sector. It relies for information on systems designed for different purposes. …the Department's view that the accountability system has been effective to date in preventing financial failure is reasonable. However, the Department is poorly placed to understand the scale of financial pressures within local authorities. As a result, it does not know enough about whether local authorities are close to failing financially and whether they are diverting financial pressures onto their services.[92]

A further report from the NAO in 2018 stated that the Government's assurance systems had improved. It stated that MHCLG used a 'local authority sustainability tool', comparing levels of reserves with shares of 'inflexible spend', mainly on social care and the servicing of debt:

> The Department uses the tool to:
>
> - model the impact of different scenarios, such as new policies, on financial risk;
> - track how far assumptions underpinning the 2015 Spending Review modelling have been borne out; and

---

88 The NAO has a power to produce a small number of general reports ('examinations') on local government: see section 35 of the *Local Audit and Accountability Act 2014*.
89 PSAA, *Report on the results of auditors' work 2017-18*, November 2018
90 Ibid, p4
91 MHCLG, *Accounting Officer System Statement*, November 2020, p47
92 NAO, *Financial sustainability of local authorities*, 2014, p33-34

- inform the Department's assessment of the level of risk of widespread financial failure.[93]

The NAO's 2019 report *Local authority governance* stated that MHCLG produces "detailed financial risk analysis reports that identify authorities about which the Department has concern and highlight the extent to which governance factors may be contributory to financial risk".[94] These analyses are not made public. The Public Accounts Committee has suggested that this hinders assessment of MHCLG's conclusions about sustainability and risk. In its 2019 report *Local government spending*, the PAC recommended that MHCLG should "revisit its refusal to publish a shared definition of financial sustainability",[95] and that:

> The Department should write to the committee by May 2019 setting out a step-by-step model of how it assures itself that the sector is sustainable… this should include a detailed account of how adequate funding need has been defined and calculated including assumptions over service levels (including both statutory and discretionary) and demand projections.[96]

The HCLG Committee's August 2019 report on local government finance included a number of pieces of evidence suggesting that data on financial sustainability, and other aspects of council performance, was hard to find:

> The Government should develop a more regularised and consistent approach to the collection and monitoring of comparative data about councils' performance, efficiency and financial sustainability. The current situation means there can be no certainty about the state of individual councils or the sector as a whole.[97]

7.4 Financial Resilience index

In response to concerns about financial resilience in the local government sector, CIPFA (the Chartered Institute for Public Finance and Accountancy, the membership body for local government finance professionals) announced plans to produce a 'financial resilience index' for English local authorities. These were published on 2 July 2018. The consultation suggested six resilience indicators:

- Level of reserves as a proportion of net revenue expenditure;
- Change in reserves over the past three years;
- Ratio of government grants to net revenue expenditure;
- Proportion of net revenue expenditure going to social care and debt financing;
- Ofsted inspection score for children's social care;

93 National Audit Office, *Financial sustainability of local authorities 2018*, HC 834 2017-19, 2018, p43
94 NAO, *Local authority governance*, HC-1865 2017-19, 2019, p44
95 Public Accounts Committee, *Local government spending*, HC-1775 2017-19, February 2019, p7
96 Public Accounts Committee, *Local government spending*, HC-1775 2017-19, February 2019, p7
97 Housing, Communities and Local Government Committee, *Local government finance and the 2019 Spending Review*, HC-2036 2017-19, 21 Aug 2019, p16

- Auditor's value for money judgement.[98]

CIPFA stated:

> … the index will not be a predictive model but a diagnostic tool – designed to identify those councils displaying consistent and comparable features that will highlight good practice, but crucially, also point to areas which are associated with financial failure.[99]

The consultation also included proposals for how scores should be allocated against each indicator, and the weighting that would be given to each of them when combining them into a single overall score. Data would have been made available in an interactive tool, permitting the production of a 'league table'.

The consultation provoked some disquiet in the sector. For instance, the LGA's response said:

> …the LGA does not believe that financial health of large and complex organisations such as local authorities can be adequately summarised and forecast by a handful of indicators. …Although not CIPFA's intention, we believe that it is inevitable that the index will be seen by some as a performance table. This is particularly likely given that the index will be published by a respected institute such as CIPFA as it will give the index a perceived credibility.[100]

John Sinnott, chief executive of Leicestershire County Council, said in July 2018:

> There is no performance information vacuum. Chief executives should ensure that their councils have systems to measure and compare performance using data from LG Inform, Public Health England and government departments. You know how well your council is doing; unofficial league tables exist for cost effectiveness and value for money, prompting questions around financial sustainability.
>
> There may be no perfect set of performance measures on which to draw up a league table but that is not to deny its potential worth.[101]

Further perspectives on the construction of a resilience index can be found in Dan Bates, "How should we measure financial resilience?", August 2018; and Don Peebles, "Save your bacon through financial resilience", April 2018.

CIPFA published a response to the consultation on 4 December 2018.[102] This document proposed fifteen indicators, extending the original six. It abandoned the proposal to produce a weighted 'total' indicator. It proposed to distribute the resilience index confidentially to finance

98 CIPFA, *Consultation – local authority financial resilience index*, July 2018, p5
99 CIPFA, *Consultation – local authority financial resilience index*, July 2018.
100 LGA, *Response to CIPFA Consultation on a Local Authority Financial Resilience Index*, August 2018, p1
101 John Sinnott, "CIPFA deserves backing over resilience", *Local Government Chronicle*, 25 July 2018
102 CIPFA, *Local authority financial resilience index: consultation response*, December 2018

teams in local authorities, with a commitment to making it publicly available in subsequent years.[103]

CIPFA did then go on to publish a high-level briefing on the initial findings of the resilience index in December 2018.[104] The press release said:

> ….the majority of councils are in a stable financial position, and are not showing signs of financial failure in spite of managing severe budget cuts. Clearly this shows effective financial management against a challenging context.
>
> However, there is a tail, of 10-15% of councils, where there are some signs of potential risk to their financial stability. Having now provided data, CIPFA will discuss professional support for CFOs in those authorities.[105]

A similar high-level finding was made public in December 2019.[106] A further edition of the financial resilience index, with nine indicators and interactive graphs, was published in January 2021.[107] The 2021 edition of the index is based on the 2019-20 financial year and therefore does not take into account the effects of the Covid-19 pandemic.

The Redmond Review of local public audit, published in July 2020, discussed how audit could contribute to assessing a local authority's financial resilience. It identified a need for clearer information about wholly-owned local authority companies within published accounts. It also suggested that financial resilience could be addressed through the value for money examinations that form part of local audit.[108]

---

103 Ibid., p6. The reference to the Public Accounts Committee is to a recommendation in the report *Financial sustainability of local authorities 2018*, HC-970 2017-19, 2018, p6

104 CIPFA, *Measured resilience in English authorities*, 2018

105 Ibid.

106 Colin Marrs, "CIPFA hopes updated resilience index will strengthen s151s", *Room 151*, 16 Dec 2019

107 See CIPFA, *Financial resilience index*, 2021. Further explanation of the indicators that make up the index can be found on the *Contextual information* page.

108 Sir Tony Redmond, *Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting*, MHCLG, September 2020, chapter 6

BRIEFING PAPER
Number 08520
27 May 2021