Fourth Report of Session 2021-22

Ministry of Housing, Communities and Local Government

COVID-19: Local government finance

Introduction from the Committee

Local authorities in England have played a vital role during the COVID-19 pandemic: paying grants to businesses, providing support to vulnerable people who are shielding, setting up community testing facilities and taking on the most challenging contact tracing, all the while keeping existing services running. Authorities have achieved this while dealing with the impact of the pandemic on their finances, which were already under strain going into the pandemic.

The Ministry of Housing, Communities & Local Government (the department) is responsible for working across government to support HM Treasury to make major decisions about local government funding. The department plays a significant role in distributing that funding. The department is also responsible for the accountability system that assures Parliament about how local authorities use their resources, including preventing and responding to financial and service failure.

The department acted quickly to support local authority finances early in the pandemic, announcing un-ringfenced grants for local authorities of £1.6 billion on 19 March 2020 and £1.6 billion on 18 April 2020. It supported local authority cash flow through measures totalling nearly £6.85 billion in the same months. In total, by early December 2020, the department had provided £4.55 billion in un-ringfenced grants to support local authorities' response to the pandemic, as part of £9.1 billion in COVID-19 funding for local authorities from government announced by that point.

Based on a report by the National Audit Office, the Committee took evidence on 18 March 2021 from the Ministry of Housing, Communities and Local Government. The Committee published its report on 4 June 2021. This is the government response to the Committee's report.

Relevant reports

- NAO report: Local government finance in the pandemic – Session 2019-21 (HC 1240)
- PAC report: COVID-19: Local government finance – Session 2021-22 (HC 239)

Government response to the Committee

1: PAC conclusion: The Department was not sufficiently prepared for the local government finance implications of a severe emergency.

1: PAC recommendation: The Department should capture learning from the pandemic and write to us by the end of 2021 setting out how it will use this to prepare a flexible framework for responding quickly to the implications of severe national emergencies for local government.

1.1 The government agrees with the Committee's recommendation.

Target implementation date: December 2021

1.2 In the run-up to the COVID-19 pandemic, the Ministry for Housing, Communities and Local Government (MHCLG or the department) had participated in Operation Cygnus, the pandemic flu preparedness exercise, with engagement led by the Resilience and

Emergencies Division. The lessons informed the Pandemic Flu Readiness Board (PFRB) work programme as commissioned in February 2017.

1.3 Departmental contingency planning had also stress-tested local government's responses to economic shock, and this planning informed the response to the pandemic; but the economic impact of the pandemic surpassed all expectations, and the department accepts that it had not modelled a crisis of this scale.

1.4 The department's objective from the outset, and the policy levers available, were clear. The key objective, to protect public services, has remained throughout, while as the pandemic developed, the department has also acted to increase support to local authorities and strengthen engagement and monitoring.

1.5 The department therefore acted quickly to provide proactive funding of £3.2 billion and build a monitoring and engagement framework to ensure the department's actions were evidence-led, responsive and timely, addressing the very serious risks to public services. In July 2020, the department then announced a comprehensive package of measures including further funding for expenditure costs and support for tax and sales fees losses. The new systems, including financial impact monitoring, which have been put in place will stand the government in good stead if they are needed again in future, as will the framework we have developed, which can support losses of income and increases in expenditure through Section 31 grants. The department will write to update the Committee by the end of 2021 to set out how it is improving its oversight of local government finance to prepare for future emergencies.

2: PAC conclusion: The pandemic has exposed limitations in the data that the Department normally collects from local authorities, meaning it has not had a proper picture of local financial resilience.

2a: PAC recommendation: The Department should draw on the experience of collecting data during the COVID-19 pandemic to improve its regular collections of local government financial data. In particular, it should write to us by October 2021, setting out:

i) what, if any, changes it plans to make to its regular collections based on its experience of data collection and use in the pandemic; and

2.1 The government agrees with the Committee's recommendation.

Target implementation date: October 2021

2.2 The department agrees that the Local authority COVID-19 financial impact monthly monitoring collection has been a valuable source of information. The collection was developed at pace in Spring 2020, and has evolved continuously, benefitting from extremely high response rates and engagement. To date, 12 rounds of information have been published. The process has been informed by close sector collaboration, and the data are collected on a voluntary basis, in recognition of the pressures local authorities are facing.

2.3 The monthly monitoring returns have been a valuable source of evidence, providing near-real time data at a time of significant volatility. These figures are, however, based on self-reported 'best estimates', and are management information rather than official certified returns and should therefore be treated with appropriate caution. This contrasts with regular data collection where timeliness is less important and greater accuracy and assurance desired.

2.4 The department has recently launched a review of pre-existing local government finance data collections, and the review's first steering group met on 15 June 2021. The review will consider issues around local authority expenditure and borrowing data, consult stakeholders to identify which data needs are currently being met, and prioritise changes to consider. In addition, the review will set out recommendations for a sustainable process for identifying and implementing changes. The department will consider the future of the monitoring collection as part of this review.

2.5 The department will write to the Committee in October 2021 to provide an update on the review and how it is taking forwards the lessons learned.

2b: PAC recommendation: The Department should draw on the experience of collecting data during the COVID-19 pandemic to improve its regular collections of local government financial data. In particular, it should write to us by October 2021, setting out:

ii) how it plans, in consultation with the sector, to improve the usefulness of its data on local authority reserves specifically.

2.6 The government agrees with the Committee's recommendation.

Target implementation date: October 2021

2.7 The department agrees that collecting more detailed information on local authority reserves levels will increase understanding and transparency around reserves. This will improve understanding of local authority reserves levels both within government and for the wider public. The department's *Local authority COVID-19 financial impact* monthly monitoring includes questions on reserves, which are useful but do not go through as much validation as official statistics so are less reliable.

2.8 The department intends to make changes to the Local Authority Revenue Expenditure and Financing collections to require more detailed information from local authorities on the different types of earmarked reserves that they hold. The department will soon consult on the proposed changes with the finance subgroup of the Central Local Information Partnership, a group made up representatives from MHCLG, local authorities and other interested expert bodies.

2.9 The department will write in October 2021 to update the Committee on the status of these changes.

2c: PAC recommendation: The Department needs to examine its arrangements, and make changes as necessary, for oversight of financial risk in the sector and ensure that lessons from the financial issues at Croydon Council have been learned. The Department should set out its response when it writes to us by October 2021.

2.10 The government agrees with the Committee's recommendation.

Target implementation date: October 2021

2.11 Whilst the department has stewardship of the overarching system, local authorities remain independent from central government, are responsible for managing their budgets in line with local priorities and are held accountable by local communities. The department does not performance manage local authorities, but relies on a series of checks and balances, including audit, as part of a wider accountability framework.

2.12 The department has closely monitored the pandemic's impact on local authorities and responded rapidly to a small number of requests for exceptional financial support. All capitalisation directions were published on Gov.uk.

2.13 The department has considered how it engages local authorities at risk of experiencing financial, governance or service delivery challenges, to ensure that government takes action, where appropriate, consistently.

2.14 In the wake of the pandemic, the department has implemented changes to its approach. The Government Internal Audit Agency (GIAA) reviewed the design of intended changes and improvements being made to the stewardship framework, intended to ensure flexibility for responding to emergencies, and improve on other issues within the previous framework of assurance. In 2021-22, GIAA will undertake an in-depth assurance review to provide assurance that the framework is working as intended, and manages risks highlighted by the National Audit Office. Since the onset of the pandemic the department has increased its engagement across the sector and improved its internal processes around risk. The department also agreed principles and an approach to dealing with requests for additional support through the Exceptional Financial support process.

2.15 Regarding Croydon Council, as the external auditors noted, "the depth of the issues …existed prior to the pandemic" but were exacerbated by it. Following a non-statutory review, the Secretary of State appointed an improvement and assurance panel. The department will continue to engage with Croydon and consider the panel's recommendations, which alongside the Secretary of State's responses are published on Gov.uk. The department has taken on board lessons from this process and this is reflected in the design of external assurance reviews for councils requesting financial support. The department will write in October 2021 to set out its response to the Committee.

3: PAC conclusion: Government support schemes during the pandemic were not always designed with sufficient knowledge of local government finance or input from the sector.

3: PAC recommendation: HM Treasury, the Department for Education, the Department of Health & Social Care, the Department for Business, Energy & Industrial Strategy, the Department for Environment, Food & Rural Affairs, and the Department for Digital, Culture, Media & Sport, in co-operation with the Department, should write to us by October 2021 setting how they will improve, and then maintain, their understanding of the operational realities of local government finance and the financial pressures authorities face.

3.1 The government agrees with the Committee's recommendation.

Target implementation date: October 2021

3.2 The department has worked closely with other government departments to ensure a coordinated response that takes close account of local government financial pressures, including on the design of the *Local authority COVID-19 financial impact* monthly monitoring, and through communication of the results. The department has also led sector engagement and ensured two-way communication between other departments and local authorities, including meetings on specific policy problems, as well as virtual visits and themed roundtables, to encourage knowledge-sharing.

3.3 The department has utilised established processes and cross-Whitehall relationships at every level, helping to embed local government finance intelligence – both technical expertise and monthly monitoring data - into policy-making processes at the earliest opportunity.

3.4 The department will work alongside other government departments to help them assess what steps can be taken to further a greater understanding of local government finance.

3.5 The department will coordinate a written response to the Committee by October 2021 outlining how each department plans to improve, and then maintain, their understanding of the operational realities of local government finance and the financial pressures authorities face.

4: PAC conclusion: The Department has not fulfilled previous assurances that it will be transparent about financial risk in the sector by sharing information with the National Audit Office.

***4: PAC recommendation**: In discussion with the National Audit Office, within three months the Department should find a way to share information relevant to financial risk in the sector, including about individual local authorities, while indicating on what basis it can or cannot be shared further.*

4.1 The government agrees with the Committee's recommendation.

Target implementation date: October 2021

4.2 The department is mindful of the need for the National Audit Office (NAO) to receive information that will allow for them to make robust conclusions about the integrity and quality of the department's work and to provide assurance on the department's management of the accountability framework, as part of ongoing studies.

4.3 The department recognises the NAO's legitimate statutory interest in these matters. At the same time, it is important that local authorities are able to engage with the department in confidence about their individual positions. The department has in the past shared material relating to our assessment of risks and challenges to support specific studies that recognises the confidentiality of conversations with individual local authorities. The department will continue to engage with NAO about how to meet their needs in this regard, in line with statutory responsibilities.

5: PAC conclusion: The Department's over-optimism about the impact of the pandemic on local authorities' risk leading to reductions in services for local people.

5a: PAC recommendation: The Department, working with other government departments, should ensure that decision-making about actions to stabilise local government finance is informed by sufficient information about the service implications of current financial pressures.

5.1 The government agrees with the Committee's recommendation.

Target implementation date: October 2021

5.2 The department believes it has made a realistic assessment of the impact of the pandemic on local authorities and the resultant risk of service reductions.

5.3 The department responded rapidly in March 2020 in providing un-ringfenced funding to support local authorities with the pressures they faced and has provided over £6 billion in un-ringfenced funding since the start of the pandemic in total. The department also rapidly established its *Local authority COVID-19 financial impact* monthly monitoring data collection process to ensure government was able to effectively monitor pressures on the sector and respond accordingly. The latest data from this monthly monitoring (May 2021) suggests that pressures have been met for the sector.

5.4 Resources made available through the 2020 Spending Review and annual settlement allowed councils in England access to an overall increase in Core Spending Power from £49 billion in 2020-21 to up to £51.3 billion in 2021-22, a 4.6% increase in cash terms. This is in line with the available increase from 2019-20 to 2020-21. This recognises the resources councils need to meet their spending pressures and maintain current service levels. The

Exceptional Financial Support process is available if needed. Every local authority has now set a budget for 2021-22.

5.5 The department has also continued to engage with other government departments throughout the pandemic on service specific pressures and additional asks placed on local authorities as part of their vital role in the pandemic response to ensure that the sector was both engaged on the policy design and fully funded for the asks placed on them. As MHCLG prepares for the 2021 Spending Review, it has engaged with departments to understand the long-term impacts of COVID-19, this includes analytical working groups to develop robust and well evidenced projections.

5.6 The department will continue its key role in ensuring local authorities are supported in their role through the pandemic and will report back on this in October 2021 to the Committee.

5b: PAC recommendation: The Department and HM Treasury should ensure that their work for the next Spending Review includes full consideration of the longer-term effects of the pandemic on local government finance and the demands placed on local authorities.

5.7 The government agrees with the Committee's recommendation.

Target implementation date: Autumn 2021

5.8 The department will use historic and any future monitoring information from local authorities to inform work for the 2021 Spending Review, as well as engaging with local authorities and sector groups more widely to understand the impacts of the pandemic.

5.9 The effects of the pandemic and the pace of recovery are still emerging and uncertain, and the department will examine carefully what evidence and assumptions can be used to model the emerging long-term impact of the pandemic on local authority finances.

5.10 The department will report back to the Committee on the consideration of the longer-term effects of the pandemic following the conclusion of the 2021 Spending Review.

6: PAC conclusion: The Department has yet to address the longstanding structural issues within local government finance.

6a: PAC recommendation: The Department should write to us by October 2021 setting out its plans to ensure that:

i) local government finance is reconsidered from first principles, reformed in a measured fashion working with the sector, and ultimately new arrangements put in place that are fit for purpose and built to last; and

6.1 The government agrees with the Committee’s recommendation.

Target implementation date: Autumn 2021

6.2 The government will set out the future plan for local government funding at the 2021 Spending Review. The government has been clear that in determining a way forward, it will need to take stock of the impact the pandemic has had on both local authority resources and service pressures to determine the appropriateness of the previous proposals for local government finance reform. Equally, the government will want to ensure that local government is able to play a vital role in levelling up.

6.3 The timing of this exercise and our response to this recommendation is therefore subject to the conclusion of the upcoming 2021 Spending Review.

6b: PAC recommendation: The Department should write to us by October 2021 setting out its plans to ensure that:

ii) a stable funding environment, ideally based on a multi-year settlement, is established as a bridging mechanism while more fundamental long-term reforms are designed.

6.4 The government agrees with the Committee's recommendation.

Target implementation date: Autumn 2021

6.5 The government agrees with the Committee's recommendation, with a stable funding environment helpful in ensuring local authorities can effectively plan. How the department determines its final approach will be informed by the 2021 Spending Review, which will be an opportunity to consider local government's funding needs in the round. The department will work with local government to understand the lasting impact on both service demands and revenue raising.

6.6 Final decisions cannot be taken until after the 2021 Spending Review has concluded and the timeline for this is not yet determined. The department will write to the Committee in due course following the conclusion of the 2021 Spending Review.

7: PAC conclusion: It is unacceptable that local authorities continue to face uncertainty about the level of financial support they can expect from government on top of the other pressures and uncertainty with which they are currently required to cope.

7: PAC recommendation: HM Treasury, working with the Department and other departments as necessary, should explore ways that the government can give local authorities more financial certainty as they develop their 2022–23 spending plans and write to us with conclusions by June 2021.

7.1 The government agrees with the Committee's recommendation.

Target implementation date: End 2021

7.2 HM Treasury, MHCLG and other departments will continue to monitor the pressures that local authorities are facing as a result of the COVID-19 pandemic and recognise the importance of giving local authorities clarity on future resources to support effective financial planning. HM Treasury wrote to the Committee on 22 June 2021 on this topic.

7.3 The government intends to confirm the overall funding settlement for local government in 2022-23 at the 2021 Spending Review, and the department is hoping to give the sector as much early financial certainty as possible. The review will deliver on the government's priorities, with further details to be set out in due course.

7.4 Following the 2021 Spending Review, MHCLG will provide further details of the proposed allocation of resources to each local authority through the provisional Local Government Finance Settlement (LGFS). The LGFS will be timed to ensure that all local authorities are able to confirm their budgets ahead of the start of the 2022-23 financial year.