HOUSE OF COMMONS

Housing, Communities and Local Government Committee

Oral evidence: Local authority financial sustainability and the section 114 regime, HC 309

Monday 8 February 2021

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Watch the meeting

Members present: Mr Clive Betts (Chair); Bob Blackman; Ian Byrne; Brendan Clarke-Smith; Ben Everitt; Rachel Hopkins; Ian Levy; Mohammad Yasin.

Questions 1 - 46

Witnesses

I. Rob Whiteman, CEO, Chartered Institute of Public Finance and Accountancy (CIPFA); Cllr Richard Watts, Chair, Resources Board, Local Government Association (LGA).

Examination of witnesses

Witnesses: Rob Whiteman and Richard Watts.

Chair: Welcome, everyone, to this afternoon's session of the Housing, Communities and Local Government Select Committee. Our session this afternoon is about local authority financial sustainability and the section 114 regime. We have one panel this afternoon, and we will come to our witnesses shortly. We will eventually have a session with the leader, chief executive and auditor of Croydon Council to look at the particular issues and challenges that authority has, but this afternoon we will be looking at the general issues about local authority finances, particularly in the current covid-related climate.

Just before we go over to our two witnesses this afternoon, I will ask members of the Committee to put on record any interests they may have that are particularly relevant to this inquiry. I am a vice-president of the Local Government Association.

Rachel Hopkins: I am a vice-president of the Local Government Association, I am a councillor in Luton and I employ a councillor.

Brendan Clarke-Smith: I am a councillor and I also employ a councillor.

Ian Byrne: I am a councillor in Liverpool.

Ben Everitt: I am a councillor.

Q1 **Chair:** Bob Blackman will be joining us; he is a vice-president of the Local Government Association as well.

To our two witnesses today, you are very welcome. Thank you for joining us. I will just let you say a little bit about yourselves before we start.

Rob Whiteman: Good afternoon. I am Rob Whiteman. I am chief executive of CIPFA, the Chartered Institute of Public Finance and Accountancy. I have a background in local government. I was a chief financial officer as well as a chief executive. I used to run the IDeA, the Improvement and Development Agency, the improvement body for local government, which is now part of the LGA, and I am a former senior civil servant. In this setting, CIPFA sets accounting standards and guidance on issues such as 114 notices and how to be an effective CFO.

Chair: We will pick some of those particular issues up in some of our questions later.

Richard Watts: I am Councillor Richard Watts. I chair the cross-party Local Government Association's Resources Board, which deals with issues of finance, welfare reform and other direct issues of relevance to this Committee. On top of that, I am also the leader of the London Borough of Islington in north London.

Q2 **Chair:** As I just mentioned, we have seen the 114 notice in Croydon. We will come on to the details of that council in another session, but does that reflect a wider problem with local authority finances? Is Croydon the tip of an iceberg that is rapidly melting beneath us anyway?

Rob Whiteman: My understanding is that there are around 12 authorities that are in discussion with the Department, with MHCLG. They are in or around a section 114 position and they are requesting capitalisation orders in order to avert that. You will want to ask the Department about this yourself. Six authorities have now agreed with the Department what a capitalisation order might look like; the other six are having ongoing discussions.

That is a lot more authorities than in the past. Having 12 authorities in that position is obviously quite significant. This is not just because of the general budget pressures facing local government; things have been brought to a head, of course, by the additional pressures of the covid crisis. On the other hand, one could say that 12 authorities being at that crunch point is not a lot for the whole sector. There are more than 12 authorities that are likely to get to that position in the next year or two if some of the issues we will talk about today, such as loss of income, difficulties with the tax-raising base and service pressures, are not resolved.

Twelve probably is the tip of the iceberg, but, as I understand it, the Department is likely to agree a capitalisation order. In effect, that would say, "Given the unusual circumstances we are in at the moment, you will be allowed to convert revenue expenditure to be capital expenditure in order that you can balance the books outside of normal accounting treatment", and the Department will put a number of requirements on the authorities in terms of what they have to do to be allowed that capitalisation order. You may want to ask about that during the hearing, and I will gladly say what I know.

Richard Watts: The honest answer to the question is that there is a specific issue around not just Croydon, although Croydon is clearly in the most acute difficulties at the moment, but a number of other councils, as Rob set out. There is a wider context to all of this, which is that local government has seen a £15 billion reduction to its core funding since 2010, at a time when demand has increased. Most high-level local authorities have seen demand for children and adult social care increase quite substantially.

That double whammy of increased demand for the most expensive services, coupled with reductions in funding, has seen local authorities go into the covid crisis in a pretty weak position. There are then all of the challenges brought about by covid, which I am happy to talk more about in detail when we get into it. That is not just extra expenditure, which Government have done a good job in meeting, but also very significant amounts of lost income, with more lost income to come as well. It is that lost income that is pushing some councils into real difficulties at the moment.

Q3 **Chair:** In terms of these 12 councils that Rob mentioned, is it true that none of them is being given any certainty about whether they will get capitalisation approved at this stage? Is it something that is going to be announced in the Budget? That seems awfully late, if councils are trying to make their own budgets for the next financial year.

Rob Whiteman: Six of them have had something in writing now that says they will be given capitalisation if they agree to the conditions that are being discussed. The other six are in discussions nearing that point.

Q4 **Chair:** Just coming on to how we reached this point, is this due to the general issue of cuts to grant over the years and then covid, particularly the lost-income situation and the different ways that has affected different authorities? Would we be able to go to those 12 authorities and say, "Those reasons are why you have got into a problem and others have not", or are there things those local authorities might have done better themselves in terms of financial management or maybe speculating on certain commercial investments?

Rob Whiteman: The fact that, before covid, we went 20 years without a 114 notice between Hackney and Northamptonshire shows that, generally speaking, from a finance perspective the section 114 regime is quite effective. People would acknowledge that local government has a very strong track record of financial management. That is because it has this unique legal duty to balance the books that does not exist for all public services.

Clearly, covid then accelerated the points that Councillor Watts made earlier. Local government came into the covid crisis already having faced quite significant cutbacks in its resources. For the authorities that are nearest the edge, it is probably a mixture of factors. In some of their cases, the regime to fund pressures might have been a little less favourable on them than it has been on some authorities. In some cases, where we have public interest reports, for example, from the auditors, it is not only about the lack of resources but about the fact that those councils have probably made some decisions that have catapulted them to this point as well.

It is not one or the other. It is that the circumstances of what is often labelled austerity or cutbacks have put the sector in a vulnerable position. Covid has pushed some people nearer the edge, but some of the people being pushed nearer the edge are being pushed as a result of some of the decisions they have made.

Richard Watts: From the LGA's point of view, I would not dissent from a great deal of what Rob said. We went a very long time without any section 114 notices at all until the Northamptonshire notice was published a few years ago; we have gone another few years and there is now another one in Croydon. In that time, a number of councils have come very close to section 114 notices but have just about avoided them, albeit taking quite a lot of the same measures they would have had to take had one been published. What that meant for local services and local council decision-making was not that materially different, but they did avoid the bad publicity and loss of control that the publication of a section 114 notice inevitably leads to.

I would stick to my categorisation. The sector was extremely challenged going into the covid crisis and remains very challenged through it. However, there are some individual issues largely revealed in auditors' reports, LGA sector-led peer reviews and a number of other external looks at councils that have pushed some councils over the edge. Other councils have been particularly unlucky with external circumstances. It would be remiss not to mention councils like Luton and the Manchester authorities, which were very financially entwined into airports for very good, long-standing reasons, for which I would not criticise those councils at all. They have been hit very hard in this crisis as well. They were particularly exposed during the covid crisis.

One thing you learn about local government finances, as you will be aware, is that it is very difficult to generalise across 300-and-something very different authorities with very different financial bases. There will be unique circumstances. What you can tie together from all of those is not immediately obvious, except for the fact that for quite a lot of them long-term pressure on adult social care and children's social care spending is really stretching them to breaking point. I would argue that is the case in Croydon as well, from having a pretty good understanding of that authority's finances.

Q5 **Chair:** Like I say, we will come on to the detail of Croydon in another session, but we will follow up on some of those issues later in this session as well. You mentioned peer review, and we will also come back to that issue to ask some questions about that.

To finish this section, Richard, you mentioned that one of the challenges was the Government support during the pandemic. On the spending side, you said that you felt the Government had generally done a pretty good job—to summarise what you said—but there were real challenges around loss of income. Do you want to say a little bit more about that? What concerns does the LGA have about the support councils have received?

Richard Watts: As I said, the financial hit to local authorities has come in three ways, primarily. The first is extra out-of-pocket expenditure on PPE, food provision and a whole range of different ways in which local councils have stepped in to support their areas. As a rule, those costs have been met by Government on a rolling basis. The LGA welcomes that, and I do not want to downplay the importance of that.

We have also lost money on things like revenue from people using gyms and leisure centres or people using pay-and-display car parks and a whole range of other issues like that. Just over half of that income has been met. The disparity between the amount of income lost and the amount of that that has been settled creates some issues for local government.

The third area is the collection fund, which is uncollected council tax and business rates. We are now running into a period at the start of next financial year when those issues start to appear on our balance sheets. We are still in detailed discussions with the Government about how some of those issues affecting the collection fund will play out. There is the potential for another financial hit as uncollectable business rates and council tax from this financial year hit next year. There is an agreement from the Government that there will be a significant settlement towards that. Again, I welcome that, but at the moment we are not talking about receiving 100% of those. There are not conversations about local government receiving 100% of those losses back, which again will still leave holes in the balance sheet compared to where we would have been, if covid had never happened.

Chair: There are important issues, and we often do forget about the lost income and the income that is going to be lost as people struggle to pay bills next year, with unemployment rising and businesses getting into continued difficulties. I am sure we will come back to those issues as well.

One of the issues that was raised in Croydon and quite a few other authorities was borrowing for yield.

Q6 **Ian Byrne:** If borrowing for yield means generating revenue, is there a problem with that?

Rob Whiteman: Yes, there is. Councils can borrow so long as they meet the tests of the prudential code. It has always been the case that borrowing for purely yield, or borrowing for purely commercial purposes, is not allowed for under the code. The purpose of the prudential code is that people can borrow to provide services and people can be quite innovative and creative. They can invest in local regeneration and transport infrastructure, including investments that may be commercial in nature but are going to be linked to the local economy or local service provision.

It has always been understood that borrowing purely for yield, particularly outside of a local authority's own area, is what is referred to as "in advance of need". In other words, you are borrowing and it is not aligned to you having a service or regeneration need within your borough. For a couple of decades, that was understood and people followed the code.

Revenue budgets became so tight. In a way, local authorities have greater capital freedoms than they have revenue freedoms. You have to have a referendum to put the council tax up. You are very dependent on government grant. Revenue is very tight. Because the capital freedoms were greater, people started to reinterpret the rules. What we saw was a pretty material increase in local authority borrowing, some of that being for commercial-yield purposes, which broke the code.

We have tightened the rules of the prudential code to be absolutely clear that borrowing for yield is not allowed. Mr Byrne, I would remind you that the vast majority of councils have not borrowed for yield; they have followed the prudential code as it has always existed. This reclarification or tightening of the rules is for those few authorities that have done a lot of commercial borrowing. At the same time as CIPFA has tightened the rules on that in the prudential code, the Treasury has tightened the rules on PWLB to make sure that it does not apply to borrowing for yield.

The little bit of interpretation that started to go on is that people said, "If we are going to use this income to subsidise services, surely it is for services. In other words, we are borrowing this money and we are going to use the income from commercial purposes to subsidise services. Therefore, it is not in advance of need". That is an interpretation that I think is against the code.

Standing back from all of this, this always remains a matter for Parliament and a matter for the Government, and I generally support where Parliament and the Government have always been, in that local authorities are public institutions that borrow in order to support services and regenerate their local economies. That involves some appropriate use of borrowing for commercial purposes towards those purposes, but essentially we are not property development companies with an ancillary public interest requirement. The scale of some borrowing in advance of need has really placed these authorities in the position of acting commercially at the forefront rather than being a local authority and providing services at the forefront.

Remember that local authorities do have access to PWLB. You notify the Treasury that you have met the rules of the prudential code and you are going to draw down this borrowing. In the corporate world, the money markets will not give you access to that capital unless you have a sound business case and you are not over-leveraged. In a way, local authorities that have borrowed excessively for yield have managed to have access to capital that a commercial venture would not have access to on that scale. I am sorry. That is a very long answer, but in summary it is a problem and we are right to try to stop it.

Ian Byrne: It was a very comprehensive answer. You have covered about three questions; well done.

Richard Watts: The LGA's view on this is that there are a small number of councils where this is potentially an issue, but we should not seek to throw the baby out with the bathwater here. We should see this issue in perspective. The National Audit Office report on commercial property income said that about 80% of so-called commercial borrowing was done by just 49 councils, albeit we were struggling towards a definition of "commercial income", so we are not necessarily comparing apples with apples in all of this. That gives you a bit of a sense of things. There is a small number of councils doing a lot of this so-called commercial borrowing. Most councils, including my own, I have to say, are not going anywhere near it.

There is about £6.6 billion of it. To put that into some context, that is out of a total council capital spending pot in the same period of £75 billion, of which only £1.4 billion—2% of all council capital funding—was these very out-of-area investments Rob was referring to. We have all seen newspaper reports of councils buying petrol stations 200 miles away and stuff like that. They are eye-catching, but they are a very small part indeed of councils' overall capital expenditure.

There is another £2.5 billion of borrowing that was not precisely in the boundaries of a local authority but was in the same economic area and so might be argued to have some regeneration benefit as well, but there is a pretty grey area in some of that activity.

The LGA would argue that there are lots of completely legitimate reasons why councils might want to buy commercial property. For example, councils are investing in local areas. There is a really good example I could quote in Stockton, where the council bought two shopping centres, neither of which was very viable, and effectively merged the businesses into one, which made it a commercially viable shopping centre. They demolished the other to build a new park, which had a transformative impact on the city centre. I would argue that projects like that are absolutely what local authorities should be pursuing in the current period, but, under the rules, that would be classed as commercial borrowing.

The LGA's view is that the Treasury's reforms to the Public Works Loans Board rules probably get the balance right in terms of discouraging the borrowing that really should not be happening, but not cracking down on this so far that you discourage high street regeneration, new housing and all the other stuff that we want local authorities to be engaging in.

Q7 **Ian Byrne:** I just have a couple of points there, Richard. You said "a small number of councils", so you do not believe it is widespread. I have a quote here. Between 2016 and 2019, there was a 14-fold increase in commercial acquisitions. If we are saying that a small number of councils are actually engaging in what we are talking about—borrowing in order to generate revenue—are those councils the ones that are most under attack from austerity? Are those the councils that are forced into this gamble to generate revenues to provide services? I am really interested in that dynamic.

Richard Watts: The honest answer is that there is not a uniform picture. To a degree, the figures are skewed by a small number of relatively small district councils that have taken very large levels of commercial borrowing. The LGA cannot speak for individual authorities. To be honest, if you want to talk to some of the councils, you would probably be better off doing it directly. The figures are, to a degree, thrown off by that. Less than five local authorities have taken on very large degrees of borrowing.

I would point out that between 2010 and 2015-16, the view of the Secretary of State was that councils should seek to replace lost grant with income from commercial borrowing. Policy then was that this was a legitimate way for councils to substitute the grant they have lost because of the programme of spending reductions. Governments have a right to change policy—I completely accept that—but there has been a pretty sharp change in tone in Government rhetoric from the coalition years to now.

Q8 **Ian Byrne:** To pick up on that point, the LGA gave evidence to the Public Accounts Committee last year and said that the Government had encouraged councils to be more commercial. How did they do that? You said before that there was a bit of a grey area between what was and was not deemed commercial.

Richard Watts: That is right. Rob has described well the kind of thinking process that has gone on in not the majority but a number of authorities in terms of how you can justify effectively commercial investments in bits of the country that are there to prop up lost revenue budgets. I have spoken to council leaders from a number of different councils who basically say that they get no revenue grant at all any more and therefore they are wholly reliant on the income they get from the commercial investments that the council has made, which continue to return a yield.

There has been a challenge in all of this. There has been a significant change in tone around all of this. As I say, the LGA's view is that we are probably now in the right place in clearly reminding councils of their duties here. They are not there to borrow purely for profit. That does, though, underline the need for sustainable local government funding so that councils do not have to do that kind of stuff. For many councils, starting with a sustainable solution to social care funding is an essential place to go very quickly.

Ian Byrne: That is an excellent answer.

Rob Whiteman: Some councils developed a poor culture on this. They got a little bit carried away by their own publicity. Certainly we saw some directors of finance who felt under enormous pressure to sign off on things they were a bit uncomfortable with, because these councils got into a culture of, "We will manage to beat austerity by being more commercial than anybody else".

CIPFA called that out to some extent, and we are glad to see that the culture is now shifting back and that people realise that the very difficult decisions that need to be made up and down the country in council budgets are not going to be put right by bending these rules to the limit that a few councils did.

Q9 **Ian Byrne:** You put the blame on the councils and not on the Government for encouraging that, as per the evidence to the Committee.

Rob Whiteman: It is not entirely the Government's fault, no. Some councils chose to get a bit carried away with their own culture on this. It is not quite fair to blame it all on the Government. The sector has to put its hands up and say, "We should have called out these councils ourselves".

CIPFA did speak out quite early on this, and we have had concerns about it for some time. We think some of these problems have been generated within the sector. We think it is important that the sector demonstrates its ability to act prudently and well. Some councils did not do that.

Q10 **Ian Byrne:** I have a straight question, Rob: if austerity had not been implemented in 2010, would those councils have been in that position? Would they have taken those decisions?

Rob Whiteman: No, probably not. As I said earlier, councils felt driven towards doing this by the cuts they faced. I accept that, but you still have to exercise judgment in these circumstances, no matter how much you feel external factors are driving you there. I have a lot of sympathy with the sector, but I am less sympathetic where people started to exercise poor judgment. In spite of the rough deal that is given to local government, the vast majority of authorities carried on acting responsibly and some let their culture slip a bit in my view.

Ben Everitt: Rob, you have cantered across the area I was going to ask some questions on, so I will start with you and we will probably get through them quite quickly, because your answers to my honourable Friend Ian were very good. You have set the tone for what I wanted to ask. My questions are about the prudential framework. Specifically, is it clear enough? Is it fit for purpose? You mentioned that there had been what you diplomatically referred to as "interpretation", but in a later answer you expanded upon how perhaps the culture had gone quite wrong and that professional judgment was not exercised in a responsible manner. How much of that can we blame on the framework and how much of that can we look to fix by tweaking it in the future?

Rob Whiteman: CIPFA has just launched a consultation on the prudential framework and code. We will be really keen to clarify any areas of doubt that people have left. It is not only about the code. There are some other factors too.

During this period, coincidentally, we have had a period when there were concerns about local public audit. We have seen that some councils have started to reinterpret the rules and bend them at the edges; in the old days, we possibly would have seen their auditors speak out against that. We have seen a few public interest reports recently. I would probably have liked to have seen some more public interest reports earlier.

You may well have some views or questions about the Redmond review later on. I hope that CIPFA has strengthened or is strengthening the prudential code; the Treasury has to be clear on the rules of PWLB; and, in its system architecture role, the Department has to make sure it responds to the Redmond review and ensure there are strong district auditors or local external auditors who can raise concerns if any of these rules are not being followed. That third leg is very important to moving forward as well.

Q11 **Ben Everitt:** You will be pleased to know, Rob, that my colleague Mohammad is going to ask about the Redmond review next. I hope that does not give you too much of a heads-up. On the local public audit side of things, a framework is only as good as the data that is used to monitor it. Is the Department using the right data to monitor local government finances?

Rob Whiteman: It has got better at that over the last year or two. They probably will not like me saying this, but they did not have all the data they needed at one stage. You may remember that, when CIPFA introduced the resilience index in order to publish comparative data on levels of reserves and financial risk, it went down like a bucket of cold sick, if you will pardon the expression.

Even though it did not always land very well, it did re-establish that we need comparative data in order to look at what is happening across the sector. That is not to stop local authorities being sovereign bodies that make their own decisions, but having comparative data helps shine a light on whether that sovereignty is being exercised properly. The Department now has a better take on which authorities are running into problems, where they are, what their resource issues are, and so on. It has a better set of data on that than it had a couple of years ago. I cannot prove that, because it does not publish this data—it is an internal department view—but, from my discussions with the Department, it has now put more resource into making sure it understands what is going on in the sector in order to be more data and evidence-driven, as it considers what is happening.

Covid is a terrible thing, but it has been handled pretty well in terms of the data available on pressures. The DELTA returns and so on actually mean that the Department and the sector together have probably got a better take on some of the pressures that are going on at the moment due to covid than they had before.

Q12 **Ben Everitt:** Richard, does that chime with your experience?

Richard Watts: Yes, it does. The point I would add, though, is that local government does not feel under-surveyed at the moment. MHCLG published a list of about 30 regular surveys our finance departments have to fill in, and so quite a lot of our effort is spent on filling in forms and returning them to Government. We understand why that is and we are not chafing against this too much.

Without getting into an episode of "Yes Minister", the survey returns have to be proportionate to the importance of the data you are collecting, given the pressures on the staff who are filling those spreadsheets in.

Ben Everitt: You may have given us a killer line for the report, Richard.

Richard Watts: It is always a pleasure to be of service.

Q13 **Ben Everitt:** In your answer to Ian earlier, you did not say this explicitly but you implied that it was obvious where people were overstepping the line when it came to borrowing for commercial use. You used words along the lines of, "Most councils would not go near that". Under the prudential code, was it really clear what was appropriate and what was not?

Richard Watts: No, it was not. It is worth saying that, as Rob mentioned, even in the case of the very small number of councils that are coming up to £1 billion of commercial borrowing, this was all signed off by external auditors and treasurers as compliant with the code, so, no, it was not clear at all. Concern was expressed about some of those authorities at the time, but there was very little within the rules that existed at the time, particularly given the absence of any adverse finding about those authorities' activities, for anyone to intervene in them.

As I said, we are probably landing in the right place in some of the regulation, which is clarity about what the regulation is intended to do without being so prescriptive that you choke off really vital local investment in an economic recovery, which we all want to see at the moment. PWLB loans fund much-needed new housing, regeneration projects and a whole range of stuff. None of us would want to see any of that made more difficult.

Q14 **Ben Everitt:** Indeed, absolutely. Where we almost got to with Rob, if I could summarise, would be that the code needs tweaking to be a bit more robust and a bit more fit for purpose, but ultimately the interpretation was down to the integrity of the officers at the council. Would that apply also to the elected members?

Richard Watts**:** Yes, absolutely it would. Ultimately, as a democrat, I think elected members should be responsible for their council's actions.

Q15 **Ben Everitt:** We can all agree that, if we have spent 20 minutes talking about a grey area, there is probably some more work to be done from the centre as well.

Richard Watts**:** To a degree, yes. As I say, the Treasury's recent reforms to the PWLB code have landed us about in the right place. We should allow those to bed in before seeing whether they need further reform. CIPFA is looking at its own prudential code as well. Given the pressure on all of us at the moment and the need to get some local investment going in our local economies at this time, I would urge that we give any further changes time to bed in before we look to revisit them.

Ben Everitt: Thank you, both. I would love to talk to you about how all of this fits into the wider reform of local government finances within the context of the fair funding review and the localisation of taxes, but I note that neither of you have a sleeping bag or a camp bed next to you, so I will hand back to the Chair to take us further along on this one.

Q16 **Chair:** I am sure the Committee will come back to those issues in due course. Rob, you mentioned that the Department has all this data, and it is probably better data than it used to have, but it does not share it more publicly. Should it?

Rob Whiteman**:** Yes, it should. There is always a risk in this area. If we do not have open and transparent data, there is not only the question of whether councils are doing the right thing and what the evidence is for knowing; there is also the question of whether Government are intervening in a fair and appropriate way. The data helps both side of the equation. We do not have an Audit Commission anymore, but if the Department sets principles on how it uses data and what they are, councils would know about those and, if necessary, that data could be published.

The Department should not operate in secret because, first, it is not as helpful to the sector to know how it is being measured and, secondly, the Government themselves need to demonstrate that they are not acting out of political bias or anything else. It serves everybody if there is open and transparent data, including the Department.

Chair: It would also serve councillors making decisions on their budgets and looking at what is happening elsewhere, as you said.

***Rob Whiteman*:** Yes.

Q17 **Mohammad Yasin:** You have touched on this already, Rob, so I will go to you first. What role can external audit play in the oversight of local authority finances?

***Rob Whiteman*:** The role of the auditor is not only to sign off the accounts. When the Audit Commission was abolished, we threw the baby out with the bathwater. We copied the way it works in the corporate sector and thought that it would work for public bodies. In the corporate sector, companies appoint their own auditors and the role of the auditor is to sign off the accounts independently as a true reflection of the company's activity.

Local public audit is so much more than that. First of all, auditors have public interest responsibilities not only to sign off the accounts but to report if they think there is poor governance or poor value for money. In throwing away everything with the Audit Commission, we lost the role of the district auditor, which predated the Audit Commission and goes back to the Victorian era. The role of having a local official to comment on and be involved in good governance, to make sure the public interest is being followed, got lost.

As public money is involved, public bodies should not appoint their own auditors. They ought to be appointed by an independent public body. Auditors are under too much pressure to reduce their fees and/or not report in the public interest if we stick with the present arrangements. I would like to see aspects of the Redmond review implemented, because local government is stronger if it has not just company audit but local public audit with auditors who do sign off the accounts but are independently appointed in order to act in the public interest and be involved in good governance.

The sector has lost out a lot from the role of external audit being reduced over the last decade. I hope the Redmond review will help to reinvigorate it.

***Richard Watts*:** From local councils' point of view, there is an elephant in the room in conversations about the Redmond review. There is an overwhelming and pressing problem in local authority audit and the Redmond review does not seem to address it: there are simply not enough auditors.

For the last two or three years, an increasing number of councils have filed late audit reports through no fault of their own; there simply have not been enough auditors to do the job. Local authorities, including my own, increasingly report that the auditors they have had have effectively had to be trained on the job by their own finance people, because they are being brought in with no specialist knowledge of local authority finances at all. It is a pretty specialist field. The most pressing problem is what we can do to increase capacity in the audit industry at the moment in order to get audits done on time with the required level of professional acumen to ensure there is appropriate challenge where necessary.

The Redmond review has come in and made some quite big recommendations, some of which are quite expensive to implement. Through the PSAA arrangements, councils are allocated an auditor rather than having that much say over choosing them. They can opt out of that, but very few choose to. There could well be a role for greater publication and scrutiny of data. I tend to welcome publication of comparative data. That is healthy, and it allows proper democratic debate and scrutiny, including through auditors. There have been some failures by auditors to spot some pretty pressing problems, as we have noted already. However, it is also better value for money for quite a lot of that to be done through a sector-led improvement process rather than necessarily audit companies coming in externally and trying to have a role as a private audit company running that public function of debate.

Local government does not particularly mourn the loss of the Audit Commission, which was a very expensive and bureaucratic body. It had come to the point where it had overstepped its reach and become incredibly complex, bureaucratic and expensive without adding that much extra value. Certainly the level of expense and bureaucracy associated with it was disproportionate to the level of benefit it created in terms of where it had got to.

Q18 **Mohammad Yasin:** Sir Tony Redmond's view is that the audit market is very fragile. Do you agree?

Richard Watts**:** Yes, it is beyond fragile. It is pretty broken at the moment.

Rob Whiteman**:** The audit market is very fragile. Councillor Watts touched on this: additional skills are required to be a local public auditor compared to a company auditor. The question is about how that market is made and satisfied. The easiest thing is for the firms to say, "Council audit is a bit more complex. We have to have skills that we do not have for company audit, so we are not going to participate in the market. We will go off and do companies". That is what some of the big four firms have done.

First of all, I do not agree with any argument that says we do not want the big players in the market. I am disappointed that the big four or the big audit firms are pulling out of this market. Local authorities are big, complex institutions with complex financial transactions and complex treasury management. You need firms in the market with very good legal teams and very high degrees of technical and legal competence.

No disrespect to high-street company auditors, but you simply cannot let them near a local authority. These are FTSE 100 companies in terms of their size. How do we attract those firms to want to be in the market? Obviously, it is around the fee regime and making sure they feel they can get an adequate return. At the moments, the firms do not feel they are getting that.

I disagree respectfully with some of what Councillor Watts said about the Redmond review missing the point, because I do not think it is. We would benefit from the creation of OLAR, the Office of Local Audit Regulation. At the moment, there are four or five players involved in this. There is PSAA, the company owned by LGA, that lets contracts; NAO sets the audit code; FRC monitors audit quality, as does ICAEW as an RSB. The Redmond review wanted to put that into one body in order to have consistent high-quality audit let through contracts that the market will respond to. That is the right way forward. I am disappointed that the Secretary of State Robert Jenrick has said that the Government are not minded to create a new public body.

The sector has overreacted to some of this. We do not want to see all aspects of the Audit Commission brought back. There was regulation, and we do not want to go back to the comprehensive performance assessment and the regulation that was scrapped. There is this knee-jerk reaction that says we cannot have anything back because otherwise we will be getting the Audit Commission back in its full form. I just do not buy into that.

The sector is also being a bit short-sighted in arguing against an independent body appointing high-quality audit. We are inviting Government into this space. It would be very easy for MHCLG to say, "The LGA and other people do not want to see the creation of a public body. We will fill some of that space ourselves". I fundamentally think, to my core, that Government should not be involved in this. It works best when, where Government have to consider using their powers, it is because somebody wholly independent of Government is exercising the role of a strong local auditor and the market makes sure they do.

The sector is being short-sighted in objecting to OLAR. It would be a good solution to have a low-cost streamlined public body in this space, making sure we get high-quality audit. We will rue it one day, as a sector, if we do not get that. We are inviting the Government into a space where they have not traditionally been. If anything, we will have government regulation of these matters rather than having a small, independent body making sure the Government exercise their powers on independent advice.

Q19 **Mohammad Yasin:** You said you support the recommendation for the creation of a new regulator. What role could this regulator play in avoiding future section 114 notices?

Rob Whiteman**:** The circumstances that lead to a 114 are primarily around budget and financial management. However, we have touched upon the accounting treatment. The way people follow the rules, on borrowing for example, matters a great deal. A council could be very overleveraged on borrowing or a council may interpret other accounting rules outside of borrowing, which are then found to be incorrect.

At the moment, it is possible that one auditor would give a certain interpretation to a council. It has been in the media, for example, that Plymouth City Council has taken out an interest-rate swap for the first time in 30 years since the House of Lords deemed them to be illegal. We are all waiting to see what the auditors will do at Plymouth. Will they say it is reasonable to take out an interest-rate swap or will they view it as illegal and ultra vires? At the moment, we could have different auditors for different councils coming up with different interpretations.

Section 114 notices are avoided not only by the resource issues we have spoken about but by auditors challenging borrowing decisions and accounting treatment in a consistent way. OLAR would be setting the audit code instead of the National Audit Office; it would be letting the contracts to auditors instead of PSAA; it would be testing the quality of audit instead of FRC and ICAEW. Because all of that would be in one body, we would have high-quality consistent audit so that all councils are making the same sorts of decisions on complex finance transactions. That in itself would help to avoid 114 notices. When you read the public interest report on Croydon or Nottingham, it is not only about resources; it is about some of the decisions they have made in their accounts that have now become undone. I want to see high-quality auditors trying to stop that happening before it does.

Q20 **Mohammad Yasin:** Richard, what is your view as a council leader?

Richard Watts**:** I have two cautions about the establishment of a new body. Having clear and unambiguous national rules would not be unhelpful, because accounting treatments do vary. We have been into this in the Redmond review process as well, but there is an awful lot of local authority audit activity that is frankly pointless. There are large debates over the valuation of property that is not for sale, is not leveraged against anything and is not really germane to local authority finances at all. Islington Town Hall sits on our accounts. It is not for sale, it is not leveraged against anything and it is not doing anything economic in our accounts, yet we still have to value it each year. That is a pointless activity that is done for the sake of it. There are arguments around consistent accounting treatment, which Rob raises, that have a lot of merit to them.

There are two issues. One is practical and one is a deep, instinctive memory built into local government that means we are worried about the creation of a new body. The Government response to Redmond is probably well judged. First, there are issues about a single body being set up that does both regulation and procurement. There are potential conflicts of interest in any body that both regulates a sector and is then solely responsible for procuring it as well. Separation between those two functions would usually be seen to be good governance.

Generally, public bodies that start off small and streamlined very rapidly develop ambitions and do not stay that way. OLAR starting off small and streamlined would not necessarily be a problem, despite the problem around the separation between some of the procurement and regulatory functions. I would be very surprised indeed if it did not quite quickly develop ambitions to develop into the Audit Commission, which by the end had really become far more trouble than it was useful.

***Rob Whiteman*:** If I could just come back on just one point very briefly, perhaps as a Committee you might like to look at Scotland, Wales and Northern Ireland. England can learn from the other three. They have the arrangements that Redmond is recommending. Scotland has the Accounts Commission and the Auditor General. It has small public bodies, in effect, doing this on behalf of councils.

We have not seen the problems in Northern Ireland, Scotland and Wales that have developed in England. The reform that involved the abolition of the Audit Commission did not apply to those countries, and they have carried on having the types of arrangements that we used to have in England. They work a lot better. Audit is working a lot better in some of the other nations of the UK, because they have carried on doing what Redmond is recommending we should go back to.

Q21 **Brendan Clarke-Smith:** Good afternoon, everybody. I just wanted to pick up on the prudential code. Rob, I wonder whether you could answer this for me. Of course, the prudential code forbids borrowing for speculative investment, but at the moment local authorities only need to have regard to it. You have said before that compliance with the prudential code should be a statutory requirement. Is that still your view, or are the Government's changes to the PWLB lending terms sufficient?

***Rob Whiteman*:** It is still my view. I would like to see Government strengthen regulation here, so that people must comply with the code rather than have regard to it. If it was the law or regulation that it had to be followed, it would also mean that the onus would not only be on the section 114 to sign this off from an accounting perspective. The leader, the chief executive and the cabinet all have a corporate responsibility to follow these regulations, because the law expects the council, as a corporate body, to follow them.

I guess we could say, "If the tightening up of the prudential code and PWLB rules work, do you need to change regulation? Is that gilding the lily?" My personal view is that, because there has been a huge amount of worry and concern about this, I would try to persuade the Government to go through and change the regulation so that we can put this to bed for a decade and feel that the system is going to be resilient.

Q22 **Brendan Clarke-Smith:** Just picking up on that, in a recent article for the website Room 151, you said you planned to strengthen the code by 2022. How do you envisage doing that?

Rob Whiteman: We will strengthen the code in terms of speaking very explicitly about these grey areas that have developed, and saying, "This is what we think. This is how you should interpret and what these grey areas mean". For example, where councils have taken the view that, because the income from commercial services will be devoted to service delivery, it is not in advance of need, we are going to say explicitly that borrowing has to be linked to a capital programme item. It is not a general issue about whether it goes into your coffers or not. Therefore, using that argument does not meet the test of the code. We are going to be much more explicit on the grey areas.

The risk, of course, is that other grey areas develop over time. At the end of the day, a principles-based system is always better than a rules-based system because people have to follow principles where they can try to find a way around an individual set of rules. I fundamentally believe that a principles-based system is right, but in the guidance we will give examples of these grey areas and explicitly say what we think should and should not happen.

Q23 **Chair:** Just going on now to the resilience index, which you mentioned before, Rob, had probably upset one or two people when you decided to produce it, how useful has it been in stopping authorities from getting into difficulties? Should it have flagged up earlier problems to some authorities that have got into difficulties?

Rob Whiteman: It has been very useful. When councils set the budget, as they are about to, the CFO, the section 151 officer, issues a section 25 statement, which is her or his view on whether the budget being set is robust and has sufficient reserves. What you would see in the section 25 statement ideally are the early warning signals or the yellow card: "A 114 notice might develop in a year or two if we do not put things right. Although we are setting a legal budget, as the 151 officer I have some real concerns about this".

The resilience index aimed to give 151 officers some evidence where they could say, as part of their statement, "Compared to other authorities, our reserves are running low", or "Compared to other authorities, our interest payments are high because our borrowing is high". We have now helped give 151 officers evidence to back up stronger section 25 statements. The quality of those statements has got better year on year because, to some extent, 151 officers feel that they have the legitimacy to speak about these issues and can compare themselves to other councils; before, they felt under a bit of pressure not to say anything very difficult, or, "Where is your evidence for saying our reserves levels are running very low?"

We have given CFOs the confidence to make bolder section 25 statements. That has helped to avoid 114s developing and it will do so in the future as well.

Q24 **Chair:** Do officers refer to the resilience index?

Rob Whiteman: They do.

Q25 **Chair:** Do you have any assessment of how many refer to it in the course of their budget?

Rob Whiteman: I will gladly ask my team to look at this, but to my knowledge I have not read any section 25 statements that do not refer to the CIPFA resilience index. We will gladly try to get some figures on that for you, but it is very regularly referred to as the source of information to help on a section 25 statement.

Q26 **Chair:** Coming over to Richard, if I went around council leaders and cabinet members for finance in different councils, would they instinctively know what I meant if I talked about a resilience index? Would they all be au fait with their council's position on it?

Rob Whiteman: Most would, yes. There is an argument for transparent information that is provided outside of Government. That is not a partisan comment; it is not a comment on any particular Government. There was a thing about the sector itself, whether that is at LGA level reflecting members or officer level through the various professional bodies such as CIPFA, owning its own data and being able to do some of its own sector-led improvement work. The sector tends to take messages better from itself than it does if it feels they are being imposed.

Q27 **Chair:** Presumably you believe, Rob, that this is a pretty accurate reflection of the state of play in an authority. Should it therefore be taken as, "If we are doing badly on this resilience index, we need to do something different?" If something different is not done, who should then try to ensure that it is done?

Rob Whiteman: That is a really interesting question. First of all, it is not a static issue. The reason why we try to have a basket of indicators is that no one indicator should be taken out of context on its own. For example, a couple of years ago, having other sources of income, from fees, charges and leisure centres, made you stronger in the resilience index because you were not dependent on business rates and council tax. At the moment, being dependent on other forms of income would show higher levels of risk because covid has reduced those levels of income. The question for us in the index is whether we are producing the right basket of indicators in order that you can form a professional judgment on your resilience. Where we want to take the index is probably having some more predictive indicators for the future around medium-term financial planning. We are going to work on that now with the sector.

However, to get to your point, if a council clearly has some real risks in its resilience index that are not reflected in its budget strategy, then—sorry to bring us back to Redmond—as well as the internal governance of the council with scrutiny committees and internal governance of the council asking those questions, it is a good question for the external auditor to ask as part of its value-for-money judgment.

Q28 **Chair:** Should this fit alongside in any way, or relate to, this data that the Ministry has that it does not want to share more publicly?

Rob Whiteman: The Ministry's dataset probably matters more to the sector than CIPFA's, if I am being honest. In a way, councillors can judge themselves by CIPFA's dataset, but they are being judged by the Department. I would hope that the Department uses a dataset that is pretty similar to the resilience index and bases it on that. We talk to the Department about whether it is using the index.

I also agree with Councillor Watts' point that, if the sector itself is generating this dataset, it is likely to be more robust and people will contribute to what the best indicators to be in it are. I would like to think that the resilience index is as good as possible and that the Government will use it themselves. However, if the Government are using their own set of data that is different and could really matter to authorities, they should publish it.

Richard Watts: I was just taking the opportunity to check on my own council's performance on the index, which is a very fair assessment. I wanted to do that because it illustrates an interesting point. Rob is right: there are lots of different things at play in local government finance, particularly for big authorities. We are spending the best part of £1 billion a year.

If you take my own authority, it is a very fair assessment. We are pretty good on most areas, but we know we have very low reserve levels. Since the 2018-19 figures the last resilience index is based on, our finance director has recommended, and as members we have agreed, to top up our reserves in order to provide some more resilience to the councils on that basis. It is too reductive to get elements of financial resilience for big councils down to a simple, "It is fine" or "It is a problem".

Having a number of different indicators provides a much richer display of information. For example, taking my own authority into account, the fact that we know our reserves are low and they are low in comparison to other authorities allows our director of finance to make an argument in our budget-setting process back to members. We have put some context around an argument that we need to put aside a bit more money just to get us through these quite difficult years.

Q29 **Rachel Hopkins:** This is primarily for Richard. As a local councillor, I have had the benefit of peer challenge. I was hoping you could tell the Committee a bit more about what peer challenge is and how it is offered to all councils.

Richard Watts: There is a very broad programme of sector-led improvement. It is a universal offer to all local authorities that we expect all local authorities to engage with once every four years. It is also a much more detailed and in-depth programme of targeted help to local authorities that various intelligence networks and publicly and privately available information indicate need help.

We would expect every local authority to engage in a peer review every four years. The results of that should be made publicly available. That effectively is a sector-led look at the performance of the authority on a series of standard metrics, but also allowing the authority to pick a question that it wants to pose itself, and to get external critically constructive challenge on how it is doing on that. To bring it back to my own authority, we last did this in 2018. That report is on our website. It was a very fair assessment of the strengths and weaknesses of our council at the time.

There is also the intelligence that the LGA's regional peer adviser network picks up in conversation with colleagues such as CIPFA and from publicly available information. There is also effectively a programme of identification, support and challenge of authorities that we think are in particular need. That is a whole range of targeted interventions, some of which are public and many of which are private and behind the scenes, in order to try to get results from them. They are about working with senior officers and senior members. Often, it is about getting an understanding within an authority about the scale of some of the problems that it faces. It is about, in the most extreme set of circumstances, working to ensure changes in leadership at both member and officer level, and that those things are handled appropriately. It is about supporting authorities through the whole improvement board process to manage persistent challenges.

The success of the peer review process, which is funded by Government and through the LGA, is best judged by the fact that we have had only two section 114 notices over the last two years. I am happy to talk a bit about the local circumstances that might have led to both of those, but I am not an expert in that. The number of section 114 notices and all the serious problems that have been avoided because they have been caught early and managed in-house, through the sector-led improvement process, have saved the state an awful lot of money and more than paid for the pretty efficient cost of this whole programme.

Q30 **Rachel Hopkins:** Just building on that, could peer challenge play a greater role in supporting local councils' financial resilience? Could it be made compulsory for councils that are in these difficult financial circumstances?

Richard Watts: There is a philosophical question: if it is compulsory, is it peer challenge anymore? I do not know. If a council has identified a financial need and refuses a peer challenge, that starts to flash red lights. That is a pretty open invitation to external compulsory intervention. The LGA would not defend a council in those circumstances that is not engaging in the voluntary tools available to it. It really is opening itself up for statutory intervention and has very little defence against that.

I am not sure that we would want peer review to be statutory. That feels a bit more like the Government process of commissioners, all of whom are effectively peers; they are largely serving councillors, local authority chief executives or ex-local authority chief executives. They are broadly the same people who do local authority peer reviews, but there is that statutory underpinning around it for a small number of councils that are really struggling.

The current system works pretty well in trying to reduce the number of councils who get to that stage in the first place. The peer review process is largely a preventative one. Where councils are in real trouble—take Croydon as an example—there are both statutory and peer-led processes going on simultaneously, hopefully working quite smartly together to support, challenge, and improve that council rapidly.

It is well worth reading the very recently published MHCLG rapid review of Croydon before you ask that council to give evidence. It was published only last week. It gives a very fair reading of the challenges, the problems in the governance of that council that led to them, and the very rapid improvements we have seen under the new political and managerial leadership in the last two or three months.

Rachel Hopkins: That is really helpful. I think others are going to probe a bit more on the section 114 in Croydon.

Q31 **Bob Blackman:** Almost seamlessly we have gone on to Croydon Council. Rob, can you start off by saying how Croydon got into the crisis it was in in the first place?

Rob Whiteman: Croydon had a strategy for a large number of years to invest in town centre regeneration in order to increase its tax yield. Ultimately, although its reserve levels were running very low as a result of that strategy, it would get more council tax and more business rate income from a regenerated town centre. Events caught up with that, where the extra tax yield did not come through quickly enough compared to their reserves running very low.

The only other thing I would say, Mr Blackman, is about the Eisenhower quote about planning being essential but all plans being useless. In a way, you cannot rely on one thing to see you through. The strategy of regeneration and growing our tax base should not have been at the expense of other things that were needed as well to balance the books. Some of Croydon’s services are quite expensive, looking at the benchmark data. They have scope to make savings that they did not make. They probably felt that they did not need to make them because they had a strategy of regeneration that would mean they could avoid cuts.

It is a little bit like Northamptonshire, which I remember you asked me about at the time. Everybody wants to avoid service cuts if they can, but Northamptonshire thought, "We can avoid service cuts because we have this great transformation programme". Croydon bet the bank on regeneration. Circumstances affected that, not least covid and what happened to the property market. At the same time, it did not therefore do some of the other things that other local authorities did. Looking at its benchmark information, some of its services are relatively quite expensive and it has not done enough to make service efficiencies compared to some other councils.

Q32 **Bob Blackman:** Richard, do you agree with that assessment?

Richard Watts: I do to a degree. The thing that the LGA has flagged all the way through it is that Croydon's core problem was not the commercial investments. Croydon's core problem was the amount it spent on children and adult social care. Speaking frankly, there was a track record of undelivered savings plans and budgets that were routinely not stuck to over many years.

There were some specific challenges that Croydon faced in terms of the number of unaccompanied asylum seekers, which did ramp up its costs. Given the Home Office building in Croydon, it meant the council had a lot of unaccompanied asylum seekers, which it was not fully funded for. Its core problem, which it tried to make up for in other ways and ultimately failed to, was that it set budgets that it routinely did not stick to around critical social care costs. There was not a culture of compliance with budgets within this organisation.

Q33 **Bob Blackman:** You referred to a culture of non-compliance for the budget, which is obviously rather important. There are two aspects of monitoring there, are there not? There are officers reporting to the authority, and then there are councillors overseeing that budget to make sure that they are on track or there is a recovery programme. By the sound of it, you are saying that neither of those was followed. Is that fair?

Richard Watts: It is difficult to get into the level of detail to start apportioning blame. Instead of me trying to give my amateur opinion on all that, I might refer you back to the report in the public interest, which the council has accepted is very fair.

Q34 **Bob Blackman:** I am not looking at apportioning blame. There is clearly an issue here where learning can take place across the LGA family on both the role of officers and the role of councillors, to make sure that, if you have a financial plan, then it must be monitored and adhered to. Otherwise, a problem is going to arise, is it not?

Richard Watts: That is absolutely right. Adhering to a financial plan is critical for any organisation under financial stress, as most local authorities, including Croydon, were. You get cultures in organisations where challenge and questions are not welcome at any level. There was a defensiveness. Speaking frankly, there was a defensiveness in the organisation under the previous sets of leadership. It took a long time, for example, to engage it in a peer review. When one was called, for understandable reasons, it was scheduled for March 2020 and was cancelled because of the outbreak of a global pandemic. That is one of those things.

The LGA's view is that, had that March 2020 peer review gone ahead, it would have unearthed a number of these issues before the public interest audit report, and it would have allowed them to be tackled slightly earlier. However, it was a multi-year problem. It is fair to say that there was a bad hand of a very difficult set of social care circumstances and a difficult set of challenges that all local authorities were struggling with, but it was not addressed well in that authority.

Q35 **Bob Blackman:** Going back to you, Rob, in terms of the commercial investments, there is a slight difference of opinion between you and Richard over what is responsible here—commercial investments or spending on other services. Did Croydon Council breach the prudential code in terms of borrowing in order to invest in these commercial property developments?

Rob Whiteman: No. This is probably more about execution than operating within the scope. For some other councils, we are worried that they have done out-of-borough investments purely for commercial purposes. The concern here is not about the scope; this is more about execution. Do they have the robust governance to make sure that commercial investments made the returns that were expected? This is more a matter of inadequate execution than operating outside of the scope of the code.

There is a lot of review work taking place in Croydon. Grant Thornton has raised some issues in the public interest report. I will not second-guess any of that, but this is probably more about poor execution. We have to wait and see what some of the reviews uncover in case I am wrong on that.

Q36 **Bob Blackman:** The council says that it will not need a third notice to be issued until its financial situation changes. What circumstances would lead to a third notice?

Rob Whiteman: Their first two notices are in respect of the current financial year and not being able to balance the books without a capitalisation order. I am of the view that a second 114 notice is not necessary for the same event. When Northamptonshire issued the second 114 notice, it was because it issued one for the next financial year. The first one was issued for the current financial year. In Croydon's case, it has issued two notices for the current year.

I welcome what the section 151 officer has done, but CIPFA has improved guidance and we are saying, "Do not issue a second or third one for the same financial year". If another notice is issued, it will be for a future year. Croydon is now in discussions with Government about the capitalisation order. It will need to balance the books by capitalisation but also efficiency measures and asset disposals. If that plan did not work, you would get a 114 notice in respect of a future year.

Q37 **Bob Blackman:** Back in November, you told this Committee that, according to the resilience index, Croydon scored badly on capital reserves. Did you make the council aware of your concern at the time?

Rob Whiteman: Yes. Just to explain CIPFA's view here, we are not a Government regulator. We are a professional body. CFOs are professionally qualified accountants that, in order to maintain their licence, have to follow professional guidance as well as undertaking continuing professional development.

For all councils that featured as a concern in the resilience index, we spoke to them before it was published, in fairness to those councils, to say, "You are not accountable to us. We are not your regulator. We are not an audit commission. We are a professional body publishing data that we think helps the 151 officer to make their section 25 advice to members". We spoke to all councils that were of concern in the resilience index so that they could prepare what to say when the resilience index was published.

Q38 **Bob Blackman:** You lead on to my final issue here as well. How unique is Croydon Council in its financial position? Are there other authorities that are in a similar set of circumstances or could be going down the same lines? We talk about the cost of services, investment decisions, etc. How widespread is this problem?

Rob Whiteman: I would not use the term "widespread", but neither would I say it is uncommon. In other words, there are more councils like Croydon, where poor execution of the strategy means that they will have problems. On the whole, the sector is well managed and well led. People are managing financial risks well, but, on the normal distribution curve, Mr Blackman, there are other councils like Croydon.

Q39 **Bob Blackman:** How many would you be concerned about if you were pressed on this?

Rob Whiteman: There are 12 councils that have particular difficulties where they are discussing capitalisation at the moment. I agree with what Councillor Watts said earlier. Some of those councils have had quite good strategies. Before covid, Manchester and Luton, having invested in their local economy to help their airports flourish as part of their regeneration, were viewed as a good thing. Now, that airport income is undone.

There are one or two councils where circumstances have undone them, but there are a dozen to 20 councils where there are concerns about poor execution. If you are spending huge amounts of money on investment and transformation, you have to deliver it. You have to have robust governance and the very best advice. If any of that starts to slip, and you do not deliver savings, efficiencies or your plans, as Councillor Watts said earlier, you can get into a cycle of non-delivery that undoes you. I would say there are a dozen to 20 councils that are a concern, Mr Blackman.

Q40 **Bob Blackman:** One of the things about Croydon was that it bought properties, allegedly at the top of the market, that now have a much lower valuation. This led to a very difficult set of financial circumstances when it tried to either offload them or revalue them at the appropriate measure. Are we talking about other authorities being in a similar type of position? That would be quite serious in terms of where things go.

Rob Whiteman: It is a really interesting question, in a way, for MHCLG too. In the real world, if your company is running into difficulty, you have to dispose of assets at times, even if you do not want to. The Department is probably going to say to councils that are asking for capitalisation orders, "We want to see that backed by asset disposals, not more borrowing". In other words, you can capitalise, but you have to dispose of your assets. That is the right thing to do to force people to really challenge whether they need to hold all these assets.

On the other hand, Mr Blackman, you do not want a fire sale. In the public interest, you do not want to dispose of assets at the wrong time. A reasonable line of questions for the Department is that you expect to see asset disposals in order that these councils do not take on more borrowing and they start to cover their capitalisations through receipts. How can you make sure that they do that on a reasonable timescale and that we do not see fire sales where assets are disposed of at less-than-good consideration? Even if the council has been in error in what it paid for the asset, it is in nobody's interest to see the public purse lose out via sale at the wrong time. I hope that helps.

Q41 **Bob Blackman:** Richard, you have heard what Rob has had to say about a number of councils being of concern. We are not saying anything more than that. Do you share the view that there are a number of authorities that are not necessarily in similar or exactly the same circumstances, but are of concern given the circumstances they are in?

Richard Watts: Yes, I do. I should say that Rob's and my explanations of what happened in Croydon are not that far apart. We would both say that there were a very extreme set of pressures on the council already. It failed to manage some of those well. It had a strategy to try to offset them that went wrong. The pandemic came along and particularly augmented those problems. There will be other councils in similar sets of circumstances to that as well. I could not put a number on it; forgive me.

There are councils that are challenged, some of which are for reasons genuinely beyond their control. Some are because of a combination of difficult external circumstances but also internal problems in their management of the very pressing problems around social care funding, which are challenging. The LGA is working with a lot of councils to run a sector-led improvement programme to keep them out of ever being in a position where they feel they need to issue a section 114 notice in the first place. We think that is in the public interest.

Q42 **Ian Byrne:** Richard, what assessment could be made of the action the Government took in advance of issuing the section 114 notice? Had they learned lessons from Northampton?

Richard Watts: It is difficult to comment on the way the Government have handled Croydon because we are still in the process; it is very much an ongoing situation. I do not want to create extra difficulties for Croydon by going into that much detail about that, other than to say the LGA's view is that the findings of the Government's own independent review are helpful and provide a way forward. We would hope that they would be adhered to.

Broadly, the section 114 process is effective in that it is very rare, as it should be. There are clear lessons. A lot of support goes into councils that issue a section 114 notice, but blimey, it is a very difficult step for a council to take. The consequences and ramifications of that are very bad. Northamptonshire was abolished as a single council as a result of it. There are clearly enormous challenges for Croydon in the current situation as well.

The signal that those sent out, which was that section 114 processes were best avoided at all costs, means that there is a very significant engagement by local authorities under real financial pressure to effectively take the kinds of measures you would undertake in a section 114 process, but without formal issuing of the notice. They try to keep that away, effectively to try to carry on managing their challenges in house without the full weight of external scrutiny and challenge, and all of the reputational problems that creates, being imposed on them as well.

Thet notice can create issues in itself for a council. As soon as a section 114 notice is issued, you become known as a crisis council. It can be more challenging to recruit staff. The amount you have to pay to get high-quality staff goes up dramatically. You are more reliant on external consultants. It is a real challenge. We can all agree that the section 114 process is best avoided if there is any legal way of doing that.

Rob Whiteman: We, including Government, want to avoid 114 notices, but if they cannot be avoided, they should be served as quickly as possible. If they are served quickly, it should not be viewed as a failure; it should be viewed as a council taking control of what it wants to do. I worked at Camden in the 1980s. Serving a 114 notice was part of turning that authority around, from a council that was regarded as not in control of its destiny to an outstanding council. Hackney Council got an award as the best council of the last 20 years, did it not? That all started with a 114 notice turning around its fortune.

I would like to change the temperature a little bit on this. If a council serves a 114 notice at the earliest opportunity, we should say, "Well done, because you are trying to turn your council around rather than doing it too late". Max Caller's report on Northamptonshire wondered whether, had the notice been served two years earlier, Northants might have avoided going down the road it did.

In terms of the Department, we issued temporary 114 guidance not to serve a notice only because of covid pressures. Ideally, being open and honest, we would have liked the Department to give a commitment at that stage that all pressures related to covid would be funded by central Government in the way that was happening with the NHS for hospitals etc. We could not get that commitment from Treasury or MHCLG. We issued temporary guidance saying, "Although the Government will not give you a commitment to cover all your costs, do not issue a 114 notice over covid without talking to the Government first".

Q43 **Ian Byrne:** Rob, sorry to cut across you, but my thinking was that Robert Jenrick gave that commitment to councils.

Rob Whiteman: If you remember, this was an area that became grey.

Ian Byrne: Yes, absolutely.

Rob Whiteman: A commitment was given, but then separate language was used about "sharing the pain". Ultimately, the Government did not give a commitment that all costs would be borne; they gave a commitment to help councils with their pressures. Our temporary guidance on 114 said, "If you are facing a 114 notice because of covid, talk to the Government". The original draft said, "You do not need to worry because Government will cover those pressures", but we had to redraft it when the language from Government changed a bit.

Q44 **Ian Byrne:** Would you like to pick up on that point, Richard, about the original commitment, from an LGA perspective?

Richard Watts: The LGA is a cross-party organisation, so I need to be quite careful with what I say about this. I would characterise it as there being a changing of tone. Without giving a word-by-word analysis of it, the working assumption that councils had that all the full costs would be covered did change during the early period of the pandemic. We have seen all out-of-pocket expenditure covered, but not all lost income covered.

Q45 **Ian Byrne:** Before Clive comes in to finish, I just want to make a point. Rob spoke about Croydon betting the bank and this question is about learning lessons. As we come out of the pandemic, from an LGA perspective—Rob, you can certainly chip in—how do we ensure that no one has to bet the bank again, and councils can plan on a stable footing?

Richard Watts: The biggest thing we need is a four-year funding settlement for local government, which the Government have indicated they are minded to look at from the next financial year onwards. That is vital if we are going to have some sort of sound basis to plan for the future. We need to look at the rest of the lost income from covid and see if we can find a better settlement for local authorities on that. The LGA's call is for all of the irrecoverable lost income to be funded. To be fair, we are not quite going to know how much that is for a while yet.

The gamechanger in this for local government finance is making significant progress on adults' and children's social care funding pressures. For most top-tier councils, that accounts for 60% to 70% of our funding. There has been talk for a long time about a sustainable social care settlement. Once that is in place, the rest of a sustainable funding model for local government in this country can fall into place relatively quickly.

Council tax is not a sustainable way of funding an increased demand for social care for much longer. It has been used as a tactical device, for reasons I understand, because it is easily available, but it is not the right long-term solution to this. Ultimately, the public will only stomach twice-inflation council tax rises for so long. We need to rapidly move towards a long-term consensus around social care funding.

Ian Byrne: That is an excellent answer.

Rob Whiteman: Council budgets are misshapen at the moment, because they are spending money on things that are different, and also the sources of income are changed with grant regimes that we have just spoken about. However, we cannot go back to the original shape because council tax and business rates are not as sustainable as they were. We are in this strange position at the moment: we can see that this misshapen settlement that we have at the moment is going to come to an end when covid comes to an end, but we cannot go back to the business-as-usual system. I agree with Councillor Watts that business rates and council tax do not look as sustainable as a bedrock for local government finance as they did before.

The Government will have to carry on with temporary funding means, even though I do not find that very attractive. I worry if councils have to bid for extra resources. It does not make for good resource allocation. At the end of the day, we need a new system of local government finance with fair allocation and people on a sustainable footing for the years to come. We are not going to be there for a couple of years. We are going to be in a period of temporary measures while the Government think about their longer-term reforms.

Chair: Thanks for those final comments, which probably raise quite considerable concerns for the medium and longer term, but ones that we do need to address; I am sure we can all agree with that. Thanks very much indeed to both of you for coming along today and covering a wide range of issues that are really crucial. They are not arcane, dry issues. These are, in the end, about delivering services that the people who rely on councils really need and value. The job that councils have done through covid is really respected and valued by people up and down the country. Thanks very much indeed to both of you coming along today.