House of Commons

Housing, Communities and Local Government Committee

Oral evidence: The funding and sustainability of local government finance, HC 514

Tuesday 8 April 2025

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Watch the meeting

Members present: Florence Eshalomi (Chair); Lewis Cocking; Chris Curtis; Mr Will Forster; Mr Gagan Mohindra; Joe Powell.

Public Accounts Committee member present: Mr Clive Betts.

Questions 67 - 125

Witnesses

I: Gareth Davies, Comptroller and Auditor General, National Audit Office; Abdool Kara, Executive Director, National Audit Office; Vicky Davis, Director, Local Government Value for Money, National Audit Office.

II: Owen Mapley, Chief Executive Officer, Chartered Institute of Public Finance and Accountancy (CIPFA); Dan Bates, Finance Specialist, OnTor Limited; Jane Pearson, Section 151 Officer, Ribble Valley Borough Council; Rob Powell, Section 151 Officer, Warwickshire County Council.

Examination of witnesses

Witnesses: Gareth Davies, Abdool Kara and Vicky Davis.

Q67 **Chair:** Good morning, everyone. I am Florence Eshalomi, Chair of the Housing, Communities and Local Government Committee. Could I ask Members to introduce themselves, please?

Chris Curtis: I am Chris Curtis, the Labour MP for Milton Keynes North.

Joe Powell: I am Joe Powell, the MP for Kensington and Bayswater.

Mr Forster: I am Will Forster, the MP for Woking.

Mr Betts: I am Clive Betts, the MP for Sheffield South East. I am guesting from the Public Accounts Committee today.

Lewis Cocking: I am Lewis Cocking, the MP for Broxbourne, and I know Owen Mapley because he was the chief executive of Hertfordshire County Council, where I am still a councillor.

Mr Mohindra: I am Gagan Mohindra, the Conservative MP for South West Hertfordshire.

Q68 **Chair:** We have had apologies from Lee Dillon, Maya Ellis, Sarah Smith and Naushabah Khan for this morning's session. We are on session three of four of our inquiry into the funding and sustainability of local government finance, something which I am sure everyone knows is constantly in the news. We have a range of experts this morning. We are going to ask you questions, and are keen to get your thoughts, concerns and comments on this really important issue. Can I ask our guests to introduce themselves for *Hansard,* please?

Vicky Davis: Good morning. I am Vicky Davis, the director of local government value for money at the National Audit Office.

Gareth Davies: Good morning. I am Gareth Davies, the Comptroller and Auditor General at the NAO.

Abdool Kara: Good morning, everyone. I am Abdool Kara, the executive director at the National Audit Office.

Q69 **Chair:** Thank you for joining us. Since the general election last year, you will be aware that additional funding has gone into local government, but it is fair to say finances remain very challenging for a number of councils across England. We are hearing concerns around SEND provision, adult social care and temporary accommodation really eating into a number of councils' local funding. Do you think that the funding sustainability across local government is getting any better or worse?

Gareth Davies: Shall I kick off with some headlines and then maybe bring in Vicky and Abdool? Our recent report where we take stock of the changes to local government finance in the last six or seven years shows that the situation has become more strained over that time. In contrast with the previous period, funding has increased but not fast enough to keep up with the growth in population, so per capita spending power for local government has actually reduced slightly over that six or seven-year period. Part of the reason for that feeling so strained is that demand for many services has gone up very quickly and faster than before.

We did a separate report recently, for example, on the SEND system—the support for children with special educational needs—a classic example of where demand has far outstripped predicted levels, putting great strain on local government finance. There are other important areas such as temporary accommodation, adult and children's social care, and so on, where the same demand-led pressures are showing through very strongly. That combination of funding struggling to keep up with per capita growth and demand-led pressures gives us the strained position that we have seen now, but Vicky might want to add something.

Q70 **Chair:** Just on that demand, from the data and evidence that you have looked at, has that demand gone up post covid or had it been going steadily up pre covid?

Gareth Davies: It depends on the source of demand; some predates the pandemic very significantly, but Vicky, you might want to say more about that.

Vicky Davis: I would say that that is correct; we saw that upward trend starting before the pandemic. Just to give a couple of examples in terms of the demand rising: in our report, we start with 2015-16 as the baseline year and compare it with ’23-24 as the latest year that we had available. There was an 84% increase in households in temporary accommodation over that time, a 140% increase in education, health and care plans, and a 15% increase in children looked after, so that demand has gone up significantly, as Gareth said, at the same time as those service pressures.

It is worth saying that over a number of years adult social care has been a particular challenge. There has been a 15% increase in requests for support for adult social care and children’s social care has also been a challenge. In more recent years, we have also seen demand for homelessness and special educational needs growing, adding to and layering on top of those demand pressures that were already coming through from social care.

I am sure we will get into talking about exceptional financial support, but it is worth saying that a total of 42 local authorities have received exceptional financial support since the regime was introduced in 2020-21, and in the most recent announcement, 30 of those 42 have extra financial support for 2025-26. That gives an indication of the pressures coming through for local authorities.

Q71 **Chair:** Specifically on the 30 with EFS funding, seven of those are in London. Does your data show that the funding pressures in all those areas are significantly higher in London boroughs?

Vicky Davis: We do not break down where the pressures are coming from in the report, either in terms of the type of authority or the location of them. Of course, the exceptional financial support announcements are all public and you can click through those and see the reasons. To give an example, I think it was Eastbourne that requested exceptional financial support the previous year, and that was directly linked to its spending on temporary accommodation. I think Newham was another one that was linked directly to temporary accommodation spending.

Abdool Kara: On the London point, I do not think we have any data that suggests that London is subject to greater demands in terms of adults or children, but it is certainly the epicentre of homelessness demand, although that is now spreading to other authorities. You are right to emphasise that there are two sides of the ledger: cash and demand. The areas where demand has gone up—adults, children, homelessness, SEND—are high-cost services and not easily digitised, so the major cost is people costs. They are also largely dependent on other parts of Government to solve. For example, homelessness needs the housing system to work, adult social care needs the Department of Health and Social Care to work, and so on. They are dependent elsewhere and have problems that authorities on their own cannot solve.

Q72 **Chair:** Exceptional financial support could effectively be classed as a payday loan because councils still have to pay that funding back. Do you think that is the way forward, if we keep seeing this short-term, one-off funding to local government as a way of addressing this really challenging funding situation?

Gareth Davies: It has been the long-standing practice of all Governments to use capital essentially to solve what is really a revenue problem. It is very poor accounting practice, but you can understand why, practically, that appears to be the easiest solution for a Government with limited resources. Successive Governments have used the same technique; it is just being exposed even more so now with the sheer number of authorities that are having that support applied. But it is not a sustainable way of managing finances.

Vicky Davis: If I can just add, what we say in our report is that those pressures build up as a result of exceptional financial support. Despite the name, it is not additional cash; it is permission to use money raised through capital, be that extra borrowing or selling off assets and using that to plug a gap that an authority has in its revenue budgets. Of course, that borrowing has to be paid off within 20 years so it is just adding to the level of borrowing that authorities may have and increasing the debt and interest costs.

Abdool Kara: It is worth saying that the previous Government consulted on revisions to the local financial system with the fair funding review, which got derailed because of the pandemic and other things that were happening at the time. It would only be speculation to suggest that had the fair funding review happened we might be in a slightly better position, but certainly this approach is a sticking plaster pending a more fundamental review of the funding system.

Q73 **Chair:** Obviously everyone is waiting for the spending review on 11 June. In essence, we have heard local government Ministers highlight that they want to look at multi-year settlements and remove some ringfencing. What more do you think central Government could be doing to help address this really key issue?

Gareth Davies: In our report, one recommendation in arriving at this better approach for the future is that, first, there is a cross-government element to this. Abdool has already mentioned that a lot of the solutions lie with individual Government Departments, not just MHCLG, so any solution to this needs to be a cross-government solution with buy-in from the relevant Departments.

A good example—something we have reported on many times in the past—is the inefficiency of running lots of small competitions for individual pots of money because it suits an individual Department's policy agenda. If you are a local authority, that looks like an extremely burdensome and expensive way of accessing small amounts of money for very specific things that may or may not fit your local priorities. That is just one example of where a cross-government solution is needed to make a more efficient way of allocating resources with fewer transaction costs. There is also the need to think about this as a whole system—not just cross-government but vertically as well—from central policymaking to local delivery. In a lot of our work, we identify good examples—such as where a new approach has been taken with effective results—but also plenty of unsuccessful areas.

I would just give you one positive example that we have identified in a recent report. Active Travel England is a small unit established by the Department for Transport, and its job is to help local authorities implement high-quality, active travel solutions—encouraging walking and cycling as opposed to using the car—as part of urban planning and other changes. What Government found is that lots of schemes were ineffective—actually counterproductive in some cases—so there was a really important need to provide expert advice and support as well as funding to have high-quality schemes where those were needed. The early evidence of the way Active Travel England is working with local authorities is very positive in getting better value for the available resource and higher-quality solutions. That is just one example where thinking differently about how central Government work with local government could be part of the solution as well.

Abdool Kara: Just to build on that, yes, there needs to be change to the financing system, but that interacts with policy. It is not our job to tell Government how to change their policy, but policy interactions are what drive demand. A very simple example of a policy change that will make a difference is the Government's announcement on allowing authorities to charge the true cost of planning fees. It is a very simple, minor change, but policy is as important as the fundamentals of the financial system.

Chair: That is vital. Lewis, you wanted to come in.

Q74 **Lewis Cocking:** It is probably a question for you all, in particular Gareth; you were speaking about the use for aid—the funding pots and what have you. How do you think the Government should give out money to local authorities? On the one hand, you can do that bidding for pots and what have you. On the other hand, for example, the UK shared prosperity fund gave each council an amount; one of my authorities got £100,000. You cannot transform a town centre with £100,000, so you are either providing the funding for the whole project, or the project does not happen. Everyone criticises that we should not do all these bidding pots and what have you, then when we share it out evenly, you do not get that much, so people moan about that. What is the answer to that situation?

Gareth Davies: As Abdool said, we do not give policy advice to Government; we audit the value for money of the results of policies, essentially. That is our role. You are right; I am not suggesting that there is an easy answer that is always correct for every circumstance, but I would say that we have definitely seen too much use of small bidding exercises, just because you can see how much that costs, often for no result at all for an individual authority that has unsuccessful bid after unsuccessful bid. That looks to us like a poor use of the available public sector resource in that case.

Sometimes, you do need to target the money very carefully; if there is a major scheme that is a high priority nationally and locally, you need to make sure that it is properly resourced in the way you described. This is not a one-or-the-other option here. What is behind our recommendation in our report for a fundamental look at the system for financing local government is first being clear about what the job is that central Government are expecting from local government; that is often not clear enough, and there are a lot of assumed responsibilities that are not adequately articulated and funded.

Secondly, how do you incentivise efficiency at a local government level? We have not mentioned that yet, but of course, efficiency varies between different local authorities, so how do you incentivise efficiency at a local level, as well as get the core funding levels fair and reasonable? When you are deciding on how to allocate the resources, these are the kinds of things that we think Government should be taking into account.

Q75 **Joe Powell:** Just a follow-up question on your comment that to solve these problems it is not just local authorities alone. We have just done a report on children in temporary accommodation, and unsurprisingly, one recommendation is more council and social housing. Have you done any assessment of the impact of taking capital for EFS in terms of things like house building, and do you have any suggestions on how we can ensure the capital budgets for councils are increased? Obviously, the Chancellor is trying to protect capital spending nationally and not raid it for day-to-day spending, so it is quite concerning if that is happening at a local level when we need capital, for example, in affordable housing.

Abdool Kara: Councils do not have a dedicated housing capital pot apart from the HRA, which is for maintenance of existing stock. We have previously done work on the affordable housing fund and made recommendations about how that could be spent better, but we have not otherwise looked at housing capital at the local authority level.

Gareth Davies: The overall capital picture set out in our report is flat and has actually been going down slightly in real terms over the last few years. Given the demand for not just housing but other infrastructure, that available capital resource has been under real strain in recent years.

Vicky Davis: I would just add there is a recognition in the consultation that was launched on local government funding in December. These are obviously the reforms that Government have said are coming in the way that local government is funded. That is a key part of one of the questions that is being asked as part of that consultation, so our sense is it is a well-understood challenge.

Q76 **Chris Curtis:** Just coming back to the small pots point—if that is what we are going to call it—the other element of this is that often the allocation can be quite an inefficient process, as in the Government having to allocate it and councils having to bid for it, and there is a dead weight cost in that. Do you have any particularly egregious examples of that dead weight cost? Is there almost a certain amount where you are wasting so much on the bureaucracy that it is just not worth funding pots below that amount?

Gareth Davies: I do not have the details to hand, but we have identified exactly that problem of the amounts just being too small to justify that kind of approach, as well as the fact that they are coming from different Departments with precious little co-ordination in many cases. Of course, Government have had several attempts to try to deal with that with things like the towns fund and other examples, which were collecting together departmental resources and having a single competition instead of lots of small ones. So there have been various ways of tackling this problem.

We even did two reports on the towns fund in the previous Parliament, and that suffered from a lack of transparency and clarity about the criteria, and the Public Accounts Committee held more than one session on the allocation process for that fund, so attempts to address the small size have come with other problems in recent years as well.

Vicky Davis: Just to give an example—not that all of them were competed pots of money—in our homelessness report of last year we listed 13 separate funds that all had a connection with authorities tackling homelessness and they were across three Departments. Some were allocated funding; some was funding that would be bid into. That gets very difficult if you are a local authority trying to navigate what your budget is for tackling homelessness.

Q77 **Mr Betts:** A few years ago, the director of housing at Sheffield told me that she had to employ two staff full-time just to bid for the pots of money that might be around. Do we know how many different pots of money and funding streams there actually are for local government to bid into and receive money from?

Gareth Davies: We did calculate that in the last Parliament, and it was many tens, but we have not done an up-to-date version of that in this report.

Q78 **Mr Betts:** How many were there in the last Parliament?

Abdool Kara: Many dozens; we can come back to you with an exact figure.

Q79 **Mr Forster:** It would be really useful to know how many pots of money and how much funding is in them, and to understand the new system. We understand Lewis's point that you probably have to bring some money together to get bang for your buck for that transformational change, but cross-party, a lot of concerned councils are spending a lot of money bidding for things and not getting them, and it is quite inefficient. Having the data would be really helpful for us to make a decision.

Abdool Kara: Yes.

Q80 **Chair:** One last question from me. Obviously, our inquiry at the moment is looking at the funding and sustainability of local government finance. In your view, if the funding remains insufficient, what more and different things do you think local government should be doing? Obviously, a number of councils have already reduced services, cut back, cut staff, cut budgets; some have increased council tax. What other funding mechanisms do you think are possible, especially where we are seeing an increase in these key demand areas?

Gareth Davies: In the previous couple of Parliaments, local government showed the way on delivering costs reductions while trying to minimise the impact on services, very significant headcount and funding reductions over a long period in the 2010s. There is still a lot of expertise in local government on how to close these gaps. Of course, at the same time, central Government saw their headcount rising and are now having to tackle exactly the same issues themselves. That is the first point I would make on that.

It is also worth saying that the extreme pressure that councils are under can give some very negative results as well and we have seen some very poor investment decisions in the search for commercial returns on local government investments, particularly commercial property. We have seen some successful examples of that, but quite a few disastrous ones as well, and we know the high-profile examples of those. That is one of the risks that you run when you operate a system under this strain: the search for ways out may cause bigger problems than they solve and that is a risk that central Government need to be aware of as they change the system.

Vicky Davis: Shall I just add to that some indications we talked about in our report? They are signs of worsening services here with authorities operating under these demand pressures. We are seeing rising numbers of complaints on things like adult social care, but also education, health and care plans—the number of appeals have doubled in that space—and how far people are having to go to get the support. Travelling out of area for temporary accommodation is a big one. There has been a 77% increase in people being placed out of the home area. Families are spending longer in bed and breakfast—over the statutory limit of six weeks, as you will be aware from your Committee's inquiry. There are a lot of signs that all is not well in terms of services, and that again is the level of demand coming to bear.

Q81 **Mr Forster:** You have recommended a whole-system, cross-governmental approach to local government finance, particularly financial sustainability. What would such an approach look like, particularly in practice, and how would it help to alleviate the financial pressures that we are seeing across so many local authorities?

Gareth Davies: First, as Abdool mentioned earlier on, it requires a policy solution to unsustainable areas of financial demand on local authorities. SEND is one where we have reported separately, and the Public Accounts Committee held an inquiry on that report. Our conclusion was that this is just a financially unsustainable regime that is not actually delivering results that are positive for the children and young people it is designed to help sufficiently as well. So only central Government can revise their policy, and the Department for Education has announced that it is doing that.

Similarly in some other areas, adult social care is a long-standing area where almost nobody is satisfied with the way it operates but actually improving it is a huge challenge, and you see the number of failed attempts to do that over the years. It is a sequence of addressing the policy drivers for demand and cost increases, which are falling on local authorities that are not adequately funded to meet them.

What is a sustainable approach to each of those areas? When you stitch it together, how do you adequately resource local authorities for the job you are expecting them to do as a whole? Then there are the very fundamental questions about how you incentivise local growth and compensate areas that do not have the natural advantages for local growth that others do. These are long-standing challenges in local government finance, which any solution is going to need to tackle afresh.

Abdool Kara: I would add the opportunity of devolution. Again, it is down to the Government what powers or additional funding mechanisms they wish to enable through devolution. Mayors can work—in some cases, they have already worked—with, for example, the police and fire side in reducing crime, and in Manchester on reducing health demand and issues. This is less about more cash and more about joining this up both at the Whitehall and local level. There are real opportunities there, as well as with trailblazer funding for some of the mayoral combined authorities.

Q82 **Mr Forster:** I have two follow-up questions. Have there been approaches to long-term financial sustainability that have worked in other areas that we could translate to local government? Gareth, you said you almost need to nationalise some of these problems or properly fund them nationally in a local setting. What level of extra funding do we need to make this financially sustainable?

Gareth Davies: I was very careful not to say it is extra funding; it is certainly not our job to recommend that to Government because where do you stop? There are challenges and spending pressures across every Department. I suppose what I was getting at is not leaving local government with an insoluble problem is the issue, and only Government can decide the balance of what that is—additional funding or a different set of legal responsibilities that are affordable.

These are policy questions that only the elected politicians can answer. It is a challenge they have to rise to, otherwise we are left with the completely unsustainable position we have now with deficits building up on the balance sheets of local authorities because they have no choice but to provide the service and have run out of resources to do that. SEND is the clearest example because we have everyone essentially pretending that these deficits do not exist when they are actually having to be funded from the reserves and borrowing of authorities. It is not our job to say where the balance should be struck but it does need to be struck; that is the point we are making.

Q83 **Mr Betts:** We had a session of the Public Accounts Committee with the permanent secretary and officials from the Department, trying to dig away at what they thought was on the agenda for the spending review—not what we agreed. It seemed to amount to the fair funding review and multi-year settlements, and maybe a bit of money from a tourist tax. They were confident that would make local government sustainable. Are you as confident?

Gareth Davies: That is a forward-looking policy question that we are not able to give a view on. Clearly, we will audit the outcome of the new system and provide the same sort of evidence as we have in this report on how it plays out in practice. The key thing here is growth, which of course is the national challenge as well for funding all government. It absolutely applies at a local level as well. Abdool mentioned the fair funding review earlier. Going back to some of the principles of that—how you incentivise local growth and therefore funding for local services while compensating areas that do not have the natural advantages on growth—may be part of it.

Q84 **Mr Betts:** I will ask you a backward-looking question then. Had the fair funding review and multi-year settlements been in place four years ago, would the problems of local government finance now have been as drastic, would they all have been solved, or would they have been less?

Gareth Davies: We cannot know, of course, so we cannot give you an authoritative NAO view on the answer to that. There are obviously lots of reasons to think that there were advantages in what was being proposed; we just cannot say what would have happened. Abdool, you might want to answer that.

Abdool Kara: Setting aside the fair funding review, we point out in the report that there are a number of areas where there has not been the reform needed. We know council tax has not been revalued since 1991, business rates have not been reset since 2013, and the deprivation formulae have not been changed for a number of years as well. Would those changes have made a difference to at least the distribution of funding? Definitely.

On the PAC session—which Vicky and I were at with you and we enjoyed very much—I would add one point, which is my reading of what the officials were saying there. It is certainly not my job to defend them, but they were hinting at a number of quite significant policy changes as well as changes to the funding regime. Gareth has already mentioned SEND. I have no idea what the changes to the SEND system would be, but one could imagine that there might be changes that make it much more financially secure, which would make much more of a difference than putting more cash into the system.

Vicky Davis: I would say this is also why our report recommends the importance of having a plan for funding and service reform, so that the sector knows what is coming and when and how this all fits together as a co-ordinated plan. We heard last week that is not all going to be in place by the time of the spending review in June.

Q85 **Mr Betts:** And there may be a further review to follow.

Vicky Davis: There will be further consultation as well.

Q86 **Mr Betts:** Coming back to the exceptional financial support, it is not exceptional anymore, is it?

Gareth Davies: Not with 42 authorities involved, no.

Q87 **Mr Betts:** What happens now, then? This is not a magic solution. It is not extra money; it is authorities borrowing more, which they will have to pay. How does that fit in with the Treasury's new directive to Departments that they should not now spend capital on revenue issues? It is particularly addressed at health and the Darzi report, but is it going to apply to local government as well?

Gareth Davies: It really lends itself to solving a one-off problem. For example, for essentially bailing an authority whose underlying annual finances are in reasonable shape out of a failed investment, this is a solution that can make some sense. We are now seeing authorities having to participate in this exceptional financial support not because they have made a catastrophic investment decision but just because they have been squeezed by the demand pressures that we have been talking about. It cannot be a sustainable solution to that because the problem you are trying to tackle has not gone away. Borrowing some money to plug an immediate gap does not address next year or the year after, so it is not a good solution in that situation.

Q88 **Mr Betts:** That leads on to the statutory override, and some authorities may have both issues, of course. How on earth is that going to be brought to a termination? Again, we had that at the session last week in the PAC, and nobody seemed to explain it; it was a bit vague what even the options were, let alone the conclusions.

Vicky Davis: We have since had the Treasury minute on the SEND PAC report, which had a recommendation in it about a solution being brought forward with urgency on the statutory override. The response in the Treasury minute is clear that this is linked with the SEND reforms that we have already spoken about. It does not give a commitment as to when there is going to be more certainty about what happens after the override runs out in March 2026.

Q89 **Mr Betts:** It could clearly be a case of having to deal with authorities or financial constraints, some of which have an override, some haven't, and how you unwind that without giving extra to authorities that have had the override when others have not gone for that and have made reductions elsewhere. It is going to be a challenge to do that fairly, isn't it?

Gareth Davies: It is.

Q90 **Lewis Cocking:** You were talking about politicians and councillors making choices and what have you. In their Planning and Infrastructure Bill, the Government have decided to bring in mandatory planning training. I am a councillor, and local government finance is complicated. It is easy to decide what day you want the bins collected as a policy, for example, but when you delve into the numbers, it is really difficult to understand that, particularly as a new councillor. Do you think there is an argument around the Government looking at the possibility where you cannot vote on the council's budget unless you have had training or been to a briefing or something to understand more about what you are doing? Obviously, when you are there for a long time, you can pick things up on what is going on but finance is not for everybody, in the nicest possible way.

Gareth Davies: In an earlier phase of my career, I audited local government and attended lots of audit committee meetings. As you say, there is a wide range of experience with that kind of material among the members of those committees. I would say that it is for local authorities to make sure that their members are inducted into their roles and then properly trained. Particularly if they are taking on specialist roles like being a member of an audit committee, for example, there should be induction and development training as part of that. That is something best left to each authority to do rather than require from the centre, but of course, that is a policy choice that Government could take a different view on. Abdool, you have been a chief executive of a local authority.

Abdool Kara: I would have loved all my members to have been trained in finance, but the fundamental difference is that planning and licensing are quasi-judicial functions that are challengeable through the courts, whereas the setting of a budget can still be challenged but is a whole council matter. The more that are trained, the better; we both agree on that.

Q91 **Lewis Cocking:** Just on that, making bad budgetary decisions can lead to massive ramifications for a council.

Abdool Kara: We have seen that with a small number of authorities that have had to issue section 114s because they have made some very poor decisions in governance terms.

Q92 **Mr Forster:** I am a member of Woking Borough Council, which I wanted to highlight as I move on to my question. Woking is obviously a stark example of this, and I wanted to explore EFS, as Clive was talking about. It just does not work in this situation. EFS works if a council has a short to medium-term issue but long term it can solve it; it just needs to transform its service, sell this big town hall, and EFS bridges that gap.

We are not seeing the problems of local authorities with that anymore. Woking Borough Council has debts of over £2 billion and is going to sell assets of about £1 billion to shrink down to a sensible size. That is in negative equity to £1 billion; it will not repay that. To keep it going, it borrows more, and that is the Government solution. So actually, rather than writing off £1 billion now, the Government are going to continue lending money to Woking, probably meaning we will have to write off more as the taxpayer going forward. Why are the Government continuing with this system that they know is flawed? Is it actually that MHCLG completely gets it but cannot get extra money out of the Treasury?

Gareth Davies: You will have to ask them; that is a question for Government, not for us.

Q93 **Mr Forster:** But why do you think this is happening?

Gareth Davies: Just because writing off £1 billion is an extremely expensive thing to do immediately, isn't it? You can see why that is unattractive. A lot of decisions in Government are essentially affordability versus value for money. It might be a poor value-for-money solution, but often the sad truth of some decisions is that it is the only one you could afford. If you are asking if there should be a better solution to this, obviously the first thing is to avoid councils getting into the position that Woking got into in the first place, and that is about governance and local audit, which you may want to come on to at some point.

Chair: We are coming on to that.

Gareth Davies: These things should not happen, and it is extremely unusual that we have had such a cluster of these across several authorities in a few years. But once they have happened, people are going to have to just recognise reality with this. There is a moral hazard here essentially of councillors spending money they do not have and then falling back on the national taxpayer when it all goes wrong. A better solution to that moral hazard is what is required.

Q94 **Joe Powell:** Moving on then to local audits, which you just referenced, what are the lessons learned from Woking and others around local audit and how would you like to see local audit improved so it contributes to a healthy financial system?

Gareth Davies: For Members' information, I worked at the Audit Commission for a long time and audited local government for many years, up to about 2012. The fact that we have had significant financial failures in local government is in part due to the weakening of the local audit regime in recent years. It certainly was not perfect before 2010, when the abolition of the Audit Commission was announced, and the councils did get into financial difficulties, but not at this scale and these numbers. I have seen the independent report on Woking, the example we have just been talking about, and it is pretty critical of both internal and external audit in that case.

Essentially, what is required is, first, a robust and properly resourced independent external audit function. We have seen the resourcing weakened and the profile of external audits reduced in local government. The arrangements that replaced the Audit Commission were fragmented, and responsibilities were spread over many organisations. Essentially, it lacked a profile and somebody who could pull all the levers to make sure that every council received a timely and robust audit, and that is what has gone wrong. We have seen big backlogs in audit opinions in recent years to the extent that several hundred councils did not have up-to-date accounts audited, which is just unacceptable.

Q95 **Joe Powell:** What is the number now?

Gareth Davies: It is coming down now because the Government have essentially implemented this backstop solution, which has required all councils and their auditors to publish audited accounts by a certain deadline. That is now steadily clearing this backlog of old years. A pretty high price has been paid, though, because in order to do that a lot of auditors have disclaimed their opinion on the accounts because they have not completed their audit work. So the assurance value of many of these audited accounts is pretty low because the auditor is essentially saying, "I have not been able to give my normal opinion on these accounts." So there is a necessary reset to clear the backlog.

Q96 **Joe Powell:** Are they effectively internal audits without any validation?

Gareth Davies: No. They have an audit report from the external auditor on them, but they are the most heavily qualified they could be, in a sense, by saying, "We don't have the information to give an opinion on these accounts." Essentially, local taxpayers up and down the country are not getting basic assurance on how their council tax is being used, and this is an unprecedented disaster. There is just no precedent for public money not being properly audited in this way in any sector in the public sector. Government have recognised that that is unacceptable and are addressing the immediate steps through these backstops but also bringing forward legislation to create a local audit office.

Q97 **Joe Powell:** Do you have any way of estimating how much could be lost to fraud, inefficiency and waste from this situation?

Gareth Davies: No, and that is the point. We do not have the information audited. Clearly, the accounts have been produced in most—not all—cases, and of course councils will have been diligent in preparing those accounts. The principle that you can only really take assurance from these as a user of the accounts if they are properly audited applies to local government as much as any other sector.

Q98 **Joe Powell:** You were coming on to the newly announced local audit office. What would you like to see that office do?

Gareth Davies: It needs to restore the status of external audit in local government as a service in which people who do it take pride and it achieves the basic objectives of any external audit, which is robust, high-quality, timely assurance. The year end for local authorities is 31 March. By the autumn at the latest, there should be audited accounts for the previous financial year so that when councils are setting their budgets over the winter, they know that they are building on a properly audited baseline and understand that the figures are robust.

Members setting budgets and overseeing their finances and local taxpayers who have no option but to pay their council tax and their business rates are all entitled to timely, properly audited information. The first priority for the new organisation is to get back to that as quickly as possible.

Q99 **Chair:** Just going back to what Clive mentioned in terms of the exceptional funding not being exceptional, do you think it is fair to local taxpayers, who again will pay their council tax, rent and business rates on time—if not, they will receive a demand from the council—for councils that may have run into financial difficulties and not produced audits for many years in some cases to be in receipt of exceptional financial support?

Gareth Davies: Obviously, it is not the fault of local residents that their council has got into this situation and that it has unaudited or disclaimed accounts, so I guess I would say it is not fair to take it out on local residents. Clearly, in some cases, people are paying additional rates of council tax, for example, because of financial difficulty that their council has got into, so it has directly affected them financially. It just illustrates how important it is to get out of this situation as quickly as possible, but penalising further by essentially not providing the resources to deal with the immediate issue is unlikely to help.

Q100 **Mr Betts:** Should there be a legal requirement to produce audited accounts by a certain date? There is a legal requirement to set a budget. Should auditors be independently appointed?

Gareth Davies: To your second question, definitely; that is a principle of public audits, that the auditor should be appointed independently of the body being audited. That is how everybody has confidence that this is a properly robust audit, and if the auditor is looking over their shoulder at whether they are going to be reappointed or not, it reduces the independence of the audit process. That is a fundamental principle.

Regarding the first question, at the moment, the Accounts and Audit Regulations do set a deadline for that.

Chair: Which many councils have missed for years.

Gareth Davies: It is clearly in regulations rather than in primary legislation. For many decades, that system worked perfectly fine, so I do not think it is the lack of a stronger date in legislation that is the issue; it is getting more robust arrangements in place in the way that is now intended. For many years, you could count the number of late council accounts on the fingers of one hand.

Q101 **Lewis Cocking:** Among councils that have faced financial distress or issued section 114 notices, do you think there have been flags within their audits that said that the council would be in financial distress before it was? This does not just happen overnight; something must have been going on in their audited accounts for the previous couple of years to lead them to that. Do you think that has been flagged enough or not?

Gareth Davies: I do not want to comment on individual cases. I referred earlier to an independent review in Woking. In some cases, it looks like there have been building concerns, and you can tell that from the way in which things are being reported, but there is a question there about why things were not then escalated faster.

In other cases, there appears to be very little reference to things before they suddenly emerge as problems. If you talk to local authorities about what would have helped in some situations, they will say a much more direct and robust intervention from the auditor when they became aware of these problems building. Of course, that is not an easy thing to do because you are stepping over the technical audit boundary into challenging the financial policy of the authority. This is not straightforward, but a confident and experienced auditor knows how to have that conversation initially with the finance director, then with the chair of the audit committee, and then with the chief executive and the leader of the council. Many times, that was what happened, and somehow we have lost that influential role of intervening informally before things become a serious problem and raising things so they can be addressed within the normal governance processes of the council. We need to get back to that.

Abdool Kara: There are some cases on public record. For example, the auditor for Nottinghamshire Energy Partnership issued recommendations, and for the previous—it no longer exists—Northamptonshire County

Council, there was a public interest report that led to the best value intervention. So there are some on record, but as Gareth says, there are many cases where the accounts and audit of them were not completed in time to make that point.

Vicky Davis: There are also a couple of section 114s that have come about because of unlawful payments, and that has been picked up through external audit.

Chair: This is something that we will definitely continue to probe and look into. Vicky, Gareth and Abdool, thank you very much for coming before the Committee this morning.

Examination of witnesses

Witnesses: Owen Mapley, Dan Bates, Jane Pearson and Rob Powell.

Q102 **Chair:** Thank you to our second panel of guests this morning. Please introduce yourselves for *Hansard*.

Owen Mapley: I am Owen Mapley, the chief executive of CIPFA, the Chartered Institute of Public Finance and Accountancy. As MP Cocking said, I was formerly the CFO and then CEO of Hertfordshire County Council.

Jane Pearson: I am Jane Pearson, the section 151 officer for Ribble Valley Borough Council.

Rob Powell: I am Rob Powell, the executive director for resources and section 151 officer at Warwickshire County Council. I am also president of the Society of County Treasurers.

Dan Bates: I am Dan Bates, an independent consultant looking at financial resilience balance sheets, but I was previously section 151 at a number of district authorities.

Q103 **Chris Curtis:** Thank you for joining us this morning. We are going to start by talking about some key cost pressures facing local councils. What have councils been doing to manage the increased demand and costs of services, with adult social care and SEND probably being the biggest examples? What can the Government do to help? Do you want to start off, Rob?

Rob Powell: For us, we have four. One is in a category of its own, which is special educational needs and disabilities. We currently have a deficit this year of £48 million on a roughly £84 million budget. That will grow, and we will end up with a cumulative deficit of about £151 million next year. That is after investing £15 million in acquiring a school for social, emotional and mental health difficulties, an enormous investment in resource provision and essentially a major transformation programme, which will be an unmanageable pressure when the statutory override ends. We have provided nearly £60 million on the balance sheet to cover some of that risk, but the scale of it is now at a level that we cannot cover. We are less than a year away from the end of the override, and that is a massive issue.

The others are really challenging and difficult but manageable as we are a really robust council. Children's social care is a problem of unit cost and complex cases, not numbers; the number of children in care has gone down. We have increased the numbers open to early help, and we are a pathfinder for the national reforms, which are probably the answer to a more preventive model, so that is much more encouraging.

Adult social care is really a problem of volume as there are far more coming into the system. We have made big changes there, but we cannot invest in capital in the same way in adult social care because it is too big, and the system and the funding stream—in my view—need a reset.

In home-to-school transport, we have legal entitlements policies that I think go back to 1948. The spend on that has tripled in the last five or six years purely because of numbers; it has gone up by 36% for mainstream children and 57% for children with special educational needs and disabilities. Our unit costs have been managed really well and are stable, but it is the SEND issue that really troubles me, and that is the one that we cannot handle locally. If you ignore that, from a Warwickshire point of view, we would feel pretty confident of navigating the storms, but in the medium term, there need to be reforms in all those areas.

Q104 **Chris Curtis:** Jane, is there anything you would like to add to that list?

Jane Pearson: Yes. I am sure you are probably all aware that Ribble Valley is a very large, rural, sparsely-populated district in the north of England—225 square miles—so as a district we are obviously quite fortunate, I suppose you could say, that we do not have the cost pressures that upper tiers and unitaries have. None the less, our cost pressures are largely around providing services in a large rural area, such as refuse collection. We have miles and miles of country lanes, few bus services and an often unreliable rail service, so it is more about access to services, elderly populations in rural areas who are potentially isolated and fuel poverty. Those are the sort of pressures we face.

Our local plan is five years old and needs to be updated, not least to reflect the new targets set by the Secretary of State in terms of house building. We are really struggling in terms of recruitment of certain staff and professionals, especially planners. While it is welcome news to put funding in those areas, it is not always easy to recruit those people, especially with LGR just around the corner.

Other pressures probably go back to the last major reorganisation. We had certain assets transferred to us—for example, a swimming pool that was very out of date and in need of refurbishment, which was a really significant cost—and discretionary services to some extent. While they are really important to residents, with LGR there is a real risk whether they will continue.

Owen Mapley: It is worth saying that what local government has achieved over the last 15 years is remarkable in the face of the pressures. It is quite right that we are focusing on the financial pressures on the sector, but it is the case that if we had not seen the huge transformation in services, there would have been vast numbers of councils in addition to the ones in difficulty now. Areas like adult care—greater integration of services with local providers and local health care providers, local voluntary sector providers and so on—children's services and early intervention to keep families together are multiple examples around the country where councils have done remarkable things to keep providing services in the face of these relentless increases in demand.

The facts now speak for themselves: the average spending of upper tier councils on the core services for adults and children is 80%, and up to 9% of the spending of housing authorities is on homelessness. Of course we want to encourage and see continued transformation, particularly with technology and so on, but the reality is that the relentless march of that demand and the associated cost of it has outstripped councils' ability to manage within it.

Dan Bates: Just to pick up on what Rob was saying about SEND and to give you a few statistics, about three-quarters of the upper-tier authorities have DSG deficits, and in pretty much all cases—whether there is a deficit or not—the reduction surplus is accelerating. In fact, if the statutory override were to finish today, there are three authorities that would have negative reserves. I suspect by the time the accounts come out in June this year, that will be in double figures. Rob was saying that Warwickshire is otherwise robust but will not be forever if it continues.

There are other authorities with very large SEND deficits that are also losing reserves at a fast rate of knots and no longer have any cash, and they are effectively financing their deficits from borrowing. So a £100 million deficit with rates at about 4% or 5% means that £4 million or £5 million is being paid on an already overheated budget simply to fund that deficit, which arguably is an underfunding. That is crowding out the ability to invest and do other good things with their capital because of borrowing costs. That situation is expected to worsen, and more authorities will be paying more in short-term borrowing interest simply because the SEND deficits are out of control.

Q105 **Chris Curtis:** I have one follow-up for Rob, if that is all right. Let us say the Government choose to consolidate funding for demand-led services: temporary accommodation and adult social care. Do you think they could use reasonable unit costs and level of demand in each authority to better calculate a base level of funding?

Rob Powell: That is essentially what the local government funding reform should do by resetting the formulae because they are out of date. I am not quite sure what you meant by consolidate funding. Do you mean nationally?

Chris Curtis: Yes.

Rob Powell: The problem would be the same issue—how to finance the costs that you have in the system—but we need the formulae to be updated because council tax is taking a much higher strain to fund these services than it is in some other areas. I am not sure that is quite right in terms of what people pay and what they get.

Q106 **Chair:** Would you say it is prudent for local authorities to look at investing in those preventive services to try to drive down demand?

Rob Powell: Very much so. The challenge is about affordability. We have invested nearly £6 million in our own children's homes, which is excellent. It is difficult to get them registered quickly, and you have to get the right children in so that they get the right outcomes, but that is a very positive thing. Our pressures in children's social care are much better controlled. We have put £3.5 million into early help, and we are a pathfinder. We cannot do that everywhere. When the pressures come, you obviously start looking at those non-statutory things and think about the affordability, but it is the right thing to do. We have done it in SEND.

We are also purchasing some buses for home-to-school transport to pilot running our own fleet, which can also provide demand-responsive transport to other residents. However, I do not think we could do that at a massive scale because we just do not have the capital, not least because at this rate with the SEND deficits, our borrowing will exceed the capital financing requirement, which means we are borrowing for revenue, and you cannot do that.

Chair: It still amazes me that we are spending on adult social care from council tax, which we will discuss when we come to council tax.

Q107 **Mr Forster:** I am going to ask some questions about council tax. How can it be reformed or replaced? Could it be made fairer? How do you think that could work? Do you think we should change the ratios of council tax bands or add in new bands?

Rob Powell: There is a fundamental question about what local government is for and how you finance it, and the financing mechanism needs to reflect that discussion. If you were just going to look at council tax, I do not think it is right that the valuations were set at a time when I was in the sixth form at school and have not changed since then. Arguably, more bands could be added to make it fair. There is the fundamental thing about people in some very affluent parts of the country paying a great deal less than people in less affluent places and arguably getting much better services just because of the anomalies that have been allowed to grow, but I would prefer to focus on the bigger question about how you finance the services that local government has to provide.

Dan Bates: With the funding review, the Government will do the equalisation. It is fair to say that under the last three Governments, council tax has been left alone with some equalisation, so those with higher tax bases and high band Es have grown their council tax. Those in often high-needs areas that have low tax bases and high levels of council tax support have not been able to grow council tax, and at the same time took the funding cuts. Equalisation will do something there. It will make the system fairer; it will not increase the quantum.

There are things that could be done that are not very popular; for example, in Scotland, they increased rates for bands E to H, and therefore took more from more wealthy homeowners. That could be done within the existing system. Again it was not popular, but this year council tax bases went up by 1.3% and in some areas by 7% or 8% because of second homes. The second homes premium—though not popular—brings extra money into the quantum.

When the Government equalise around tax base, they provide an assumed national council tax rate. A number of authorities are well below that rate and are effectively stranded well below the rate because of their referendum criteria. I think five out of six of those given more than 5% increases were way below band E. Again, it is not very popular, but the Government could allow those at much lower than band E rates to catch up to the notional council tax rate and bring more money into the system so that council tax accounts for more. It will not be popular with residents, but it is one way of bringing in more spending power to help the Government within the existing system.

Owen Mapley: The more significant the reform, the longer it is likely to take, so there should be a debate about longer-term reforms and alternative sources of funding through other types of tax or local shares of national taxes and so on, but in regard to the urgency of the financial problems that so many councils have, there are short-term things that could be changed around council tax that may provide support. We would absolutely endorse the need for greater local flexibility. There is a debate about the cap and whether that is appropriate. Nobody wants to see higher council tax, but some pressures are such that that could be eased by giving councils more flexibility around the discounts they use and maybe linking it in with the national missions.

There are lots of housing permissions that have been given but not built out. Radical short-term things like an ability to start charging council tax after a period to the developers if they have not built those out needs to be looked at in addition to things more longer term because, of course, council tax is inherently hard to change. I would support what everybody has said: that the outdated ratios, valuation matrices and so on are essential to get updated. It is good to know that that is exactly what is being worked on now, and we await the consultation with interest in the coming weeks.

Jane Pearson: The situation we have now across the country is a patchwork of different financing strategies. Different councils are having to look to different areas, so we have a real mismatch of local income taxes, tourist taxes, second homes premiums and green waste charges. Some councils have really had to max out in those areas so there is then a question of fairness. Again, we have been quite fortunate in Ribble Valley that, since 2010, the key funding streams have been about encouraging growth. Our main industries are agriculture, hospitality, leisure and the aerospace industry, but hospitality and leisure are absolutely crucial.

Over the same period—since 2010—we have seen a significant amount of house building, which has then attracted further businesses. The two funding streams I am talking about are the new homes bonus and business rate growth. For many years, we have been told that the new homes bonus would cease, but obviously it has not; it has continued. Currently, about 25% of our budget is funded from those growth streams. We know they will end, so another question for us is what will come out of those reforms, and what protection measures there will be.

Since 2013, there has always been the intention that business rates baselines would be reset, but they have not been. That means that when they do end, the cliff is going to be higher, so the cliff edge will be significant. In Lancashire, we have a Lancashire business rate pool, and all our members have done very well out of the growth because of the reasons I have just said.

Q108 **Mr Forster:** Those have been really helpful contributions. Owen, you mentioned council tax on new properties that are under development or stalled. I actually raised that with Matt Pennycook a while ago, and the Department was quite dismissive; it does not want to put pressure on the construction industry. A lot of comments were made about needing national funding for services delivered locally like SEND, and I get that.

Focusing more on council tax, quite a few have said, "Well, we just need a review; the fact that it is based on '92 prices is ridiculous." The common one is that Buckingham Palace should be paying more than a Blackpool semi-detached. If the Government were to do a revaluation—obviously in the internet age, it would not be as difficult as it would have been in the 90s—do you think it should be net-neutral income, so just about updating numbers, or does it need to be about increasing the pool? How do you do that in a managed way? If a large house in London/the south of England is clearly going to need to pay more council tax based on updated property values, what is the phasing in of that? Do they have one massive bill in one go, or would it be slower than that? How does that work, in your opinion?

Rob Powell: On the net-neutral question, first, we need to decide what councils are there to do. If we are expected to meet the current statutory duties and levels of demand, I would argue there is not enough money in the system, however you distribute it. If that is the case, it is probably not net-neutral. It also relates to whatever the solution will be to the SEND deficits because that is incredibly serious for our financing.

In regard to the transitional arrangements, there are lots of different ways that you can phase things, give people notice, use reliefs and make sure that that is manageable. There may be some benefits in terms of housing in having a system that is more closely geared to property values as well. It might change some incentives and help to get some benefits on housing. It needs to be looked at in the round in terms of what the Government are trying to do with this.

Q109 **Mr Betts:** What do you think should be done about the business rates system? There have been promises of major reform in the past, particularly addressing the enormous disparity between retail shops on the high street and warehouses for online distribution. It seems that we are now back to maybe just resetting the business rate retention system, which is all about being looked at with a few tweaks to the hospitality industry. It is not very radical, is it?

Dan Bates: It is not very radical, but it is a bit like council tax revaluation; it is almost in the too-hard-to-do box in terms of how you find a valuation of an organisation that is largely on the internet and does not have land value. It is difficult to do, but that does not mean it should not be done and there should not be an attempt to do it.

Meanwhile, in the existing system, the non-radical part of it is even less radical in that a reset has not happened since 2013 to 2014, which has created a massive redistribution of funding across authorities with those that are not losing out on business rates growth. It is a difficult one to answer because it would take fundamental rethinking and, in terms of stability, a lot of work to get from the existing system to a new system. It just feels sometimes that that is too hard to do, so it does not get done.

Owen Mapley: There are things that could be looked at. It is really hard and is tweaked in pretty much every Budget in terms of reliefs and exemptions, which adds to the overall complexity in the system. I would be a bit cautious about just further tweaking, but more fundamental reform is inherently difficult. We did a report with the LGA and Solace over the course of the last year, which showed there were things you can look at such as more flexibility that you could give councils on business rates relief, charitable and empty property relief, whether exemptions are appropriate, or cutdowns on business rates avoidance. There have been schemes in Wales and Scotland that have been pretty successful in making sure that charitable relief is applied fairly.

There are a number of things like that that could be looked at, but again, these are in the margins of things. The more fundamental question is about what we are asking local government to do and whether there is sufficient funding in the system to do it. In the environment we are now in, nobody is expecting huge increases, so you are then left wondering what else you can do. Further efficiency is always possible but is getting increasingly hard. We need to look at the demands we make on local authorities.

Q110 **Mr Betts:** A system that is built on needing more and more reliefs and exemptions is not really a stable system, is it?

Owen Mapley: That is the story of local government funding over a long time; it is such a complicated mix of different things with so many different exemptions and so on. What we are looking for is short-term support while building towards more radical, longer-term reform if there is the political appetite to do that.

Q111 **Chris Curtis:** This question is potentially to Owen on the rates resets. I understand that there is obviously a geographic inequality element to this that has been growing since 2013, but the councils that have probably seen the biggest growth are the ones that have really tried hard to move barriers to investment, encourage businesses to move in, and make sure that they have planning committees that support building rather than opposing it—all the things that a pro-growth Government who put growth as their No. 1 mission should be encouraging. Do they not deserve to keep a good chunk of the business rates that they have worked so hard to bring in?

Owen Mapley: That is absolutely a take, and I completely agree with the point about what we want our local authorities to be doing. So much of the debate is focused on survival, but we all know that local authorities work best when they are champions of the wider determinants—not just health and wellbeing but employability, economic growth and so on. We need to find time in this difficult debate to see how local and central Government can work together to empower local councils to do exactly that.

Q112 **Chris Curtis:** I get this is geographic, so we should not dismiss that point. It is easier to get investment in some areas than others, but ultimately, a business rates reset will take money away from those that have been really encouraging investing in business and potentially moving it to places that have been trying to block investments in their local area.

Owen Mapley: But you also have to look at the geographic differences. The ability of some areas to encourage and drive that business growth is very different in different parts of the country, so you also have to look at redistribution and transitional relief if you make major changes. But I get the point: absolutely, local authorities should be best enabled to be local drivers of economic growth.

Jane Pearson: To me, it comes back to the word uncertainty. It was always the intention that business rates would be reset from the outset of the business rates retention system, and that has not happened. It was also intended that there would be reviews of the central list. There are some areas that have high risks, for example, power stations, and therefore have not taken the gamble—if I can put it like that—to give away the Government's safety net by joining pools. But it is more the uncertainty that has been there for so long. Local authorities are extremely complex. We really need certainty.

As any 151 officer would say, it is that real difficulty in making what are—to some extent—educated guesses with public money as to what the future—two, three or four years—will look like. Just having one-year-only settlements makes that really difficult, which is paradoxically why some councils such as ourselves have built up reserves. It is because of that unknown that we were unsure whether key funding streams would end overnight, which we were told they would for many years. It is not just about fairness; it is about having certainty.

Q113 **Mr Forster:** I want to come on to other sources of income. Partly, I was asked to do this from a Woking perspective, as when councils try to find other sources of income, it can go spectacularly wrong. I would really welcome your thoughts on some examples of best practices with this. What are the examples where they have been able to manage the risk effectively, and what is the best percentage a council is able to get from another source of income?

Rob Powell: I can tell you what we have done in Warwickshire: we have tried to be commercial and look at our balance sheet as well as our revenue. There are two major things. First, we have always traded quite a lot of services. We turn over about £45 million. A lot of that is to schools, but it is also to other councils. We have a fantastic legal service that supports many other local authorities, and we make about £11 million of gross surplus and get a contribution of about £2.5 million to our overhead, so that is worth doing. It is not without risk, and academisation in the schools market is quite a big risk to that. I do not think it will go up.

Secondly, we have set up a property and development group, which is not about acquiring properties for rent; it is about developing our land, and we will make more by doing that than just selling the land to a developer. It is only in Warwickshire. It is about getting good-quality, sustainable housing and business premises. It is about small business units that the market does not build as it tends to build the big sheds. It is a gap in the market. The group manages our rent roll for the council as well and is a lot better at it than we were when we were trying to do it alongside everything else in our property team. It is a couple of years old and is still building up. It is going to build 1,200 properties in the next five years and has a pipeline of about 2,200. It should give us a consistent £3.4 million into our medium-term financial strategy—about 1% on the council tax—but it is not risk-free. We have not gone into this with our eyes closed. We have a reasonable reserve to cover commercial risk and timing differences as the company ramps up.

The big schemes are being done in partnership with Vistry Group, a big house builder, which is a really sensible deal for us in the way that it is structured. It is minimising our borrowing exposure on the large schemes and leveraging the land assets that we have. We govern that very tightly and carefully, and all our commercial activity has to be within Warwickshire or it requires extra sign-off from councillors. We are only doing this to amplify our outcomes, but it has a financial upside. That is what we have done.

Owen Mapley: There are plenty of examples of prudent councils that have taken and managed risks in core areas of their competency around developing their own assets but not going out radically into the commercial property market, which they are not an expert at. We have seen services that are provided as trading services instead of outsourcing; they can provide steady income. But as Rob says, there are a set of risks, and it is a sign of just how pressured this sector is that we are asking councils to almost scrabble around and look for any way of raising money, and that risks inappropriate activity because of the pressures that they are under.

I can think of no other part of the public sector that has to do that. We do not ask our schools or hospitals to act commercially and get into investments and so on to fund their core services. It comes back to the theme that we have all been talking about: what do we want our local authorities to do, and how can we ensure that there is adequate funding for them to do that?

Dan Bates: Aligned to that as well is that it is not exactly a general fund, but there is also the HRA where there is a lot of expertise and lots of really good examples of where authorities with HRAs have built houses, sometimes commercially and sometimes mixed, and have been able to achieve some really good things in terms of outcomes, utilising expertise and resources, which has been curtailed severely by rent freezes, policies over right to buy and so on. There is a massive sector that is capable of delivering some really good outcomes for housing supply as much as anything, but at the moment, it is a bit hamstrung by the financial situation and some rules and regulations that it is bound by.

Chair: We touched on it earlier, but Lewis is going to ask about financial distress.

Q114 **Lewis Cocking:** Councils do not go bankrupt overnight. Do you think there are enough early warning systems in place to alert people that if you keep making decisions like this, you may end up in financial difficulty?

Owen Mapley: An early warning system would be useful if you were seeing increasing numbers of councils struggling to balance their books and having to go to ever more extreme ways to ward off bankruptcy. As you discussed in the last session, given the fact that we now have 30 councils in exceptional financial support, the canary in the coalmine is not just singing; it is lying on the floor, gasping for breath. That is an early warning system right there.

We should not understate how much information there is in the public domain. I have been a civil servant in central Government, a board member in the NHS, and a CFO in local government. There is more information published in the public domain in local government than in any other sector I have worked in. Of course, it is important that that gets independently audited, and I am sure we will talk about local audit. There is so much information out there that is beholden to local authorities themselves through their audit committees. It is really important to have a rigorous, high-quality audit committee with appropriately qualified people, who if necessary are independent, chairing those to give a really good hard kick of the tyres locally and scrutinise the management accounts and forward plans that are published. Hundreds of pages of financial information are published by local authorities.

In addition to other forms of peer reviews and the MHCLG's review of at-risk councils, there is a lot of information out there, so as the risks and pressures go up, we have to pay attention to all those early warning signs. The fact is that more and more councils are now beyond the point where it was an exceptional problem, poorly managed, or there was bad governance. We are just getting more and more councils that are struggling to keep their nose above water with the relentless rise of the demand pressures.

Q115 **Lewis Cocking:** But do you think those warning signs are good enough? Take peer reviews, for example. Lots of councils that have gone bankrupt or been issued section 114 notices have had really stunning peer reviews— nothing to see here; everything is really good; the council is really good—and then suddenly, within 12 months to two years, they are in massive financial difficulty, so the early warning signs are not working, are they?

Owen Mapley: I agree that in some that have gone spectacularly wrong, there were signs that were not listened to, even if they were there. Given the pressures they are under, there may be even more that could be done. For example, with the exceptional financial support, there were resilience reviews of those councils commissioned by MHCLG. I will declare an interest: CIPFA did most of those reviews. It was an additional independent way of coming in to look at finances, but absolutely, we need to be open to considering whether there are more robust measures.

I am sure we will talk about local audit, but the opinion of the local auditor is important on those accounts. The dynamic governance relationship between the auditor and the council has been lost over the years. There has been a reduction in the emphasis on the value for money reporting that they do. There has been less routine walking the corridors and having a dynamic relationship with the leader, the chief exec and the CFO. We need to get back into not just good, timely, qualified accounts but a good, healthy governance and assurance landscape where a combination of the council's own activities, independent third-party reviews and the work of the external and the internal auditor is valued and used both locally and nationally, whether it be through the new local audit office or the Department and so on.

Dan Bates: I agree. Some sector-driven reviews have not been great, but MHCLG has a role to play as well. I listened to last Thursday's Committee with the MHCLG officers who said they were really confident that they would know if there was a problem occurring. If that confidence was based on the previous Oflog, then I would not have any confidence whatsoever because Oflog just created a whole burden on the sector, taking poor-quality data that was out of date, very singly focused around one or two dubious measures, some of which were not bad, and set a whole load of hares running based upon that. The Department has a role to play in properly understanding its sector and having early warning systems. They say they are confident; I hope that they have ramped up that work since Oflog was abolished.

Jane Pearson: I have two things to say. First, governance can be the boring side of local government, but it is always crucial. Secondly, audits can tend to be very much backward-looking. There need to be many more forward-looking assessments done, which would really aid decision-making, and everybody would be much more in tune with what the future looks like, but then we are back to the uncertainty of local government finance.

Q116 **Joe Powell:** Coming to ringfencing, I will ask these questions together to avoid everyone just agreeing that ringfencing is bad. What ringfencing would you get rid of and what would you keep?

Jane Pearson: Local government should be funded properly, and it is about the pot.

Chair: No strings attached.

Q117 **Joe Powell:** Are there any strings you would keep?

Jane Pearson: There may be one or two, but I feel that we are all saying the same thing: the pot is not big enough. If the pot stays the same, then it just creates a new set of winners and losers. Some funding streams—especially some housing ones—have real value in being ringfenced and very specific, but overall I feel strongly that the pot for local government should be big enough to pay for the crucial services that we are intended to deliver.

Rob Powell: I do not think ringfencing is terribly helpful, but it is a function of the variety of funding sources and different Departments funding local government. For me, it is that first-principles question. We get 130-odd grants.

Q118 **Joe Powell:** One hundred and thirty?

Rob Powell: Yes, with an average value of £2.5 million. There is a cottage industry behind me because I have to sign everything off.

Q119 **Joe Powell:** How many staff do you have to employ to manage it?

Rob Powell: We have not counted them because it is arms and legs, but it will be a lot of people working on that. There is a whole thing about erring on the side of not ringfencing and simplifying things. If I was in the Department for Health and Social Care or DfE, I could understand why you would want to know your money was going on social care or—

Q120 **Chair:** The public health budget, for example.

Rob Powell: Public health, yes.

Q121 **Joe Powell:** The Government have their missions, and previous witnesses have talked about a shift to more of an outcomes approach. How do you think that could work?

Dan Bates: Local authorities know their areas and the outcomes they want to achieve. The problem with ringfencing is it is a top-down approach; the Government say, "This is what we want from you," and therefore we have to go and chase that. A lot of that work could be spent saying, "This is what we need locally; is there a government pot that meets that?" So there will be some ringfences needed because you want to have a specific government priority address, but there will be lots more where local areas can express what they need, particularly if they are working together at the combined authority area.

Some pots could filter into those because the work has been done, the need has been proven, and the funding is there, but a lot of people have said to me previously, "We are getting money for that, but we need it for this. We're not allowed to transfer it across to this, and this is where we know the need is." More of a concordat is needed between local and central Government to allow local authorities to express what their needs are and know that there is funding there to help.

Q122 **Joe Powell:** One example we have heard about is the prevention of homelessness versus addressing homelessness. Obviously, you do not want to underfund prevention; you have a statutory duty to look after people. It is an interesting example. Owen, do you have any reflections on that?

Owen Mapley: I agree that the move has to be more towards outcomes, but it also has to be more towards local partners collaborating and working together. I would argue that ringfences constrain some of that working together. I saw a BBC News article today talking about what Washwood Heath Health and Wellbeing Centre is achieving by having doctors, GPs, nurses, occupational therapists, council social care teams, mental health professionals and charity staff working under one roof. If they were all facing ringfences to do something in a particular way, it would guard against that sort of multi-agency collaboration.

We must empower local partners to work together and create a culture where they are less protective, but of course they are all under pressure, and the tendency will always be to put in more ringfences. We still see it happening, for example, with the recent pothole funding; it is just so tempting. So do we empower and trust local authorities to deliver?

Chair: Thank you. We will move on to local government funding reform.

Q123 **Chris Curtis:** Is there anything radical to the way we fund local government that you think would be a good idea for the Government to put on the table—for example, introducing new taxes, such as a tourist levy; moving from the poverty taxes we have to a land value tax; looking at assigning a portion of national taxes to local authorities; or anything else radical you think the Government should be looking into? Does anyone want to come up with some ideas?

Owen Mapley: Very quickly, any or all of those are worth exploring, but let us not kid ourselves about the clear and present danger that we are already facing due to the urgency of the problems. There is a risk that we could have interesting, long-term debates about how the sector could be funded, and what we need is a really hard look at what we are asking the sector to do and how we can support it to transition to a more sustainable model. It would be great if we could have those as well as short-term things, but there is a risk that some of those could prove distracting when it is clear that the overall pot is constrained because of the wider public financing situation.

Jane Pearson: With LGR on the table at the same time, we are potentially talking about a perfect storm. In terms of being radical, it is the key things about being accountable and fair. The new methodology talks about determining the differences between authorities in terms of demands and needs. It is then about the cost drivers and being fully transparent with what those are, and looking at area cost adjustments and the ability of different areas to raise council tax. To me, it would be quite radical if they were all done in a transparent, fair and accountable manner because we have not had that for so long.

Q124 **Chris Curtis:** So potentially leave the more radical options until we have LGR done?

Jane Pearson: Yes.

Dan Bates: Slightly less radical things that could be done in the HRA would be to replace some lost income, get rid of the straitjackets around rent increases and allow HRAs to get back to investing in housing stock. Although it is a little less palatable, the same could be done for council tax to allow some of those that are stranded and below band E—if they want to and can agree—to bring more income in. Stop constraining local government's incomes, obviously remove the ringfences, and support good projects rather than look to constrain and control.

Rob Powell: I would echo Owen. There is a short-term piece, but in the longer term, local government has shown itself to be one of the most innovative parts of the public sector. With more fiscal devolution, there is a lot more that we could do, and we would probably deliver value for money based on track record.

Q125 **Mr Betts:** The Public Accounts Committee and the permanent secretary were saying that the review of funding would probably only change the fair funding review, the distribution of the money, and probably also the multi-year settlements that had been promised, but maybe not much else. Council tax and business rate reform were ruled out. Are the multi-year settlements and fair funding review going to sort out the problem?

Dan Bates: I do not think they will sort out the problem, but multi-year settlements are really welcomed. When I think back to the one four-year settlement in the middle of the three Conservative and coalition Governments, the certainty was at least there, even though they were not very nice figures. In terms of everything else, in aggregate, local government will still have the same problems. It will redistribute those problems because those that have done really badly over the last 15 years will do less badly, but in a zero-sum game, those that have done okay will start to lose out. I do not think it will change local government's problems in aggregate; it will move the problems to different authorities.

Jane Pearson: I feel quite strongly that local government is the Cinderella service of the public sector. Some services that we provide—certainly on the discretionary lines—really assist in terms of reducing demand on the NHS and so on. If more money is not put into the local government pot, then I really feel we will just be creating a new set of winners and losers.

Owen Mapley: I would say those changes are necessary but not sufficient. What is also needed came through loud and clear in the previous session: the need for policy reform to try to address those demands, drivers and some services. It is worth saying that I wrote to all the chief financial officers as they were finalising their budgets for this financial year and said that standard practice is to look two to three years ahead in the way they do their section 25 statements, looking at the adequacy of their reserves and the robustness of their estimates. Given the fundamental uncertainties, the fact we have a spending review coming, and major funding and policy reform mooted, it would be appropriate to shrink that horizon.

If you can get through 2025 and 2026, that would be fine, but if we get past the spending review and reforms and there is still no improvement, I cannot continue to be ruthlessly pragmatic in that sort of advice to CFOs. We will see increasing numbers of section 151 officers struggling to see whether there is going to be sufficient things coming down the road to keep them sustainable in the medium term rather than just the current constant short terms of exceptional this and exceptional that.

Chair: Thank you very much. Our discussion will definitely continue. The one thing that is loud and clear is the question of what local government is for, and making sure it is adequately funded.