National Audit Office

Local government finance in the pandemic

Ministry of Housing, Communities & Local Government

REPORT

by the Comptroller and Auditor General

SESSION 2019–2021
10 MARCH 2021
HC 1240

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Local government finance in the pandemic

Ministry of Housing, Communities & Local Government

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 8 March 2021

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act

Gareth Davies
Comptroller and Auditor General
National Audit Office

3 March 2021

HC 1240 | £10.00

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009117 03/21 NAO

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Key facts

£9.7bn

of COVID-19 cost pressures and income losses estimated for 2020-21 as reported by local authorities in early December 2020

£9.1bn

estimated additional financial support from government for the sector in 2020-21, announced by early December 2020

1

chief finance officer has issued a section 114 notice in 2020-21, indicating that the authority is at risk of failing to balance its budget, which would be unlawful

75%	of irrecoverable council tax and business rates losses in 2020-21 will be covered by government
0%	of local authorities' losses from commercial investments covered by the government's income compensation scheme
75%	of authorities have a reported 'funding gap' in terms of their forecast pressures and estimated government support
46%	of chief finance officers from single tier and county councils, those with social care responsibilities, in our survey told us they had or were planning to use reserves to address COVID-19 pressures in 2020-21
94%	of chief finance officers in our survey from single tier and county councils expect to make cuts in service budgets in 2021-22
5%	increase in local council tax support claimants from quarter three in 2019-20 to quarter two in 2020-21

Summary

1 The COVID-19 pandemic has been an unprecedented public health and economic emergency. Local authorities in England have made a major contribution to the national response to the pandemic, working to protect local communities and businesses, while continuing to deliver existing services. The pandemic has in turn placed significant pressure on local authorities' finances, which in many cases were already under strain going into the pandemic.

2 Local authorities need to be able to absorb these pressures. Individual or system-wide financial failures are poor value for money and are likely to have significant impacts on local communities.

3 The overall financial framework for local government is the responsibility of the Ministry of Housing, Communities & Local Government (the Department). Its responsibilities include:

- distributing the majority of funding voted by Parliament to support local authorities to deliver services;
- taking the lead across government in supporting HM Treasury on decisions about local government funding at major fiscal events; and
- maintaining a system of local accountability that assures Parliament about how local authorities use their resources, including preventing and responding to financial and service failure.

4 Other government departments have policy responsibilities for statutory services delivered by local authorities. They are responsible for establishing their own arrangements to assure themselves that services remain sustainable and statutory responsibilities are met. Departments can provide specific funding to local authorities if required.

5 Departments' core responsibilities remain unchanged by the pandemic. In particular, the Department remains responsible for a framework that provides assurance on the financial health of the sector, and allows for intervention in individual cases and in response to system-wide risks. Accordingly, the Department has had to work across government to ensure the framework can respond to the pressures and demands this unprecedented emergency has caused for authorities. The Department assesses financial sustainability using authorities' capacity to deliver their statutory services while also taking into account whether they have flexibility to respond to events and emergencies, and are able to provide the broader local leadership expected by communities.

Our report

6 Our report examines if the Department's approach to local government finance in the pandemic enabled it to assess and fund the costs of new services which local authorities have been asked to deliver and fulfil its responsibilities for securing financial sustainability across the sector. We expect the Department to:

- have a clear understanding of the implications for authorities' finances and services of COVID-19 pressures;
- have worked effectively with other departments to understand service cost pressures in the sector; and
- have a clear and robust plan to secure the sector's financial sustainability over both the short term and the medium term.

7 Our report is in four parts:

- Part One looks at the financial health of the sector before the pandemic and the financial impact of the pandemic in 2020-21.
- Part Two examines action taken by the government to support the sector in 2020-21.
- Part Three assesses the effectiveness of government measures to support the sector in 2020-21.
- Part Four examines the steps taken by government to support the sector's financial sustainability in 2021-22.

Scope of our work

8 Our report focuses on pressures and funding that have potentially direct impacts on authorities' financial sustainability.[1] We exclude COVID-19 business grants and rates relief schemes operated by authorities on behalf of government. This reflects the focus of the Department's own monitoring.

9 Our fieldwork was completed in early January 2021 and does not include the impact of the January national lock-down. The most recent data in our report on the financial impact on the sector were provided by local authorities in early December 2020.

10 Much of the analytical work in this report is forward-looking and relies on authorities' forecasts of financial impacts and our own estimates of potential funding available from government. Where findings in this report are based on estimates they should be treated as indicative rather than formal forecasts.

1 We define 'local authorities' as principal councils. These include metropolitan borough councils, unitary authorities, London borough councils, county councils and district councils. See Appendix Two.

Key findings

Financial impacts of the pandemic in 2020-21

11 **Local authorities have forecast that COVID-19 will create £6.9 billion of cost pressures in 2020-21.** Local authorities have faced a range of cost pressures due to the pandemic including the need to deliver new programmes and services; increases in the costs of, and growing demand for, some existing services; and reduced opportunities to deliver savings programmes (paragraphs 1.9 to 1.16, Figures 2 and 3).

12 **Also, local authorities face reductions in non-tax income amounting to a forecast loss of £2.8 billion in 2020-21 due to the pandemic.** Authorities have reported losses in their sales, fees and charges (£2.1 billion), commercial (£523 million) and other income streams (£221 million). Authorities have also forecast losses in council tax (£1.3 billion) and business rates (£1.6 billion) income for 2020-21. However, local authority accounting means that these tax losses will only affect authorities' budgets next year (paragraphs 1.17 to 1.21, 4.2 and 4.3, Figure 4).

13 **Combined cost and non-tax income pressures (£9.7 billion) are significant for the sector at 17.6% of revenue expenditure, but impacts vary across authorities.** The forecast impacts are greatest among district councils (equivalent to 20.4% of 2019-20 revenue expenditure) due to their exposure to income-generating services. County councils (16.2%) appear to be the least vulnerable owing to their more limited exposure to income losses. There are also marked variations in combined cost pressures and income losses among authorities of the same type. These are likely to be driven by differences in data-reporting alongside a range of local conditions and decisions (paragraphs 1.22 to 1.25, Figures 5 and 6).

Government's response in 2020-21

14 **Officials told us that the government's overall approach has been to provide support that is "timely, targeted and temporary" rather than an open-ended guarantee.** The government's aim throughout the pandemic has been to support the sector to respond to COVID-19 while also enabling the sector to deliver mainstream services. Given the uncertainty about the duration and the impact of the pandemic, officials told us the government's ambitions have not extended to blanket guarantees for local government. The sales, fees and charges compensation scheme announced in July 2020, for instance, provides partial compensation on authorities' losses. However, our case studies, workshops and stakeholder discussions indicate that ministerial statements in March 2020 that government would do "whatever is necessary" to support councils were taken by some finance directors and stakeholder bodies as meaning that a guarantee was in fact offered by government at the outset (paragraphs 2.1 and 2.2).

15 **The government's approach, led by the Department, to this unprecedented emergency has evolved from prioritising immediate action to a more strategic approach.** In unprecedented circumstances, the Department did not have a ready-made strategic framework to apply at the outset of the pandemic and early initiatives, such as the initial tranche of funding provided in March, were based on the limited information available. As the Department's evidence base improved, by July 2020, its response to the pandemic had evolved into a multi-stranded approach that addresses authorities' cost pressures through tranches of unringfenced grants; partially compensates for authorities' lost income; and provides an exceptional financial support safety net for authorities with severe financial challenges (paragraphs 2.3 to 2.5, 2.29 to 2.31, and Figure 7).

16 **The Department has collected data on the financial impact of the pandemic on local authorities from the beginning of 2020-21**. From April 2020, the Department introduced a monthly survey of financial pressures in the sector. Despite some data quality issues, and in the absence of any other equivalent data sources, it is an important and powerful data set, which several departments have used to shape their responses. The Department deserves credit for introducing this survey, as do local authorities for engaging with it fully (paragraphs 2.9 to 2.14 and 2.22).

17 **The Department has engaged well with the sector, but there is room for improvement in how other departments engage with local authorities.** During the pandemic, Department officials have engaged intensively with the sector and we have received very positive feedback from the sector on this engagement, the Department's understanding of local government finance issues and its response to sector feedback. It was felt to be a two-way process, with feedback and information from the sector informing decision-making in the Department. However, a common perception in our case studies, workshops and stakeholder interviews was that some other government departments lacked the Department's understanding of local government finance and related practical details of delivering specific schemes. This reflects findings from our previous work on local authority financial sustainability (paragraphs 2.15 to 2.18).

18 **The Department's incremental approach to the provision of funding in-year does not support good financial planning.** The Department has allocated four tranches of unringfenced funding totalling £4.55 billion. However, the approach of keeping the need for future funding under review for continuing or new pressures creates uncertainty in the sector and does not allow good financial planning. Finance directors do not know how long a tranche of funding is supposed to last or if there will be another (paragraphs 2.24, 2.29 to 2.34, and Figure 7).

19 The Department has set up an exceptional financial support safety net for authorities facing unmanageable financial pressures. The Department can provide exceptional support, primarily through capitalisation directions, for authorities facing "unmanageable pressures" and has done so for four authorities. However, other than referring to a "small number of authorities" when questioned by the Committee of Public Accounts the Department has not shared the number of authorities that have enquired about exceptional support or those where the Department has concerns about the financial health of the authority. The Department told us its conversations about exceptional support are confidential and sharing information on the number of these authorities or of those it considers to be at risk more generally would invite public speculation about the authorities involved. We recognise the value to the Department of having a safe space to engage with individual authorities. However, it is not possible to understand the full picture of stress in the sector or to evaluate the Department's effectiveness in addressing it without knowing the level of demand for exceptional support or the Department's views on financial risk in the sector more generally. The Department has not yet found a way of being more transparent about the level of financial stress in the sector while nonetheless maintaining a safe space to engage with individual authorities (paragraphs 2.42 to 2.46 and 3.25).

Outcomes for local authorities in 2020-21

20 There is a 'funding gap' between forecast pressures and estimated funding at the national level, with many authorities 'under-funded' relative to the pressures they have reported. Government has so far announced £9.1 billion[2] in financial support to offset forecast financial pressures of £9.7 billion for 2020-21, leaving a deficit of £605 million. This net deficit results from £323 million of over-funding in 85 authorities, and £909 million in under-funding in 252 authorities[3] (74.8%) (paragraphs 3.5 and 3.6, Figures 10 and 11).

21 The reported 'funding gap' is substantial for some authorities. Some 30.0% of authorities will see a gap between their total COVID-19 financial pressures and their additional funding equal to 5% or more of their revenue expenditure in 2019-20. District councils have the highest funding gaps: 49.7% have estimated funding gaps equivalent to 5% or more of their revenue expenditure. Among single tier and county councils, those with social care responsibilities, 5.3% have estimated funding gaps of more than 5% of their revenue spend (paragraph 3.11, Figure 14).

2 The estimate of financial support includes our understanding of government grant funding up to early December 2020 (further funding has been received since this date), and our estimate of sales, fees and charges income compensation of £1.23 billion for the whole of 2020-21.

3 Note that the case-level analysis of over- and under-funding excludes Isles of Scilly and City of London. The disaggregated gross over- and under-funding therefore does not add up to the overall balance.

22 During 2020-21, local authorities have undertaken a range of unplanned actions in response to COVID-19 pressures. Many authorities have taken unplanned in-year actions. For example, 53% of respondents to our survey from single tier and county councils said they had made unplanned in-year savings to service budgets in response to COVID-19 pressures. Some 67% of our survey respondents from these types of authorities said that they had made unplanned in-year savings from other budgets (paragraph 3.12, Figure 15).

23 Many authorities still need to take further steps to balance their 2020-21 budgets. In our survey, 26% of respondents from single tier and county councils indicated that as of late December 2020 their forecast year-end position, ahead of any further action, was a "material overspend". Most of these respondents (81%) said they planned to apply their reserves to their overspend. Overall, 46% of survey respondents from single tier and county councils said that they had already used reserves this year, or planned to, to address COVID-19 pressures (paragraphs 3.13 to 3.14).

24 A combination of high reported funding gaps and low reserve levels means that some authorities are at risk of financial failure. The Department has created a risk metric using funding gaps and reserve levels that provides indicative information to inform its internal monitoring of risk. Applying this metric to our estimates of funding gaps indicates that very few authorities (1.5%) would be regarded as being at acute risk. However, 5.9% are in the high-risk category and 27.3% in medium-risk. Some 9.4% of single tier and county councils fall in the acute or high-risk categories compared with 5.9% of district councils (paragraphs 3.21 to 3.24, Figure 18).

25 By 10 February 2021, the Department had provided exceptional financial support to four authorities. This support is in the form of capitalisation directions totalling £50.5 million. There are two further councils where non-statutory reviews commissioned by the Department have suggested that a capitalisation direction may be necessary. These are Croydon Council, where a section 114 notice is in place, and Nottingham City Council (paragraphs 3.25 and 3.26).

Local authority finances in 2021-22 and beyond

26 Local authority finances will continue to be under significant pressure in 2021-22. In addition to any ongoing costs and income losses due to the pandemic, authorities will need to replenish reserves where necessary, deliver delayed savings programmes and address tax deficits from 2020-21. They are also likely to be operating with reduced tax bases and increased service demand as their local communities and businesses recover. The pace and scale of recovery in income-earning services and commercial investments is uncertain (paragraphs 4.1 to 4.6).

27 Authorities have developed their 2021-22 budgets in the context of significant uncertainty about the normal funding they would receive or have access to. It was not until 17 December that authorities received information on the actual grant funding levels they would receive and other key financial parameters to support their 2021-22 budgets. Council tax billing authorities must set their budgets by 11 March, with precepting authorities by 1 March. Some authorities we spoke to said that not having financial information until late in the budget process did not support value-for-money decision-making. For instance, authorities lack time to review savings options and make well-considered decisions. Late decisions about government funding are not new and we have reported previously on this issue, but this year finance directors considered that circumstances were more detrimental than normal owing to the additional uncertainties created by the pandemic (paragraphs 4.8 to 4.10).

28 The 2021-22 local government finance settlement is only designed to provide certainty on a short-term, time-limited basis. The finance settlement provides the sector with certainty through to the middle of 2021-22 rather than for the whole year. This time-limited approach is a continuation of arrangements for this year, and there are lessons that the Department can learn from how it performed in 2020-21. Many finance directors we spoke to regretted that the financial settlement was not on a multi-year basis, which they consider supports improved financial planning and provides better value for money (paragraphs 4.11 to 4.13).

29 The settlement will allow authorities to set balanced budgets for 2021-22 but with significant uncertainties and risks. Most respondents to our survey (93% of respondents from single tier and councils and 92% from district councils) indicated that they currently felt able to set a balanced budget for 2021-22, a legal requirement. However, 83% of survey respondents from district councils and 84% of respondents from single tier and county councils said their budget-setting process for 2021-22 was more challenging than for 2020-21. Respondents also indicated that there is a degree of risk and uncertainty in their budgets. Only 52% of respondents from single tier and county councils said that they were both able to set a balanced budget currently and were confident in both the estimates in their budgets and the adequacy of their reserves (paragraphs 4.18 to 4.21, Figure 19).

30 Many authorities will reduce service budgets in 2021-22. Our survey indicates that 94% of respondents from single tier and county councils and 81% from district councils expect to reduce service budgets. Some respondents considered that service users would be affected by their savings plans, due to reduced service levels from cutting staffing and general efficiencies. In other cases, authorities indicated that specific savings or income-generation measures would have direct and immediate effects on service users (paragraphs 4.24 to 4.25, Figure 21).

31 Authorities' finances have been scarred by the pandemic and will not simply return to business as usual once the pandemic ends. A key theme from our case study discussions, stakeholder interviews and workshops was the long-lasting impact the pandemic is expected to have on authorities' finances. Survey respondents indicated that they thought financial recovery would be a medium- to long-term process. Only 20% of single tier and county council respondents and 15% of districts indicated that their finances would return to pre-pandemic levels in the next two financial years. Some 53% of respondents from single tier and county councils indicated that they would need to build up their reserves in the next two to three years, but only 16% of these respondents felt confident that they would be able to do this (paragraphs 4.27 to 4.30, Figure 22).

Conclusion on value for money

32 Local authorities have played an important role in the public response to the pandemic, despite being under significant financial pressure. Steps taken by the government, led by the Department, have supported authorities in this pandemic response. The Department's successful monthly collection of data and continued intensive engagement with the sector provided a good evidence base to underpin the financial and other support provided by government. Action by the Department and wider government to support the sector has averted system-wide financial failure at a very challenging time and means that the Department has managed the most severe risks to value for money in the short term.

33 Notwithstanding these actions to support the sector, the financial position of local government remains a cause for concern. Many authorities will be relying on reserves to balance their 2020-21 year-end budgets. Despite continuing support into 2021-22 the outlook for next year is uncertain. Many authorities are setting budgets for 2021-22 in which they have limited confidence, and which are balanced through cuts to service budgets and the use of reserves.

Recommendations

34 To ensure that risks to value for money are managed going forward, the Department needs to learn lessons from 2020-21.

To maintain successful elements of its approach:

a the Department should continue with the effective aspects of its approach to supporting the sector during the pandemic: intensive sector engagement, improved monitoring and providing unringfenced general grants.

To further improve other elements:

b other departments, drawing on the support of the Department, should improve their links with, and understanding of, local authorities, drawing on learning from the Social Care Sector COVID-19 Support Taskforce;

c the Department and HM Treasury should explore how to provide the sector with greater clarity over future funding both during the pandemic and the recovery including:

- signalling clearly on a timely basis the likelihood of further funding or support; and
- supporting value for money in local decision-making by looking for ways to reduce uncertainty in time to be of use to next year's local authority budget-setting process.

d In recognition that the sector remains under significant financial stress in the short term, the Department should:

- maintain its exceptional support offer, with appropriate capacity within the Department to ensure timely consideration of requests; and
- consider how it can present information about levels of financial stress in the sector without undermining engagement with individual authorities.

To address long-standing issues and ensure the government and the sector are prepared for the future:

e the Department, working with other departments, should focus more fully on risks to service sustainability. Government, led by the Department should:

- assess authorities' 2021-22 budgets to understand the impact on service budgets and the implications for service users, other service providers and long-term value for money; and
- use this service-level information, alongside its financial monitoring data, to inform in-year and future funding decisions.

f The Department, supported by the rest of government, should carry out a review of the lessons from the pandemic in order to understand better the information it needs to manage financial risk in the sector, including:

- the Department's reliance on its additional COVID-19 monitoring activities to identify the broad range and high level of risk in Croydon Council, and the implicit limitations of its standard risk monitoring work; and
- the problems that the pandemic has exposed with data on authorities' reserves, which led to the Department collecting experimental data on reserves in-year.

g In time to be of use to authorities' 2022-23 budget-setting processes the Department and HM Treasury should produce a long-term financial plan for the sector that:

- sets out when the various paused elements of the local government finance reform programme will be restarted; and
- considers any further steps that will be needed to support the sector to recover from the financial scarring from the pandemic.

h In preparation for, and to mitigate the impacts of, future pandemics or similar crises, the Department needs to:

- incorporate an assessment of the sector's resilience to a future pandemic or similar crisis as part of its ongoing monitoring and assessment of financial sustainability; and
- undertake a review of the government's response in relation to local authorities and use this information to create an emergency financial response framework.

Part One

Financial impacts of the pandemic in 2020-21

Financial sustainability before the pandemic

1.1 Despite a degree of stability in recent years, local authority finances at the start of the pandemic were under pressure following a period of funding reductions, growth in service demand and delayed reforms to the local finance framework.

Financial robustness of the sector

Funding and demand pressures

1.2 Government funding for local authorities has fallen since 2010-11 as successive governments have sought to reduce the fiscal deficit (**Figure 1** overleaf). Increases in council tax led to a real-terms stabilisation in their 'spending power' (government funding plus council tax) from 2016-17.

1.3 This period of falling or flat funding has coincided with growing service demand. The overall population has grown by 6.9% from 2010 to 2019. Our previous work has shown that there have been increases in demand for adult social care, children's social care and homelessness services.[4]

Financial vulnerability

1.4 Funding reductions and growing demand means that authorities' finances were potentially more vulnerable to the impact of the pandemic than they would have been otherwise:

- Authorities' finances are more reliant on their local economies and residents. We estimate that 82.6% of authorities' income in 2019-20 was income, such as council tax, retained business rates, and sales, fees and charges, that was dependent to some extent on local conditions.[5] This was 48.6% in 2010-11.

4 Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018, para 1.15 and Figure 4.

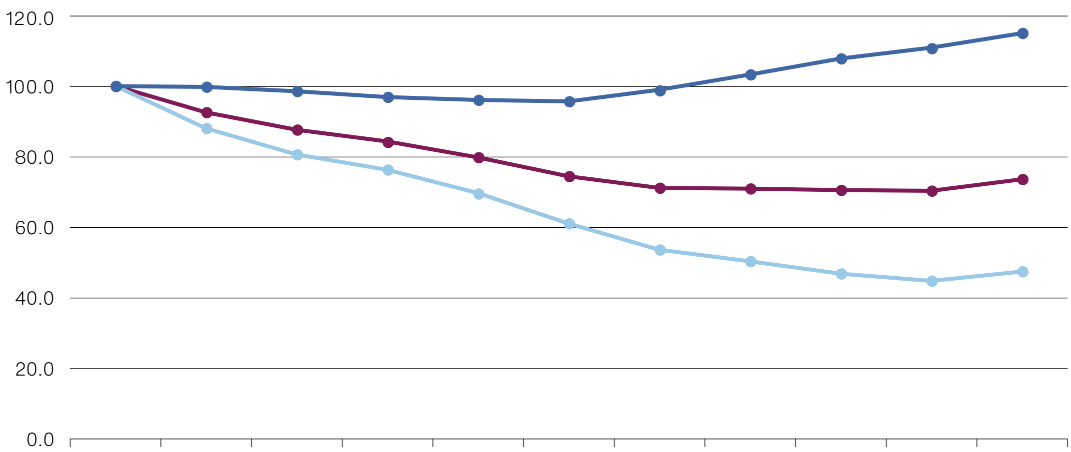
5 This excludes grants passed to schools. Furthermore, locally retained business rates income is protected by a safety net whereby authorities are compensated if income falls below 92.5% of their baseline. Classifying locally retained business rates as other funding, rather than as local funding, would mean that local funding accounted for 60.7% of local authority income in 2019-20.

- Among councils with social care responsibilities (single tier and county councils) service spending is increasingly concentrated on statutory services, meaning these authorities have less headroom to find savings. Spend on social care as a share of service spend increased from 59.3% in 2010-11 to 69.4% in 2019-20 for these authorities.
- Some authorities had low reserves before the pandemic. In 2019-20 5.3% of single tier and county councils had reserves equivalent to less than 10% of their net revenue expenditure.[6]

Figure 1
Change in spending power in English local authorities 2010-11 to 2020-21

Spending power fell rapidly from 2010-11 to 2016-17 at the sector level but has been relatively stable since then, with growth in 2020-21

Spending power and its components (indexed: 2010-11=100) (real terms in 2019-20 prices)



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Spending power	100.0	92.6	87.7	84.3	79.9	74.6	71.2	71.0	70.6	70.5	73.7
Government funded spending power	100.0	88.1	80.8	76.3	69.7	61.2	53.7	50.5	47.0	45.0	47.5
Council Tax	100.0	99.8	98.6	97.0	96.1	95.8	99.0	103.3	107.9	110.9	115.2

Notes

1 Spending power is an indicator that captures the main streams of government funding to local authorities alongside council tax. There have been significant changes in the duties placed on local authorities and the way financial data were reported in this period. To allow for a like-for-like comparison over time we adjust the data to account for these changes using a chain-linked index approach. This means that the results from our time series analysis show percentage change in a weighted index. This provides a good estimate of change over the period that is not skewed by changes in duties and reporting approaches. However, because the data is weighted it will not match spending power and council tax data published by the Department precisely. Our full methodology is available with our report Financial sustainability of local authorities 2018 (Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018).

2 The values of the three data series are indexed against their 2010-11 values to enable comparison from a common starting point.

3 Funding received by local authorities through the Better Care Fund is excluded from this analysis.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

6 There is no standard measure of reserves sufficiency. However, Northamptonshire County Council, which experienced financial failure in 2017-18, provides a benchmark. Its reserves going into that year were 4.7% of its net revenue expenditure.

1.5 Despite these broad trends, authorities entered the pandemic in different financial positions. Among our case study authorities East Sussex County Council felt that it entered 2020-21 in relatively sound financial health. Its 2020-21 budget included the opportunity for investment in service developments, particularly children's and adult social care.[7] In contrast, Wirral Council's and Croydon Council's 2020-21 budgets contained significant savings targets.

Robustness of the financial framework

1.6 Our report *Local authority financial sustainability 2018* found that there was no long-term funding plan for local authorities. Instead, the funding landscape was characterised by one-off and short-term funding initiatives This position remained unchanged leading into the pandemic. Local authorities budgeted for 2020-21 based on a one-year financial settlement. Major reform initiatives such as the Fair Funding Review, a proposed move to 75% local retention of business rates, and a reform plan for adult social care funding, that could potentially have amounted to a long-term funding plan for local authorities, have not been delivered.

1.7 Financial uncertainty, both short term and long term, creates risks for value for money as it encourages short-term decision-making and undermines strategic planning.

Financial pressures in 2020-21 due to the pandemic

1.8 Local authorities have faced a range of cost and income pressures as a result of the pandemic.

Cost and spending pressures

1.9 The Ministry of Housing, Communities & Local Government (the Department) has introduced a monthly monitoring survey through which local authorities provide monthly outturn and annual forecast data on COVID-19-related spending costs. Authorities have forecast COVID-19-related spend pressures of £6.9 billion for the full year. This is equivalent to 12.5% of their overall revenue expenditure in 2019-20.[8]

1.10 Cost pressures have varied across different authority types, ranging from 7.1% of revenue expenditure in district councils to 14.3% in county councils (**Figure 2** overleaf).

Delivering COVID-19 responses

1.11 Spending pressures have fallen most heavily on local authorities' adult social care, housing and public health services (**Figure 3** on page 19). Given the nature of the pandemic, this is to be expected as authorities have taken a range of steps to support the most vulnerable and at-risk elements of their communities.

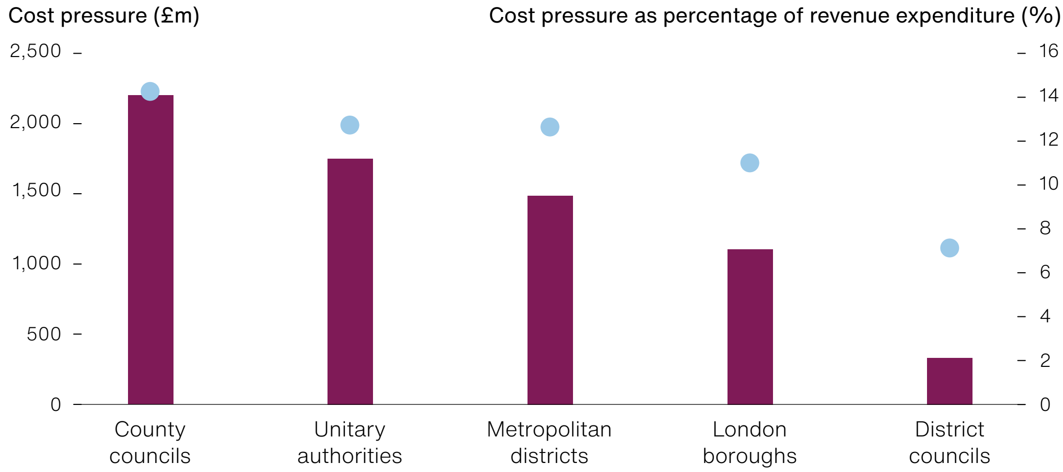
7 East Sussex County Council told us that, notwithstanding their relatively healthy financial position for 2020-21, the medium-term financial plan was still in deficit beyond 2020-21 and, unless future settlements were better than expected, further savings would have been needed.

8 We use an adjusted measure of revenue expenditure. See methodology (Appendix Two).

Figure 2

Forecast cost pressures for local authorities in England in 2020-21 due to COVID-19, by authority type

County councils have reported the greatest relative cost pressures during the pandemic



	County councils	Unitary authorities	Metropolitan districts	London boroughs	District councils
Cost pressures (£m)	2,201	1,748	1,485	1,106	329
Cost pressures as percentage of revenue expenditure (%)	14.3	12.7	12.6	11.5	7.1

Notes

1 The figure shows authorities' forecast cost pressures for the whole of 2020-21. Data was provided by authorities in early December 2020. We show aggregated England level data. We include data for City of London and the Isles of Scilly. We have imputed data for three missing authorities (see Appendix Two).

2 Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

1.12 It also reflects that local authorities have delivered specific programmes of support on behalf of central government. This includes infection control programmes in the adult social care sector, test and trace schemes and the Everyone In initiative to support rough sleepers.[9]

Increased costs of delivering and maintaining existing services

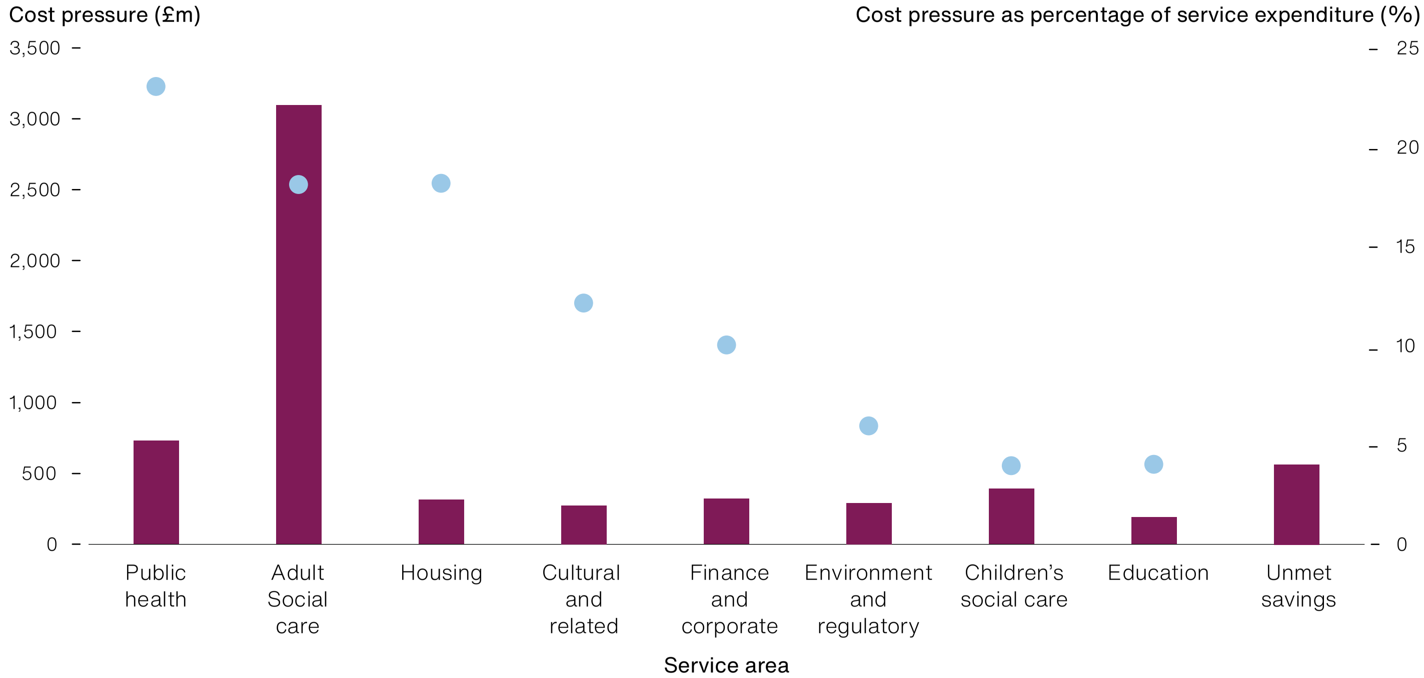
1.13 Our case study authorities identified a variety of ways in which delivering existing services has become more expensive. In relation to waste collection, for instance, Bath and North East Somerset Council told us that social distancing guidelines meant that crewing arrangements had to be changed and more wagons hired.

9 Comptroller and Auditor General*, The government's approach to test and trace in England – interim report*, Session 2019–2021, HC 1070, National Audit Office, December 2020; Comptroller and Auditor General, *Readying the NHS and adult social care in England for COVID-19,* Session 2019–2021, HC 367, National Audit Office, June 2020; Comptroller and Auditor General, *Investigation into the housing of rough sleepers during the COVID-19 pandemic*, Session 2019–2021, HC 1075, National Audit Office, June 2020; Comptroller and Auditor General, *Protecting and supporting the clinically extremely vulnerable during lockdown*, Session 2019–2021, HC 1131, National Audit Office, February 2021.

Figure 3

Local authority cost pressures in England in 2020-21 due to COVID-19, by service area

Authorities have forecast that the greatest cost pressures in 2020-21, relative to previous expenditure, will fall on their public health, adult social care and housing services



	Public health	Adult Social care	Housing	Cultural and related	Finance and corporate	Environment and regulatory	Children's social care	Education	Unmet savings
Full year forecast	730	3,081	315	273	320	291	390	191	562
Full year estimate as percentage of 2019-20 service area spend (%)	22.6	18.2	17.7	12.3	9.9	5.7	3.9	3.6	

Notes

1 The figure shows authorities' forecast cost pressures by service area for the whole of 2020-21. Data was provided by authorities in early December 2020. We show aggregated England level data. We include data for City of London and the Isles of Scilly. We have imputed data for three missing authorities (see Appendix Two).

2 Service spend data for 2019-20 is from the Department's 2019-20 Revenue Outturn data. We adjust education service spend in 2019-20 to remove Dedicated Schools Grant, Pupil Premium Grant, and Universal Infant Free School Meals since these were not included in the reporting.

3 We do not calculate unmet savings as a share of an existing budget as we do not have data that equates to an existing budget for this type of cost pressure.

Source: National Audit Office analysis of Ministry of Housing, Communities and Local Government data

1.14 Some authorities noted that due to illness, self-isolation and shielding by staff across various services, staff costs had increased, for instance due to increased use of temporary staff. Authorities also noted the costs associated with planning and managing COVID-19-related working arrangements and programmes.

Increased demand for services

1.15 COVID-19 pressures have also added to local authority cost pressures by increasing demand for some services. Some of our case study authorities reported that domestic waste levels had increased leading to increased waste collection costs. Other authorities identified increased numbers of looked-after children. Precautionary spending on death management and spending on domestic abuse services has also increased.

Undelivered savings

1.16 Some of our case studies reported that the increased demands and pressures due to responding to the pandemic had prevented them from implementing transformation programmes and securing the savings included in their 2020-21 budgets. Bedford Council told us that owing to the pandemic it was pausing the implementation of its digital transformation programme.

Income pressures

1.17 Local authorities' ability to generate income from tax and non-tax sources has been affected by the pandemic. However, local authority accounting practices mean that while losses in sales, fees and charges income and from commercial investments will impact on authorities in-year, council tax and business rates losses will only affect authorities' budgets next year. We discuss tax losses in Part Four.

Total non-tax income losses

1.18 For 2020-21 authorities have forecast losses of £2.8 billion in non-tax income. This is equivalent to 5.2% of revenue expenditure in 2019-20. District councils, whose budgets are in general more focused on income-earning service areas, are forecasting relatively greater losses as a proportion of spend than other authority types (**Figure 4**).

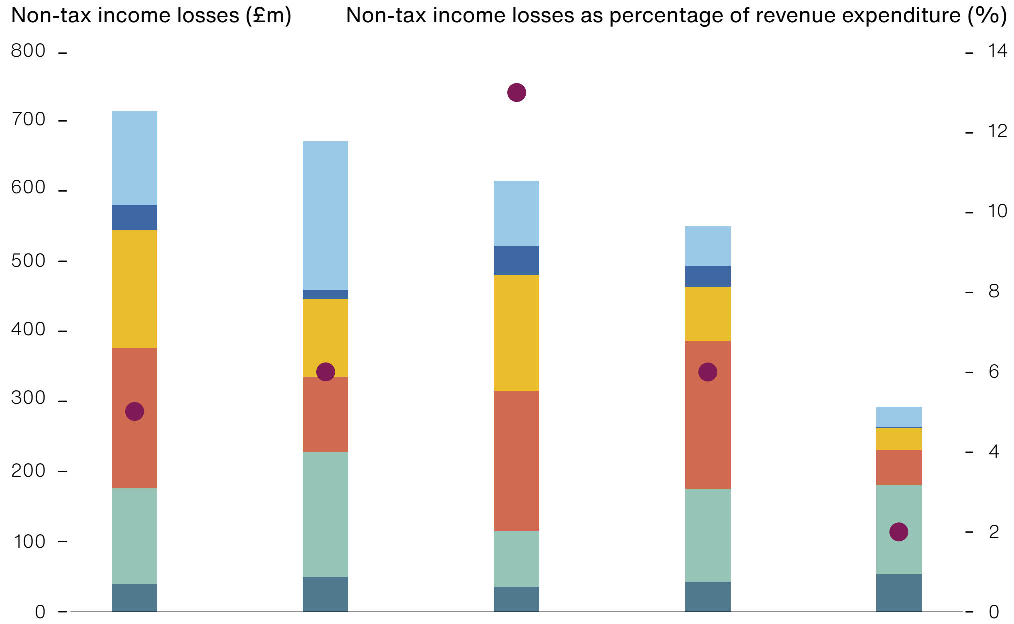
Sales, fees and charges income losses

1.19 COVID-19 restrictions that have been in place at different times throughout the year have led to the closure of certain local authority-owned facilities such as leisure centres, museums and theatres, and have substantially reduced demand for others such as car parks. For 2020-21, authorities have forecast £2.1 billion in lost sales, fees and charges income, of which £695 million is due to lost car parking income, and £554 million due to losses from their recreation and cultural services.

Figure 4

Forecast non-tax income pressures for local authorities in England in 2020-21 due to COVID-19

District councils have forecast the highest non-tax income losses relative to their spend



	Unitary authorities	Metropolitan districts	District councils	London boroughs	County councils
Commercial income (£m)	134	212	93	56	28
Sales fees and Charges – Planning and development (£m)	36	14	42	31	2
Sales fees and Charges – Cultural and related (£m)	169	111	165	77	32
Sales fees and Charges – Highways and transport (£m)	201	107	200	213	51
Sales Fees and Charges – Other (£m)	136	178	80	132	127
Other non-tax income (£m)	40	50	35	43	53
Non-tax income pressures as percentage of revenue expenditure (%)	5.2	5.7	13.3	5.7	1.9

Notes

1 The figure shows authorities' forecast non-tax income losses of different types for the whole of 2020-21. Data was provided by authorities in early December 2020. We show aggregated England level data. We include data for City of London and the Isles of Scilly. We have imputed data for three missing authorities (see Appendix Two).

2 Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).

3 Other non-tax income relates to income losses experienced by councils that do not fall under the other standard categories.

Source: National Audit Office analysis of Ministry of Housing, Communities and Local Government data

Commercial and other income losses

1.20 Local authorities also generate income from commercial investments such as rent from properties developed in regeneration schemes, or dividends from investments in local infrastructure such as airports. In recent years some authorities have also made investments in commercial property solely to secure yield.

1.21 Income from commercial investments has been vulnerable to the impacts of COVID-19 restrictions as footfall into shopping areas has fallen, and demand for flights has reduced, for instance. As of December 2020, authorities forecast total losses of £523 million from commercial income for the whole of 2020-21.

Variation in pressures

Variation by authority type

1.22 Authorities have forecast combined cost pressures and non-tax income losses of £9.7 billion arising from COVID-19 pressures, equivalent to 17.6% of 2019-20 revenue expenditure. Forecast impacts are relatively greatest among district councils owing to their exposure to income losses (**Figure 5**).

Patterns of variation

1.23 There are marked differences in reported pressures between authorities of the same type. This is present in the forecast data for authorities' expected cost pressures and income losses for the full year (**Figure 6** on page 24). Some of the variation may reflect the inherent uncertainty in making these forecasts.

1.24 We undertook statistical analysis in order to try to understand why different local authorities are reporting such marked differences in their cost pressures and income losses (see Appendix Two). This focused on the extent to which local characteristics such as local demographics, levels of deprivation or the prevalence of COVID-19 were linked to variations in reported cost pressures or income losses. We examined outturn data for the period April to November 2020.[10] Our analysis found little evidence that local demographics or the prevalence of COVID-19 had statistically significant links to the variation in cost pressures. We found a possible link between cost pressures and deprivation for single tier and county councils. However, our analysis indicated that the majority of variation is explained by factors outside our model.[11]

1.25 Our case study interviews, review of local authority papers and analysis of the Department's data suggest several reasons for the lack of apparent explanation for these marked patterns of variation. These include:

- authorities' costs and income losses reflect precautionary measures to prevent the appearance or spread of COVID-19 in their area, rather than solely being the consequence of the actual prevalence of COVID-19 in their area;

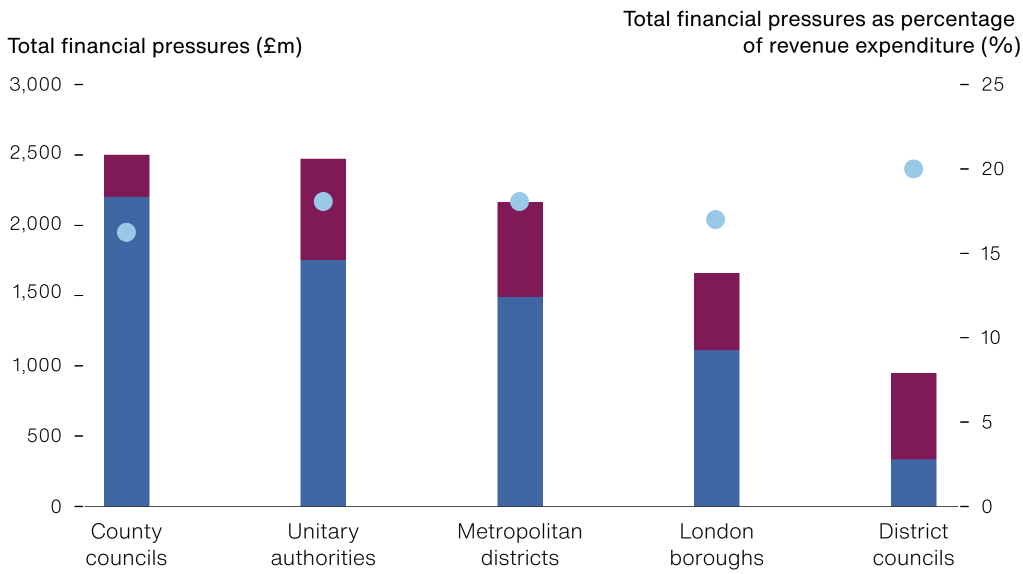
10 We examined outturn data to remove any variability that was due to authorities adopting different forecasting approaches.
11 The explanatory power of the models tested for cost pressures was generally low. See Appendix Two for detail.

- the potential for different reporting approaches to be taken by local authorities in responding to the Department's monthly survey; and
- local factors such as the financial health of each authority ahead of the pandemic, the extent to which authorities' finances were exposed to local non-tax income streams, if authorities have their own local housing stock (which has the potential to reduce costs linked to supporting rough sleepers), and if authorities' leisure provision is in-house or outsourced.

Figure 5

Total financial pressures for local authorities in England in 2020-21 due to COVID-19

District councils have forecast the highest total financial pressures (cost pressures and non-tax income losses) relative to their spend



	County councils	Unitary authorities	Metropolitan districts	London boroughs	District councils
Income losses (£m)	293	716	672	551	616
Cost pressures (£m)	2,201	1,748	1,485	1,106	329
Total financial pressures as a percentage of revenue expenditure (%)	16.2	18.0	18.4	17.2	20.4

Notes

1 The figure shows authorities' forecast cost pressures and non-tax income losses for the whole of 2020-21. Data was provided by authorities in early December 2020. We show aggregated England level data. We include data for City of London and the Isles of Scilly. We have imputed data for three missing authorities (see Appendix Two).

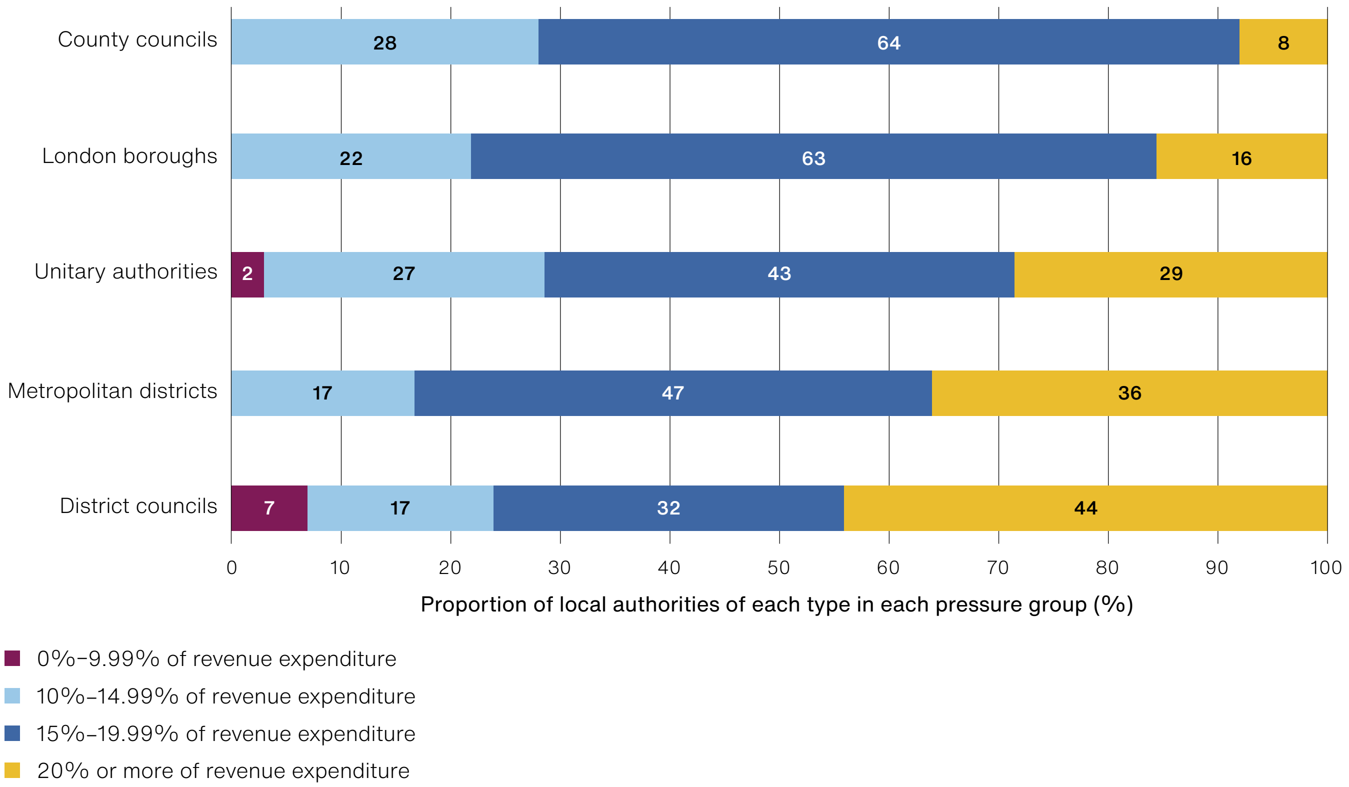
2 Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 6

Variation in total forecast financial pressures between English local authorities due to COVID-19, in 2020-21

There is marked variation in the total forecast financial pressures (cost pressures and non-tax income losses) as a share of expenditure between authorities of different types and between authorities of the same type



Notes

1 The figure shows authorities' forecast cost pressures and non-tax income losses for the whole of 2020-21. Data was provided by authorities in early December 2020. We show aggregated England level data. We exclude data for City of London and the Isles of Scilly (337 in total). We have imputed data for three missing authorities (see Appendix Two).

2 Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).

3 Numbers may not sum to 100 due to rounding.

4 For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point.

Source: National Audit Office analysis of Ministry of Housing, Communities and Local Government data

Part Two

The government's response in 2020-21 to the pandemic

The government's approach

Aims

2.1 The Ministry of Housing, Communities & Local Government's (the Department's) and HM Treasury's aim throughout the pandemic has been to support the sector to respond to the unprecedented challenge caused by COVID-19 while delivering mainstream services. Given uncertainty about the duration and the impact of the pandemic, the government has sought to act in line with the Chancellor's early statement that COVID-19 support would be "timely, targeted and temporary". Officials were clear that the government has not issued a blanket guarantee to local government. However, evidence from among our case studies, workshops and stakeholder discussions indicates that ministerial statements in March 2020 that government would do "whatever is necessary" to support councils were taken by some finance directors and stakeholder bodies as meaning that a guarantee was in fact offered by government at the outset.

2.2 The Department told us that there is a clear expectation that the sector would cover some of the cost of the pandemic and this is made clear, for example, by the fact that compensation for tax losses and sales, fees and charges losses is partial. This scheme was announced in July 2020. Officials told us that government support was always intended to be sufficient to give the sector confidence so the leadership of councils is not distracted from its COVID-19 response by having to address the prospect of financial failure.

Strategy development

2.3 The Department, like other parts of government, has had to respond to an unprecedented emergency. This involves managing trade-offs between speed, effectiveness, cost and control.

2.4 In these circumstances, the Department did not have a stable strategic framework in the early stages of the pandemic with which to pursue its policy aims. The uncertainty of the situation, the lack of information and the need to respond at pace meant that initiatives in February, March and April were developed prioritising speed of action over taking time to gather information which would have enabled a more finely targeted but slower response.

2.5 As the Department's information has improved and the uncertainties around the pandemic lessened partially, the Department's response has evolved. It now has a multi-stranded approach and the flexibility to address different levels of need across the sector:

- Authorities' cost pressures are addressed through the provision of unringfenced tranches of funding (four to date).
- Authorities' non-tax income losses are partially offset through a sale, fees and charges compensation scheme.
- Authorities' tax losses are partially covered by a compensation scheme and the impact is spread over three years.
- An exceptional support programme provides a potential safety net for individual authorities.

Planning and set-up

Preparedness

2.6 The government's high-level plan for pandemic flu does not mention local government finance. However, the Department told us that it had stress-tested its response to an economic shock as part of its contingency planning. They considered this work was relevant to the COVID-19 pandemic. However, the speed and scale of the economic impact of the pandemic exceeded the economic shock assumed for the stress-testing. The Department had not developed its thinking on a mechanism for compensating authorities for very sharp falls in sales, fees and charges income or considered in detail the variation in local authority dependence on this income.

Resources and organisation

2.7 Work in response to the pandemic within the Department started in January 2020. By late February, potential COVID-19 cost impacts were a major part of the local government finance directorate's work. The team leading on Spending Review engagement with other government departments refocused on engagement with departments about COVID-19. Also, flexible resource within the directorate's central policy and planning function was moved to work on COVID-19 financing. There was a formal restructure in May to confirm temporary arrangements.

2.8 Early work with other departments built on existing relationships with HM Treasury, the Department of Health & Social Care (DHSC) and the Department for Education (DfE) and focused on modelling changes in service costs due to the pandemic. For example, DHSC provided an estimate of cost pressures on adult social care that was central to discussions of the first tranche of unringfenced funding.

Information and data

Monthly survey

2.9 At the start of the pandemic, there was inevitably no structured data on COVID-19 pressures. The Department's information on COVID-19 impacts came from other government departments, contacts with individual authorities, representative bodies, and some limited information flowing from local resilience forums.

2.10 In late March, the Department started developing a monthly data collection, to ensure relevant, timely and regular data that it could use for assurance on funding already given and to understand the need for future funding. In developing the monthly survey, the Department drew on discussions with the Local Government Association and treasurers' societies. Analysts also engaged with other government departments responsible for particular service areas. It has achieved response rates of at least 96.8% in all eight rounds to date.

Data quality

2.11 The Department accepts there are data quality issues at case-level with the monthly survey, which limits comparability of results reported by individual authorities. Data returned by authorities are supposed to be agreed by local authority finance directors (section 151 officers) but are not certified or audited. Authorities are allowed to use differing methods and assumptions to produce forecasts and the Department does not challenge unusual or unlikely results. The Department has continued to update the guidance between rounds in order to improve the quality and consistency of reporting and assumptions used.

Use of data

2.12 From April 2020 onwards, analysis of the monthly survey has been central to the allocation of funding to the sector. It has informed consideration of the quanta for unringfenced funding, from the third tranche onwards. The data also informed decisions about other funding streams, such as the sales, fees and charges compensation scheme and the leisure fund created by the Department for Digital, Culture, Media & Sport (DCMS).

2.13 The Department has deliberately avoided creating any substantial direct relationship between the data provided by an individual authority and the funding that authority receives. This means that the impact of any individual data quality issue is smoothed and there is no direct incentive for authorities that could put pressure on data quality. The Department has achieved this through a COVID-19 relative needs formula based on statistical analysis of the monthly survey returns.

2.14 The Department also uses these data to inform its monitoring of the financial sustainability of the sector as a whole and individual at-risk authorities. The Department has used this information to identify authorities it feels are potentially at financial risk. Where these authorities have not already contacted the Department, it has contacted them as part of sector engagement.

Government engagement with the sector

The Department (MHCLG)

2.15 During the pandemic, officials engaged intensively with the sector, built around regular virtual meetings with representatives. These stabilised into weekly virtual meetings with the Local Government Association and the leaders of the local authority treasurers' societies. Less frequent meetings with other sector stakeholders continued alongside. Other forms of engagement include:

- attending a wide range of sector events;
- gathering queries on a wide range of topics and providing answers in regularly updated FAQs; and
- engaging with more than one-third of authorities about their situations, either at the authority's initiative or following up monthly survey data or other information.

The Department also took actions to facilitate engagement between the sector and other government departments.

2.16 Overall, we have received very positive feedback from the sector about Departmental engagement, its understanding of local government finance issues and its response to sector feedback. Officials described the regular meetings (and intervening ad hoc communications) as enabling them to work more closely and constructively with the sector than ever before. Representatives of the treasurers' societies and other sector stakeholders agreed. Some case study authorities also praised Departmental engagement. For both local authorities and the Department, this intensive effort came while key staff were also engaged with other urgent work, testing organisational resilience.

Other government departments

2.17 Some sector stakeholders and finance directors we spoke to were less positive about engagement with government departments other than MHCLG. A number of finance directors we spoke to noted that the sector was often less involved in the design of schemes led by other departments compared with those led by MHCLG. Some finance directors also noted that other departments sometimes did not give any advance notice of new announcements, specified arrangements that were impractical or burdensome to implement, or inadvertently created public expectations that councils could not meet.[12]

2.18 One notable reason cited in our case studies, workshops and stakeholder interviews to account for the difference in the quality of engagement with other departments compared with MHCLG was an alleged lack of understanding or experience of local government financial arrangements in other departments. For example, some finance directors and stakeholder representatives mentioned high turnover rates among HM Treasury officials, which we have previously said creates risks for maintaining skills and experience.[13] A second potential explanatory factor is that, as noted in our previous work, departments can sometimes focus primarily on 'their' policy interests, and do not necessarily consider the implications of any policy change for authorities involved in its implementation.[14] There may well be other explanations for the concerns raised by authorities despite the engagement that departments or arm's-length bodies did undertake. However, taken together, the feedback from finance directors is that there is a clear desire in the sector for other departments to deepen their understanding of local authorities both now and in the future.

2.19 The importance of engaging with local authorities has recently been recognised by the Social Care Sector COVID-19 Support Taskforce. Following its review of the government's support for social care in the first wave of the pandemic it recommended "that DHSC [the Department of Health & Social Care] significantly boosts its own expertise and capacity, in relation to social care, for the duration of the pandemic and beyond. It should do this by bringing in, perhaps through secondment, senior local authority figures with current/recent experience at senior levels both within social care and public health".[15]

12 Some of this feedback related to schemes that do not fall directly within the scope of this study. Nonetheless, the perception evidenced by this feedback is relevant.

13 Comptroller and Auditor General, *Improving government's planning and spending framework*, Session 2017–2019, HC 1679, National Audit Office, November 2018.

14 Comptroller and Auditor General, *Financial sustainability of local authorities 2018*, Session 2017–2019, HC 834, National Audit Office, March 2018, para 4.50.

15 Department of Health & Social Care, *Social Care Sector: Covid-19 Support Taskforce Final Report*, September 2020, recommendation 34. DHSC told us it is taking steps to act upon the Taskforce's recommendations.

Departmental engagement with other departments

2.20 The Department worked closely with DHSC and DfE on the first tranche of unringfenced funding. The Department then re-purposed existing Spending Review procedures to find out from other departments with policy responsibility for local government services about COVID-19 costs in their service areas. These informed major funding decisions from the second tranche onwards.

2.21 All departments had sector contacts within their service areas. Some had structured data sources. For example, the Department for Environment, Food and Rural Affairs (Defra) supported and had access to the results of the Association of Directors of Environment, Planning and Transport's local authority surveys about COVID-19 impacts on waste services, which started at the end of March. Similarly, from early May DfE started surveying local authorities about COVID-19 pressures on children's services.

2.22 As the Department developed and refined the monthly data collection, this became the main form of estimating cost and income pressures in the sector. Cost estimates from other departments were used for triangulation rather than as central information sources. Other departments we spoke to recognised the value of the monthly data that the Department shared with them.

Actions to support the sector

2.23 Departments have provided support to the sector in a range of different ways.

General funding

2.24 The Department has allocated four tranches of general, unringfenced funding of £4.55 billion to support the sector and introduced a sales, fees and charges compensation scheme (**Figure 7** on pages 31 and 32).

Allocation models

2.25 The Department used three different methods to allocate COVID-19 support funding across the sector over time. The first tranche of funding was allocated using a formula last updated in 2012-13. The second tranche was allocated on a per capita basis in the absence of a more detailed method.

2.26 For the third tranche, the Department created a relative needs formula based on a statistical analysis of the monthly survey data. This formula was also used for the fourth tranche (and for further funding for authorities in 2021-22). The fourth tranche involved a retrospective application of the relative needs formula to the first two tranches, correcting over- and under-funding from those tranches.

Figure 7
Unringfenced funding and cash flow support for English local authorities for 2020-21 COVID-19 pressures (announced March 2020 to December 2020)

Type of action (and lead government department)	Date(s)	Description
Unringfenced funding (MHCLG, DHSC)	March 2020	£1.6 billion (**tranche 1**). To help authorities address the pressures they are facing in response to the pandemic across all services as a result of reduced income, rising costs or increased demand. In particular, for supporting adult social care workforce, and for services helping the most vulnerable, such as children's social care and support for homeless people and rough sleepers. £1.39 billion (87%) was paid to single tier and county councils only, and £0.21 billion (13%) was paid to all local authorities.[1] The £1.39 billion (87%) was allocated using the relative needs formula for adult social care (as a proxy for need relating to adult and children's social care). The £0.21 billion (13%) was allocated using individual shares of the aggregate start-up funding assessment at the start of business rates retention (as a proxy for need in other services).
Cash flow support (MHCLG)	March 2020	Payment of tranche 1 (£1.6 billion) in March rather than April as originally planned. Payment of £1.8 billion to compensate local authorities for COVID-19 business rates reliefs in advance rather than after the reliefs are applied.
Cash flow support (MHCLG)	April 2020	Councils able to defer £2.6 billion of payments due to central government over the following three months as part of the business rates retention scheme. Care grants of £850 million paid in April rather than in April, May and June.
Unringfenced funding (MHCLG)	April 2020	£1.6 billion (**tranche 2**). To help authorities to meet expenditure and income pressures arising from the pandemic, deal with the new responsibilities government has asked of them, and continue to deliver frontline services. Paid to all local authorities.[1] Allocated on a per capita basis; in two-tier areas 65% of funding went to county councils and 35% went to district councils. The level of funding for district councils reflects their income losses.
Unringfenced funding (MHCLG)	July 2020	£500 million (**tranche 3**).[2] To respond to coronavirus spending pressures across all services. Paid to all local authorities. Allocated on the basis of a COVID-19 relative needs formula (although £6 million was top-sliced for COVID-19 pressures in relation to unaccompanied asylum-seeking children and distributed differently).

Figure 7 *continued*

Unringfenced funding and cash flow support for English local authorities for 2020-21 COVID-19 pressures (announced March 2020 to December 2020)

Type of action (and lead government department)	Date(s)	Description
Unringfenced funding (MHCLG)	July 2020 (initial announcement; guidance in August)	Amount: open-ended. Income **compensation scheme for lost sales, fees and charges** relative to budgeted levels. Paid to all local authorities.[1] Compensation is calculated net of any mitigation or other compensation and only relates to unavoidable losses that are not recovered in the financial year. Authorities are not compensated for the first 5% loss against budgeted income and are compensated for three-quarters of losses thereafter.
Unringfenced funding (MHCLG)	October 2020	£919 million (**tranche 4**). To respond to coronavirus spending pressures across all services. Paid to all local authorities. Allocated so as to bring individual authority funding across tranches 1-4 as close as possible to what it would be if the total amount from those tranches had all been allocated using the COVID-19 relative needs formula from tranche 3, subject to a floor whereby each council received at least £100,000 from tranche 4.

Notes

1 This funding for all local authorities also covers fire and rescue authorities and combined authorities. Funding for these other bodies has not been included in our detailed funding analysis. See Figure 24 in Appendix 2 for detail.

2 The £500 million announced in July included a £6 million top slice for unaccompanied asylum-seeking children (UASC). This has not been included in our detailed funding analysis (see Figure 24 in Appendix Two for more on that analysis). The funding is used by the Department for Education to provide targeted support to local authorities facing pressures in caring for UASC during the COVID-19 pandemic. Those local authorities across England currently looking after UASC and former UASC who are now care-leavers were eligible to bid for a funding contribution for costs covering up to a three-month period.

3 Abbreviations used: MHCLG (the Ministry of Housing, Communities & Local Government) and DHSC (the Department of Health & Social Care).

Source: National Audit Office analysis of data from government departments

2.27 The relative needs formula applies a statistical approach to allocate funding for upper and lower tier services across authorities, weighting need by local deprivation.[16] However, our review of the formula suggests that the funding allocations based on costs reported for lower tier services are largely dependent on a policy choice made by the Department about how to allocate costs between upper and lower tier services.[17]

2.28 The use of policy choices in allocation formula is not uncommon. However, the significance of policy choices to the outcome of this formula is not at present sufficiently clear in the Department's presentation of the formula. If the formula is used to allocate funding going forward the Department needs to develop a robust statistical formula for lower tier costs or clarify that allocations for lower tier services are driven by policy choice rather than statistical modelling.

Lack of clarity over objectives

2.29 The first tranche was primarily to support cost pressures, while the second also included income losses. The Department told us the two tranches were intended to be viewed collectively. The Department published a list of 'priority services' which this funding was particularly intended to support. The Department said funding was based on applying 'new burdens' principles to assess funding needs for these priority services.

2.30 With the introduction of the relative needs formula in tranche three, the Department switched to a general funding model largely based on self-reported need (alongside a separate compensation scheme for income losses). The switch to this approach was completed in the fourth tranche, which calculated over- and under-funding in tranche one and two allocations as judged by the formula and adjusted tranche four allocations to correct these. This effectively removed the use of tranches one and two to support income losses. Also, while the government still sees certain service areas as a priority, this unringfenced funding is now calculated predominantly on the basis of authorities' reported costs in any service. However, the Department told us it continues to oversee the application of 'new burdens' principles in relation to specific funding that has been provided by a range of government departments to meet new service pressures.

16 Upper tier services are provided by single tier authorities and county councils. Lower tier service are provided by single tier authorities and district councils.

17 The Department calculated the tier split for lower tier services by dividing district council cost pressures by those reported by county councils. In our view the correct arithmetic method would have been to calculate district council pressure as a proportion of total spend in two-tier areas (county council plus district council). The Department took a policy decision to use its approach as it creates a larger weight for lower tier services, which in turns produces a stronger link between reported spend and deprivation in its regression model. If the correct arithmetic approach is used, the link between reported spend and deprivation for lower tier services reduces substantially.

2.31 In contrast to the first two tranches of funding when they were announced, the Department now sees funding for all tranches as recognising the sector's reported costs across all services. The use of this approach on three successive occasions (tranches three and four, and funding announced for 2021-22) means the Department now appears to have a stable allocation model. We recognise the early challenges the Department faced and this is an improvement on the early months, notwithstanding our comments on the technical aspects of the relative needs formula.

Incrementalism

2.32 The approach of keeping funding under review and maintaining ministerial room for manoeuvre means that when each of the four tranches of unringfenced funding was announced the sector did not know if or when to expect future funding or how this would be assessed. It would not have been possible for authorities to predict the substantial changes to the government's approach between the first and fourth tranches.

2.33 A theme in discussions with finance directors was that this incremental approach had led to substantial uncertainty during the year, with impacts on the focus of finance directors. It can also lead to a cautious approach to both authorities' COVID-19 responses and their normal services. As one finance director put it, "I don't know how hard to apply the handbrake."

2.34 Departmental and HM Treasury officials told us that they felt they had signalled sufficiently to the sector that funding needs were constantly under review, and consequently that additional funding was potentially available. However, from our discussions with finance directors it was clear that what was highly significant was the logical implication: that additional funding might *not* be available.

Lack of support for commercial income losses

2.35 The sales, fees and charges compensation scheme contains a deductible element through which the Department sought to reflect normal year-on-year volatility of sales, fees and charges. Authorities must absorb losses up to 5% against their budgeted income. Thereafter, 75% of irrecoverable losses are compensated. The Department wanted to encourage authorities to try to collect income.

2.36 The scheme does not provide compensation for any lost commercial income. This reflects the government's policy position that councils should have risk management policies in place to manage shortfalls in income from assets bought solely for commercial yield and of discouraging such investment. However, many authorities we spoke to expressed concern that this blanket exclusion also covered long-standing and policy-driven commercial income sources, such as shops inherited from a development corporation in the 1980s, strategic investments in airports, or properties purchased as part of town-centre regeneration.

2.37 There are significant limitations in the data available on local authorities' income from commercial investment. Consequently, it is difficult to separate yield-focused income from other forms of commercial income. So, it is difficult to assess how much the incomes of authorities who hold other forms of commercial investment will be affected.

2.38 HM Treasury and Departmental officials told us they recognised these issues with the data and analytical challenges. Nonetheless, the Department told us it had carried out analysis of the scale and distribution of both yield-focused and other commercial income to support ministerial decision-making. The Department has not shared this analysis.

Specific funding

2.39 In contrast to general funding, some government funding is for specific purposes (**Figure 8** on pages 36 and 37). Authorities and stakeholders have stated concerns about some specific funding streams.[18] There have been a range of specific funding pots under £100 million. Some finance directors we spoke to criticised bidding requirements, assurance needed or detailed constraints disproportionate to the scale of the funding.

2.40 Some finance directors' concerns about some of the larger specific schemes included:

- the conditions and assurance requirements attached to the Infection Control Fund are seen as onerous and complex, leading to claims that the burden could negate the value of the funding for recipients. DHSC considered that it was appropriate to put in place robust assurance processes for measuring the impact of the funding and for ensuring public funds were being used properly; and
- the level of evidence needed to bid for the National Leisure Recovery Fund was seen as disproportionate and the limits placed on the eligible costs and period covered as undermining the aim of supporting service viability. DCMS has confirmed its judgement that requiring the evidence was necessary to ensure adherence to the principles of *Managing Public Money.*[19]

2.41 Support for leisure services was frequently mentioned as a concern in our case studies, workshops and stakeholder interviews, with concerns including seeing the support offered via different routes (the tranches, income compensation, the Recovery Fund and potentially furlough) as confusing, incoherent or unfair. DCMS officials told us that a need to gather detailed information about how leisure services are delivered was a factor in the timing of the launch of the recovery fund.

18 Given the timing of its announcement relative to our fieldwork, the COVID winter grant scheme was not discussed with authorities and stakeholders as part of our fieldwork.

19 The National Leisure Recovery Fund requested and received applications for funding to be spent on reopening leisure facilities before 31 March 2021. However, given changing circumstances, the funding awarded will be able to be spent on both lockdown costs and later reopening.

Figure 8

Selected specific funding for English local authorities for 2020-21 COVID-19 pressures (announced March to December 2020)

Type of action (and lead government department)	Date(s)	Description
Specific funding (MHCLG)	March 2020	£500 million **Local Council Tax Hardship Fund**. To be used to support economically vulnerable people and households by reducing their council tax bills. Paid to billing authorities (single tier and district councils). Allocated using each authority's share of working age Local Council Tax Support recipients in Q3 2019-20.
Specific funding (DHSC)	May 2020 (announced; paid in May and July)	£600 million **Infection Control Fund** (round 1). To be passed to care homes to help them cover the costs of implementing measures to reduce coronavirus transmission. Paid to authorities with adult social care responsibilities (single tier and county councils). Allocated on the basis of the share of care home beds in each authority's area, with an adjustment in respect of local wages and prices.
Specific funding (DHSC)	May 2020 (initial announcement)	As of the end of December 2020, more than £978 million has been allocated from the **Contain Outbreak Management Fund** (COMF) to English local authorities. This includes £300 million originally provided under the test and trace service support grant, £485 million provided through the COMF up to 2 December, and a further £193 million provided through the COMF in December. The COMF provides funding to local authorities in England to be used for test, trace and contain activity in order to reduce the spread of coronavirus in their area. Payments were made to either upper or lower tier authorities in line with the policy in place at the time. Allocated in proportion to 2020-21 Public Health Grant allocations, or by population with different rates for different tiers.
Specific funding (MHCLG)	May 2020 (announced; allocated in October)	£116 million **Next Steps Accommodation Programme** – long-term accommodation and support. To be used to secure long-term accommodation and support for rough sleepers, whether through purchase, refurbishment or leasing. Paid to local housing authorities. Allocated on the basis of bids received.

Figure 8 *continued*

Selected specific funding for English local authorities for 2020-21 COVID-19 pressures (announced March to December 2020)

Type of action (and lead government department)	Date(s)	Description
Specific funding (DHSC)	October 2020 (announced; paid in October and December)	£546 million **Infection Control Fund** (round 2). To be used to support adult social care providers to reduce COVID-19 transmission. Paid to authorities with adult social care responsibilities (single tier and county councils). 71% is allocated on the basis of the share of care home beds in each authority's area and 29% is allocated on the basis of the share of users supported by community care providers in each authority's area (in each case with an adjustment in respect of local wages and prices).
Specific funding (DCMS)	October 2020 (announced in principle; details published December)	£100 million **National Leisure Recovery Fund**. To assist local authorities in England with the cost of reopening of outsourced public leisure facilities between December 2020 and March 2021 and so support recovery of the public leisure sector. Open to local authorities with responsibility for providing leisure services that had outsourced leisure provision at the start of the pandemic. The funding must be passed to the leisure providers in full but can substitute COVID-19 financial support the authority would have provided from other sources.
Specific funding (DWP)	November 2020	£170 million **COVID-19 Winter Grant Scheme**. To assist local authorities to support families with children, other vulnerable households and individuals. The grant was intended to be used to help households that had been particularly affected by the pandemic meet costs of food and utilities. The funding was to be used from December 2020 to March 2021. The scheme was provided by DWP through county councils and unitary authorities (including metropolitan councils and London boroughs) which administer the scheme.

Notes

1 Only specific funding with announcements or allocations worth £100 million or more across all authorities in the period covered is included in this table.

2 This table includes funding that we cannot allocate to a specific local authority and so totals may differ from Figure 24.

3 Abbreviations used: MHCLG (the Ministry of Housing, Communities & Local Government), DHSC (the Department of Health & Social Care), DCMS (the Department for Digital, Culture, Media & Sport), and DWP (the Department for Work & Pensions).

Source: National Audit Office analysis of data from government departments

Exceptional support

2.42 Since March 2020, the Department has requested that authorities with immediate unmanageable financial pressures to contact Departmental officials. To ensure a consistent approach, the Department then worked closely with the Chartered Institute of Public Finance and Accountancy (CIPFA). In June, following discussions with the Department that had started in March, CIPFA changed its guidance to say that section 151 officers should communicate with the Department in advance of issuing a section 114 notice.

2.43 In any year the Department can provide exceptional support to authorities experiencing significant financial difficulties, most commonly a capitalisation direction. This allows authorities to either borrow or use capital receipts to support revenue spending. Officials expected a substantially larger number of conversations about exceptional support in 2020-21 given pandemic pressures.

2.44 Ministers decide whether to give exceptional support. Officials establish the underlying causes of the need for exceptional support to give ministers assurance that exceptional support would enable an authority to set a balanced budget and sustain its financial position.

2.45 We view the number of authorities engaging with the Department about exceptional support as an important indicator of the remaining level of financial stress in the sector and therefore the effectiveness of the Department's other measures in mitigating it. We take the same view of the number of authorities the Department views as being at potential financial risk, based on its own analysis.

2.46 The Department's position is that sharing information on the number of authorities interested in exceptional financial support or at risk more generally would invite public speculation on the identities of the authorities involved. However, without this information it is not possible to understand the full picture of stress in the sector or for us to evaluate the Department's effectiveness fully.

Other support

2.47 Departments provided a range of other forms of support. One specific form of support that DHSC told us about was the provision of free personal protective equipment (PPE). Free PPE has been delivered directly to registered social care providers, while PPE for non-registered providers (for example, personal assistants) has gone to local authorities and local resilience forums for onward distribution. In DHSC's view, without this free PPE it is likely local authorities would have had to pay more for the services they commission to be COVID-19-compliant.

2.48 In general, other support measures (**Figure 9**) did not involve estimates of specific savings or costs avoided.

Figure 9

Selected other support by government departments for English local authorities in 2020-21 (announced March 2020 to December 2020)

Lead government department	Date(s)	Description
MHCLG	March 2020	Announcement of initial intention to extend deadline for financial audit of local authority 2019-20 accounts to 30 September 2020.
DHSC	March 2020	Relaxation of specific legal duties under the Care Act to assess or meet needs for care and support ('Care Act easements').
MHCLG	April 2020	Deadline for financial audit of local authority 2019-20 accounts moved from 31 July to 30 November.
Defra	April 2020	Publication of guidance on prioritising waste collection services during the pandemic, supplemented by guidance on opening Household Waste Recycling Centres during the pandemic.
MHCLG	April 2020	A significant change to formula funding for local authorities (the Relative Review of Needs and Resources or Fair Funding Review), alongside a business rates retention reset, will no longer be implemented in 2021-22.
MHCLG	April 2020	The move from 50% to 75% local retention of business rates will no longer be implemented in 2021-22.
DfE	April 2020 (initially; further changes in August)	Temporary regulations introducing flexibilities to a number of aspects of children's social care, including enabling virtual contact with children where appropriate.
DfE	May 2020	Temporary relaxation until September of specific legal duties under the Children and Families Act 2014 in connection with Special Educational Needs and Disabilities.
MHCLG	May 2020	The next revaluation of business rates will take place in 2022 rather than being brought forward to 2021, as previously decided.

Notes

1 'Other support' is non-funding support that nonetheless has financial implications. For example, it can be to aid financial planning, ease capacity pressures or ease service expectations.

2 Abbreviations used: MHCLG (the Ministry of Housing, Communities & Local Government), DHSC (the Department of Health & Social Care), Defra (the Department for Environment, Food & Rural Affairs), and DfE (the Department for Education).

Source: National Audit Office analysis of data from government departments

Part Three

Outcomes for the sector in 2020-21

Funding sufficiency

The funding base

3.1 The Ministry of Housing, Communities & Local Government (the Department) collects monthly data on authorities' costs due to COVID-19. These include the increased costs of delivering existing services, meeting the costs of increased service demand and the costs of delivering COVID-19 programmes on behalf of government. Many of these government programmes include specific funding to support their delivery.

3.2 To ensure that authorities recorded programme costs comparably, the Department included a list of funding streams in round 8 (December 2020) of its survey that it expected to be reflected in authorities' reported costs. We use this list of schemes to define our measure of government funding for 2020-21 (Appendix Two, Figure 24). Some funding lines discussed previously (Figure 8) are not included in this body of funding. This reflects choices made by the Department.

3.3 It is possible that some authorities may not have included all of the costs associated with these funding streams in their return. However, the survey tool indicated clearly that costs associated with these schemes should be included. We therefore assume that they have been.

3.4 We include funding announced or provided up to and including early December 2020. The data on reported costs from the sector were provided by local authorities in early December 2020.

Sector-level funding sufficiency

3.5 At the sector level, there is a reported funding gap between the various streams of financial support and authorities' forecast cost pressures and income losses (**Figure 10**).

Figure 10

Total COVID-19 financial pressures and funding for English local authorities in 2020-21 (reported or announced by early December 2020)

Pressure/Funding stream	£ billion
Cost pressures	(6.87)
Non-tax income losses	(2.85)
Sub-total	**(9.72)**
Unringfenced grants (four tranches)	4.55
Other funding	3.33
Estimated sales, fees and charges income compensation	1.23
Sub-total	**9.11**
Balance	**(0.60)**

Note

1 Figures may not sum due to rounding. The precise gap between financial pressures and estimated income is £605 million.

2 The figure for sales, fees and charges income compensation is a National Audit Office estimate drawing on local authority forecast losses. It covers potential compensation for losses for the whole of 2020-21. See Appendix Two for details.

3 The cost pressure figures are forecasts made by authorities in early December of their likely full year costs. This includes Isles of Scilly, and City of London, which have otherwise been excluded from the case level analysis. For the three councils that did not submit a return in December their latest forecast was used.

4 The figures on grant and other funding cover the period up to early December 2020. See Figure 24 in Appendix Two.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Local authority-level funding sufficiency

3.6 The £586 million gap at the sector level arises because 252 'under-funded' authorities (74.8%) face a shortfall of £909 million, and 85 'over-funded' authorities have a surplus of £323 million (**Figure 11** overleaf).[20]

Variation in local authority-level outcomes

3.7 Local authorities have received funding to address COVID-19 cost pressures and income losses separately.

Cost pressures and funding variances

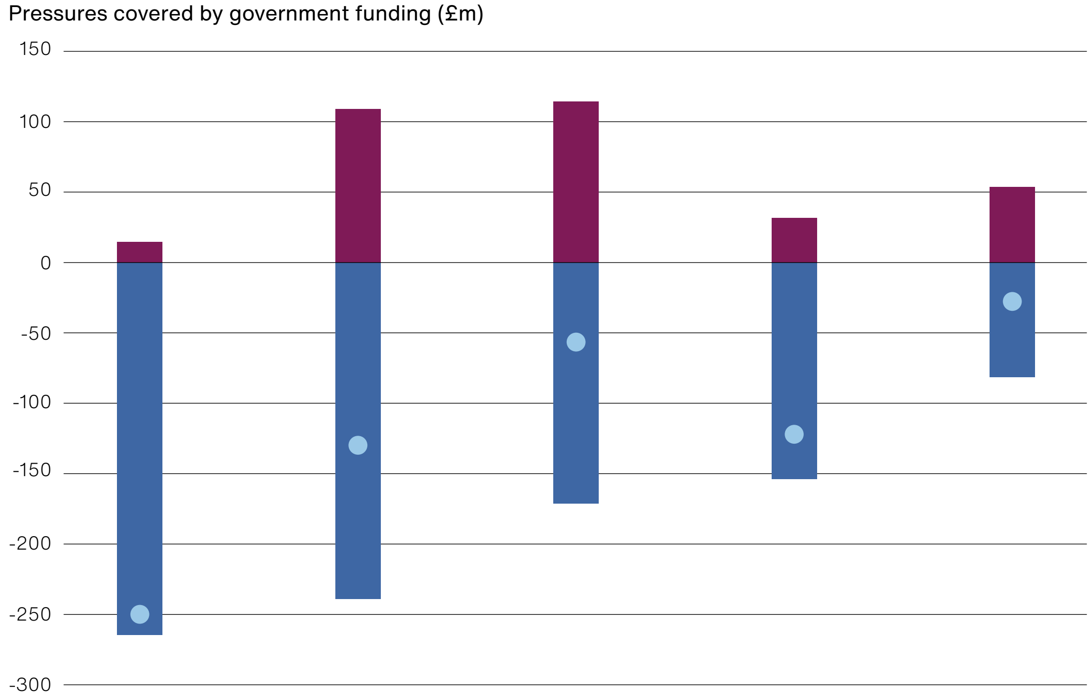
3.8 The great majority of authorities appear to be receiving more in COVID-19-related funding for cost pressures than their forecast cost pressures (**Figure 12** on page 43). But this is not the case for all authorities.

20 Case-level analysis has been done excluding Isles of Scilly and City of London from the estimates. The gap is therefore not the same as in the table, which shows the aggregate pressures including all local authorities.

Figure 11

Gross reported 'over-funding' and 'under-funding' for English local authorities by authority type in 2020-21

District councils have the largest reported gross and net under-funding as at December 2020



	District councils	Unitary authorities	Metropolitan districts	London boroughs	County councils
Gross over-funding (£m)	14	109	114	32	54
Gross under-funding (£m)	-265	-239	-171	-154	-81
Net funding position (£m)	-250	-130	-57	-122	-28

Count of councils	District councils	Unitary authorities	Metropolitan districts	London boroughs	County councils
Over-funded	29	22	14	9	11
Under-funded	159	34	22	23	14
Total	**188**	**56**	**36**	**32**	**25**

Notes

1 The figure shows the sum of reported under-funding for under-funded authorities for each type, and the sum of reported over-funding for over-funded authorities of each type. The net funding position nets off over- and under-funding for each authority type. Data is rounded and may not sum to the net funding position.

2 The funding gap is based on full year cost pressures and income pressures reported by local authorities in December 2020 against funding announced by government by early December 2020 and a National Audit Office estimate of likely sales, fees and charges compensation for 2020-21.

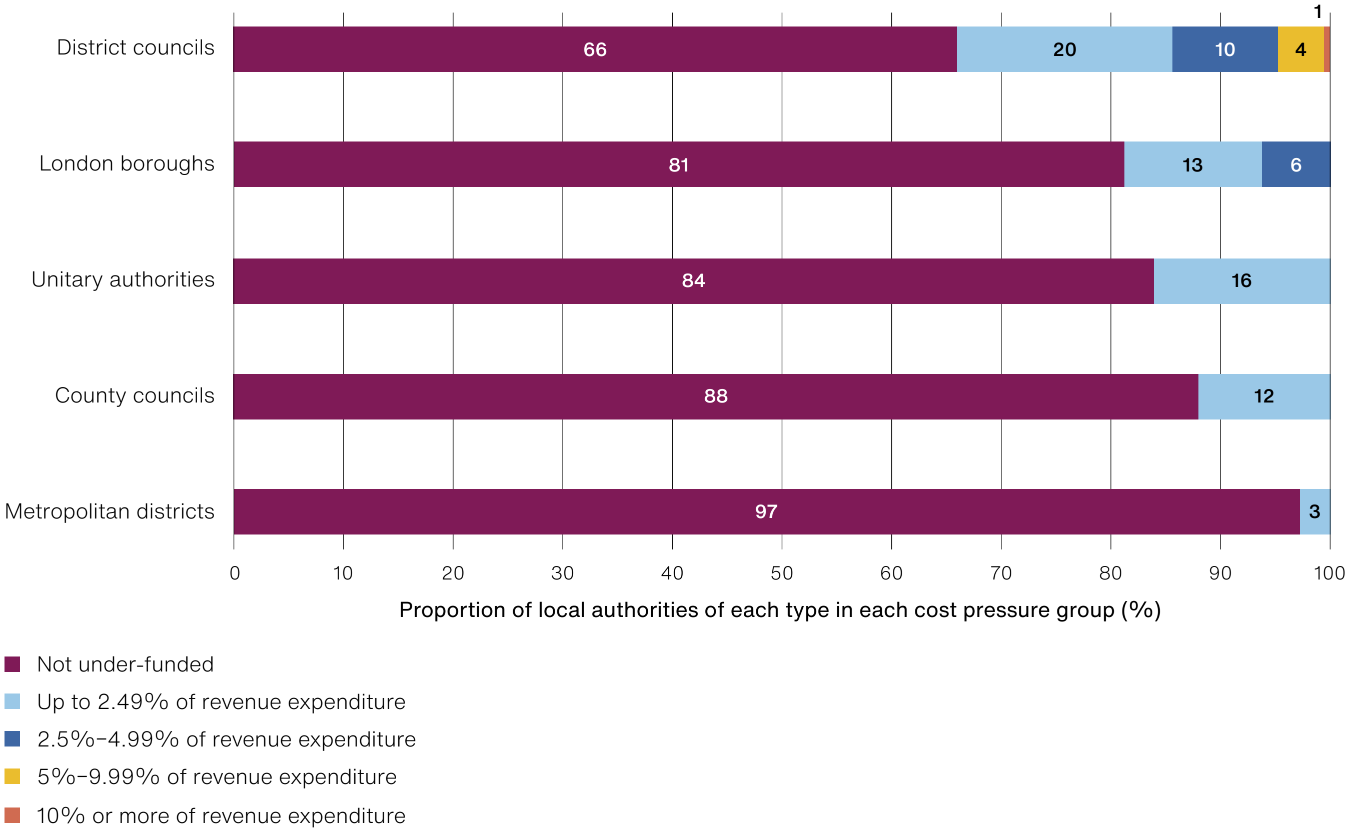
3 We include estimates for all councils in England except City of London and the Isles of Scilly. Data for missing authorities has been imputed (see Appendix Two for details).

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 12

Variance between forecast cost pressures and additional funding for cost pressures for English local authorities in 2020-21

The majority of authorities had reported cost pressures in early December 2020 below the level of funding announced at that time



Notes

1. This includes estimates for all councils in England except City of London and Isles of Scilly. Data for missing authorities has been imputed (see Appendix Two).
2. The figure compares full year cost pressures reported by local authorities in December 2020 against funding announced by government by early December 2020. The balance is shown as a share of revenue expenditure.
3. Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).
4. Totals may not sum to 100 due to rounding.
5. For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Income losses and funding variances

3.9 All authorities will receive less from the sales, fees and charges compensation scheme than their forecast non-tax income losses relative to budget. The compensation addresses sales, fees and charges losses over a 5% budget threshold, and thereafter at 75p in the £1. Commercial and other non-tax income losses are not compensated.

3.10 Some authorities face significant gaps between their income losses and estimated compensation. Overall, we estimate 8.0% of authorities will see an income compensation gap equivalent to 10% or more of their revenue expenditure, and 35.9% a gap of 5% or more. This varies across different authority types (**Figure 13**).

Total pressures and funding variances at the case level

3.11 Many authorities may be left with a reported total funding gap. Overall, we estimate 30.0% of authorities will see a gap between their total COVID-19 financial pressures and their additional funding equivalent to 5% or more of their revenue expenditure. District councils have the highest funding gaps; 49.7% have estimated funding gaps equivalent to 5% or more of their revenue expenditure (**Figure 14** on page 46). Among single tier and county councils, those with social care responsibilities, 5.3% have estimated funding gaps of more than 5% of their revenue spend.

Implications of funding pressures and gaps

Managing in-year pressures

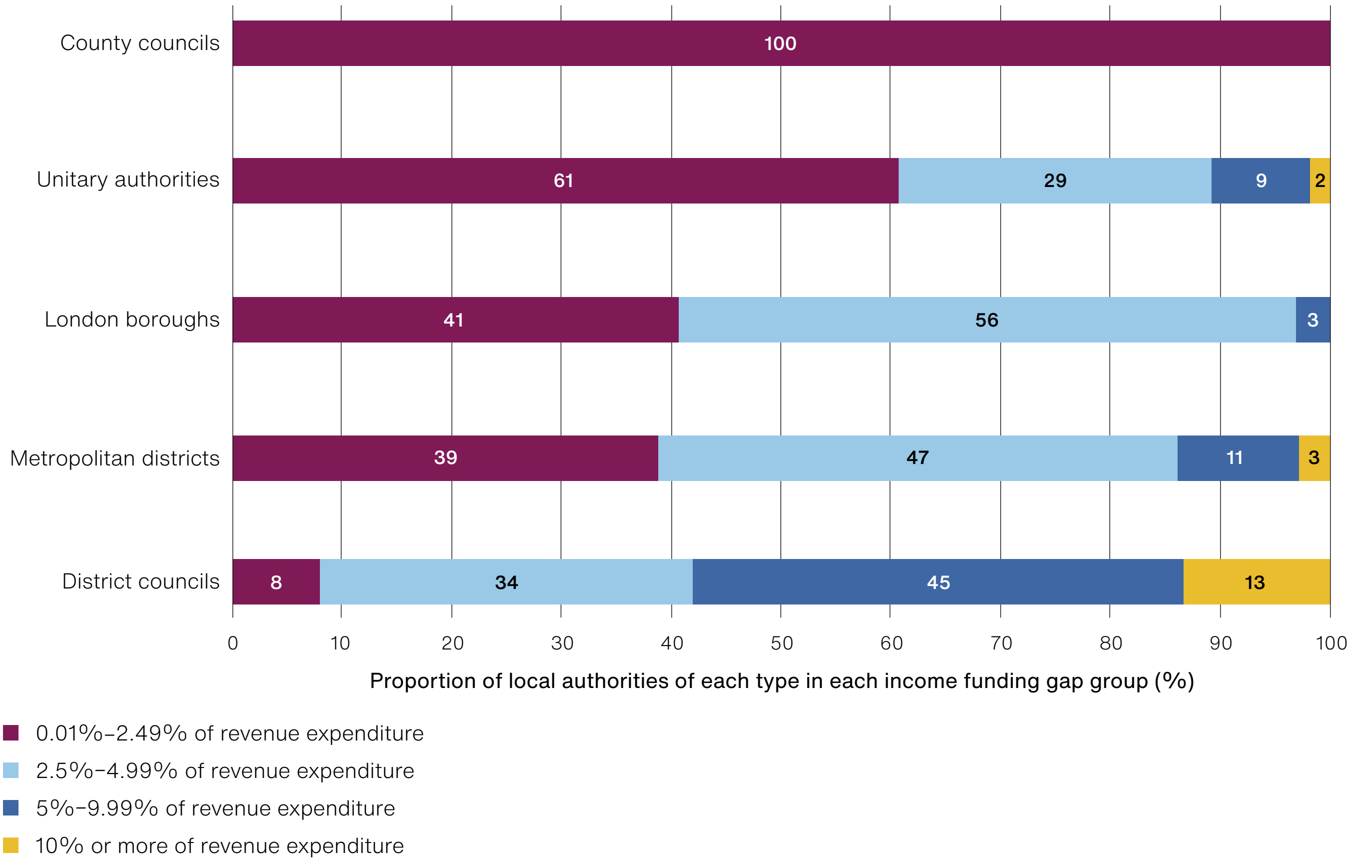
3.12 We undertook a survey of local authority section 151 officers. This showed that many authorities have taken unplanned in-year actions in response to COVID-19 pressures (**Figure 15** on page 47).[21] This may reflect a variety of circumstances as perceived locally, including the policy uncertainty referred to elsewhere in this report and local estimates of individual 'funding gaps' at particular points in time.

21 Our survey had a response of 55.0% for single tier and county councils, and 28.2% for district councils. The relatively lower response rate for districts should be considered when using these data and we present the two groups separately as a result. See Appendix Two for detail.

Figure 13

Variance between forecast non-tax income losses and estimated sales, fees and charges compensation for English local authorities in 2020-21

District councils have reported the greatest gap relative to their spending base between forecast non-tax income losses and estimated sales, fees and charges compensation



Notes

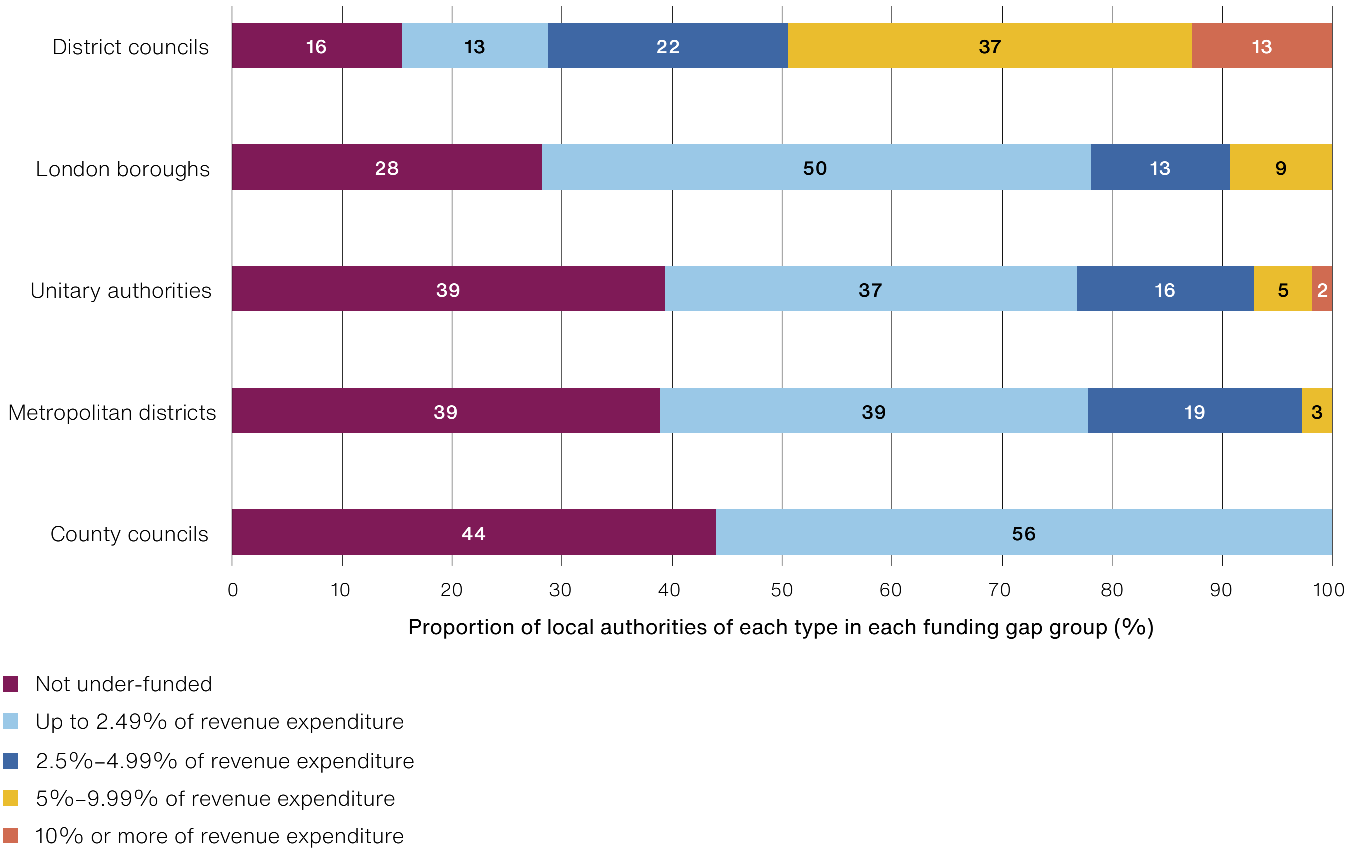
1. This includes estimates for all local authorities in England except City of London and Isles of Scilly. We impute data for missing authorities (see Appendix Two).
2. The figure compares whole year forecasts of non-tax income reported by authorities in early December 2020 against a National Audit Office estimate of likely sales, fees and charges compensation for 2020-21. The balance is shown as a proportion of revenue expenditure.
3. Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).
4. Totals may not sum to 100 due to rounding.
5. For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 14

Reported total funding gaps as a share of revenue spending for English local authorities in 2020-21

District councils have the greatest reported total funding gaps as a proportion of their spending



Notes

1 This includes estimates for all councils in England except City of London and Isles of Scilly. We impute data for missing authorities (see Appendix Two).

2 Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).

3 Totals may not sum to 100 due to rounding.

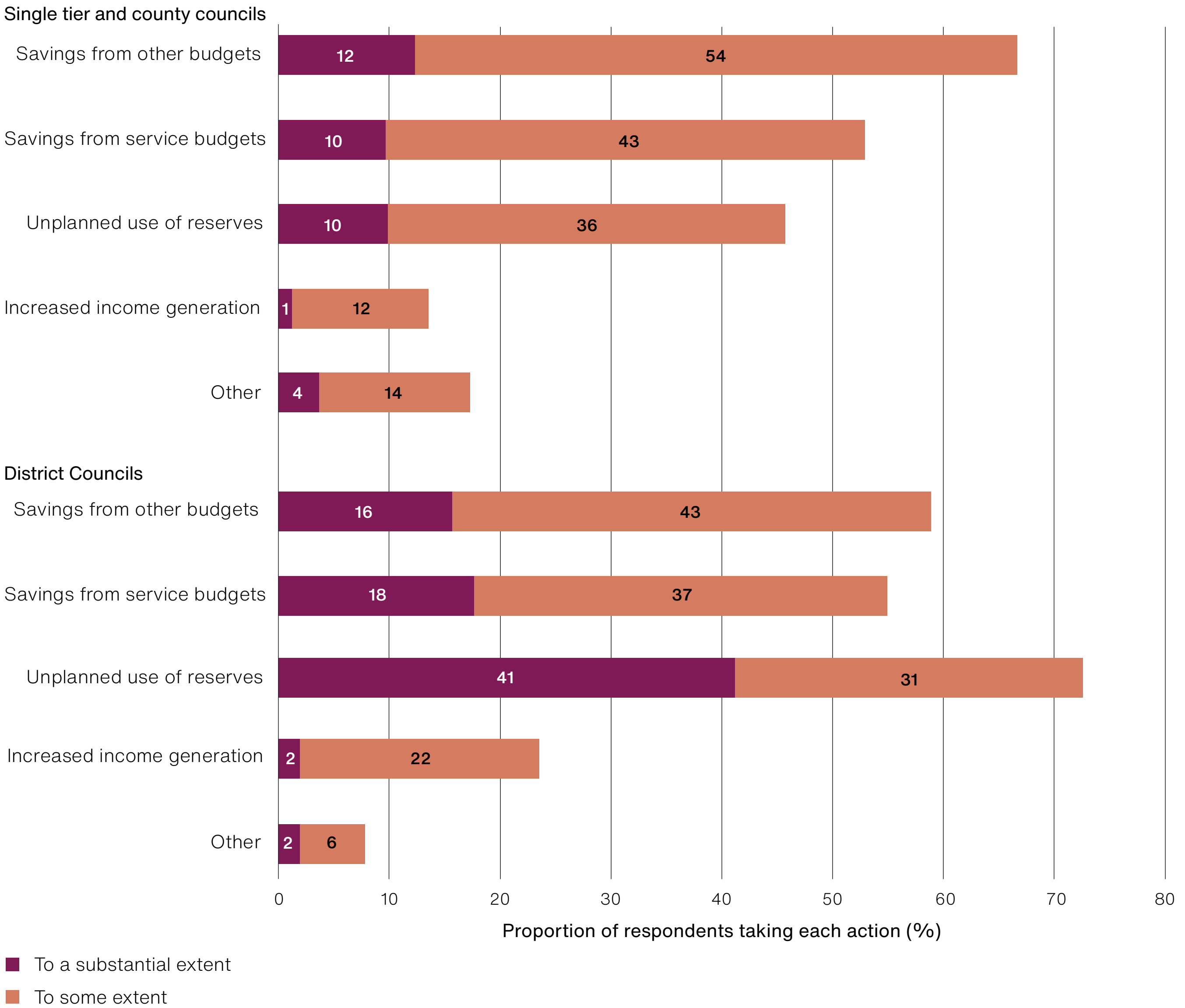
4 For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 15

Actions taken by English local authorities in-year to date to address COVID-19 financial pressures in 2020-21

More than half of respondents from both district councils and single tier and county councils have made savings in their service budgets in 2020-21 to date in response to COVID-19 pressures



Notes

1 N=51 for district councils. N=81 single tier and county councils.

2 Respondents were asked whether they had taken any of the actions in the year to date. The survey ran for the second half of December 2020 and the first week of January 2021.

3 Not all respondents provided a response for all of the options in the question. We show data for those responding either "to a substantial extent" or "to some extent" as a proportion of those that responded to at least one option to the question (see Appendix Two).

4 'Other budgets' include corporate budgets, treasury management and capital financing.

5 Data is rounded to whole numbers. Where data from this chart is used elsewhere in the report it is based on the unrounded underlying data and therefore may differ marginally.

Source: National Audit Office survey

Use of reserves in 2020-21

3.13 In our survey, 23% of respondents from district councils and 26% of respondents from single tier and county councils indicated that as of late December 2020 their forecast year-end position, ahead of any additional actions, was a 'material overspend'. The use of reserves was the most frequently cited method to address overspends, with all respondents from district councils and 81% of respondents from single tier and county councils forecasting a material overspend saying they would apply reserves. We also found in our review of budget monitoring reports from before the settlement that around half of the councils reviewed made reference to planning or considering the use of reserves to meet pressures. Our case studies also provided examples of how they were looking to use reserves in the different scenarios they were considering before the settlement was announced. Further, some of the respondents to our survey intended to make additional savings from service budgets (18% of respondents from district councils and 43% of respondents from single tier and county councils) and other budgets (45% of respondents from district councils and 57% of respondents from single tier and county councils) to balance their budgets.[22]

3.14 Overall, 73% of respondents from district councils and 46% of single tier and county councils said that they had either already used reserves or planned to this year in order to address COVID-19 pressures.

Levels of reserves

3.15 The Department collects data annually on the level of authorities' financial reserves. This includes unallocated reserves, which are held as a contingency to address unplanned in-year issues, and earmarked reserves, held for specific purposes such as to fund capital programmes. In principle, earmarked reserves can be released for other purposes.

3.16 It is a formal requirement of the budget-setting process that authorities hold sufficient reserves to accommodate the risks associated with their budget. Therefore, authorities will try to avoid running their reserves down, even unallocated ones, to such an extent that they would be unable to set their next budget.

3.17 In its monthly survey, the Department has begun to collect data on the level of reserves that authorities feel they have 'available' to address COVID-19 pressures. The concept of 'availability' reflects the fact that not all of an authority's unallocated reserves are necessarily available, while some of their earmarked reserves may be. The Department had previously assessed authorities' financial sustainability in terms of their total reserves (unallocated plus earmarked).

22 These figures are as a share of respondents who were forecasting a "material overspend" in 2020-21.

3.18 Our analysis shows that for a sizeable group of authorities, their COVID-19 funding gaps will account for a large amount, or exceed, the reserves they have identified as 'available' (**Figure 16** overleaf). Overall, 31.5% of local authorities reported a funding gap that exceeded their level of available reserves. The level varied between different groups. Across single tier and county councils as a whole, 29.5% had estimated funding gaps in excess of their total available reserves.

3.19 While the Department collected these data it also told us that there were issues of data quality in some cases. Some 20.3% of authorities stated that they had no reserves that were available to address financial pressures due to the pandemic.

3.20 In general authorities have said that their available reserves are less than their unallocated reserves. Nonetheless, in many cases, authorities' remaining funding gaps are equivalent to a substantial share of their unallocated reserves (**Figure 17** overleaf). For example, 13.9% of councils reported pressures that exceeded their level of unallocated reserves as at 1 April 2020. This applied to 16.5% of district councils, and 10.7% of county and single tier authorities.

Risk of financial failure

Sufficiency of reserves

3.21 Reserve levels are a key measure of the financial sustainability of an authority. Where authorities have insufficient reserves to meet financial pressures, they are at risk of failing to balance their budgets, a legal requirement.

3.22 There is no standard comparable measure for assessing the sufficiency of reserves at the sector level. The Department has created a risk metric to inform its internal monitoring in the context of COVID-19 pressures. Under this model authorities are grouped into different risk categories based on the level of remaining reserves of different types after COVID-19 funding gaps have been netted off.[23] However, the Department has requested that we do not publicise the precise thresholds used to create these groups, which it uses as an indicative first step in its assessment.

3.23 Applying this framework to our estimates of funding gaps indicates that very few authorities would be regarded as acute risks: only 1.5% of all authorities. However, 5.9% are in the high-risk category and 27.3% in the medium-risk category.[24]

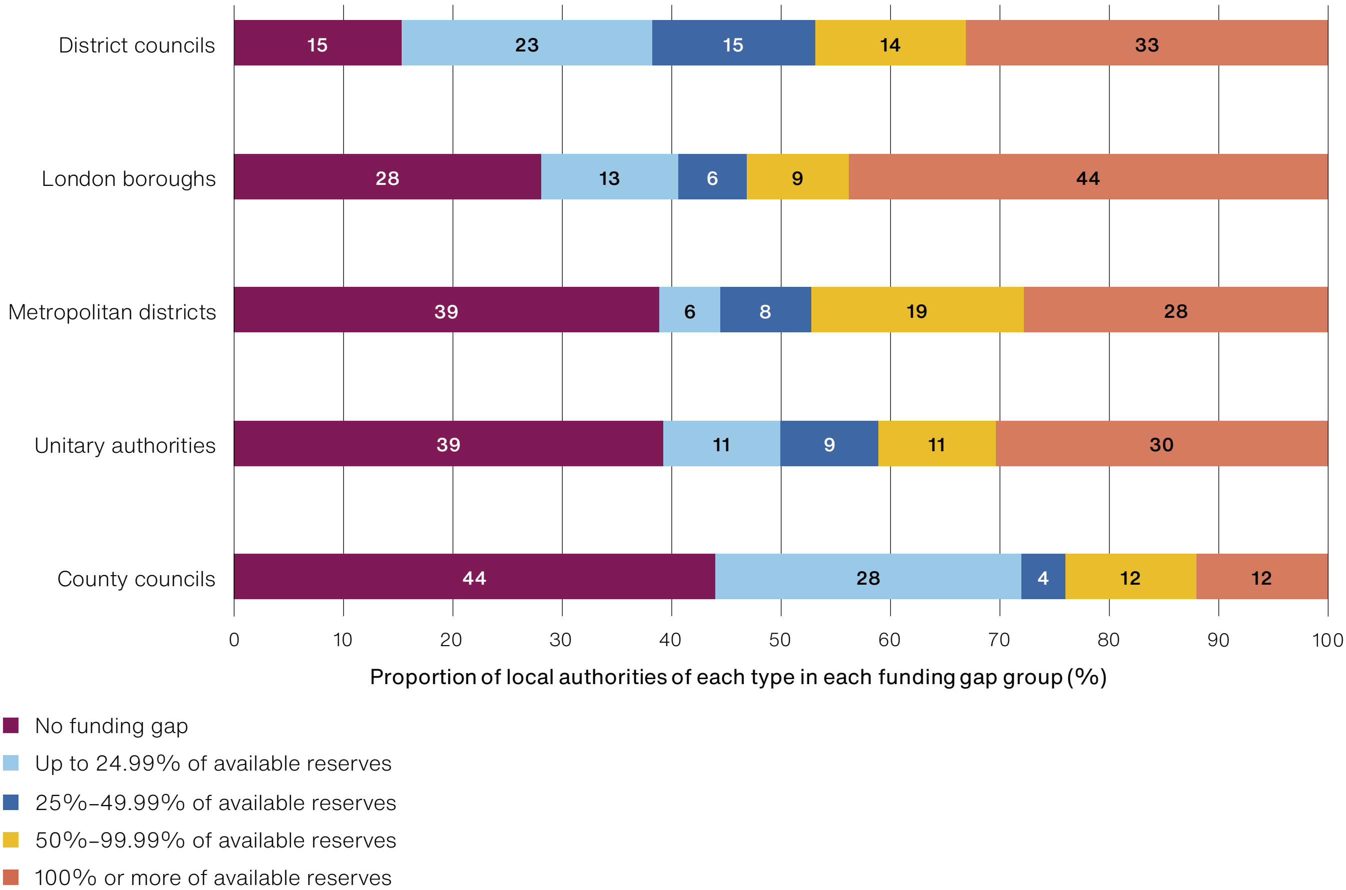
23 More detail on the methods used to create these groups is provided in Appendix Two. However, please note that the Department has requested that the precise thresholds used to create the groups are not publicised.

24 Given the large number of estimates and assumptions underlying this analysis it should be treated as illustrative. Furthermore, while the framework is used by the Department, we have applied it to our own analysis of reported funding gaps and reserve levels.

Figure 16

Reported funding gaps as a share of 'available reserves' in English local authorities in 2020-21

London boroughs have the greatest proportion of authorities with estimated funding gaps that exceed their level of available reserves



Notes

1 This includes estimates for all councils in England except City of London and Isles of Scilly. We imputed data for missing authorities (see Appendix Two).

2 The figure takes our estimated funding gap for each authority as of December 2020 and calculates that figure as a share of the authority's reported "available reserves".

3 "Available reserves" are earmarked or unallocated reserves identified by authorities as available to be used to address COVID-19 pressures as of December 2020 in the Department's monthly survey. Two councils indicated that they had nil earmarked reserves while they had reported earmarked reserves in the Revenue Outturn return (RO). For these the adjusted RO estimate was used.

4 Totals may not sum to 100 due to rounding.

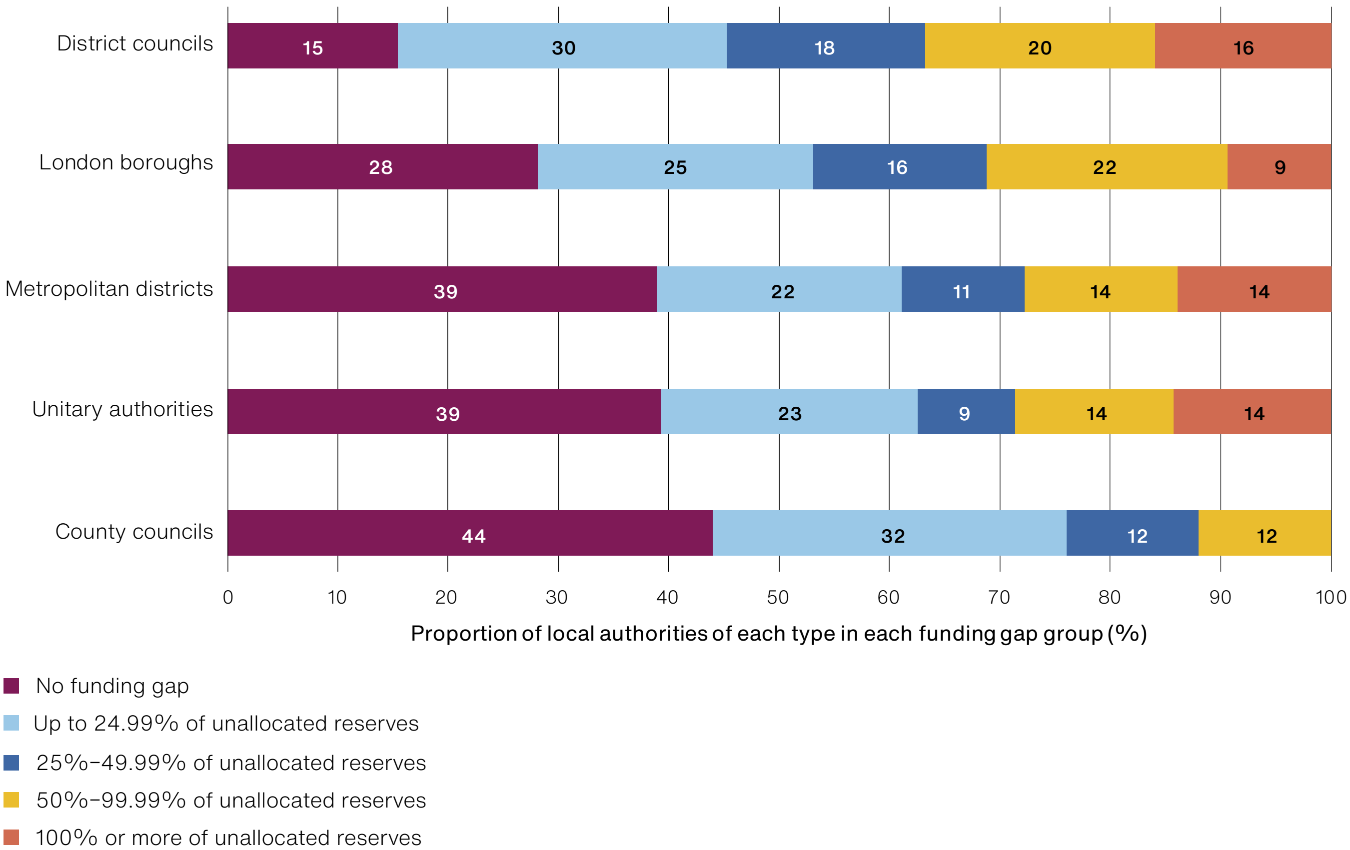
5 For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Figure 17

Reported funding gaps as a share of unallocated reserves in English local authorities in 2020-21

Many authorities of different types have funding gaps in excess of, or equivalent to a large proportion of, their unallocated reserves



Notes

1 This includes estimates for all councils in England except City of London and Isles of Scilly. We impute data for missing authorities (see Appendix Two).

2 Revenue expenditure is an adjusted version of authorities' 2019-20 revenue expenditure (see Appendix Two).

3 Totals may not sum due to rounding.

4 For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

3.24 District councils face larger funding gaps and tend to have relatively higher levels of reserves and therefore are better able to mitigate the risks of the pressures they face (**Figure 18**). In contrast, single tier and county councils face lower funding gaps, but have lower reserves levels. Overall, some 9.4% of single tier and county councils fall in the acute or high-risk categories compared with 5.9% of district councils.

Exceptional financial support and risk monitoring

Capitalisation directions

3.25 The Department told us that it is in discussion with a "small number" of authorities about providing capitalisation directions to allow them to balance their budgets this year or next year. By 10 February 2021, the Department had provided exceptional financial support to four authorities. This support is in the form of capitalisation directions for 2020-21 totalling £50.5 million. There are two further councils where non-statutory reviews commissioned by the Department have suggested that a capitalisation direction or other exceptional support is necessary. These are the Croydon Council and Nottingham City Council.

Section 114 notices

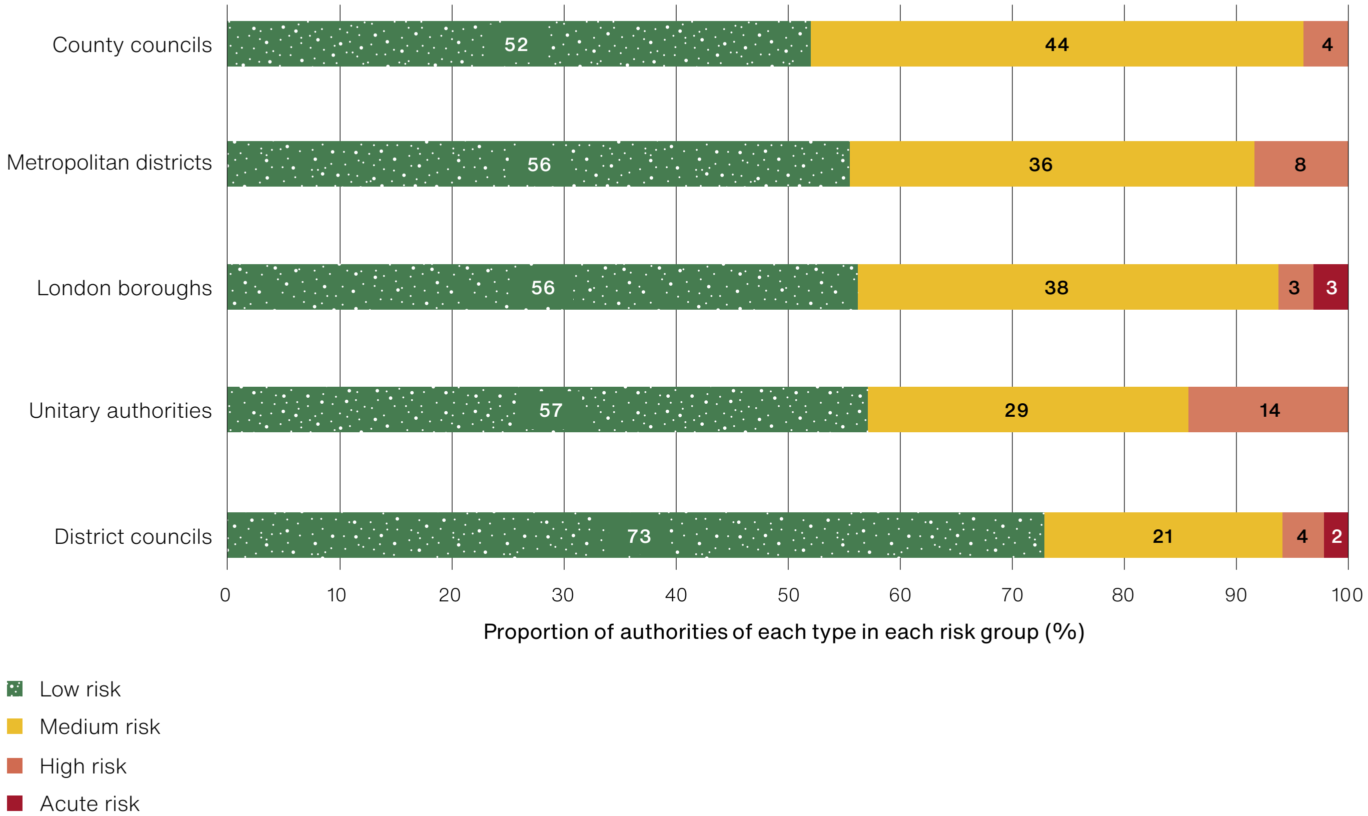
3.26 By the end of February 2021, the section 151 officer of one council, Croydon Council, had issued a section 114 notice indicating that the authority is at risk of failing to balance its budget, which would be unlawful. Croydon Council has had a continued section 114 notice in place since November 2020. The Department told us that while it had been discussing a capitalisation direction with the council it had not received a formal application until after a section 114 notice had been issued. This action follows the publication of a public interest report by the authority's external auditor which was critical of the authority's financial management arrangements. The report found that the roots of the authority's problems lay in poor decision-making and financial control over several years, meaning that the authority was poorly placed to cope with the impact of the pandemic.

3.27 The Department told us that Croydon Council had been on their 'long list' of councils at risk for some years. However, the Department only started to become more aware of the full scale of the authority's underlying issues through the COVID-19 monitoring returns and other communications from April 2020. The Department attributed this to Croydon Council itself not having previously had a good grasp of its financial position and the risks to that position. In February 2021, the Department announced an Improvement and Assurance Panel for the council.

3.28 Section 114 notices lead to the introduction of restrictions on new spending. The Department told us it is confident, based on both legal advice and assurances from the council, that these restrictions will not hamper Croydon's ability to continue to support its community in the pandemic.

Figure 18
Risk categorisation of English local authorities in 2020-21

Most local authorities are categorised as low risk based on their reported funding gaps and level of reserves, but a substantial proportion of single tier and county councils are categorised as medium or higher risk



Notes

1 This includes estimates based on reported pressures for all local authorities in England except City of London and Isles of Scilly. We impute data for missing authorities (see Appendix Two).

2 We use total unringfenced reserves (unallocated plus earmarked reserves) as at 31 March 2020 reported in the 2019-20 revenue outturn. We adjust for COVID-19 payments received by authorities on 27 March 2020 (see Appendix Two).

3 This analysis uses the Department's own metrics, applying estimates from analysis done by the National Audit Office.

4 For presentational purposes data is rounded to whole numbers. Where these figures are used elsewhere in the report they are shown to one decimal point.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

Part Four

Local authority finances in 2021-22 and beyond

Pressures for 2021-22

4.1 The ability of authorities to set and deliver their 2021-22 budgets has been a major issue of concern raised in our discussions with finance directors.

Tax losses

Tax deficits 2020-21

4.2 Tax losses do not have a direct in-year impact and will only hit local authority budgets the following year. As of December 2020, authorities forecast that business rates collected in 2020-21 would be £1.6 billion lower than budgeted due to the pandemic. Council tax income collected would be £1.3 billion lower. Not all this tax income is permanently lost, however. Some uncollected 2020-21 business rates and council tax are likely to be recoverable in the future.

4.3 Before the pandemic, authorities were required to address the previous year's tax deficits fully in the following year. The government announced in July 2020 that 2020-21 tax losses would be spread over three years. The government also committed in July to sharing part of irrecoverable local tax losses for 2020-21. The government share was announced in the Spending Review as 75%.

Tax base reduction

4.4 A common theme in our review of authorities' financial monitoring papers was an expectation that authorities' tax bases are likely to shrink in 2021-22 as the economic downturn affects local labour markets and economies.

4.5 The potential for a reduction in authorities' council tax bases is apparent in the recent increase in council tax support claimants. From the third quarter of 2019-20 to the second quarter of 2020-21, the number of claimants increased by 4.9%. This compares to the four years to the third quarter of 2019-20, when the total number of council tax support claimants fell by 10.6%. Council tax support claimants receive reduced council tax bills.

Other pressures for 2021-22

4.6 In addition to dealing with tax deficits and reduced tax bases, local authorities need to address other potential financial pressures, including:

- ongoing cost and demand pressures from the pandemic;
- replenishing diminished reserves;
- delivering delayed savings programmes from 2020-21;
- dealing with any service demand growth due to the economic downturn such as demand for welfare and business support service; and
- dealing with any further non-tax income losses due the continuation of the pandemic or the economic downturn.

4.7 There is no published national data on authorities' forecast pressures for 2021-22.

Budgeting in the context of uncertainty

4.8 Authorities had little sense of major elements of their budgets for 2021-22, such as council tax referendum limits, or the future of the adult social care precept, the Better Care Fund and New Homes Bonus, until the announcement of the Spending Review on 25 November 2020. It was not until 17 December that individual authorities found out their actual levels of grant funding. Council tax billing authorities are legally required to set their budgets by 11 March, with precepting authorities by 1 March. These issues are not new but this year finance directors considered they were more detrimental then normal owing to the additional uncertainties created by the pandemic.

4.9 Some authorities we spoke to talked of the difficulties of what was described as "planning in a vacuum" and said uncertainty does not support value-for-money decision-making. Examples of the impact of uncertainty provided by chief finance officers included:

- elected members holding off making difficult decisions in the hope that the settlement would be more positive than expected;
- a lack of time to review savings options to make good rather than quick decisions;
- a tendency to be overly cautious and cut services rather than to plan for efficiencies over the medium term; and
- the tendency to build up reserves in-year in the expectation that they will be needed to balance the next budget.

4.10 The Ministry of Housing, Communities & Local Government (the Department) told us that it recognised the sector's challenges and had consulted informally with HM Treasury on ways to address this ahead of the publication of the Spending Review. However, government considered it was impossible to provide information in advance to authorities that would provide them with any meaningful certainty without restricting ministers' ability to make decisions at the end of the Review.

The Spending Review and local government finance settlement

Objectives

4.11 The government initially planned a multi-year Comprehensive Spending Review. However, in October 2020 the government decided, given "the unprecedented uncertainty of COVID-19", to carry out a one-year review focused on COVID-19 response and supporting jobs.

4.12 This policy approach is largely a continuation of the government's approach to the sector in 2020-21; providing funding upfront to see authorities through the next few months and then reviewing the situation periodically. As the Secretary of State for Housing, Communities & Local Government said when announcing the provisional local government finance settlement: "The purpose of today's settlement, in looking ahead to the likely COVID expenditure that councils will face next year, is to ensure that … [in respect of in-year impacts] …they at least have forward guidance to the middle point of the next calendar year."[25]

4.13 Consequently, the Spending Review and the settlement are designed to guide the sector through the ongoing period of uncertainty, rather than seeking to set a base to support the sector's recovery or attempting to re-engage with the stalled local government finance reform programme. Some finance directors we spoke to accepted that reform could not be taken forward during the pandemic, while noting that this added to pre-existing delays. However, they regretted that the Spending Review and finance settlement are not on a multi-year basis, which in their view would support improved financial planning and provide better value for money.

Outcomes from the Spending Review and the finance settlement

Mainstream elements

4.14 The settlement provides the sector with an increase of up to 4.5% in spending power (council tax and government funding) in cash terms.[26] It includes some new social care funding and additional funding for lower-tier services. It also includes a council tax referendum limit of 2% (or £5 for district councils if higher) and the flexibility for social care authorities to add a social care precept of up to 3% either this year or next.

25 *Hansard*, HC Deb, 17 December 2020, vol. 686, col. 430.
26 This reflects the cash terms increase in the provisional settlement announced 17 December 2020. The final settlement announced 4 February 2021 amounted to a final increase of 4.6% in cash terms. These figures cover all types of local authorities, rather than solely principal authorities.

4.15 The increase in spending power is underpinned by some key assumptions:

- The 4.5% cash terms increase in spending power assumes all social care authorities will increase their council tax rates by 5% in 2021-22.
- Modelled growth in council tax income assumes that authorities' tax bases will grow in line with the average since 2016-17. Despite including it in its modelling, the Department recognises that this is unlikely to be achieved and has provided additional funding as part of its COVID-19 support package to offset this.

COVID-19 support funding

4.16 The settlement contained some support to help authorities address ongoing pressures from the pandemic. These included:

- a further tranche of unringfenced funding (£1.55 billion) to address cost pressures;
- a continuation of the sales, fees and charges income compensation scheme for the first quarter of 2021-22;
- a commitment to meet 75% of authorities' irrecoverable tax losses from 2020-21; and
- a £670 million grant to authorities to support households least able to afford council tax costs. The Department has used this funding to justify not adjusting its assumption that the council tax base growth will continue in line with the recent trend.

Implications of the 2021-22 finance settlement

4.17 Following the publication of the provisional local government finance settlement we surveyed local authorities' section 151 officers. We also interviewed the chairs of five of the six treasurers' societies.

Budget setting

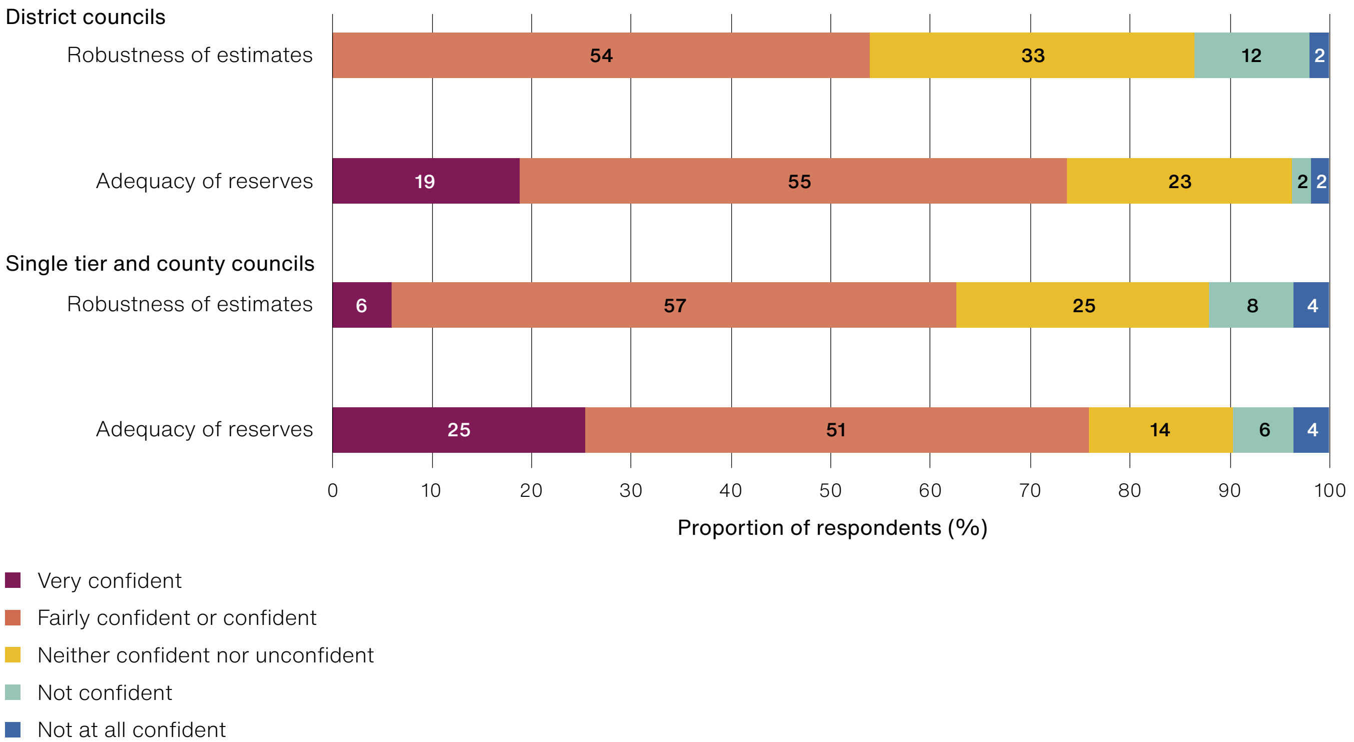
4.18 The great majority of survey respondents (92% of district councils, and 93% of single tier and county councils) indicated that they would be able to set a balanced budget for 2021-22. However, 6% of respondents from district councils said they were currently uncertain. Among respondents from single tier and county councils, 5% said they were currently uncertain and 1% (one respondent) said they were unable to set a balanced budget.

4.19 Even where authorities indicated that they can set a balanced budget this will not always be straightforward. Some 84% of respondents from single tier and councils and 83% from district councils said that the budget-setting process had been more challenging or significantly more challenging than setting their 2020-21 budgets.

4.20 Respondents also indicated that there is risk and uncertainty in their budgets (**Figure 19**). Section 151 officers are required to accompany their budgets with a Section 25 report, which sets out the risk associated with the robustness of their estimates and the adequacy of their reserves. Our survey showed that many respondents lack confidence in these elements of their budgets.

Figure 19
Survey respondents' confidence in core elements of their draft 2021-22 budgets

Most, but by no means all, respondents were confident in their budget estimates and adequacy of reserves in their draft 2021-22 budgets



Notes

1 For robustness of estimates N=53 district councils and N=83 single tier and county councils. For adequacy of reserves, N=52 district councils and N=83 single tier and county councils. No respondents to the question answered 'don't know' or 'prefer not to say'.

2 The survey ran from 18 December 2020 to 5 January 2021.

3 Totals may not sum to 100 due to rounding.

4 Data is rounded to whole numbers. Where data from this chart is used elsewhere in the report it is based on the unrounded underlying data and therefore may differ marginally.

Source: National Audit Office survey

4.21 Among single tier and county councils we identified four groups of survey respondents in terms of degrees of risk and uncertainty within their draft budget setting for 2021-22:[27]

- Fifty-two per cent can set a balanced budget and are confident in both their estimates and the adequacy of their reserves.
- Thirty-five per cent can set a balanced budget but have expressed confidence in only one of their estimates or reserves.
- Seven per cent can set a balanced budget but have not expressed confidence in either their estimates or their reserves.
- Six per cent have not indicated that they are currently able to set a balanced budget.

Budget delivery

4.22 We asked survey respondents how confident they were that they would be able to avoid issuing a section 114 notice in 2021-22 (**Figure 20** overleaf). Some 12% of respondents from single tier and county councils responded either neutrally or expressed a lack of confidence that they can avoid a section 114 notice in 2021-22. The figure for respondents from district councils was 6%.

4.23 For comparison, we asked survey respondents to recall how confident they felt about their ability to avoid a section 114 notice when setting their budget for 2020-21. Based on their recollections from last year, 4% of respondents from single tier and county councils expressed a lack of confidence or felt neutral about their ability to avoid a section 114 notice in 2020-21 when setting their budget for that year. The figure for respondents from district councils was 0%.

Implications of savings plans

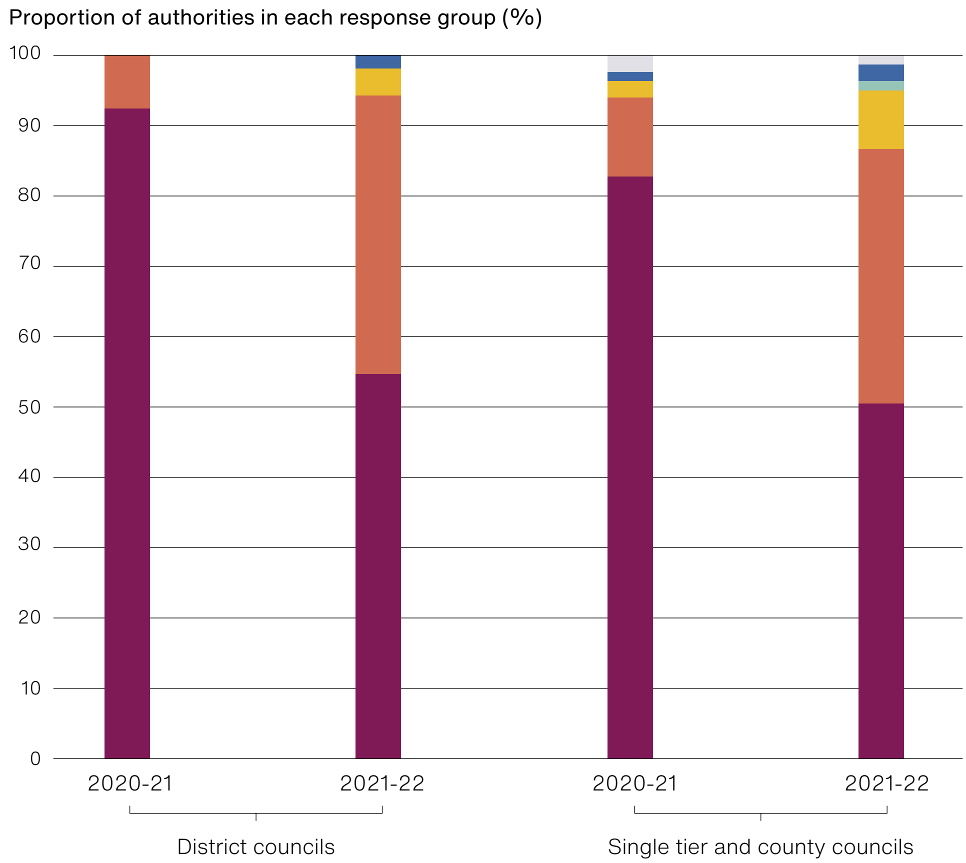
4.24 Our survey indicates that to balance their 2021-22 budgets respondents expect to make reductions in service budgets (**Figure 21** on page 61). Some 94% of respondents from single tier and county councils and 81% from district councils responding to the question indicated that they would take this action.

27 The grouping excludes respondents that indicated they did not know or did not respond to either of the two questions used to create these groups.

Figure 20

Survey respondents' confidence when setting their 2020-21 and 2021-22 budgets that they could avoid a section 114 notice in-year

The majority of respondents were confident that they will not require a section 114 in 2021-22



	District councils 2020-21	District councils 2021-22	Single tier and county councils 2020-21	Single tier and county councils 2021-22
Don't know (%)	0	0	2	1
Not at all confident (%)	0	2	1	2
Not confident (%)	0	0	0	1
Neither confident or unconfident (%)	0	4	2	8
Fairly confident (%)	8	40	11	36
Very confident (%)	92	55	82	51

Notes

1 N=53 for district councils and N=83 for single tier and county councils.

2 The survey ran from 18 December 2020 to 5 January 2021.

3 Totals may not sum to 100 due to rounding.

4 One single tier or county council responded 'rather not say' to question 11 (covering 2020-21 budget). This is not included in the figure.

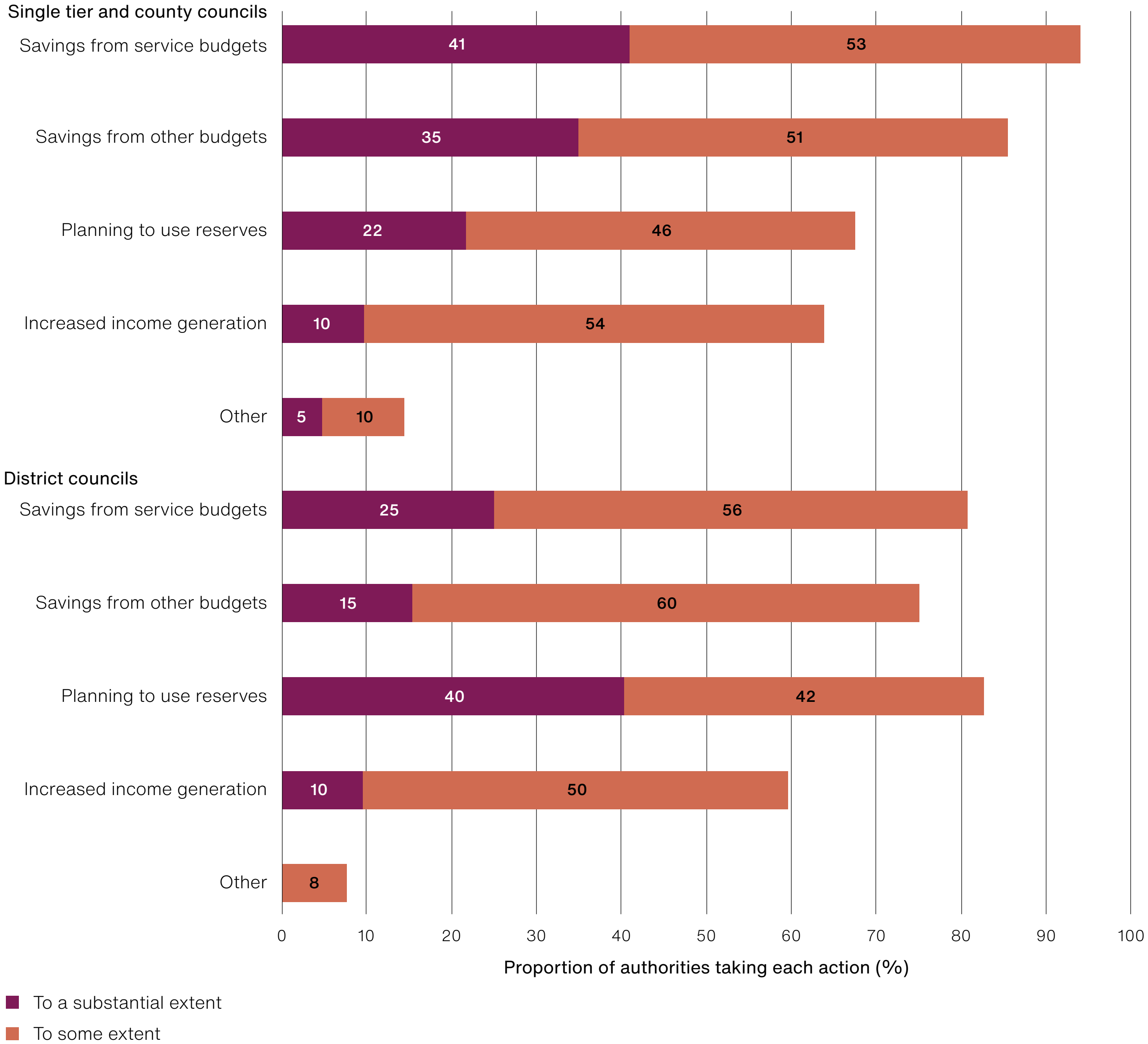
5 Data is rounded to whole numbers. Where data from this chart is used elsewhere in the report it is based on the unrounded underlying data and therefore may differ marginally.

Source: National Audit Office survey

Figure 21

Measures required to set a balanced 2021-22 budget identified by survey respondents

Most respondents indicated that they were considering savings within service budgets in order to balance their 2021-22 budgets



Notes

1 N=52 for district councils and N=83 for single tier and county councils.

2 Not all respondents provided a response for all the options in the question. We show data for those responding either “to a substantial extent” or “to some extent” as a proportion of those that responded to at least one option to the question (see Appendix Two)

3 The survey ran from 18 December 2020 to 5 January 2021.

4 ‘Other budgets’ include corporate budgets, treasury management and capital financing.

5 Data is rounded to whole numbers. Where data from this chart is used elsewhere in the report it is based on the unrounded underlying data and therefore may differ marginally.

Source: National Audit Office survey

4.25 We asked respondents for examples of their savings plans and if service users would be affected.[28] Some respondents said that service users would be affected by reduced staffing levels and general efficiencies, which would ultimately reduce the level of service an authority could provide over time. In other cases, authorities indicated that specific savings or income-generation measures would directly affect service users. Examples include:

- reviews of adult social care and special educational needs and disabilities (SEND) care packages;
- increased client contributions for adult social care;
- closure of libraries;
- closure of, or restriction of opening hours for, facilities such as information centres and theatres;
- reduced frequency of residual waste collections;
- reduced discretionary spend on home-to-school transport;
- reductions in subsidies for bus routes; and
- reductions in grants for homelessness support.

4.26 The Department told us that the funding provided through the settlement, which to a large extent is a ‘roll-over’ from the 2020-21 settlement, assumed that authorities would be able to provide services to the same level as intended in the 2020-21 settlement, subject to local decisions about priorities, particularly council tax. This assumption sets aside COVID-19 impacts and funding.

Medium-term recovery

4.27 Across the case studies, workshops and stakeholder interviews there is evidence that some finance directors expect the pandemic to have a medium-term to long-term impact on the sector’s finances. Authorities’ finances will be scarred. Rather than them simply returning to normal once the pandemic is over it is likely that a programme of financial recovery will be required.

4.28 Some 53% of respondents from single tier and county councils and 67% of district councils indicated that they would need to build up their reserves over the next two to three years. However, only 16% of these respondents from single tier and county councils and 26% from district councils felt confident that they would be able to do this.

28 The question was an optional, free text question to collect examples of service budget reductions. It does not provide a quantitative assessment of the impacts of service budget reductions.

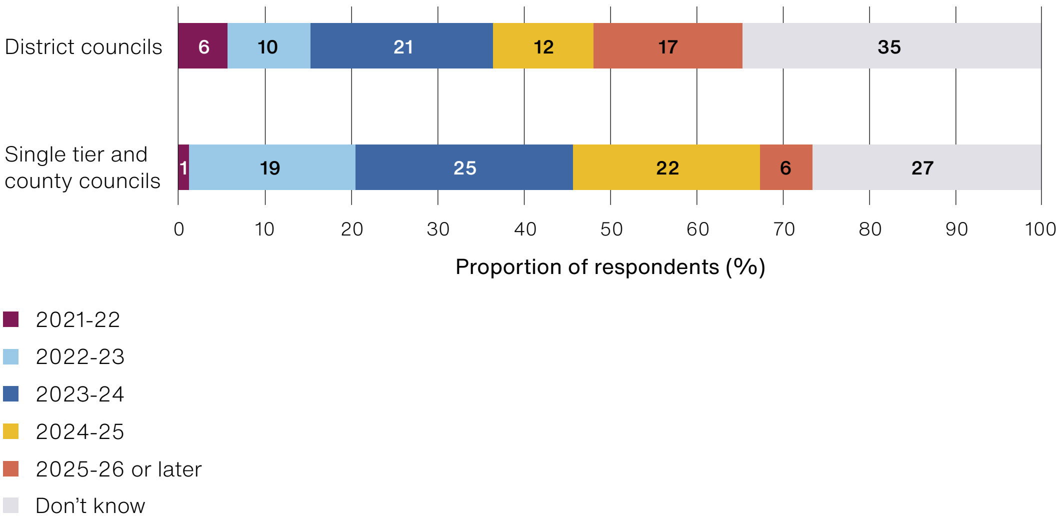
4.29 A consequence of this uncertainty and lack of confidence is that many authorities do not know when their finances will recover or feel that it will take several years. Our survey asked respondents to identify which year they felt their finances would return to pre-pandemic levels. Some 27% of single tier and county council respondents and 35% from district councils stated they did not know (**Figure 22**).

4.30 Other respondents indicated that they felt recovery in their finances would be a medium- to long-term process. Some 53% of single tier and county council respondents and 50% from districts indicated that their finances would not recover until at least 2023-24, two full financial years away.

Figure 22

Year in which survey respondents expect their finances to return to pre-COVID-19 levels

Many survey respondents do not expect their finances to return to pre-COVID-19 levels until 2023-24 at the earliest



Notes

1 N=52 for district councils and N=83 single tier and county councils.

2 The survey ran from 18 December 2020 to 5 January 2021.

3 There was only one respondent (from a single-tier or county council) who responded 'Rather not say" This is included in the category 'Don't know'.

4 Totals may not sum to 100 due to rounding.

5 Data is rounded to whole numbers. Where data from this chart is used elsewhere in the report it is based on the unrounded underlying data and therefore may differ marginally.

Source: National Audit Office survey

Appendix One

Our audit approach

1 This study examines the challenges COVID-19 has posed for local authority finances. It assesses government's effectiveness in providing funding to support COVID-19 cost pressures and its effectiveness in supporting the sector's financial sustainability. The study reviewed:

- the impact of COVID-19 on local authorities' finances in 2020-21;
- the steps taken by government, led by the Ministry of Housing, Communities & Local Government (the Department) to support the sector in 2020-21;
- the effectiveness of government actions, led by the Department, to support local authority financial sustainability in 2020-21; and
- the steps taken by government, led by the Department, to support local authority financial sustainability in 2021-22.

2 For the first and third objectives we:

- reviewed data on the sector's financial position prior to the pandemic;
- analysed Departmental data on authorities' cost pressures and income losses;
- reviewed data on government financial support for the sector;
- examined data on local authorities' reserves levels;
- used a risk metric developed by the Department to assess levels of financial risk in the sector; and
- spoke to case study authorities, local authority workshop participants and local government stakeholders to understand their experiences first-hand.

3 For the second of these objectives we:

- spoke to officials in a number of government departments to understand what actions they had undertaken, and how and why these responses were developed; and
- spoke to case study authorities, local authority workshop participants and local government stakeholders to understand their views on the support the sector had received from government.

4 For the fourth of these objectives we:

- spoke to officials in the Department and HM Treasury about the Spending Review. We also spoke to the Department about the local government finance settlement;
- spoke to case study authorities, local authority workshop participants and local government stakeholders to understand their views on their financial position or the position of the sector in 2021-22 and beyond;
- undertook interviews with representatives from five of the treasurers' societies immediately following the publication of the provisional local government finance settlement; and
- undertook a survey of local authority section 151 officers to gather their views on their authority's finances going into 2021-22. The survey also covered actions taken by authorities in response to pressures in 2020-21.

5 Our audit approach is summarised in **Figure 23** overleaf. Our evidence base is summarised in Appendix Two.

Figure 23

Our audit approach

The objective of government

To support the sector to respond to the unprecedented challenge caused by COVID-19 while also being able to deliver mainstream services.

How this will be achieved

By ensuring that there is an effective framework in place to understand financial pressures from the COVID-19 pandemic and identify systemic risk. By clearly setting out objectives in relation to financial sustainability and putting in place effective actions to deliver them in both the short term and medium term.

Our study

Examines if the Department's approach to local government finance in the pandemic enabled it to assess and fund the costs of new services which local authorities have been asked to deliver and fulfil its responsibilities for securing financial sustainability across the sector.

Our evaluative criteria

Government, led by the Department, has a clear understanding of the implications for authorities' finances and services of COVID-19 pressures.

The Department has worked effectively with other departments to understand service cost pressures in the sector.

Government, led by the Department, has a clear and robust plan to secure the sector's financial sustainability over both the short term and medium term.

Our evidence

(see Appendix Two for details)

We analysed Departmental data on financial pressures faced by the sector, interviewed stakeholders and examined case studies, and spoke to government departments.

We spoke to the Department and a number of other departments about how information had been collected and shared across government. We also spoke to case study authorities and local authority workshop participants about their views on cross-government working.

We spoke to the Department and HM Treasury about funding for the sector in 2021-22. We spoke to treasurers' societies about the local government finance settlement. We undertook a survey of local authority section 151 officers about their authority's finances going into 2021-22.

Our conclusions

Local authorities have played an important role in the public response to the pandemic, despite being under significant financial pressure. Steps taken by the government, led by the Department, have supported authorities in this pandemic response. The Department's successful monthly collection of data and continued intensive engagement with the sector provided a good evidence base to underpin the financial and other support provided by government. Action by the Department and wider government to support the sector has averted system-wide financial failure at a very challenging time and means that the Department has managed the most severe risks to value for money in the short term.

Notwithstanding these actions to support the sector, the financial position of local government remains a cause for concern. Many authorities will be relying on reserves to balance their 2020-21 year-end budgets. Despite continuing support into 2021-22 the outlook for next year is uncertain. Many authorities are setting budgets for 2021-22 in which they have limited confidence, and which are balanced through cuts to service budgets and the use of reserves.

Appendix Two

Our evidence base

1 Our independent conclusions on whether the Ministry of Housing, Communities & Local Government's (the Department's) approach enabled it to support the sector in the pandemic effectively were reached following our analysis of evidence collected primarily between July and December 2020.

2 We applied an analytical framework with evaluative criteria that sets out how the government's overall objective can be achieved. Our analytical approach is set out in Appendix One.

3 We define 'local authorities' as principal councils (of which there are 339 in England in 2020-21). These include metropolitan borough councils, unitary authorities, London borough councils, county councils and district councils. We include the Isles of Scilly and the City of London where we present data at the national level in order to ensure consistency with Departmental data. However, we exclude both when undertaking case-level analysis given the particular nature of these authorities.

4 We group metropolitan borough councils, unitary authorities, London borough councils and county councils together as 'single tier and county councils' throughout the report.

5 We exclude combined authorities, police and crime commissioners, stand-alone fire and rescue authorities, national park authorities and the Greater London Authority.

Quantitative analysis

Core elements

Deflating

6 Unless otherwise stated all financial data are in nominal terms. Where financial data have been converted into real terms we use the GDP deflator series published by HM Treasury in November 2020 with the Spending Review.

7 Owing to a significant ‘atypical movement’ in the deflator series in 2020-21, due to the impact of COVID-19, we take the deflator for 2020-21 to be the average of 2019-20 and 2021-22 price levels rather than using the published figure for 2020-21. This is similar to the approach used by HM Treasury in the Spending Review, which considered the annual average real growth rates over 2019-20 to 2021-22.

Revenue expenditure baseline

8 Throughout the report we use authorities’ revenue expenditure both as a benchmark and to standardise financial data across different authorities. Data are taken from the Department’s Revenue Outturn (RO) set of data returns. However, we adjust our measure and it includes:

- net revenue expenditure;
- sales, fees and charges income;
- surplus on external trading accounts; and
- interest and investment income.

9 This therefore excludes most spending supported by, or income from government grants, and is largely a measure of an authority’s own resources.

10 We use data from the 2019-20 RO. For simplicity – and due to the uncertainty of inflation in 2020-21 – we leave the 2019-20 data in nominal terms.

11 We have not adjusted for the COVID-19 grants and rates reliefs authorities received at the end of March 2020. Where authorities have recorded this income in the RO we assume, in line with the Department, it has been placed in reserves, rather than impacting on expenditure.

12 To assess the level of service expenditure overall we have used the total reported by councils in England as published in the final RO. This includes data imputed by the Department for a small number of missing authorities.

13 Buckinghamshire unitary authority was established in 2020-21. To form a baseline from the 2019-20 RO we sum the values provided by the previous authorities that were reorganised to form the new authority.

The financial starting point of the sector

14 We drew on and updated evidence from our previous work on the financial sustainability of local authorities. This includes an update of our analysis of changes in spending power. All references to spending power in this report relate to our chain-linked time series developed in our study *Financial sustainability of local authorities 2018*. The methodology for our time series is available with that report.

15 We used data from the RO to:

- assess the change in the extent to which local authority income is reliant to some extent on local conditions from 2010-11 to 2019-20:
  - in 2010-11 for local funding we include council tax, sales, fees and charges, gross surplus on external trading accounts, and interest and investment income. Other income streams include redistributed non-domestic rates, revenue support grant, area-based grant, special and specific grants inside aggregate external finance (excluding schools grants) and council tax benefit paid to the collection fund; and
  - in 2019-20 for local funding we include council tax, locally retained business rates, sales, fees and charges, gross surplus on external trading accounts, and interest and investment income. Other income streams include revenue support grant, local services support grant, public health grant and special and specific grants inside aggregate external finance (excluding schools grants);
- assess the change in the share of service spend accounted for by children's and adult social care between 2010-11 and 2019-20. Our measure of service spend excludes education, fire, police, public health and 'other' services. We show the aggregated spend for single tier and county councils. We adjust the data to include major transfers from NHS bodies. We also adjust for changes in the definition of children's social care within the RO in this period; and
- levels of reserves in single tier and county councils prior to the pandemic. We show unallocated and earmarked reserves at 31 March 2020 as a share of net revenue expenditure. Our benchmark calculation for Northamptonshire County Council shows unallocated and earmarked reserves at 31 March 2017 as a share of net revenue expenditure.

Financial pressures in 2020-21

Analysis of the Department's monthly survey

16 We analysed Departmental management data on local authority cost pressures and income losses. Local authorities returned monthly data on cost pressures and lost income due to COVID-19 pressures. We have used the returns from rounds 1–8 (covering March–November outturns and a December forecast). They also include a forecast for the full year. We use the Round 8 annual forecast, the latest available at the time of our analysis. This means we are reporting forecast annual pressures as estimated in early December 2020.

17 Other elements of our analysis:

- We exclude spend data reported for March 2020 from our analysis of outturn spend. Authorities reported £79 million of COVID-19-related spend in that month.
- Our data on forecasts are for the financial year 2020-21.
- Authorities reported their cost pressures net of savings where staff had been furloughed.
- Authorities also estimate that furloughing staff will mitigate sales, fees and charges income losses to a degree (£42 million). We have assumed that this is also netted off projected income losses.
- In line with the Department's monitoring we have not netted off housing costs potentially recovered through housing benefit or universal credit (£35 million).
- Our analysis of cost pressures as a share of individual service spend uses service spending data from the 2019-20 RO.

Missing cases

18 The monthly returns had high response rates, but across the returns there were a total of 23 authorities that did not submit returns in all rounds. For the rounds covering this financial year and included in the analysis (covering outturns starting April) this number was 13. These have been excluded in case-level analysis of outturn data but are included in aggregate figures using imputation. For aggregate analysis the estimates use imputed values for outturn data, and last available value for forecasts. Where case-level analysis examined forecast rather than outturn data we used the last available forecast for authorities that did not submit a return in Round 8.

19 The imputation of outturn data points was done in line with the Department's imputation methodology using the 2018-based population estimates of 2020 to scale the pressures based on authority type and population. The number of authorities requiring imputation is small (23 in total and 13 in scope), never above four in the returns of interest (April–December). The exercise does therefore not have a material impact on the overall figures but has been done to align our results with the Department's.

20 For forecasts, we used the prior month's annual forecast as this was available in all cases.

21 Note that imputed outturn values are only used in headline figures and aggregate. Any analysis and charts showing case-level variation excludes imputed outturns since we are not confident that this is an accurate representation of individual observations.

Patterns of variation – regression analysis

22 We ran a number of models to test for possible links between hypothesised explanatory variables and variation in cost pressures and income losses. This was done using an ordinary least squares (OLS) regression with robust standard errors of a full cross-section of local authorities, excluding Isles of Scilly and City of London.

23 The OLS regression also included additional variables to test whether the model could be optimised. Within the scope of this work we tested the link between deprivation and financial pressures controlling for:[29]

- financial profile (change in spending power since 2010-11 and 2016-17 separately);
- demographics: age, dependency ratio, population size and population density; and
- COVID-19 exposure: cumulative COVID-19 death rates as at start of October 2020.

24 Considering drivers of cost pressures, we found a link between deprivation and reported cost pressures for single tier and county councils, but the models were generally of weak explanatory power, with R^2 of less than 0.1 and adjusted R^2 of less than 0.05. This is weaker than we would normally publish and suggests that our models do not explain the great majority of the variation. We did not find a statistically significant link between deprivation and variation in outturn costs reported by district councils. The detailed model outputs are available on request.

25 In relation to income losses, some of the models suggested links between, for example, age, population size and spending power change. However, we do not have sufficient confidence in the robustness of these models, the size or direction of the coefficients, or a good enough understanding of what the variables were controlling for in practice to publish these. Again, the detailed model outputs are available on request.

Relative needs formula

26 We used the Department's monthly survey data to re-run different permutations of the relative needs formula. We reviewed the overall formula and the underlying regression analysis, comparing different tier splits and using it to estimate what local authorities would have received in Round 4 had the funding floor not been in place. We also tested the assumptions of the formula, running additional regressions to test the robustness of the deprivation weight and goodness of fit overall when Area Cost Adjustments were excluded.

29 Measured as the 2019 average deprivation score in the area published by the Ministry of Housing, Communities & Local Government. These are published at lower-tier as well as single- and upper-tier level.

Funding levels

27 Given that our cost data were provided by local authorities in early December we include funding provided to authorities or announced by this point (**Figure 24**). This approach is in line with the Department's approach shared with us in January 2021, and we use the same main funding as included in their analysis. We recognise that additional funding from some of these sources has been provided subsequently.

Figure 24

Financial support for COVID-19 cost pressures for English local authorities in 2020-21

Support for cost pressures	(£m)
COVID-19 emergency funding	4,553
Adult social care Infection Control Fund	1,146
Additional adult social care spend funded by clinical commissioning groups	937
Contain Outbreak Management Fund (COMF) (including test and trace service support grant)	785
COVID-19 Winter Grant Scheme	170
Next Steps Accommodation Programme (NSAP)	71
Reopening High-Streets Safely Fund	50
Compliance and Enforcement Grant	30
Emergency support for rough sleepers	3
Emergency Active Travel Fund (Tranche 1)	20
Local authority emergency assistance grant for food and essential supplies	63
Additional Home to School and College Transport Capacity Funding (H2ST)	54
Total	**7,883**

Notes

1 This breakdown covers the funding that has been matched to the 339 individual local authorities analysed at case level to assess levels of over- and underfunding and complete the risk assessment. This means that funding provided to combined authorities or police and fire authorities is out of scope. It also does not include 12 joint bids worth £3.2 million of the NSAP that could not be broken down by council. Therefore, the funding levels included above for NSAP, Home to School and College Transport Capacity Funding and the Emergency Active Travel Fund are lower than the total value of the fund announced.

2 The COMF funding reflects the £785 million provided up to 2 December 2020 and includes the £300 million provided through the test and trace service support grant. A further £193 million has been allocated to authorities for December 2020. However, in order to ensure comparability with our cost data, which were collected in early December we do not include this in our case level analysis.

3 Additional Adult Social Care spend funded by clinical commissioning groups is derived from the full-year estimates submitted by councils in the latest monthly survey return.

4 The unringfenced funding excludes funding in tranches 1 and 2 that went to fire and rescue authorities, and the £6 million top slice in tranche 3 that was set aside for unaccompanied asylum-seeking children.

5 Data may not sum to the total due to rounding.

Source: National Audit Office analysis of Ministry of Housing, Communities & Local Government data

28 We only include funding provided to principal local authorities, rather than other bodies such as charities or combined authorities. In a small number of instances funding has been provided on a joint basis to groups of authorities. We exclude this funding as we cannot allocate it to individual authorities.

Estimated compensation for sales, fees and charges losses

29 The Department has introduced a compensation scheme for sales, fees and charges income losses. Local authorities will submit detailed data on retrospective losses in three separate rounds to cover losses in 2020-21. The total amount that authorities will receive is therefore not knowable at this stage. However, we take the core elements of the compensation scheme and authorities' forecast losses from the monthly survey to produce an estimate.

30 The scheme will compensate authorities for 75% of their irrecoverable losses above 5% of their budgeted sales, fees and charges income. We apply these principles to the monthly survey data in the following way:

- In the absence of nationally available data on authorities' sales, fees and charges budget we use the outturn data from the 2019-20 RO. We convert the 2019-20 outturn data into 2020-21 prices so that both losses and the baseline are on the same terms.
- We estimate a 5% threshold for each of the individual service lines included in the monthly return. For 'other services' we include all other service lines not specified individually with the exception of education, fire and rescue and police. It is possible that some authorities have included sales, fees and charges losses associated with education services but our review of the free text in the monthly surveys suggests this is not common, and if we were to include education it would significantly skew the size of the 5% deductible element for 'other services'.
- We calculate 75% of the balance for each service area once the 5% budget threshold has been applied.
- We sum the calculations for each service area to create an estimate of total sales, fees and charges compensation for each local authority for the full year.
- A small number of authorities are left with a relatively low level of potential compensation. This is likely to reflect issues with our calculation of the 5% budget threshold for 'other services'. To address this, we have applied a levelling-up process whereby all authorities are brought up to the lower quartile in terms of the estimated share of forecast losses for which they will be compensated.

31 Our method assumes that all reported non-tax income losses are irrecoverable. Local authorities provided an estimate of the amount of the proportion of their sales, fees and charges losses that they felt was recoverable. However, the great majority stated that none of their losses were recoverable, and in the small number of instances where this was not the case respondents gave widely differing responses. Adjusting for recoverability would therefore leave most authorities unchanged, but significantly change the results for a small number. Consequently, we have not adjusted these data.

32 We have assumed that local authorities have netted off potential claims from the Coronavirus Job Retention Scheme. In December these were estimated to be £42 million.

33 We have not used the actual compensation received by authorities to date in our analysis as this information was only available for part of the year at the time of our analysis.

Reported funding gaps

34 We compare the size of forecast cost pressures against the funding streams identified by the Department to create a cost pressure funding gap. We compare authorities' forecast non-tax income losses against our estimate of sales, fees and charges compensation. We sum them to create a total pressures funding gap.

35 The Department includes a measure of tax losses in their analysis of 2020-21 financial pressures. Given that these costs will be addressed in 2021-22 we do not include tax losses in our measure of financial pressure in 2020-21.

36 We exclude cost pressures and income losses in March 2020. We assume that, although it was allocated on 27 March 2020, the first tranche of funding from the Department was used wholly to address cost pressures in 2020-21. We assume that cost pressures in March 2020 were addressed through authorities' use of reserves in 2019-20.

Reserves

37 We undertake three main pieces of analysis involving authorities' reserves:

- We look at authorities' 'available' reserves relative to their reported funding gap. The scale of 'available' reserves is taken directly from the Department's monthly survey. Authorities were asked to identify the proportion of their unallocated and earmarked reserves that were available to address COVID-19 pressures. The Department has indicated that authorities have taken different approaches in how they responded to this question. It is also possible that some authorities may have included COVID-19 support funding received in March 2020 in their reserves. Despite these issues we include this analysis as it provides detail on authorities' own perception of their resilience, and also demonstrates the challenges of collecting data on reserves.

- We compare authorities' funding gaps against their unallocated reserves. We use their unallocated reserves as reported for 31 March 2020 from the 2019-20 RO. We do not adjust unallocated reserves for COVID-19 payments received by authorities in late March 2020. The Department's assumption is that, given that this funding was received so late in the year, it was placed into reserves rather than spent in-year. Our assumption is that this funding was added to authorities' earmarked reserves rather than their unallocated reserves. Unadjusted earmarked reserves grew substantially in 2019-20 while unallocated reserves remained relatively stable.
- For our risk analysis we use unallocated and earmarked reserves as reported on 31 March 2020 from the 2019-20 RO. We adjust earmarked reserves for COVID-19 payments made in March 2020.

Risk analysis

38 We used a risk metric used by the Department to monitor risk at the current time. Under this model authorities are grouped based on the level of remaining reserves of different types after their reported COVID-19 funding gaps are netted off. At the Department's request we have not published the values for the thresholds used to place authorities in different groups:

- Acute-risk authorities are those with total reserves (unallocated and earmarked) below a threshold identified by the Department relative to their net revenue expenditure after accounting for the funding gap.
- High-risk authorities are those where if they were to apply their reserves to their funding gap they would have to use a substantial share of their earmarked reserves in order to prevent their unallocated reserves falling below a key threshold, in the Department's view, as a share of net revenue expenditure.
- Medium-risk authorities are those where if they were to apply their reserves to their funding gap they would have to use a small amount of their earmarked reserves in order to prevent their unallocated reserves falling below a key threshold as a share of net revenue expenditure.
- Low-risk authorities are those that have no initial funding gap or where they have no funding gap once unallocated reserves have been applied to a point where they do not fall below a key threshold as a share of net revenue expenditure.

39 Some authorities have unallocated reserves below the Department's key threshold of their net revenue expenditure even before any funding gap is taken into account. In these cases we not only apply the funding gap to an authority's reserves, but also include the cost of restoring their unallocated reserve levels up to the threshold of net revenue expenditure identified by the Department. This ensures that each authority is placed in its respective group on a genuinely comparable basis.

40 Data for net revenue expenditure and reserves are taken from the 2019-20 RO. We adjust the reserves data for the COVID-19 funding received by authorities on 27 March.

Survey of section 151 officers

41 We carried out an online local authority survey following the announcement of the provisional local government finance settlement on 17 December. The survey ran from 18 December 2020 to 5 January 2021. A survey link was mailed by the Chartered Institute of Public Finance and Accountancy on our behalf to all section 151 officers of English local authorities. Respondents were able to complete the form anonymously if they chose.

42 Questions covered the implications of the provisional settlement for authorities' 2021-22 budget setting, and their experience to date of delivering their 2020-21 budget.

43 Questions were not mandatory except for confirmation of section 151 status (or that the respondent was under the direction of their section 151 officer). Some respondents provided useable responses to certain questions but did not respond to all relevant questions. We have included partial responses in the response profile. Each question base represents the individuals responding to that particular question and is set out in the note to the relevant chart in the report.

44 For questions with a level of item non-response rate, that is, where multiple options were provided and respondents did not indicate a preference across all, we use the number of respondents that have responded to at least one item as the question base. This was done as the level of item non-response rates was low across the questions, and the sample was considered too small to impute results.

45 The survey achieved a 40.1% response rate. However, there are differences by authority type (**Figure 25**). Response rates received from single tier and county councils, with a combined response rate of 55.0%, were higher than for district councils (28.2%), meaning that they are underrepresented overall and responses for these authorities should be treated accordingly. To address this difference in representation, we present our survey results separately for district councils and single tier and county councils. Considering the risk of non-response bias, we present the results as proportion of respondents; do not make estimates of prevalence in the population; and use the survey where consistent with other study evidence rather than as a stand-alone evidence base.

46 As with many surveys, it is possible that that there is a degree of selection bias in terms of our respondents. Given that some of our respondents provided data on an anonymous basis it is not possible for us to fully test for this. However, where respondents were identifiable there is a close fit between the distribution of authorities in different risk groups responding to the survey and those in the population as a whole. The available evidence suggests that there is not a bias in our respondents to those with a higher level of financial risk.

Figure 25

Response profile for National Audit Office survey of local authorities

Type	Respondents (count)	Group total (count)	Percent (of group total)
			(%)
County council	19	25	76.0
District councils	53	188	28.2
London borough	22	33	66.7
Metropolitan district	14	36	38.9
Unitary authority	28	57	49.1
Total	**136**	**339**	**40.1**

Note

1 There were no usable responses that did not indicate what type of council they represented.

Source: National Audit Office survey

Qualitative analysis

Departmental interviews

47 We held several meetings with the Department. These meetings covered:

- the overall strategy, approach and policy context for local government finance in the pandemic;
- background to their monthly survey design and collection method, use of, and conclusions from the survey data;
- the ‘new burdens’ doctrine and government priorities; and
- financial sustainability – in relation to sales, fees charges, tax, commercial income, reserves.

48 We also met with officials from selected other government departments that covered areas included in the additional new burdens identified in the Secretary of State's letter:

- Department for Environment, Food & Rural Affairs regarding funding for local government in respect of Departmental responsibilities.
- Department for Education regarding children's social care, special educational needs and disabilities (SEND) and home-to-school transport.
- Department for Digital, Culture, Media & Sport regarding leisure funding (two interviews).
- Department of Health & Social Care regarding adult social care services and infection control funding (two interviews).
- HM Treasury regarding the central government strategy and the Spending Review.

49 We used these interviews to understand how these departments:

- interacted with the Department as part of COVID-19-related support for local government;
- used data and sector engagement to understand the impact of the pandemic; and
- monitored local authorities regarding the policy their department has responsibility for.

Stakeholder interviews

50 We engaged with a range of other stakeholder groups including the:

- Local Government Association;
- Institute of Revenues Rating and Valuation; and
- Chartered Institute of Public Finance and Accountancy.
- We also interviewed the chairs of most of the local authority treasurers' societies, the:
  - Society of County Treasurers;
  - Society of District Council Treasurers;
  - Society of London Treasurers;
  - Association of Local Authority Treasurers' Societies; and
  - Society of Municipal Treasurers.

51 In the initial interviews, we discussed the financial challenges that their members were facing, their experience of engagement with government about financial pressures during the pandemic, and the effectiveness of government support for their members. The members were also directly consulted using structured workshops, as described below. The exception was the Society of Unitary Treasurers, with whom we conducted an additional workshop instead.

52 We spoke to the chairs (apart from the Society of Unitary Treasurers) twice, with the second interview taking place on 18 December, the day after the publication of the provisional local government finance settlement, so we could explore reactions to the settlement.

Workshops

53 We held six online workshops with groups of section 151 officers from different types of authorities. The sessions were organised by the relevant treasurers' societies.[30] To avoid burdening participants, these workshops were within the agenda of existing meetings or in one case a conference. Accordingly, the invitations went to an existing, broad-based membership rather than participants selected specifically by the societies. We do not consider there was additional risk of bias from taking this approach. The sessions ranged between half an hour and an hour and a half. We had two sessions organised by the Society of Unitary Treasurers. The sessions followed the same format regardless of the setting.

54 The workshops were semi-structured, and we asked participants about 2020-21 pressures on their authority, their views on the support they had received from government, their experience of engaging with departments, and their expectations for their 2021-22 budgets. The discussions were designed to be open-ended, with topics and broad questions being introduced as themes for discussion. Longer workshops allowed more detailed discussions.

55 Some of these workshops had large numbers of attendees, most obviously the one that was part of a conference. To have the best chance of understanding the range of participant views, we encouraged attendees to use the chat bar or equivalent to express agreement or disagreement with people speaking, or to make any additional points. We have drawn on both verbal and written contributions to the workshops and treated them in the same way for the purpose of analysis.

56 Attendance across the workshops varied between 11 and 88 people. Across all the sessions there were contributions from at least 74 different participants.

30 Not including the Association of Local Authority Treasurers' Societies.

Case studies

57 We used case studies to gain an understanding of the key financial challenges facing local authorities in the context of COVID-19, in particular for financial planning, funding service delivery, experience of engaging and working with the Department and other parts of central government, funding for cost pressures and government support in relation to income losses and financial sustainability more broadly. Due to COVID-19 we could not visit the authorities in person. Interviews were instead conducted online and over the phone.

58 In total, we were in contact with eight case study authorities, selected to ensure that we had a mix of different types of authority and a broad geographical spread. In most cases we spoke to a minimum of the finance director, the finance portfolio holder or committee chair, and a selection of service directors. However, in two cases we spoke only to the finance director.

59 Our case study authorities were:

- Bath and North East Somerset Council;
- Bedford Borough Council;
- Croydon Council;
- East Sussex County Council;
- Lancaster City Council;
- North Hertfordshire District Council;
- West Suffolk Council; and
- Wirral Metropolitan Borough Council.

60 With the exception of the settlement-focused interviews with treasurers' societies, our sector fieldwork took place between September and November 2020. Given the timing of its announcement relative to our fieldwork, the COVID winter grant scheme was not discussed with authorities and stakeholders as part of our fieldwork.

61 We collated our findings across data collected from the case studies and workshops for the purpose of this report. The interview and workshop data were collated and coded by themes to allow us to synthesise data across the different sources.

Document review

62 **We reviewed departmental documents.** This included a review of government guidance and commitments during and following on from the pandemic as well as a deep-dive into the Departmental monthly survey to understand the overall magnitude of pressures in the sector and case-level variation.

63 **We reviewed National Audit Office research and external literature.** We focused on our recent research covering financial sustainability and resilience in local government and Committee of Public Accounts report recommendations to identify historic challenges and likely risks.

64 **We carried out a document review of 100 local authorities' cabinet papers up until November 2020.** We created a random sample, stratified by local authority type, and located budget monitoring reports to the cabinet or relevant committee for September through November 2020. We reviewed the documents for information on COVID-19 pressures, nature of losses, overspend, budget gaps, use of reserves, savings performance and pressures on the local tax base.

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National Audit Office

Design and Production by NAO External Relations
DP Ref: 009117-001

£10.00

ISBN 978-1-78604-361-0