Agenda Item

FOR PUBLICATION

DERBYSHIRE COUNTY COUNCIL

AUDIT COMMITTEE

7 December 2021

Report of the Director of Finance & ICT

Financial Sustainability, The Section 114 Regime and Assessment of the Council's Position

1. Divisions Affected

1.1 County-wide.

2. Key Decision

2.1 This is not a Key Decision.

3. Purpose

3.1 To provide Audit Committee with details of two reports from the Department for Levelling Up, Housing and Communities (DLUHC) on local authority financial sustainability and the Section 114 (S114) regime, which is a notice which Chief Finance Officers may issue if there is a significant risk that an authority will not be able to deliver a balanced budget by the end of the current financial year, along with information on assessment of the Council's position.

3.2 The DLUHC reports are:

- A response to the Housing, Communities and Local Government Select Committee's July 2021 report on Local Authority Financial Sustainability and the S114 Regime.

- A report on the Local Government Finance Review of Slough Borough Council, following its issuing a S114 notice in July 2021.

4. Information and Analysis

Background

4.1 The Housing, Communities and Local Government Select Committee (Select Committee) published a report on 19 July 2021 on Local Authority Financial Sustainability and the S114 Regime, following an inquiry. The Council submitted written evidence to the inquiry in January 2021.

4.2 The Chair of the Select Committee said: “Council budgets have been stretched for several years and the social care funding crisis is at the heart of financial pressures for many councils. A solution to social care funding would go a long way to restoring local government finances. Covid-19 has also hit councils hard and, while the Government responded to the pandemic with substantial financial support, they now need to come forward with a long-term sustainable way of funding councils and the services they provide.”

4.3 He went on to say “The system of local government finance should enable councils to increase revenue by growing their tax base while protecting those councils who are less able to do this, through no fault of their own. To this end, the Government should implement the Fair Funding Review and business rates reset as soon as possible and allow councils to retain 75% of business rates from 2022. So that this represents a net increase in funding, we urge the Government not to impose commensurate cuts to grant funding, and the additional funding should then be put towards equalisation between councils. In the longer-term, the Government should consider options for wider reform of council tax and business rates, including possibly replacing them with a proportional property tax.” However, recent announcements have indicated that the Fair Funding Review is unlikely to go ahead.

4.4 The degree of uncertainty over medium term funding can be related to the following issues in particular:

- The increasing likelihood of councils issuing ‘S114’ notices, allied to the requirements of the Financial Management Code for transparency in the sustainability of individual local authorities.
- The continuing increase in pressures.
- The need to maintain a significant and risk assessed level of reserves over the medium term.

- The increasing difficulty in making significant and sustainable budget reductions.

4.5 In Local Government, the Chief Finance Officer, also known as the Section 151 Officer (S151 Officer), has the power under the Local Government Finance Act 1988 to issue a S114 notice if there is a significant risk that an authority will not be able to deliver a balanced budget by the end of the current financial year. This is an emergency situation, whereby a response is required by legislation. Councillors have 21 days from the issue of a S114 notice to discuss the implications at a Full Council meeting.

4.6 The notice means that no new expenditure is permitted, except for safeguarding vulnerable people and statutory services and continuing to meet existing contractual obligations. Council officers must therefore carry out their duties in line with contractual obligations and to acceptable standards, whilst being aware of the financial situation. Any spending that is not essential or which can be postponed should not take place and essential spend is monitored. The only allowable expenditure permitted under an emergency protocol includes the following categories:

- Existing staff payroll and pension costs.
- Expenditure on goods and services which have already been received.
- Expenditure required to deliver the council's provision of statutory services at a minimum possible level.
- Urgent expenditure required to safeguard vulnerable residents.
- Expenditure required through existing legal agreements and contracts.
- Expenditure funded through ring-fenced grants.
- Expenditure necessary to achieve value for money and/or mitigate additional in year costs.

4.7 Three councils have issued S114 notices in the last three years - Northamptonshire in 2018, Croydon in late 2020, and Slough in July 2021.

4.8 This report gives information on two recent publications by DLUHC on local authority financial sustainability and S114 notices, of which Audit Committee should be aware, along with information on assessment of the Council's position. It should be read alongside the following report to this Council meeting: Assessment of Going Concern Status 2020-21, which informs Audit Committee of the Council's Director of Finance &

ICT's assessment, as Section 151 Officer, of the Council's status as a 'going concern' for the purpose of producing its Statement of Accounts for 2020-21.

Government Response to the Select Committee Report

4.9 In October 2021 DLUHC published its response to the Select Committee's report on Financial Sustainability and the S114 Regime.

4.10 The value of local government and the vital role the sector plays in delivering key public services is recognised, as well as the challenges the sector is currently facing. DLUHC states that it will work to provide a sustainable financial footing, enabling delivery of vital frontline services and supporting other government priorities. In taking stock to determine any future reforms it will consider the impact of the pandemic on local authority resources and service pressures.

4.11 The report includes responses to thirteen recommendations on social care, funding, Covid-19, local authority commercial investment and audit and control. These responses are included in full at Appendix 2 to this report and are summarised below against the recommendations raised.

4.12 ***The funding of social care in England should urgently be reformed***
Funding already provided. The Government has committed to investing an additional £5.4 billion over three years, which will allow it to begin a comprehensive programme of reform for adult social care. This includes protecting individuals from unpredictable costs and major improvements to the wider social care system in England. The Government will work with care users, providers, and other partners to co-develop more detail on these plans and publish further detail in a White Paper for reform later this year.

4.13 ***The Fair Funding Review and business rates reset should be implemented as soon as possible, as the quickest way of partly restoring the link between funding and need***
The Government announced last year that it would not proceed with the implementation of the Review of Relative Needs and Resources (formerly the Fair Funding Review) and 75% Business Rates Retention in 2021-22 and also decided not to reset accumulated business rates growth in 2021-22. The Government now needs to take stock of the impact of the pandemic on both local authority resources and service pressures, to determine the direction of local government finance reform. However, recent announcements have indicated that the Fair Funding Review is unlikely to go ahead.

4.14 ***Council Tax should be reformed by undertaking a revaluation of properties and introducing additional council tax bands***
The Government has no plans to replace or fundamentally reform Council Tax. A revaluation would be expensive to undertake and could result in increases to bills for many households. Given that Council Tax is retained locally, a revaluation would not address the disparity between strength of Council Tax base and need. The Government recognises that councils have differing abilities to generate income from Council Tax and ensures that the Local Government Finance Settlement takes these into account when the distribution of funding is determined each year. The Government has also equalised against the adult social care precept since its introduction, ensuring that funding - including that raised through the precept - is distributed in line with its assessment of relative need.

4.15 ***The funding base of local government should be widened to make it less vulnerable to shocks, including giving councils more flexibility over local taxes and other revenue-raising powers***
Through the Chancellor's Fundamental Review of Business Rates, the Government is considering options for reforming the business rates system. The Review's Call for Evidence, published in July 2020, sought views on a range of potential reforms. Within the existing system, the Review also explored whether business rates reliefs and exemptions should be set locally, and options for greater local flexibility to adjust the multipliers. The Review will conclude in the Autumn. On 27 October 2021, in the Spending Review 2021 (SR 2021), a reform of business rates was announced, including a significant tax cut for retail, hospitality and leisure industries. Local authorities will be fully compensated for the loss of income as a result of these business rates measures and will receive new burdens funding for administrative and IT costs. There will be additional compensation for under-indexation of the Business Rates multiplier, including the gap between CPI and RPI inflation rates. It was also announced that there will be more frequent Business Rates revaluations, which will be every three years from 2023. Around £1.6bn of new funding is to be allocated over each year of the SR 2021 period, for social care and other services. This is the largest increase in core local government funding in over a decade. Funding for the additional cost of NI for Social Care is included in this new funding. A further £3.6bn of the £5.4bn of funding for adult social care reform announced on 7 September 2021 will be routed through local government, to implement the cap on personal care costs and changes to the means test.

4.16 ***Business rates should be reformed***
The Government is continuing to consider options for reforming the business rates system. The Chancellor's Fundamental Review of Business Rates is looking at how the system currently works, issues to be addressed, and ideas for change. Amongst other options for reform, the Government continues to consider whether there is a case for introducing an online sales tax as part of the Review.

4.17 ***The next financial settlement for local government must be a multi-year settlement***
Government agrees that a stable funding environment ensures local authorities can plan effectively and recognises that multi-year settlements provide certainty. The approach to the next settlement will be informed by the ongoing Spending Review, which will be an opportunity to consider local government's funding needs in the round. Government appreciates that multiple, competitive funds bring challenges to local councils and is exploring opportunities to simplify the system, whilst recognising that there will be cases where competitions or ringfences are helpful in ensuring value for money.

4.18 ***Ways of mitigating the uneven Covid-19 financial support across local authorities should be considered, providing greater certainty to councils over what future costs incurred as a result of the pandemic it intends to cover***
The Government is continuing to use monitoring information and engagement with the sector to inform its work on the ongoing Spending Review. The Government recognises that there will be individual authorities with either unique circumstances or residual issues resulting in significant pressures and will continue to work with them and keep the situation under review.

4.19 ***Legislation should be introduced to make compliance with the Prudential Code by local authorities a statutory duty***
CIPFA is making changes to its statutory codes to make clearer that authorities must not invest principally for yield. Government has worked closely with CIPFA in developing the amendments. The new codes are in consultation with planned implementation from April 2022. The programme of work will strengthen the capital system and compliance with the Prudential Framework. The actions take a holistic approach to strengthening the system at multiple points using 'three lines of control':

- Detection of risks through scrutiny and transparency, including improving Government's data for monitoring sector risk.
- Supporting processes at local level over decisions making and risk management by working with partners to improve local capability.

- Strengthening the Prudential Framework itself, including tightening legislation on the Minimum Revenue Provision duty and application of the statutory borrowing capping powers.

4.20 ***Data collected by the Government on local authority commercial investment should be improved***
The most recent data already demonstrates that both new borrowing and commercial investment decreased significantly in 2020-21 relative to 2019-20. Government is improving its monitoring of the sector and its early identification of risk. Local authorities are now required to submit three-year capital spending and borrowing plans in order to access the Public Works Loan Board (PWLB). Government is reviewing all submitted plans to assess the capital plans submitted to determine whether the information provided is compatible with the PWLB's lending terms, including that the local authority is not borrowing for yield. The information in the plans will be used alongside other data to improve Government's monitoring of the sector.

4.21 ***The ability of local authorities to choose their own auditors should be removed***
While local bodies have the power to appoint their own auditors, the large majority of principal bodies to date have chosen not to, with 98% of such bodies choosing to opt-in to the appointing person arrangements overseen by PSAA from 2018-19 to 2022-23, whereby PSAA appoint auditors on their behalf. Whilst opting-in to PSAA's procurement arrangements is optional, local bodies may determine that the scheme continues to offer a valuable alternative to making their own arrangements, particularly given ongoing issues of market fragility and the limited supply of qualified public auditors. The Government is confident that the broader checks and balances in the system, including the FRC's audit quality review framework, help to ensure that auditors will be confident to flag up issues that emerge. Local auditors provide an independent assessment and are required to report their findings, regardless of how they are appointed.

4.22 ***The new system leader (for audits) should be able to join up individual auditor findings with a view to identifying systemic issues across local government***
Agreed.

4.23 ***The Section 114 regime should be changed to provide Chief Finance Officers with intermediary measures that can be applied at a much earlier stage to highlight concerns before a council's finances deteriorate so far as to require a section 114 notice***

S114 notices are an important and effective part of the local government finance system, as both a legal mechanism and as a spending control for councils that have particular issues in setting or maintaining a balanced budget. However, S114 notices exist within a wider system of checks and balances, such as the statutory requirement for S151 Officers to report on the robustness of budget estimates and adequacy of reserves as part of the annual budget setting process; or the additional powers and duties afforded to external auditors under the Local Audit and Accountability Act 2014, for example to issue statutory recommendations or reports in the public interest, to highlight concerns about an authority's finances. This means Government expects councils to take a number of steps to address financial challenges before reaching a point where issuing a notice is necessary.

4.24 ***Chief Finance Officers should report to both the Executive and appropriate scrutiny committees on a quarterly basis on the state of local authority finances and, in particular, draw attention to potential serious financial problems***

The Government agrees that it is essential that S151 Officers are afforded appropriate input into decision making processes, and there are clear existing duties for them to report on serious financial problems through the S114 framework and the requirement for reporting on the adequacy of reserves. Effective financial governance is essential to the proper functioning of local government and a core part of a council's meeting the 'best value' duty. Steps are being taken to strengthen local government audit committee arrangements. In the local audit framework: technical consultation published on 28 July 2021, the Government set out proposals for updated guidance relating to audit committee arrangements, including the appointment of independent members, and that Accounts and Audit Regulations are amended so that Full Council should receive the Auditor's Annual Report, accompanied by a report from the Audit Committee with responses to the Auditor's Annual Report. This consultation also reaffirmed the expectation that auditors must have appropriate powers and opportunities to meet with the appropriate statutory officers, including Chief Finance Officers.

Local Government Finance Review of Slough Borough Council

4.25 In October 2021 DLUHC published a report on the Local Government Finance Review of Slough Borough Council (SBC), following its issuing a S114 notice in July 2021, requesting exceptional financial support in respect of the financial year 2021-22, to help it balance its budget by raising capital borrowing to support some of its revenue expenditure.

4.26 Accordingly, DLUHC agreed in-principle to provide support and commissioned the Chartered Institute of Public Finance and Accountancy (CIPFA) to undertake an independent and detailed financial assurance review of SBC. Since the original capitalisation request for 2021-22, SBC has identified further substantial liabilities for previous years, which it is unable to meet from its reserves. These liabilities also impact substantially on the financial position for SBC in the current financial year and beyond.

4.27 The current financial challenge facing SBC is acute. The S151 Officer issued a statutory S114 notice in July 2021, which set out total potential liabilities across SBC of some £174m up to 2024-25. At this stage, and as recognised by the S151 Officer, this figure could still grow, due to further risks faced by SBC.

4.28 SBC cannot become a financially self-sustaining council without considerable Government support that allows it to increase its borrowing to fund these liabilities in the short-term to medium-term, pending the sale of substantial SBC assets in the region of £200m. The S151 officer considers that it may need to achieve asset sales of twice this amount (£400m) if it also wants to reduce the level of its external borrowing and significantly reduce the scale of its ongoing budget gap.

4.29 SBC's record in delivering substantial savings is a mixed one and many of the savings identified in the last two years' budgets have proved to be unrealistic. It has also not made some of the tough financial decisions that other councils have taken to balance their budget. This means that there is considerable uncertainty around its ability to deliver the savings it needs to deliver both in the short and medium term.

4.30 At this stage, assurance cannot be provided that SBC will be able to balance its budget in the medium to long term. This does not reflect any lack of commitment from SBC but instead the size and scale of the financial challenge relative to the budget. In particular this recognises:

- The scale of the current and potential liabilities faced by SBC relative to its revenue budget.

- The potential for the scale of liabilities to increase even further as further investigative work is undertaken particularly around SBC-owned companies.
- The unprecedented level of savings that SBC would need to make over the period of its Medium-Term Financial Plan.
- SBC will find it difficult to deliver substantial savings from statutory services which account for some two thirds of its budget.
- SBC does not have a good track record in delivering savings.
- Future financial viability and savings depend on a major disposal of SBC assets of up to £400m, which may take considerable time if SBC is to achieve best value.

4.31 The conclusion is that SBC will require immediate Government support in the form of a capitalisation direction of some £112m. Of this sum, £52.8m is required to cover estimated past liabilities up to the end of March 2021 and a further £58.9m is needed to cover potential liabilities for the current financial year 2021-22.

4.32 In addition, SBC will need further support of some £33.2m if it is to set a balanced and legal budget for 2022-23 in line with its Medium-Term Financial Plan. It then needs a further £29.3m in the following two years, making a total of some £174m, to set a balanced budget over the period of the Medium-Term Financial Strategy. The need to account appropriately for the minimum revenue provision amounts to some £62m of the total projected £174m liability. At this stage, all of these figures are indicative and could be influenced by a range of economic and demographic factors as well as Government decisions as part of any Spending Review.

4.33 In view of the scale of the capitalisation direction required and the fragility of SBC's finances, a need for ongoing oversight of financial plans has been identified, to ensure that SBC is making the progress that it needs to make in starting to rebalance its budget. A list of key milestones, each representing a gateway review for independent evaluation, have been set out through to May 2023. Failure to pass each of these gateways will serve as an indication that SBC will not be able to balance its budgets in the medium to long term. In such circumstances, other more fundamental or structural changes around the future of SBC would need to be considered.

4.34 Issues are identified in the report which must be addressed as part of the work the S151 Officer is taking to strengthen financial sustainability and financial governance and oversight. Addressing these issues by implementing the recommendations in the report should help meet the financial challenge, restore financial management and manage the level of potential capitalisation that SBC will require. These recommendations are included in full at Appendix 3 to this report and are listed below:

- Establish a detailed plan to close the short and long-term budget gap.
- Establish a high-level risk register.
- Set limits on future borrowing and capital spending.
- Gain increased assurance concerning the potential scale of past and future liabilities.
- Develop an outline asset disposal plan to provide the funds required for the capitalisation directive.
- Raise Member awareness of the scale of the financial challenge and its implications.
- Address immediate financial governance risks.
- Prepare an Annual Governance Statement for 2020-21.
- Undertake an independent review of the procurement function.
- Review the provision of internal audit.
- Enhance financial capacity.
- Stabilise the finance leadership team.

Derbyshire County Council's Position

4.35 In February 2021 the Council's Director of Finance & ICT, as S151 Officer, concluded that the Council could set a balanced budget for 2021-22 and across the period of the Five Year Financial Plan (FYFP) and that it remained a 'going concern', although difficult decisions and strong, robust financial management would continue to be required. The following matters were considered in arriving at this conclusion:

- The Council has a well-established and robust corporate governance framework. This includes the statutory elements like the post of Monitoring Officer and the S151 Officer, in addition to the current political arrangements. The Council's Annual Governance Statement process has not identified any material issues that may significantly impact on the Council's Financial Resilience, except for the impact of Covid-19 on financial sustainability, which has been considered. The Council is working with the Local Resilience Forum on Covid-19 recovery. The Council's focus is still firmly on the response activities and the Council is working with a range of partners locally and regionally on a Covid-19 recovery programme.

- As a principal local authority, the Council has to operate within a highly legislated and controlled environment. An example of this is the requirement to set a balanced budget each year, combined with the legal requirement for the Council to have regard to consideration of such matters as the robustness of budget estimates and the adequacy of reserves. In addition to the legal framework and Government control, there are other factors, such as the role undertaken by the external auditor, as well as the statutory requirement, in some cases, for compliance with best practice and guidance published by CIPFA and other relevant bodies. For example, the Council has measured itself against the principles set out in CIPFA's Financial Management Code and is confident that it is achieving these in all substantive areas.

- Against this backdrop it is considered unlikely that a local authority would be 'allowed to fail', with the likelihood being that when faced with such a scenario, that Government would intervene, supported by organisations such as the Local Government Association, to bring about the required improvements or maintain service delivery.

- Whilst the Council has deployable resources and assets at its disposal in the short to medium term, there remains a risk to its financial sustainability in the longer term from costs associated with Covid-19 and of not achieving substantial budget savings.

- It is unclear how much further Government support will be provided to cover the costs resulting from the pandemic; these costs are expected to be well in excess of the support already provided. Although the immediate impact of losses on the Council Tax and Business Rates collection funds has been eased, by allowing these costs to be spread over three years instead of one, the Government's has only committed to reimburse councils for some of these losses. It is also apparent that Government will only provide compensation for some of the Council's lost income from fees and charges. Consideration will be required as to how the Council can react to replace these income streams if they fail to recover to pre-Covid-19 levels.

- Despite these risks, the Council has sufficient reserves it can deploy to meet the anticipated funding shortfall, should it be required to do so. If it were to use its reserves for this purpose, however, this would significantly impact on the funding of the Council's planned improvements, delay some savings plans and require additional general reserves to be set aside in order to ensure that the balance of general reserves remains at a prudent risk-assessed level. Due to the Council's Treasury Management Strategy over the last decade being to use internal borrowing, rather than take on new long-term external borrowing, the Council has head-room, within the scope of its powers under the Prudential Framework, to take on additional external borrowing to preserve the liquidity of its cash flow, should it need to do so.

- Experience and investigations into those councils experiencing financial failure demonstrates that periods of lower than allowed Council Tax rises can contribute significantly to exacerbate other financial issues, such as reducing Government support, increasing budget pressures, an overly-optimistic savings programme or lack of strength on the Balance Sheet.

4.36 It is clear from the report into SBC that it is vital that budget savings are delivered according to realistic plans and that tough decisions are taken to balance the budget.

4.37 A further report to this Audit Committee meeting: 'Assessment of Going Concern Status 2020-21' informs Audit Committee of the S151 Officer's updated assessment of the Council's status as a going concern, for the purpose of producing its Statement of Accounts for 2020-21. This status will be reassessed at the time of production of the Council's budget for 2022-23 and across the period of the FYFP and will be presented to Full Council for approval in February 2022.

5. Consultation

5.1 No consultation is required.

6. Alternative Options Considered

6.1 N/A – this report advises Audit Committee on two reports from DLUHC on local authority financial sustainability and the S114 regime, along with information on assessment of the Council's position.

7. Implications

7.1 The implications are detailed at Appendix One.

8. Background Papers

8.1 Papers held electronically by Financial Strategy, Finance & ICT, Room 137, County Hall.

9. Appendices

9.1 Appendix 1 – Relevant implications considered in the preparation of the report.

9.2 Appendix 2 – DLUHC Report on Financial Sustainability and the Section 114 Regime – Recommendations and Responses.

9.3 Appendix 3 – DLUHC Local Government Finance Review – Slough Borough Council – Issues and Recommendations.

10. Recommendations

That Audit Committee:

10.1 Notes the DLUHC response to the Housing, Communities and Local Government Select Committee's report on Local Authority Financial Sustainability and the S114 Regime and the DLUHC report on the Local Government Finance Review of Slough Borough Council, following its issuing a S114 notice, along with information on the assessment of the Council's going concern position.

11. Reasons for Recommendations

11.1 It is prudent and responsible practice for Audit Committee to be kept informed of DLUHC reports relating to financial sustainability and the S114 regime, accompanied by information to sign post previous and future assessments of the Council's position.

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This report has been approved by the following officers:

On behalf of: Director of Finance and ICT Director of Legal Services and Monitoring Officer	

Implications

Financial

1.1 As outlined in the body of the report.

Legal

2.1 As outlined in the body of the report.

Human Resources

3.1 None.

Information Technology

4.1 None.

Equalities Impact

5.1 None.

Corporate objectives and priorities for change

6.1 The Council is committed to ensuring good financial management and compliance with applicable laws and regulations.

Other (for example, Health and Safety, Environmental Sustainability, Property and Asset Management, Risk Management and Safeguarding)

7.1 None.

DLUHC Report on Financial Sustainability and the Section 114 Regime

Recommendations and Responses

Social Care

Recommendation One:

The failure to properly fund children's and adult social care, especially adult social care, is the single biggest threat facing local government financial resilience. Given that the cost of providing social care consumes between 60% and 70% of the budgets of top-tier councils, a solution to this funding crisis alone could largely restore local government finances. The Government's current policy of effectively forcing local councils to impose successive above-inflation council tax rises is imposing additional burdens on council taxpayers. It is disappointing that the recent Queen's Speech made so little mention of plans to reform social care funding. We are also concerned about the cuts to more discretionary services arising from councils' need to prioritise social care provision. ***We recommend that the Government urgently reform the funding of social care in England.***

Government response:

Since the start of the pandemic, we have committed over £12 billion in financial support to councils to tackle the impacts of COVID-19, including over £6 billion of un-ringfenced grants (£4.6 billion for 2020/21 and £1.55 billion for 2021/22) which can be used on social care. At a national level, 32% of the additional £6 billion has been allocated to adult social care, equivalent to £1.9 billion and 8.9% has been allocated to children's social care, equivalent to £521 million.

Throughout the pandemic, we have also made available over £2 billion in specific funding for adult social care. This is made up of the £1.49 billion Infection Control Fund, £396 million Rapid Testing Fund and £120 million Workforce Capacity Fund. In addition, in 2021/22 we are providing councils with access to over £1 billion of additional funding for social care, through a £300 million increase to the social care grant, and enabling up to a further £790 million of new funding though a 3 per cent adult social care precept.

We are committed to the delivery of world-leading health and social care across the whole of the UK, and our 7 September 2021 announcement marked an important step on the journey to reforming adult social care. We have committed to investing an additional £5.4 billion over three years, which will allow us to begin a comprehensive programme of reform for adult social care. This includes protecting individuals from unpredictable costs and major improvements to the wider social care system in England. We will work with care users, providers, and other partners to co-develop more detail on these plans and publish further detail in a White Paper for reform later this year.

Funding

Recommendation Two:

We recommend that the Government implement the Fair Funding Review and business rates reset as soon as possible, as the quickest way of partly restoring the link between funding and need. *The Government should also allow councils to retain 75% of business rates from 2022, but so that this represents a net increase in funding, we urge it not to impose commensurate cuts to grant funding. The additional funding should then be put towards equalisation in a separate grant designed for this purpose. We also urge the Government to clarify what level of funding equalisation it considers to be appropriate for local government.*

Government response:

The Government announced last year that it would not proceed with the implementation of the Review of Relative Needs and Resources (formerly the Fair Funding Review) and 75% Business Rates Retention in 2021/22. We also decided not to reset accumulated business rates growth in 2021/22. These decisions have allowed both the Government and councils to focus on meeting the immediate public health challenges posed by the COVID-19 pandemic, driving forward recovery and maintaining critical services. This decision was broadly welcomed across the sector. We now need to take stock of the impact the pandemic has had on both local authority resources and service pressures to determine the direction of local government finance reform. Decisions on the way forward will be taken at the ongoing Spending Review.

Recommendation Three:

The Government should reform council tax by undertaking a revaluation of properties and introducing additional council tax bands, in line with the recommendations of our predecessor Committee. *In the longer term, the Government should consider options for wider reform of council tax and business rates, including possibly replacing them with a proportional property tax.*

Government response:

Council tax provides stable income for local authorities to deliver a range of vital local services, and predictable bills for taxpayers. This certainty is particularly important as the country recovers and builds back from the pandemic. To ensure fairness, each council has its own local council tax support scheme to provide reductions in council tax for residents in financial need. The Government has provided councils with £670 million of new funding for these schemes in 2021/22. The Government has no plans to replace or fundamentally reform council tax. A revaluation would be expensive to undertake and could result in increases to bills for many households. The creation of higher council tax bands, which in itself would require a revaluation, may penalise people on fixed incomes, including pensioners, who could face a substantial tax rise without having the income to pay the higher bill. Given that council tax is retained locally, a revaluation would not address the disparity between strength of council tax base and need. The Government recognises that councils have differing abilities to generate income from council tax and ensures that the Local Government Finance Settlement takes these into account when the distribution of funding is determined each year. It has also equalised against the adult social care precept since its introduction, ensuring that funding - including that raised through the precept - is distributed in line with its assessment of relative need.

Recommendation Four:

We recommend that the Government widen the funding base of local government to make it less vulnerable to shocks such as the COVID-19 pandemic, including by giving councils more flexibility over local taxes and other revenue-raising powers. *This would also align with giving local authorities more powers over spending, which we will consider in our future report on devolution in England. Giving local government more powers to raise and spend money is a position supported by our predecessor Committee.*

Government response:

The Government considers that the current charging regime for individual services strikes the right balance between allowing councils to raise revenue to cover the cost of providing services and ensuring that service users are treated fairly and fully informed of costs incurred. For statutory services, the power to charge is prescribed by service specific legislation, which may specify the charging framework. For discretionary services, local authorities have the power to charge up to full cost recovery provided the user has agreed to be charged and there is no pre-existing legislation governing the charging regime. If local authorities wish to charge above cost recovery for services, they are able to do this commercially via a trading company.

It has always been the case that council tax decisions are taken by local authorities. In line with its manifesto commitment, the Government continues to maintain a referendum threshold to ensure that local residents can have the final say over excessive increases. The Government has set varied referendum thresholds from year to year and for different types of local authority to reflect differing circumstances, following annual consultation with the sector. The principles – which are approved by the House of Commons each year – are not a cap and it is open to an authority to set a larger increase and make the case for it to voters.

The Government has also responded to requests for local flexibility through providing councils with greater discretion over a number of council tax discounts, levels of empty homes premium and the design of local council tax support schemes.

Through the Chancellor’s Fundamental Review of Business Rates, the Government is considering options for reforming the business rates system. The Review’s Call for Evidence, published in July 2020, sought views on a range of potential reforms, including options for alternative taxes to either replace of complement the business rate system. Within the existing system, the Review also explored whether business rates reliefs and exemptions should be set locally, and options for greater local flexibility to adjust the multipliers. The Review will conclude in the Autumn.

In addition, following the Prime Minister’s statement on 7 September, revenue from a new Health and Social Care Levy will go to local authorities.

Recommendation Five:

We also recommend that the Government reform business rates, in particular by finding a mechanism by which to level the playing field between bricks-and-mortar and online retailers. *This is an issue we will return to in our upcoming report on supporting high streets after COVID-19.*

Government response:

In response to the pandemic, the Government provided eligible retail, hospitality, and leisure properties with a business rates relief worth a total of £16 billion across 2020/21 and 2021/22. This comes on top of a range of business rates measures introduced since 2016 which are worth around £15 billion over the next five years.

The Government is continuing to consider options for reforming the business rates system and the Chancellor is currently carrying out a Fundamental Review of Business Rates. This Fundamental Review is looking at how the system currently works, issues to be addressed, and ideas for change. Stakeholders were invited to provide their views on the tax as part of the Review's call for evidence and these responses were summarised in the Interim Report published on 23 March. Amongst other options for reform, the Government continues to consider whether there is a case for introducing an online sales tax as part of the Fundamental Review of Business Rates. The Review will conclude in the autumn.

Recommendation Six:

The next financial settlement for local government must be a multi-year settlement. *The Government should also consolidate the number of small and ring-fenced grants, which can limit local authorities' ability to provide services flexibly, and should reduce the number of bidding processes, which can be burdensome and time consuming.*

Government response:

Government agrees that a stable funding environment ensures local authorities can plan effectively and recognises that multi-year settlements provide certainty. The approach to the next settlement will be informed by the ongoing Spending Review, which will be an opportunity to consider local government's funding needs in the round.

We appreciate that multiple, competitive funds bring challenges to local councils. We are exploring opportunities to simplify the system, while recognising that there will be cases where competitions or ringfences are helpful in ensuring value for money.

COVID-19

Recommendation Seven:

We urge the Government to consider ways of mitigating the uneven financial support across local authorities and provide greater certainty to councils over what future costs incurred as a result of the pandemic it intends to cover.

Government response:

Providing certainty and stability to the sector throughout the pandemic has been a priority for the Government. The Government has demonstrated this by committing over £12 billion to councils in England to tackle the impacts of COVID-19, over £6 billion of which was unringfenced.

Tranches 3 and 4 of our support through the pandemic alongside the additional £1.55 billion of unringfenced funding for 2021/22 distributed expenditure grant based on need through the COVID-19 Relative Needs Formula (RNF). This new formula was designed to account for population, deprivation and the varying costs of delivering services across the country.

The Government has always ensured that funding is distributed according to need to local authorities, with each funding allocation informed by the latest assessment of pressures reported by councils. We have continued to work with local government, including through tailored financial monitoring. The Government is continuing to use monitoring information and engagement with the sector to inform its work on the ongoing Spending Review.

The Government recognises that there will be individual authorities with either unique circumstances or residual issues resulting in significant pressures. We will continue to work with them and keep the situation under review.

Local Authority Commercial Investment

Recommendation Eight:

We recommend that the Government legislate to make compliance with the prudential code by local authorities a statutory duty.

Government response:

Under the current system, primary legislation sets out that local authorities must have regard to the four statutory codes produced by Government and CIPFA, which includes the Prudential Code. Local authorities must appropriately comply with the codes unless there are clear reasons for departure.

In response to PAC's recommendations on LA commercial investments, CIPFA is making changes to its statutory codes to make clearer that authorities must not invest principally for yield. Government has worked closely with CIPFA in developing the amendments. The new codes are in consultation with planned implementation from April 2022.

Government's programme of work will strengthen the capital system and compliance with the Prudential Framework. This reinforces the Government's message to the sector and sets out clearly the actions Government is taking. The actions take a holistic approach to strengthening the system at multiple points using 'three lines of control':

1) detection of risks through scrutiny and transparency, including improving Government's data for monitoring sector risk;

2) supporting processes at local level over decisions making and risk management by working with partners to improve local capability; and

3) strengthening the Prudential Framework itself. Including tightening legislation on the Minimum Revenue Provision duty and application of the statutory borrowing capping powers.

Recommendation Nine:

The Government should also make good on its commitment to improving the data it collects on local authority commercial investment.

Government response:

In reviewing the capital system, Government has drawn on the evidence from its continued monitoring of sector data and sector engagement, and evidence that has come to light from those authorities that have approached Government for emergency financial support. The most recent data already demonstrates that both new borrowing and commercial investment decreased significantly in 2020/21 relative to 2019/20.

Government is improving its monitoring of the sector through improved data collection and intelligence gathering. Government has now completed the voluntary data survey to gather additional information on sector behaviour and is now using the findings to implement permanent changes to its regular data collection from February 2022.

Government is also improving its early identification of risk, by developing additional metrics to use our data and qualitative information in a tool for the earlier identification of risky capital practices. This will be used alongside targeted engagement to address risk and non-compliance in a more timely way.

Lastly, local authorities are now required to submit three-year capital spending and borrowing plans in order to access the Public Works Loan Board (PWLB). Government is reviewing all submitted plans to assess the capital plans submitted to determine whether the information provided is compatible with the PWLB's lending terms, including that the local authority is not borrowing for yield. The information in the plans will be used alongside other data to improve Government's monitoring of the sector.

Audit and Control

Recommendation Ten:

We recommend the Government remove the ability of local authorities to choose their own auditors. *The risk is that auditors will be reluctant to flag up potential problems for fear of losing their contract. The Government should consider who will be best placed to appoint local authority auditors, given that it should not be local authorities themselves, and ARGA doing so could lead to a conflict of interest.*

Government response:

In September 2020, Sir Tony Redmond published his review of local authority financial reporting and external audit. Since then, the Government has undertaken a range of activities in response to all 23 of Sir Tony's recommendations. This includes extending audit deadlines from July to September for two years, amending regulations to increase flexibilities to ensure that audit firms can more easily claim for the full costs of audit and providing £15 million to local bodies to help with the costs of audit. Also, strengthening local audit arrangements, and confirming our intention to establish the Audit, Reporting and Governance Authority (ARGA), as the new system leader for local audit.

The Government has also reiterated its view that there should be independence between the procurement of audit services and audit quality oversight and monitoring functions. Additionally, the Public Sector Auditor Appointments Ltd (PSAA) is the organisation best placed to act as the appointing body. This includes overseeing the next opt-in bulk procurement, due to their technical expertise and the proactive work they have done to help identify improvements that can be made to the process[1].

While local bodies have the power to appoint their own auditors, the large majority of principal bodies to date (all bar nine) have chosen not to, with 98% of such bodies choosing to opt-in to the appointing person arrangements overseen by PSAA from 2018/19 to 2022/23, whereby PSAA appoint auditors on their behalf. While opting-in to PSAA's procurement arrangements is optional, local bodies may determine that the scheme continues to offer a valuable alternative to making their own arrangements, particularly given ongoing issues of market fragility and the limited supply of qualified public auditors.

The Government is confident that the broader checks and balances in the system, including the FRC's audit quality review framework, help to ensure that auditors will be confident to flag up issues that emerge. Local auditors provide an independent assessment and are required to report their findings, regardless of how they are appointed.

Maintaining around the appointment of local auditors will also help to provide continuity, given the proximity of PSAA's next procurement exercise, which is due to launch shortly, for completion by June 2022. However, the Government will be taking the views of stakeholders into consideration through its recent local audit framework: technical consultation and will keep all existing arrangements under review.

[1] See https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical consultation paragraphs 77-88.

Recommendation Eleven:

We also ask the Government to confirm that the new system leader will be able to join up individual auditor findings with a view to identifying systemic issues across local government. *Without a central body responsible for oversight of the sector, we see no way of ensuring a robust and transparent regime of local audit.*

Government response:

We agree that it is important that the new system leader will be able to join up individual auditor findings with a view to identifying systemic issues across local government. In the recent local audit framework: technical consultation, the Government strongly agreed with Sir Tony Redmond's recommendation that the system leader for local audit should have responsibility for producing annual reports summarising the state of local audit[2].

The consultation proposes that ARGA's statutory function as local audit system leader will form a distinct, standing element of ARGA's annual reporting, potentially as a separate annex to the main annual report which ARGA produces. And that, in addition to reporting against its own system leader objective, this would be an important mechanism for ARGA to report to the Department for Levelling Up, Housing and Communities on the state of the local audit market, as well as to inform the Department for Levelling Up, Housing and Communities' stewardship of the local government accountability framework. This could include detail summarising the results of audits, similarly to Public Sector Auditor Appointments (PSAA) previous reporting, as well as identifying emerging themes and issues facing local bodies.

The consultation seeking views on this closed on 22 September, and the Government is now analysing the responses to this as it develops its thinking further.

[2] See https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical consultation paragraphs 58-62

Recommendation Twelve:

We recommend that the Government consider changing the section 114 regime to provide Chief Finance Officers with intermediary measures that can be applied at a much earlier stage to highlight concerns before a council's finances deteriorate so far as to require a section 114 notice.

Government response:

Section 114 notices are an important and effective part of the local government finance system as both a legal mechanism and as a spending control for councils that have particular issues in setting or maintaining a balanced budget. However, Section 114 notices exist within a wider system of checks and balances, such as the statutory requirement for Section 151 Officers to report on the robustness of budget estimates and adequacy of reserves as part of the annual budget setting process; or the additional powers and duties afforded to external auditors under the Local Audit and Accountability Act 2014, for example to issue statutory recommendations or reports in the public interest, to highlight concerns about an authority's finances. This means we would expect councils to take a number of steps to address financial challenges before reaching a point where issuing a notice is necessary.

Recommendation Thirteen:

We also recommend that Chief Finance Officers report to both the Executive and appropriate scrutiny committees on a quarterly basis on the state of local authority finances and, in particular, draw attention to potential serious financial problems.

Government response:

The Government agrees that it is essential that Section 151 Officers are afforded appropriate input into decision making processes, and there are clear existing duties for them to report on serious financial problems through the Section 114 framework and Section 25 requirement for reporting on the adequacy of reserves. Effective financial governance is essential to the proper functioning of local government and a core part of a council's meeting the 'best value' duty set out in the Local Govt Act 1999.

Alongside this, we are also taking steps to strengthen local government audit committee arrangements. In the local audit framework: technical consultation published on 28 July, the Government set out proposals for updated guidance relating to audit committee arrangements, including the appointment of independent members, and that Accounts and Audit regulations are amended so that Full Council should receive the Auditor's Annual Report, accompanied by a report from the Audit Committee with responses to the Auditor's Annual Report. This consultation also reaffirmed the expectation that auditors must have appropriate powers and opportunities to meet with the appropriate statutory officers, including Chief Finance Officers.

DLUHC Report on Local Government Finance Review – Slough Borough Council

Issues and Recommendations

Recommendations on strengthening financial sustainability

A. On future sustainability: Establish a detailed plan to close the short and long-term budget gap

The Council has already produced a plan to improve financial management, but it now needs to set out clearly how it is going to rebalance its budget in the medium term in response to the S114 notice.

We recognise that work has already started to engage with Members on the approach that the Council will take. We also recognise that the scale of the problem means that a measured approach needs to be taken and the problem will take considerable time to resolve, if in fact it can be resolved.

The S.151 Officer needs to set out clearly how the Council will develop a plan to rebalance its budget and ensure that this has the support and commitment of both the Council's management team and all Councillors.

We recommend that: -

- The S151 Officer presents the plan for the steps needed to rebalance the budget to Council in October 2021 and seek Council approval for the Plan.
- The Council produces an outline plan to close its identified budget gap for 2022-23 (before taking account of additional Section 114 liabilities) by November 2021.
- The Council produces a longer-term outline plan for closing the MTFS budget gap by December 2021 with a view to formal approval of the budget and MTFS by February 2022.
- The Council produces detailed delivery plans for savings required over the MTFS by May 2022.

B. On future sustainability: Establish a high-level risk register

It is recognised that the S151 Officer is reviewing the Council's arrangements for the management of risk.

At this stage it is important the Cabinet and Senior Officers have a high level of awareness of the key financial and strategic risks that the organisation faces. This is essential if the organisation is to ensure that it effectively manages such risks and will help to inform future financial plans.

We recommend that: -
The Council reviews the existing risk register to identify the high-level risks facing the organisation and allocate a senior risk owner for each risk.

C. On commercial activities and borrowing: Set limits on future borrowing and capital spending

The Council already has one of the highest levels of borrowing, compared to other similar councils. In the short-term Council borrowing could rise to nearly £1bn, although it is appreciated that plans for asset disposals will significantly reduce this figure.

In the meantime, strict limits need to be placed on Council borrowing over and above any borrowing required to support the capitalisation direction. In turn this will impact on the size and scale of the capital programme.

In the first instance it would be appropriate for the Council to agree tight limits on further borrowing and ensure that any further capital investment is restricted to essential schemes required to repair, maintain, or replace existing assets.

We recommend that: -

- The Council sets very tight limits for future borrowing to enable it to better manage the subsequent revenue costs associated with repaying such debts.
- The Council restricts investment in its capital programme to essential schemes as identified above.

D. On commercial activities and borrowing: Gain increased assurance concerning the potential scale of past and future liabilities

The Council does not have robust arrangements for preparing accounts and it will take considerable time to put these arrangements in place.

We recognise the detailed plans that the S151 Officer is preparing for closure of the accounts and the reasonableness of this approach. The closedown plan focusses on key risk areas, including companies. We understand that it will be a considerable time before the Finance team can prepare reliable financial statements for 2019-20 and beyond.

Nevertheless, it is important that this does not prevent the Council gaining greater assurance over the potential scale of liabilities that it faces before it sets the budget for 2022-23.

We recommend that: -
The Council further reviews the risk-based approach to identifying liabilities to enable it to improve its assurance around the size and scale of current and future liabilities before it sets the budget for 2022-23.

E. On assets: Develop an outline asset disposal plan to provide the funds required for the capitalisation directive

We recognise that work is already underway to prepare an asset disposal plan for the Council.

The Council needs to consider the level of skill and expertise required to dispose of significant assets and obtain best value.

The disposal plan needs to consider the significant risks as it considers the disposal of a large part of its estate and the level of expertise it will require to value its assets and secure appropriate legal advice on any issues that may impede the disposal of assets or the achievement of best value.

The potential sums involved are substantial as are the risks if the Council does not approach the disposals in a structured way.

We recommend that: -
The Council formulates and agrees at an early stage its approach to asset disposals, including the issues identified in Section 6, and how it will secure the necessary expertise that it needs to achieve best value.

Recommendations on strengthening financial governance and oversight

F. Raise Member awareness of the scale of the financial challenge and its implications

Few councils have faced a financial challenge as severe as the one that Slough Council faces.

We recognise the initial steps that the S151 Officer has taken to provide effective briefings to Members on the scale of the financial challenge. Nevertheless, there is still a danger that this can be viewed as only a technical financial issue that will be resolved by the finance professionals.

The impact that this financial challenge will have on the way the Council operates and the services that it can deliver needs to be set out explicitly to Members along with the tough decisions that they will need to make.

Members will be faced with many difficult and challenging decisions over the next months and years and it is vital that they understand the Council's financial position when they consider these tough decisions.

Equally the oversight role provided by the Audit Committee is complex and essential for an organisation facing the challenges that Slough faces. It is important that members of the Audit Committee understand their role clearly and that this is part of the induction process for new Audit Committee members.

We recommend that: -

- Mandatory briefings are provided to all Members on the Council's financial challenge.
- Specific further training is provided to members of the Audit Committee to raise further awareness of their governance role and that this training is repeated as part of the induction process for all new members when they join.

G. Address immediate financial governance risks

It will take time to improve overall financial governance, but the Council needs to focus on immediate risks to ensure that its scheme of delegation operates effectively and that decisions are made at an appropriate level.

To some extent this risk is addressed currently by the Expenditure Control Panels, established as part of the Section 114 notice process. These are, however, only a short- 8 term measure. The Council needs to ensure that the Financial Management System reflects the delegations within the restructured organisation. It also needs to ensure that all staff including interim and agency staff are aware of their responsibility for financial management. In the medium term this will be assisted by a review of financial regulations.

We recommend that: -

- The Council strengthens key controls within its financial management system as set out above.
- The Council reviews financial regulations in the medium term
- The Council sets out clearly the financial responsibilities of all new staff, interim and agency staff when they commence work with the Council.

H. Prepare an Annual Governance Statement for 2020-21

The Council has not prepared an Annual Governance Statement for 2020-21 which means that it has not set out an up-to-date view of its governance and the actions needed to improve it.

The existing Annual Governance Statement for 2019-20 does not contain any action plan and the final assessment is now outdated and unrealistic given the challenges that the Council now faces.

We recommend that: -
An updated Annual Governance Statement and Action Plan should be prepared for consideration by the Audit and Governance Committee by December 2021.

I. Undertake an independent review of the procurement function

The procurement function plays an integral role in delivering sound financial governance. There is an urgent need to gain independent assurance that this function is operating effectively and, where necessary, to identify improvement that needs to be made.

The procurement function has not been subject to a detailed internal audit review in recent years and so little assurance can be gained that the function is operating effectively. We consider that the best way to do this is to commission an independent review of the procurement function, including commissioning and contract management, given that the Council’s internal auditors are currently contracted to deliver part of this service.

We recommend that: -
The Council commission a separate independent review of the procurement function, rather than including this within the annual internal audit plan.

J. Review the provision of internal audit

It is essential that the Council can rely on the quality of the work carried out by internal audit so that it can gain effective assurance from that work concerning both the steps to improve the financial governance of the organisation and the operation of key financial controls.

We recommend that: -
The Council commissions an independent review of the internal audit arrangements to ensure that they are effective and provide sufficient coverage to give it the assurance that it needs during this period of financial challenge.

K. Enhance financial capacity

The Section 24 recommendation issued by the External Auditor highlights the need to improve financial capacity.

We are concerned that the plans within the 'Our Futures' reorganisation do not enable an adequate finance function, particularly around expertise on technical and financial strategy, which is at the core of an effective finance team.

The finance team faces the dual challenge of not only rebalancing the Council budget but also restoring sound and effective financial management across the organisation. We share the concern of the External Auditors on the capacity of the finance team to deliver on both of these dual challenges.

The S151 officer's immediate plans to restore sound financial management are reasonable. They set out the key issues that need to be addressed in response to the Section 24 notice and key financial risks. This plan is being delivered by a small number of mainly interim staff, who face the same deadline of multiple significant tasks. We therefore consider that there is a high risk in terms of delivery of this plan without additional finance capacity.

We recommend that: -

- The S151 officer reviews the level of resource required to deliver the plan for restoring sound financial management
- The organisation makes further provision to enhance the capacity within the finance team including exploring other delivery avenues, such as the use of shared services.
- The Council commissions an independent review to demonstrate that financial procedures and processes are robust by May 2023.

L. Stabilise the finance leadership team

We recognise the significant contribution that many finance staff are making to address the financial challenge facing the Council. It is crucial for the Council to retain the current S151 officer and his team if the Council is to stabilise and strengthen the finances.

Nevertheless, there is a substantial risk that as the S151 Officer is on an interim contract and that he is largely supported by a group of experienced interim staff, they could leave the organisation with little notice. There is an equal concern that this would also lead to a substantial loss of corporate memory and hinder plans to address the financial challenge.

We recognise that the S151 officer intends to set out a new finance structure in October. Given the scale of the risks involved, we believe that more immediate action is needed to address this issue.

We recommend that: -

- The S151 officer immediately commences the appointment process for a permanent Deputy S151 Officer.
- The Council seek to re-negotiate the contractual terms for the S151 officer and his team to extend the notice period they are required to give prior to departure.