Local Government Audit Committee Briefing

Quarter 1, March 2019

EY

Building a better working world

Contents at a glance

This sector briefing is one of the ways that we support you and your organisation in an environment that is constantly changing and evolving.

It covers issues which may have an impact on your organisation and the Local Government sector as a whole.

This briefing is produced by our national Government and Public Sector (GPS) team, using our public sector knowledge, and EY's wider expertise across UK and international business.

This briefing brings together not only technical issues relevant to the Local Government sector but also wider matters of potential interest to you and your organisation.

Links to where you can find out more on any of the articles featured can be found at the end of the briefing.

We hope that you find the briefing informative and should this raise any issues that you would like to discuss further please contact your local audit team.

Government and economic news

EY Club Item

The EY ITEM Club's winter forecasts describe the UK economy as being 'mired in a Brexit fog'. The uncertainty arising from the lack of clarity around the timing and nature of the UK's withdrawal from the EU, along with the associated downside economic risks, contribute to a relatively gloomy outlook for the UK economy. This, in turn, has a number of significant consequences when applying a local government focus.

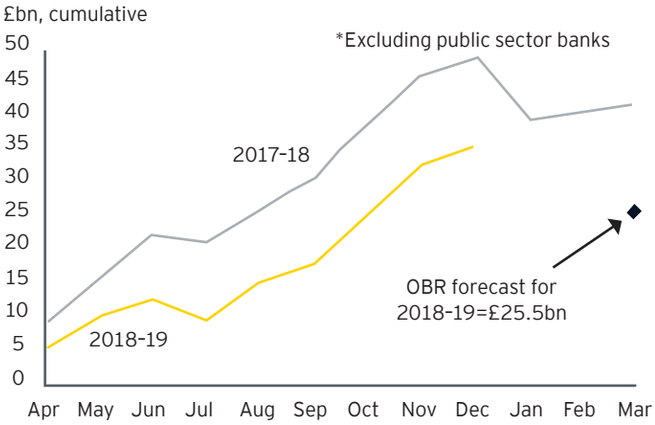
UK GDP grew 1.4% in 2018; the smallest rise since 2009. Under the assumption that the UK leaves the EU with a deal , growth is predicted to increase marginally to 1.5% in 2019, whilst a 'no-deal' scenario is projected to yield just 0.7% growth in 2019 (although there is significant uncertainty around this forecast). The initial economic shock, coupled with the current lack of capital investment and expected reduced migration, would adversely impact the level of UK economic activity in the long term.

Continued improvement to Public Sector Net Borrowing has not reversed the trend of rising local authority debt

Despite the UK's relatively slow recent economic growth, public finances have seen substantial year-on- year improvement over the fiscal year 2018/19 so far. This has continued the recent consistent pattern of the budget deficit — measured in terms of Public Sector Net Borrowing excluding banks (PSNBex) — coming in below the projections made by the Office for Budget Responsibility (OBR).

This has led the OBR to substantially revise down its forecasts for underlying government borrowing over the medium term. However, local authorities are continuing to take advantage of the powers granted under the Localism Act, allowing them to apply to borrow money cheaply from central government and provide capital support to LATCOs and Housing Associations. This has seen annual borrowing by local authorities double in just two years to £10bn in 2017/18, with total outstanding local authority debt approaching £100bn. Many local authorities are thereby exposed to the risk of a borrower defaulting, or a fall in asset prices if they have utilised debt to fund such acquisitions, a risk that is exacerbated by Brexit. This is substantiated by increased borrowing activity from the PWLB; the February 2019 rolling year to date figure borrowed from PWLB stands at £8.2bn, compared to £4.4bn at the same point in 2018. Whilst a number of local authorities are using the capital to fund integral activities such as regeneration schemes, a number are also restructuring their financing through converting shorter term debt into longer term borrowing.

Figure 1: UK – Public sector net borrowing



Source: EY ITEM Club

Public sector investment may form a crucial component in revitalising the economy

Whilst rhetoric from the government has suggested 'an end to austerity', few firm commitments have been made to provide further funding to local government. However, the impact of Brexit, along with the need to deliver a number of core policy pledges (especially focused towards housing, regeneration and public health), may see an increase in public sector investment in the years ahead. Private consumption and investment is likely to be below the levels they otherwise would be, and public spending could contribute to making up this shortfall.

In addition to increasing consumer confidence, this may help to offset the effects of an anticipated interest rate rise in 2019, which – all else equal – would be expected to encourage saving and reduce consumption and investment in the short term.

Homelessness is at record levels

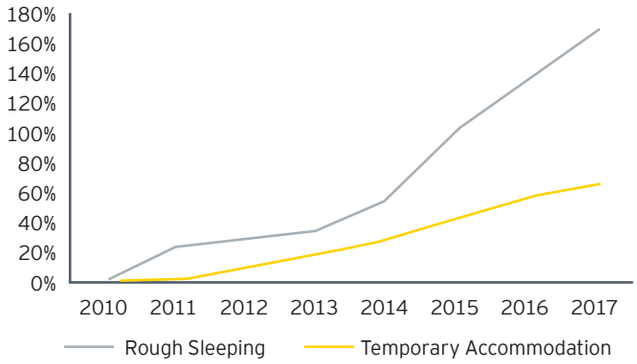
In a single night in autumn 2018, 4,677 people were counted or estimated to be sleeping rough across England. This represents an increase of 65% since 2010. Other sources, such as the charity Crisis, suggest that the true number may be much higher.

The task increasingly falls on local authorities to find new ways to deal with the growing problem of homelessness. The Homelessness Reduction Act 2017 introduced new duties to provide prevention and relief for homelessness for anyone eligible for public funds – not just those who are unintentionally homeless and have priority needs.

Rough sleeping is just one form of homelessness. On 30 June 2018, 82,310 households were in temporary accommodation. There are also likely to be many families living in unsuitable housing, sofa surfing, or staying with family and friends.

The most common reason for homelessness is the end of private tenancy. Tenancies can end for a range of reason; often the cause is the tenant becoming unable to able to pay their rent – either because their income (from benefits or work) decreases, joint incomes being split through separation, or rising rental costs.

Figure 2: %Increase in Homelessness, England 2010–2017



Source: MHCLG Homelessness Data (www.gov.uk)

Rent controls may ease affordability

What can be done to make housing more affordable? One possible solution is rent controls. By capping rents – or increases to rents – rent controls can reduce the costs of housing for tenants whilst preventing landlords from making excessive profits. Recently, there been calls for the Government to devolve the power to implement rent controls to local authorities, enabling them to set controls at the level required by the area.

The main argument against rent controls is that they distort the market. Those fortunate to be housed benefit from lower rents, but supply drops, making it harder to find housing in the first place. Providing rental properties becomes less attractive to landlords and developers; they may choose to invest less in maintaining or upgrading properties or sell them, reducing the size of the rental market.

Opponents to rent controls also argue that they discourage investment, reducing the quality of rental homes, and lead to more ancillary costs being passed on to tenants. Supporters, on the other hand, argue that the rental market is already distorted. Under this line of argument, landlords have market power through monopolistic competition that allows them to restrict the numbers of homes available, driving up the price (and their profits). By pushing the price back down, rental controls would force landlords to seek profits through increasing supply instead.

Ultimately, more homes are needed — and soon

The underlying problem with rent controls is that they focus on the symptom, not the cause. In order to address the housing shortage and reduce homelessness, local authorities need to focus on increasing housing supply.

Last year, the Government removed Housing Revenue Account borrowing caps, enabling district and unitary councils to finance more new developments. Only one in ten such authorities built any homes last year. Of the 340,000 new homes estimated to be needed in 2017/18, only 222,000 were built. A rapid shift toward large- scale house building is now possible, but it requires boldness and ambition — and a willingness to tackle the negative associations of council housing.

The house-building market is dominated by a small number of large firms, and some argue that reducing barriers to entry could help stoke competition. Releasing smaller plots of public land could help small builders enter the market and subsidies or policy intervention could encourage the introduction of innovative, new construction techniques. Other ideas include intervening where properties have not been occupied for large periods or supporting community- led housing groups. With Brexit likely to compound problems in the housing market, it's imperative that local authorities take positive action now.

2019/20 Local Government Settlement

On 29 January the Government confirmed the Local Government Finance Settlement for 2019/20. The settlement is the annual determination of funding allocations from central government to local government.

Key elements of the finance settlement include:

Council Tax

Authorities will be able to increase council tax for 2019/20 up to a maximum of 3% without the need for a local referendum. For shire district authorities, a higher limit of either 3% or £5 on a Band D bill applies. In addition, social care authorities are allowed to increase council tax by a further 2% (provided that the precept does not exceed a maximum of 6% increase over the three year period from 2017/18 to 2019/20). During consultation, the preference of many local authorities was for the council tax referendum level to be removed altogether, however the view of the government is that this level of flexibility should be sufficient to address local needs, whilst protecting households from excessive increase in council tax.

Business Rates

£180 million surplus in the business rates levy account was achieved in 2018/19 and will be distributed to authorities based on the local authority's 2013–14 Settlement Funding Assessment. The Secretary of State confirmed the aim to introduce 75% Business Rate Retention for all local authorities from 2020/21 Fifteen local authorities, London boroughs and the City of London Corporation will pilot certain aspects of the 75% Business Rate Retention scheme in 2019/20 prior to full implementation in 2020/21.

Social Care

The Government has confirmed £240 million of adult social care winter pressures funding in both 2018/19 and 2019/20. Local authorities will also receive an additional £410mn social care grant in 2019/20 to support both adult and children social care services. This grant is aimed at preventing additional demand on the NHS.

New Homes Bonus

The payment threshold for New Homes Bonus will remain unchanged at 0.4%. This threshold represents the baseline housing growth required by central government to qualify for New Homes Bonus funding. Central government will be providing an additional £18 million to allow this baseline to remain unchanged.

On top of these financial measures, the Government also announced that it was developing a package of support to help councils become more efficient and achieve better service outcomes. A continuous improvement tool is expected to be launched in Spring 2019.

The Government also confirmed that it is likely to implement the Fair Funding Review in April 2020. This review will impact how funding is allocated and distributed across local authorities. It is expected the review will focus on population, deprivation and sparsity as the main cost drivers. The government closed consultation on how the fair funding review will work in practice on 21 February 2019. The areas of focus in the consultation included options to implement a relative needs assessed funding formulae and options to measure the council tax base.

The Local Government Association (LGA) has responded to the finance settlement by stating that, overall, local authorities will still face a £3.2bn funding gap during 2019/20. The finance settlement saw some welcomed extra funding in relation to social care; however this one off funding is not an answer to the long term sustainability of the social care sector. This settlement is the final year of the existing four year offer. The LGA has raised concerns that there is no clarity over funding levels after March 2020, which hampers meaningful financial planning.

The Chartered Institute of Public Finance and Accountancy (CIPFA) has responded to the settlement by calling on central Government to consider policy options for longer term reform in order to increase financial sustainability across the local government sector, including fire and police bodies.

Additionally, CIPFA have welcomed the Secretary of State's concern over some local authorities that are borrowing in advance of need to purely create profit which does not 'sit right' with the council's obligation to be prudent and the primary purpose to deliver services. It is estimated that over the past two years local authorities have in total spent £1.8bn on investment properties. This is a six times increase compared to 2013/14 levels of spending. Returns from investment properties are exposed to the volatility of market conditions. This introduces a level of risk into local authority budgets, as authorities may become over reliant on rental income to finance services for the public. There is an even greater risk if the initial investment was financed through borrowing; if the markets were to take an unfavourable turn, then it would be left to the council tax payers to foot the bill. It is for this reason that CIPFA has urged authorities to take a balanced and proportional approach to commercial ventures.

Council Tax Increases for 2019/20

Local authorities have established their annual budget for the 2019/20 financial year beginning 01 April 2019. An integral part of setting a balanced budget is the determination of the appropriate level of council tax. Council tax is a key source of funding for local authorities.

CIPFA has conducted a Council Tax Survey based on responses from 312 local authorities in England. The results of the survey concluded that 80% of authorities increased council tax by the maximum amount allowable of 2.99% without triggering a local referendum. The average band D council tax bill for English authorities increased by £75.60, equivalent to 4.5%, for 2019/20. This is the second largest increase of council tax that has occurred in the previous ten years.

The CEO of CIPFA has commented that the extent of council tax increases is a reflection of the 'incredible fiscal pressure' faced by local authorities. CIPFA has called on central Government to take decisions to secure the future funding of local authorities as 'council tax is regressive, and increasingly divorced from the reality of property values'.

Accounting, auditing and governance

NAO report: Local Authority Governance

The National Audit Office (NAO) has published a report on local authority governance. The report examined the pressures faced by local government governance systems, the extent to which local governance arrangements function as intended and whether the Ministry of Housing, Communities and Local Government (MHCLG) is fulfilling its responsibilities as steward of the system.

Key findings of the report were that:

- The risk profile faced by many local authorities has increased due to reduced spending power, increased demand for services and increased commercial activity in order to generate new income streams. External auditors have indicated that risk profiles were 37% higher in 2017/18 as a result of these activities.
- Effective governance arrangements are important to ensure financial control at times of financial pressure. Local authorities are accountable to their communities on how monies are spent and ensuring that spending represents value for money. Good governance means that proper arrangements are in place to ensure effective budgetary control and budget setting scrutiny.
- Concerns have been raised by external audit firms on the effectiveness of internal checks and balances; including the effectiveness and sustainability of internal audit, governance arrangements and the adequacy of risk management processes.
- Over half of section 151 officers requested greater focus from external audit on value for money conclusion and less on capital assets.
- MHCLG has the ability to intervene where it has concerns over governance arrangements; however the process for engagement is not transparent.

The NAO report recommended that MHCLG should adopt a stronger leadership role to oversee and coordinate the key aspects of the governance framework.

CIPFA's Chief Executive Officer welcomed the report stating that no authority should remain complacent with their current governance arrangements, given the significant financial and delivery challenges authorities face. The report also found that while 87% of s151 officers who report directly to the Chief Executive responded as they were able to provide unfettered advice to the senior leadership team, this dropped to 52% where

s151 officers who responded as not having a clear reporting line. CIPFA has called for all s151 officers to be placed in a position where they can directly report any concerns they may have to the senior leadership team.

Accounting Standard IFRS 16: Leases – change of timetable

The Government's Financial Reporting Advisory Board (FRAB) has decided to defer the implementation of the new Accounting standard IFRS 16 Leases until 01 April 2020, which is one year later than originally intended. The CIPFA/LASAAC Local Authority Accounting Code Board has similarly agreed to delay the implementation of IFRS 16 in the Local Government Code of Practice until 01 April 2020 for local government bodies. This decision was made to avoid the additional work load caused by the Whole of Government Accounts data collection process and to finalise the approach relating to the subsequent re-measurement of right-of-use assets.

CIPFA/LASAAC have encouraged local authorities to continue to progress their plans for the implementation of the new standard including to ensure that local authorities have the appropriate information, processes and systems in place.

CIPFA: Streamlining of the accounts

CIPFA, in conjunction with the Society of London Treasurers and external audit firms, has prepared guidance for local authorities, aimed at chief finance officers and heads of finance, on how to streamline the authority's annual financial statements; including the year end closure processes and format of the published financial statements.

Aspects covered by the guidance include using materiality to avoid key messages being obscured by excess detail, reviewing accounting policies so that only relevant information is included and consideration of the presentation and layout of the financial statements themselves.

The key benefits to local authorities for stream lining their financial statements and year end closure processes include:

- More accurate in year information.
- Reduced time to prepare the accounts.
- Enhanced reputation of the finance function.
- Smoother external audit process.

The report includes guidance on how to prepare working papers with sufficient and appropriate audit evidence, which will inevitably reduce delays/issues during the external audit process and a pre-audit checklist on the draft year-end accounts.

This guidance is available free from CIPFA's website and is based on information as per Public Sector Accounts Workshops.

Regulation news

Financial Resilience in English Authorities

CIPFA have released a briefing on the financial resilience index for local authorities in England. The index provides aggregated statistics on councils across a range of indicators including 'change of reserves', 'council budget flexibility' and 'reserves depletion time'. A beta version of the tool has been shared with authorities.

The index indicated that the majority of authorities had a stable financial position and were not showing signs of potential risk to their financial stability. This demonstrates that the majority of authorities have shown effective financial management in a challenging context given the pressures that authorities have faced in the past years and continue to face.

However, approximately 10–15% of authorities showed signs of risk to their financial stability. CIPFA have stated that they will discuss professional support to the Chief Finance Officer's of the authorities affected. CIPFA believes timely, transparent and clear advice to these authorities, can be effective in stabilising these authorities before it is too late.

The NAO has also recently developed a financial sustainability visualisation tool based on the data published by MHCLG over the past seven years. The tool is useful to clearly visualise trends within the local government sector by individual authority. The NAO has highlighted that whilst the data in the visualisation can provide a relevant assessment of the financial sustainability of individual authorities it by no means represents a full assessment. The purpose of the tool is to facilitate comparison between individual authorities or groups of authorities.

Key questions for the Audit Committee

EY Club Item

Is your authority prepared for the different scenarios on the UK's exit from the EU?

Is your authority exposed to risk of borrowers' default, if there is a fall in asset price?

How is your local authority dealing with the growing problem of homelessness?

2019–20 Local Government Settlement

Has your authority considered the impact of the 2019–20 finance settlement? How has this been reflected in budget setting and medium term financial planning?

Does your authority have a balanced and proportionate approach to commercialisation ventures?

Has your authority considered the potential impacts from the Government's Fairer Funding Review, and if so what those impacts will have on your authority?

NAO report: Local Authority Governance

Is your authority satisfied that appropriate governance arrangements are n place?

Does your s151 officer have the ability to raise concerns directly with the senior leadership team of the authority?

Accounting Standard IFRS 16 Leases

What plans does the authority have in place to ensure it will be ready to implement the IFRS 16 new accounting standard when it becomes effective on 1st April 2020? Does the authority have the appropriate information, processes and systems in place?

CIPFA: Streamlining of the accounts

How has the authority reflected on the first year (2017–18) of the faster close accounts deadline?

How has the authority considered what improvements and efficiencies can be achieved for the current year (2018–19)?

Has the authority reviewed how it can streamline its financial statements and year end closure processes?

Financial Resilience in English Authorities

What was the outcome of CIPFA's financial resilience index for your authority? What are the medium term risk to financial resilience of your authority?

Has your authority used the NAO's financial stability visualisation tool to identify the risks to financial stability compared to similar authorities?

Find out more

EY Club Item

https://www.ey.com/uk/en/issues/business-environment/financial-markets-and-economy

2019–20 Local Government Settlement

https://www.gov.uk/government/speeches/final-local-government-finance-settlement-2019-to-2020-written-statement

https://www.local.gov.uk/parliament/briefings-and-responses/provisional-local-government-finance-settlement-201920-day

https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-responds-to-the-provisional-local-government-finance-settlement-201920

https://www.thebureauinvestigates.com/stories/2018-12-04/councils-borrow-billions-to-buy-real-estate

Council Tax Increases for 2019/20

https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/council-tax-increases-in-england-to-be-second-highest-in-10-years

NAO report: Local Authority Governance

https://www.nao.org.uk/report/local-authority-governance-2/

https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-response-to-nao-report-on-local-government-governance

Accounting IFRS 16: Leases — change of timetable

https://www.cipfa.org/policy-and-guidance/technical-panels-and-boards/cipfa-lasaac-local-authority-code-board

Financial Resilience in English Authorities

https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-releases-briefing-on-financial-resilience-index

https://www.nao.org.uk/highlights/financial-sustainability-of-local-authorities-2018-visualisation/

CIPFA: Streamlining of the accounts

https://www.cipfa.org/policy-and-guidance/technical-panels-and-boards/local-authority-accounting-panel

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ED None

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