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The Committee of Public Accounts

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Summary

After seven years of government funding reductions totalling nearly 50% and rising demand for services, local authorities are under real strain. Key services that support vulnerable people, such as social care and housing, are now under enormous pressure. Other important local services in areas such as planning, transport, and cultural services have seen spending cut by between a third and a half. Local authorities face an estimated funding gap of over £5 billion by the end of the decade. The harsh reality is that more and more local authorities are now showing signs of financial stress such as overspending on services. They now face a period of greater uncertainty as their funding framework beyond 2019–20 is unclear.

The Ministry of Housing, Communities and Local Government (the Department) has not yet developed a plan to secure their long-term financial future. It is not transparent enough about its understanding of the pressures faced by local authorities, meaning Parliament and the taxpayer cannot be sure that it genuinely understands or is addressing the issue. The Department is overly reliant on a favourable outcome from the 2019 Spending Review to address authorities' financial issues. This is particularly complacent given that the previous Spending Review settlement resulted in many local authorities having to rely on reserves to fill the gaps in funding. This is an unsustainable situation. The recent announcement about additional money for the NHS did not include anything for social care. Given that social care is the other half of the equation, it is vital that there is a long-term solution.

Introduction

Since 2010–11 successive governments have reduced funding to English local authorities as part of their efforts to reduce the fiscal deficit. By 2017–18 government funding to authorities had fallen by 49.1% in real terms. Over the same period, local authorities have faced growing demand for key services such as adult and children's social care, and housing services, alongside new cost pressures such as the National Living Wage. While local authorities have coped well in absorbing these costs, there is now growing evidence of pressure in the system. Local authorities are increasingly reliant on unsustainable measures such as reducing debt costs or drawing down their reserves. Local authorities with social care responsibilities overspent their service budgets by over £1 billion in 2016–17, and there is evidence of service reductions across a number of areas such as waste collection, libraries and bus services.

The Department is responsible for the financial framework for local government which covers the distribution of government funding alongside other factors such as arrangements for business rates retention, council tax, and commercial investment. The Department also takes the lead on assessing the funding requirements of local authorities as part of Spending Reviews and supporting the financial sustainability of the sector by changing the overall financial framework if required. A number of other government departments are responsible for policies and services that are delivered by local authorities. For instance, the Department for Education has policy responsibility for children's social care services delivered by local authorities.

Conclusions and recommendations

1. **Seven years of funding reductions have left an increasing number of local authorities in a worrying financial position.** The spending power (government funding plus council tax) of local authorities as a whole has fallen 28.6% since 2010–11. This has coincided with a growth in demand in key services, such as a 14.3% increase in the estimated population aged 65 and over in need of social care, and a 10.9% increase in the number of children looked after. Signs of financial pressure are now present amongst local authorities, particularly those with social care responsibilities. Nearly two thirds of these local authorities drew on their funding reserves in 2016–17 to support their spending and over 80% overspent their social care budgets. Some of these local authorities are rapidly depleting their reserves: more than one in ten local authorities with social care responsibilities will have completely exhausted their reserves within three years if they continue to use them at the rate they did in 2016–17. In February 2018, the statutory financial officer for Northamptonshire County Council issued a section 114 notice indicating that the authority was at risk of spending more in the financial year than the resources it had available, which would have been unlawful. Despite this evidence of financial pressure, the Department's view is that the local authority sector is sustainable.

   Recommendation: ***The Department should, by the end of September 2018, write to the Committee to explain why it believes that the local authority sector is sustainable in the current spending review period, and detailing what it is doing to minimise the risk of financial failure in authorities currently on its risk register.***

2. **The Department is overly reliant on the next Spending Review, which is now under greater pressure following the announcement on NHS funding, to address the financial challenges currently facing local authorities.** The Department told us that it was starting to prepare for the 2019 Spending Review so that it could provide the Treasury and other government departments with a clear picture of the pressures being faced by local authorities. The Department recognises the current pattern where authorities rely on their reserves in order to balance their books would not be a sustainable outcome from the 2019 Spending Review. However, we are concerned that the Department lacks the information or ability to provide a sufficiently compelling evidence to make a case for the levels of local authority funding needed. The Department told us that it took expected increases in demand for services, demographic changes and rising homelessness into account as part of its bid for the previous Spending Review, although it would not provide us with details. Yet in 2016–17, the first year of the 2015 Spending Review period, local authorities with social care responsibilities overspent their service budgets by over £1 billion and used £858 million of their reserves. The Department had to introduce a range of additional funding measures to support the sector in the short term. The Department recognises that it needs to improve its evidence base and improve engagement with other departments to avoid this situation happening again during the next Spending Review period. If the Department is not able to secure sufficient funding for local authorities from the Spending Review, alternative means of ensuring that local authorities remain financially sustainable will be needed.

Recommendation: ***The Department should write to the Committee within the next six months setting out how it is planning to work with other departments effectively and make the case to HM Treasury for local authority funding persuasively at the next Spending Review; and in addition to securing funding at the next Spending Review, what steps it will take to support the sector in meeting its funding and demand challenges.***

3. **The Department does not have a consistent and transparent method to assess financial risk in local authorities.** The Department uses a range of data and information to assess sustainability in the local authority sector on an ongoing basis but does not share its methodology with the sector or publish the outputs of its work. There is therefore no shared definition of what financial sustainability means in practice in the local authority sector. In particular, the Department is not able to say at what specific point it would have a concern either about individual local authorities or the sector as a whole. This lack of information on the Department's understanding of financial risk amongst local authorities complicates both assessing risk in the local authority sector and holding the Department to account. It also raises a concern that the Department lacks a clear methodology for assessing risk on a consistent basis. Similarly, the Department does not make public any of the work underlying its bid as part of the government's 2015 Spending Review, which determined how much money the Department will have over the following four years, and how much government funding local authorities will receive. This evidence is vital to make the case to Treasury for more funding particularly at a time when there are so many competing calls for increased funding across Whitehall. The next Spending Review is due in 2019 and will determine funding levels for 2020–21 and beyond. Both the Department and representatives from the local authority sector recognise that there needs to be more data and analysis on financial risk in the sector and greater transparency on the findings.

Recommendation: ***The Department should:***

- ***within the next 12 months, work with the local authorities and key stakeholder bodies to agree and publish a shared definition of local authority financial sustainability and a methodology for assessing the extent to which local authorities are at risk; and***
- ***take a more transparent approach to the next spending review and publish its projections for demand and spending by service area once the spending review has concluded, together with its monitoring of outcomes against these projections.***

4. **Increased pressure on funding from social care is limiting spend across other service areas, and the implications of this for service users and taxpayers are unclear.** Local authorities are spending a greater proportion of their funding on social care services. The share of local authorities' service spend devoted to adult and children's social care grew from 45.3% in 2010–11 to 54.4% in 2016–17. This results from a combination of a 3% real-terms reduction in social care spend and a 32.6% reduction in spend outside social care. Some service areas have seen very substantial reductions. Spend on planning and development has fallen by 52.8%, housing services by 45.6%, and highways and transport by 37.1%. Council tax rates

are increasing and much of the additional income is being used to fill the gap in funding for social care. In many cases there is insufficient data to assess the impact of these funding reductions on service users. There is also no single point within government that monitors the impact of spending reductions on services. This means that the Department may not know if pressures in one service area quickly transfer to others or the extent of the risk that this poses to local authorities or service users.

Recommendation: ***The Department should write to the Committee by the end of September 2018 setting out how it will work with other relevant departments on an ongoing basis to ensure that it properly understands local authorities' performance across the full range of local services they deliver, the extent to which pressures in some service areas are affecting others, and any service areas where departments have any areas of concern. The results from this work should be published on a regular basis.***

5. **The lack of a long-term funding plan for local authorities is a risk to value for taxpayers' money.** A series of significant changes to the funding of local government and the scale of funding will come into force in 2021. These are the 2019 Spending Review, the Fair Funding Review and the introduction of 75% local retention of business rates (up from 50% retention). The Spending Review will set the total amount of government funding available for local authorities, the Fair Funding Review will set the framework for distributing funding between authorities, and increased business rates retention will affect the size of fluctuations in local income (depending on precisely how increased retention is implemented). Local authorities will not know the cumulative outcome of these changes until late in 2019, by which stage they will be well into the process of setting their budgets for 2020–21. The government is considering making changes to funding arrangements for adult social care too, although both the timing and the impact of these is uncertain. The lack of clarity over the design of the new funding framework and the potential scale of changes to their funding means that authorities are not able to manage their financial planning within their normal three to five year medium-term financial strategies, and will have to take a short-term approach. This makes it more difficult for local authorities to take a considered, long-term approach to delivering savings and making investments. This is a risk both to the value-for-money of local authority spending and also to their financial sustainability.

Recommendation: ***In order to support authorities' financial planning:***

- ***the Department should publish a timetable as soon as possible showing when it will have to take key decisions, and when worked examples will be available relating to the Fair Funding Review, the introduction of 75% local retention of business rates and the 2019 Spending Review. The timetable should ensure that the outcomes of the Fair Funding Review and the design of the 75% local business rates retention are known to the sector as early as possible in 2019; and***

- ***ahead of the announcement of the outcome of the Spending Review, the Fair Funding Review and the new business rates scheme, the Department, with HM Treasury, must provide assurance to local authorities that their***

funding for 2020–21 and 2021–22 will be within a certain margin of change, and that they will put in place transitional arrangements to mitigate the effects of substantial changes in funding levels over the medium term.

6. **Arrangements covering accountability for, and scrutiny of, local authority spending may not be sufficiently robust given the level of financial pressure local authorities face.** Local authorities are audited by independent external audit firms. Most authorities also have an internal scrutiny function that holds the executive to account. Both audit and scrutiny form an important part of the framework to support financial sustainability in local authorities. However, there are weaknesses in aspects of the current arrangements. We were told by local authority stakeholders that there was a risk that the role of the external auditor was becoming reduced to that of purely financial audit and meeting regulatory requirements, rather than scrutinising the financial standing of the authority. The willingness and capacity of authorities' audit committees to respond to external auditors' findings is also a concern and was a factor in the issues faced by Northamptonshire County Council. Scrutiny committees also support local arrangements to secure financial sustainability, but stakeholder bodies questioned whether their level of resourcing was adequate and whether they received sufficient independent advice.

    Recommendation: ***The Department should, by May 2019, review the way audit committees and scrutiny functions operate in examining and challenging local risks to financial sustainability.***

7. **The introduction of IFRS nine poses a risk to good financial management and planning in local authorities, including council tax levels.** New international accounting requirements for the treatment of gains and losses from investments have the potential to add significant volatility to local authorities' general funds. Fluctuations in the market value of some investments may now be reflected in the accounts as if these changes were actual income or spending. This notional income or spending could in turn have implications for local authorities' reserves and their council tax rates. Previously, changes in the value of asset or investment only affected the council's overall finances when the asset was sold and the value of the gain or loss compared to the original price was confirmed. Stakeholder organisations have proposed that the Department should exercise its powers to introduce a statutory override to the new arrangements to better protect local authorities' finances.

    Recommendation: ***The Department should introduce a statutory override for the requirement under IFRS 9 for local authorities to account for gains and losses from investments in their general funds, in order to prevent any distorting effects on local government financial management.***

1 The Department's understanding of financial risk amongst local authorities

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from the Ministry of Housing, Communities and Local Government (the Department) and local authority stakeholders on the financial sustainability of local authorities in England.[1]

2. Local authorities provide a range of services such as highways and transport, culture and leisure, and housing. Some services, such as adult social care and waste collection, are statutory duties set by government. Local authorities can also provide discretionary services in line with local priorities, such as economic development or support for tourism. Different types of local authority have different service responsibilities. For instance, only London borough councils, metropolitan borough councils, county councils and unitary authorities have responsibility for adult and children's social care. District councils do not.[2]

3. The Department is responsible for distributing the majority of government funding for local authorities. Departmental ministers set the limits on the extent to which local authorities can increase their council tax rates without holding a local referendum. The Department is also responsible for taking the cross-government lead in supporting HM Treasury on decisions about local government funding at spending reviews. Spending reviews determine how much money the Department will have over the following four years, and how much government funding local authorities will receive. The Department also maintains a system of local accountability that assures Parliament about how local authorities use their resources, including preventing and responding to financial and service failure. Local authorities also deliver services that are the responsibility of government departments other than the Ministry of Housing, Communities and Local Government, in which case those departments are responsible for establishing their own arrangements to ensure services are delivered and are financially sustainable.[3]

4. Local authorities in England have had their funding reduced since 2010–11 as successive governments have sought to reduce the fiscal deficit. Local authorities have also seen increases in demand for key services in areas such as adult and children's social care.[4] The financial position of the local authority sector has worsened markedly since we last looked at this in 2014.[5] The breadth of service spending by local authorities was narrowing and becoming focused on a core offer centred on social care.[6]

1 Report by the Comptroller and Auditor General, Financial sustainability of local authorities 2018 , Session 2017–19, HC 834, 8 March 2018
2 C&AG's Report, paras 2, 3.3; figures 10, 17
3 C&AG's Report, para 3
4 C&AG's Report, para 10
5 C&AG's Report, para 15; Public Accounts Committee, Financial sustainability of local authorities 2014, 34th Report of Session 2014–15, HC 833, 19 January 2015
6 C&AG's Report, paras 13, 27

Risks to financial sustainability

5. Between 2010–11 and 2017–18 government funding for local authorities fell 49.1% in real terms. Over the same period local authorities' spending power (government funding plus council tax) has fallen by 28.6% in real terms. Council tax income has grown in this period, which has offset the reductions in government funding to a degree. The level of reductions in spending power varied markedly between different types of local authority, with some metropolitan borough councils and London borough councils having their spending power reduced by over 40%. The reductions have now levelled off and spending power is now expected to stay roughly flat in real terms up to 2019–20 across the local authority sector as a whole.[7]

6. The reduction in spending power faced by local authorities has coincided with an increase in demand for social care and housing services. Between 2010–11 and 2016–17 the estimated population in need of care aged 18 to 64 in England increased by 9.5%, and the estimated population in need aged 65 and over increased by 14.3%. Over the same period the number of children looked after by local authorities increased by 10.9% and the number of households accepted as unintentionally homeless and in priority need increased by 33.9%. In addition to growing demand for services, local authorities have also had to absorb a range of other cost pressures. These include the National Living Wage, increased employer national insurance contributions and the apprenticeship levy.[8] The Local Government Association told us that a combination of increases in service demand, additional cost pressures and reductions in funding will leave the sector with an estimated funding gap of over £5 billion by the end of the decade.[9]

7. Many local authorities, particularly those with social care responsibilities, began to show potentially worrying signs of being under financial pressure. In 2016–17 local authorities with social care responsibilities as a whole overspent their service budgets by over £1 billion. This was largely attributable to a 10.4% overspend on children's services, and a 3.7% overspend on adult social care.[10]

8. In response to reductions in their funding, local authorities can reduce the amount that they spend on public services, reduce other areas of spend, seek new sources of income or use their finance reserves to fill any remaining gaps. An increasing number of local authorities with social care responsibilities are now drawing down their financial reserves, with 66.2% doing so in 2016–17.[11] Some of these authorities are drawing down their reserves at a very rapid rate, and 10.6% will exhaust their reserves within three years if they continue to use them at the rate they did in 2016–17.[12]

9. We asked the Department whether it was worried about the impact of simultaneous reductions in local authority funding and increased demand for services. The Department recognised that the current financial position is hard for local authorities and that growth in spending on social care means that financial risk is increasing in the system.[13] However, it nonetheless asserted that the local authority sector is sustainable for the current Spending

7 Q 1; C&AG's Report, paras 1.5–1.6, 1.11; figure 2
8 Q 1; C&AG's Report, para 1.19; figure 4
9 Q 1
10 Q 58; C&AG's Report, para 3.6; figure 17
11 Q 61; C&AG's Report, para 3.16
12 Q 1; C&AG's Report, para 16
13 Qq 62, 81

Review period. The Department said that that local authorities as a whole had built up their reserves prior to 2016–17, and that the Office for Budget Responsibility forecasts that authorities' use of their reserves will decline. The Department told us that where it identifies that local authorities are under financial pressure then it will respond and put money into the system, such as its new funding for adult social care.[14]

10. In February 2018, the statutory financial officer for Northamptonshire County Council issued a section 114 notice indicating that the authority was at risk of spending more in the financial year than the resources it had available, which would have been unlawful. The authority effectively put itself into special financial measures. The authority was already subject to an inspection of its financial management and governance ordered by the Secretary of State.[15] The Department told us that it has a risk register of local authorities. It would not share how many authorities were currently rated as being at risk, but the Department told us that it did not believe that any other local authority was in the same position as Northamptonshire County Council.[16] However, it would not provide an assurance that there would not be any further section 114 notices in this spending review period.[17]

Defining and assessing financial sustainability

11. The Department is responsible for maintaining a framework that provides assurance about how local authorities use their resources, including understanding risks to financial sustainability in order to prevent financial failure. We asked the Department how it assessed the financial sustainability of local authorities. The Department told us that it does not have a measure of sustainability and it was unable to provide a definition of unsustainable.[18] Likewise, it told us that it does not have a threshold figure at which it would be concerned by the share of service spend accounted for by social care.[19]

12. We asked on what basis the Department asserted that the local authority sector is financially sustainable without being able to measure it. The Department told us that it uses a range of data and information to assess sustainability in the local authority sector. This includes analysis of data on a range of financial measures such as local authorities' use of reserves. The Department told us that it has developed a financial sustainability data tool to support its analysis and that it liaised closely with other departments, particularly the Department for Education and the Department for Health and Social Care. It also said that it examines the capacity of leadership to take challenging financial decisions, and that they draw on the peer challenge work undertaken by the Local Government Association which can also include analysis of financial planning and decision making.[20]

13. However, the Department's sustainability tool still does not include a definition of unsustainability, but relies on identifying outliers to raise concerns about areas.[21] The Department was similarly unable to explain satisfactorily precisely how, drawing on the information available to it, it assesses on a consistent basis whether an authority

14 Qq 60, 62–63
15 C&AG's Report, paras 17, 3.25–3.26
16 Qq 86–87
17 Q 217
18 Qq 104, 119
19 Q 78
20 Qq 89, 105
21 Qq 114–116

is financially sustainable or not, and therefore how it could conclude that the sector is sustainable. The Department is therefore not able to say at what specific point it would have a concern either about individual local authorities or the sector as a whole.[22]

14. The Association of Local Authority Treasurers Societies (ALATS) told us that there is a growing level of nervousness and uncertainty among local authorities over their ability to balance their budgets in future. We asked whether it knew how many local authority chief finance officers were at the point where they felt that they were will not be able to balance their budgets in the next couple of years. ALATS told us that it did not have that data.[23] ALATS recognised that there was a lack of data on the level of financial stress faced by local authorities, and that it needed to put more effort into data provision.[24]

15. The Department told us that it would make a thorough quantitative assessment of the local authority sector's costs and pressures as part of the next Spending Review. However, it would not share the results of its assessment of the financial sustainability of the local authority sector that made at the 2015 Spending Review, citing that this was given as confidential advice to Ministers.[25] The Department conceded that as a result there was little analysis of the sustainability of the local authority sector in the public domain. It also told us that it would prefer greater transparency and openness on the financial sustainability of local authorities as this allows the Government to be challenged on its estimates relating to local authority financial sustainability. It suggested that it would like to see organisations such as the Institute for Fiscal Studies take up this sort of work, and that it was engaging with the Office for Budget Responsibility on some aspects of the assessment of local authority financial sustainability.[26]

Improving accountability arrangements

16. The financial accounts of local authorities are audited by independent external auditors. They also assess whether authorities have adequate arrangements in place to ensure that local spending is value for money. We asked members of our pre-panel whether they thought external auditors were up to the job in terms of providing sufficient warning on risks to a local authority's financial sustainability.[27] ALATs told us that external auditors were equipped to carry out a full and thorough financial audit of local authorities, but that it missed the additional scrutiny, particularly around data, that was previously provided by the Audit Commission.[28] The Chartered Institute of Public Finance and Accountancy (CIPFA) similarly told us that the fees paid to firms for their audit of local authorities had been reduced substantially. It warned that there is a risk that the role of the external auditor is "… reduced to signing off the accounts and meeting […] regulatory requirements"[29] and that it was important to ensure that there is not a race to the bottom in terms of the quality of external audit".[30] CIPFA told us that despite fee reductions, external auditors should not forget that they still retain their public interest reporting responsibilities, which allow them report on any matter coming to their notice

22 Q 125
23 Q 7
24 Q 23
25 Qq 106–107
26 Q 111
27 Q 37
28 Q 40
29 Q 38
30 Q 1

during the audit. CIPFA also told us that it intended to produce a resilience index to help local authorities understand if they were using their reserves at an alarming rate. The NAO told us that external auditors have issued numerous qualifications and warnings. It also reported concerns that local authorities may not be paying sufficient attention to these findings. It cited the example of Northamptonshire County Council where a series of red flags by the external auditor had not been robustly addressed by the local authority.[31]

17. Most authorities have an internal scrutiny function that holds the executive to account. We asked our pre-panel witnesses whether local authorities were providing sufficient resources to support their scrutiny functions, including their financial scrutiny functions, and ensure they had the independent advice they needed to challenge decisions. The Society for Local Authority Chief Executives (SOLACE) told us that scrutiny was most effective when there is rounded, independent evidence.[32] But it recognised that the scrutiny function in local authorities is variable and it is not getting to the heart of the pre-policy scrutiny with the kind of expert, independent advice and evidence that it should.[33] ALATS added that while it would hope that local authorities do make sufficient resources available to provide advice to their scrutiny functions it conceded that scrutiny advice was currently a "mixed bag".[34]

31 Qq 39–40
32 Q 29
33 Q 31
34 Q 33

2 Ensuring financial sustainability in the future

Lack of clear long-term funding plan

18. In 2015–16, the Department offered local authorities a four-year funding settlement to allow them to plan their finances more effectively, so local authorities' funding is currently fixed until the end of 2019–20. The Department told us that certainty allows councils to "make longer-term decisions in terms of its investment or how it will manage its services" and that "there is a case on value for money terms" for "longer-term certainty whenever we can give it".[35] Local authorities do not yet know what their overall funding settlement will be from the start of 2020–21. Some other important decisions about local authorities' funding are also expected, including: increases in the proportion of local business rates that local authorities can keep; the Fair Funding Review, which will decide how local business rates are distributed from 2020–21; and proposals on how to deliver a long-term, sustainable solution to providing care for older people in need.[36]

19. The impact of these proposed changes on local authorities' overall and individual funding are still unclear. Most of these changes will take effect in 2020–21, with decisions potentially being made close to the start of that financial year. The current level of uncertainty over local authorities' future funding is causing concern within the sector. The Local Government Association (LGA) told us that councillors and officers across all councils share a nervousness about the cliff edge that they face in terms of the uncertainty around their financial situation.[37] The Department told us that decisions about the overall level of government funding for councils after 2019–20 will be made by Ministers as part of the next Spending Review. Neither the Department nor the Treasury Officer of Accounts could be more specific about the timing of these decisions other than "during 2019".[38]

20. Good financial planning relies on certainty and stability, while financial uncertainty creates risks to value for money.[39] SOLACE told us that changes to local authorities' funding without warning "undermines the long-term planning we need to be able to undertake in order to ensure the value-for-money of every public pound that is spent". We received written evidence from Core Cities and Sheffield City Council , which expressed concern that the effect of the funding distribution formula being designed as part of the Fair Funding Review will not be known until almost the point at which budgets have to be set for 2020–21.[40] Core Cities told us that "the future of Business Rates retention and planned business rates reset in 2020/21 is very concerning".[41] London Councils similarly told us that "having settled on 75% retention, the Government must urgently clarify a number of technical issues regarding the design of the scheme to provide as much certainty to the sector as possible."[42] The LGA told us that the proposals to change funding for adult social care in future adds even further uncertainty to local authorities' finances.[43]

35 Qq 10, 126–128; C&AG's report, figure 3
36 C&AG's Report para 4.22–4.23
37 Q 10
38 Qq 127, 200–202
39 SOLACE (FAL0007); London Councils (FAL0011); C&AG's Report para 4.24
40 Core Cities (FAL0003); Sheffield City Council (FAL0002)
41 Core Cities (FAL0003)
42 London Councils (FAL0011)
43 Local Government Association (FAL0006)

21. Putting in place transitional arrangements could limit the scale and impact of changes at short notice to local authorities' funding. SOLACE told us that "it is absolutely vital that there is adequate planning undertaken with regard to any transitional arrangements that will be needed to avoid […] shocks to an already shocked system."[44] In their written evidence to us, Core Cities and Sheffield City Council told us that that "there is a maximum pace of change that can be handled" and transitional arrangements for previous major changes had recognised this. They pointed out the value of providing information in advance on transitional arrangements, such as any upper and lower limits to changes in funding for individual councils.[45]

The 2019 Spending Review

22. At the 2015 Spending Review, the Department led cross-government work to assess the funding needs of local authorities in the four-year period to March 2020 in order to provide advice to Ministers.[46] However, in 2016–17, the first year of the spending review period, local authorities with social care responsibilities overspent their service budgets by £1.023 billion, and used £858 million of their reserves.[47] Since the start of the Spending Review period, the Department has provided additional grant funding to local authorities to fill gaps in funding for adult social care and enabled councils to raise additional money from local taxpayers through council tax.[48]

23. The Department asserted that the recent short-term increases mean that the local authority sector is financially sustainable until the next Spending Review, at which point it will reassess the longer-term financial sustainability local authorities.[49] It accepted, however, that local authorities' use of reserves was not sustainable and that it could not base its proposals for the next spending review settlement on the assumption that local authorities could use their reserves to balance the books.[50] The Department told us that it was clear that 2019 "is an important spending review for local government" and that it was committed to working with other government departments to make sure the Spending Review reflects the needs of local government.[51]

24. Evidence from local government sources was emphatic about the equal, or even greater, importance of addressing the overall level of funding compared to reassessing the distribution of funding.[52] For example, SOLACE told us that "We have strong concerns about focusing on issues of distribution before the more fundamental question of sufficiency has been addressed" and Core Cities said "Whilst it is clear there are significant inequities in the current distribution across local authorities the overall inadequacy of funds is equally significant." Several of these sources suggested that this could be done in other ways than simply providing money from central government, such as broadening the range of local income sources that councils can draw on. London Councils told us

44 SOLACE (FAL0007)
45 Core Cities (FAL0003); Sheffield City Council (FAL0002)
46 C&AG's Report, paras 4.4–4.6
47 C&AG's Report, figures 17, 21
48 Qq 70–71, 129–131; C&AG's report, figure 3
49 Q71
50 Q 62
51 Q 179
52 SOLACE (FAL0007); CIPFA (FAL0008); London Councils (FAL0011); Core Cities (FAL0003); Sheffield City Council (FAL0002)

that if central government is not prepared to increase the quantum of centrally allocated resources available, then it needs to give local government greater control over its own resources and enhance its range and mixture of revenue raising capabilities.[53]

25. The Department told us that it was starting work towards next year's Spending Review so that it could give Ministers in both the Treasury and in its Department, as well across the rest of Whitehall, a clear picture of the "pressures and opportunities for local government".[54] It agreed that it needed to improve its approach, including by improving engagement with other Departments, "because the tighter the finances get, the more important it is that our analysis is as comprehensive as possible".[55] The Department told us that it took expected increases in demand for services, demographic changes and rising homelessness into account as part of its bid for the previous Spending Review.[56] We asked the Department for details of these projections. The Department was not willing to share this information with us.[57] We sought these facts and figures to help us assess the credibility of the Department's approach to analysis and its judgements about future sustainability, such as it will make at the next Spending Review.[58]

Impact of social care pressures on other local authority services

26. Over the last six years, local authorities have spent a greater proportion of their funding on providing adult and children's social care services. These services are the responsibility of the Departments of Health and Social Care and for Education but are delivered by local authorities, primarily from local authority general funding. The share of local authorities' spend on services that was devoted to adult and children's social care has increased from 45.3% in 2010–11 to 54.4% in 2016–17. In 2015–16 and 2016–7 the Department enabled councils with social care responsibilities to increase council tax between 2016–17 and 2019–20 specifically to pay for adult social care. Since 2015–16 the money that councils raise from council tax has increased in real terms and it is projected to increase further in 2019–20.[59]

27. We asked the Department about whether the increase in social care's share of spending was putting greater pressure on other services. The Department accepted that these figures show "increasingly councils are having to spend their money on demand-led services, where they can't always control the costs that they will have to cope with".[60] The Department was clear that its aim was that councils were able to carry out "all the responsibilities that local government needs to carry out", which went wider than social care services.[61] From 2010–11 to 2016–17 there was a 3% real-terms reduction in social care spend and a 32.6% reduction in spend outside social care. Some individual service areas have seen very substantial reductions in spend. Spend on planning and development

53 London Councils (FAL0011); Core Cities (FAL0003); Sheffield City Council (FAL0002)
54 Q 59
55 Qq 112; 179–185
56 Q 137
57 Qq 133–149, 159–160
58 Qq 133–142
59 C&AG's Report, paras 1.12, 2.9; figures 1, 3
60 Qq 77, 81
61 Q 78

has fallen by 52.8%, housing services outside the Housing Revenue Account have fallen by 45.6%, and highways and transport spending has reduced by 37.1%. In many cases there is insufficient data to assess the impact of these funding reductions on service users.[62]

28. There is no single point within government that monitors the impact of spending reductions on services between spending reviews. The absence of this ongoing effective co-ordination means that the Department may not know if pressures in one service area quickly transfer to others or the extent of the risk that this poses to local authorities.[63] The Department told us that it has worked intensely with the Departments of Health and Care and for Education but acknowledged that its engagement with other Departments has been less structured. It asserted that there is a regular meeting at which "every Department can come and find out what is going on and raise any concerns".[64] We asked the Department for an example of this process working in practice, and discussions taking place with other government departments about the performance of existing local services outwith social care. The Department could not immediately provide a relevant example and instead described the meetings that were being established for the next Spending Review or discussions around new burdens.[65] The Department subsequently wrote to us on this point and described a range of meetings that seemed focused on individual councils that had already reached the point of intervention, the development of new policy, or the management of specific, existing funding streams or mechanisms. The letter did not contain a clear description of work on ongoing pressures and the impact of funding reductions.[66]

Statutory override for new international accounting standards

29. Local authorities will be affected by the introduction of new international accounting requirements within International Financial Reporting Standard 9 (IFRS 9). IFRS 9 will potentially impact many investments, most clearly those carried out through collective investment vehicles (where investors pool funds to invest together). Local authorities' financial accounts will now need to reflect changes in the market value of assets such as property funds or money market funds. These unrealised gains and losses (transactions that have occurred on paper, but have not actually taken place) will be treated as actual revenue income and spending affecting the council's budgetary balance, even though the investment is still held by the council and may eventually be sold at a different value. This means that if the value of an affected investment falls by £10 million then the council's reserves will be £10 million lower. This money will not be available to spend on services, and if reserves fall too low then the council will need to replenish them, for example by raising council tax or making further service cuts. Previously changes in the market value of assets and investments owned by a local authority would have been charged to an accounting reserve until the investment was sold and the gain or loss confirmed.[67]

30. CIPFA is required by UK law to adopt IFRS 9 within the code it sets for local authority accounting. However, it told us that it is concerned about the impact of IFRS 9 on local authority finances. Under the new arrangements, CIPFA told us that "ups and

62 C&AG's Report, paras 2.8, 2.32; figures 15, 17
63 C&AG's Report, para 4.50
64 Qq 167, 179
65 Qq 165–179, 187–193
66 MHCLG (FAL00013)
67 Q 13; CIPFA, IFRS 9 and collective investment vehicles, February 2018

downs" in the market value of a local authority's assets would have a "a real revenue hit" on local authorities. Taxpayers would subsequently be affected as IFRS 9 could affect how much money the local authority holds in its reserves and potentially how much the local authority needs to raise through council tax. CIPFA has asked the Department, on behalf of the local authority sector, to provide a statutory override for this change.[68] The Department confirmed to us that a statutory override is possible and that this is currently under consideration.[69]

68 Qq 13–14; CIPFA, IFRS 9 and collective investment vehicles, February 2018
69 Qq 197–199

Formal minutes

Wednesday 27 June 2018

Members present:

Meg Hillier, in the Chair

Caroline Flint	Lee Rowley
Anne Marie Morris	Gareth Snell

Draft Report (*Financial sustainability of local authorities*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 30 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Fiftieth of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 2 July 2018 at 3.30pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 9 May 2018

	Question number
Mark Lloyd, Chief Executive, Local Government Association, Martin Reeves, Spokesman for Local Government Finance, Society of Local Authority Chief Executives, Rob Whiteman, Chief Executive, CIPFA, and Duncan Whitfield, President, Association of Local Authority Treasurers	Q1–40
Melanie Dawes, Permanent Secretary, Ministry of Housing, Communities and Local Government, and Jo Farrar, Director General, Local Government, Ministry of Housing, Communities and Local Government	Q41–217

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

FAL numbers are generated by the evidence processing system and so may not be complete.

1 Care England (FAL0001)

2 Chartered Institute of Public Finance and Accountancy (FAL0008)

3 Core Cities UK (FAL0003)

4 County Councils Network (FAL0005)

5 Dr Thomas Elston and Dr Ruth Dixon (FAL0009)

6 Local Government Association (FAL0006)

7 London Councils (FAL0011)

8 Ministry of Housing, Communities & Local Government (FAL0012)

9 Ministry of Housing, Communities & Local Government (FAL0013)

10 Professor Laurence Ferry (FAL0010)

11 Sheffield City Council (FAL0002)

12 Solace (FAL0007)

List of Reports from the Committee during the current session

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2017–19

First Report	Tackling online VAT fraud and error	HC 312 (Cm 9549)
Second Report	Brexit and the future of Customs	HC 401 (Cm 9565)
Third Report	Hinkley Point C	HC 393 (Cm 9565)
Fourth Report	Clinical correspondence handling at NHS Shared Business Services	HC 396 (Cm 9575)
Fifth Report	Managing the costs of clinical negligence in hospital trusts	HC 397 (Cm 9575)
Sixth Report	The growing threat of online fraud	HC 399 (Cm 9575)
Seventh Report	Brexit and the UK border	HC 558 (Cm 9575)
Eighth Report	Mental health in prisons	HC 400 (Cm 9575) (Cm 9596)
Ninth Report	Sheffield to Rotherham tram-trains	HC 453 (Cm 9575)
Tenth Report	High Speed 2 Annual Report and Accounts	HC 454 (Cm 9575)
Eleventh Report	Homeless households	HC 462 (Cm 9575) (Cm 9618)
Twelfth Report	HMRC's Performance in 2016–17	HC 456 (Cm 9596)
Thirteenth Report	NHS continuing healthcare funding	HC 455 (Cm 9596)
Fourteenth Report	Delivering Carrier Strike	HC 394 (Cm 9596)
Fifteenth Report	Offender-monitoring tags	HC 458 (Cm 9596)
Sixteenth Report	Government borrowing and the Whole of Government Accounts	HC 463 (Cm 9596)
Seventeenth Report	Retaining and developing the teaching workforce	HC 460 (Cm 9596)

Eighteenth Report	Exiting the European Union	HC 467 (Cm 9596)
Nineteenth Report	Excess Votes 2016–17	HC 806 (Cm 9596)
Twentieth Report	Update on the Thameslink Programme	HC 466 (Cm 9618)
Twenty-First Report	The Nuclear Decommissioning Authority’s Magnox	HC 461 (Cm 9618)
Twenty-Second Report	The monitoring, inspection and funding of Learndirect Ltd.	HC 875 (Cm 9618)
Twenty-Third Report	Alternative Higher Education Providers	HC 736 (Cm 9618)
Twenty-Fourth Report	Care Quality Commission: regulating health and social care	HC 468 (Cm 9618)
Twenty-Fifth Report	The sale of the Green Investment Bank	HC 468 (Cm 9618)
Twenty-Sixth Report	Governance and departmental oversight of the Greater Cambridge Greater Peterborough Local Enterprise Partnership	HC 896 (Cm 9618)
Twenty-Seventh Report	Government contracts for Community Rehabilitation Companies	HC 897 (Cm 9618)
Twenty-Eighth Report	Ministry of Defence: Acquisition and support of defence equipment	HC 724 (Cm 9618)
Twenty-Ninth Report	Sustainability and transformation in the NHS	HC 793 (Cm 9618)
Thirtieth Report	Academy schools’ finances	HC 760 (Cm 9618)
Thirty-First Report	The future of the National Lottery	HC 898 (Cm 9643)
Thirty-Second Report	Cyber-attack on the NHS	HC 787 (Cm 9643)
Thirty-Third Report	Research and Development funding across government	HC 668 (Cm 9643)
Thirty-Fourth Report	Exiting the European Union: The Department for Business, Energy and Industrial Strategy	HC 687 (Cm 9643)
Thirty-Fifth Report	Rail franchising in the UK	HC 689 (Cm 9643)
Thirty-Sixth Report	Reducing modern slavery	HC 886 (Cm 9643)
Thirty-Seventh Report	Exiting the European Union: The Department for Environment, Food & Rural Affairs and the Department for International Trade	HC 699 (Cm 9643)
Thirty-Eighth Report	The adult social care workforce in England	HC 690
Thirty-Ninth Report	The Defence Equipment Plan 2017–2027	HC 880

Fortieth Report	Renewable Heat Incentive in Great Britain	HC 696
Forty-First Report	Government risk assessments relating to Carillion	HC 1045
Forty-Second Report	Modernising the Disclosure and Barring Service	HC 695
Forty-Third Report	Clinical correspondence handling in the NHS	HC 929
Forty-Fourth Report	Reducing emergency admissions	HC 795
Forty-Fifth Report	The higher education market	HC 693
Forty-Sixth Report	Private Finance Initiatives	HC 894
Forty-Seventh Report	Delivering STEM skills for the economy	HC 691
Forty-Eighth Report	Exiting the EU: The financial settlement	HC 973
First Special Report	Chair of the Public Accounts Committee's Second Annual Report	HC 347