National Audit Office

Report
by the Comptroller
and Auditor General

Department for Communities and Local Government

Financial sustainability of local authorities 2014

HC 783 SESSION 2014-15 19 NOVEMBER 2014

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

National Audit Office

Department for Communities and Local Government

Financial sustainability of local authorities 2014

Report by the Comptroller and Auditor General

Ordered by the House of Commons
to be printed on 18 November 2014

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

Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

11 November 2014

HC 783 | £10.00

This study examines evidence of the impact of funding reductions, and the Department for Communities and Local Government’s actions to inform itself of likely impact on financial and service sustainability of local authorities.

10562 11/14 NAO

Contents

The National Audit Office study team consisted of:
Ayanle Ali, Simon Bittlestone, Alex Burfitt, Tim Davies, Richard Douglas, Daniel Lambauer, David Medina, Zaina Steityeh, David Timmins, Durk Zwaagstra, under the direction of Aileen Murphie.

This report can be found on the National Audit Office website at www.nao.org.uk

For further information about the National Audit Office please contact:

National Audit Office
Press Office
157–197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Enquiries: www.nao.org.uk/contact-us

Website: www.nao.org.uk

Twitter: @NAOorguk

Key facts

37%

estimated real-terms reduction in government funding to local authorities, 2010-11 to 2015-16

25%

estimated real-terms reduction in local authorities' income once council tax is included, 2010-11 to 2015-16

56%

metropolitan and unitary councils that local auditors are concerned will not meet medium-term savings targets

46%	budgeted real-terms reduction to planning and development service area, 2010-11 to 2014-15
7%	budgeted real-terms increase to children's social care service area, 2010-11 to 2014-15
16.6%	reduction in full-time equivalent posts in local authorities, excluding the total school workforce, between 2010 and 2013
6.9%	limit to annual fall in a local authority's income in 2014-15, set by the Department for Communities and Local Government
10%	reduction in local authority funding in 2015-16 set by the government at the 2013 spending round
0	'section 114' reports issued during the 2010 spending review period by local authority chief finance officers because of unbalanced budgets

Summary

1 Since 2010, the government has reduced funding for local government in England as part of its plan to reduce the fiscal deficit. The government has also changed the nature of funding for local authorities. This has created financial opportunities for local authorities, but also increased financial risks and uncertainty.

2 Local authorities deliver a range of services. The government sets statutory duties for them to provide certain services, ranging from adult social care to waste collection. Local authorities also provide discretionary services, according to local priorities. To remain financially sustainable, local authorities must be able to meet their statutory service obligations. This is becoming more challenging in the current financial context.

3 The Department for Communities and Local Government (the Department) has overall responsibility in central government for local authorities' funding. Its main responsibilities include:

- distributing the majority of funding voted by Parliament to support local authorities in delivering their core services;
- taking the cross-government lead in supporting HM Treasury over decisions on local government funding; and
- overseeing the system of local accountability, which enables the government to assure Parliament that local authorities spend their resources with regularity, propriety and value for money.

4 Government policy dictates factors such as the overall scale of funding reductions faced by the sector, the statutory responsibilities placed on local authorities and the introduction of new statutory duties.

5 The Department's position is complex. It oversees the government's planned reductions in funding for local authorities in the context of the government's localism agenda. Under this, local authorities have greater control over their spending decisions. A consequence of localism is that the Department has less oversight of the financial and service sustainability of local authorities.[1] It also relies on a network of other departments for funding and service information relating to local authorities.

1 Comptroller and Auditor General, *Local government funding: Assurance to Parliament*, Session 2014-15, HC 174, National Audit Office, June 2014.

6 This report examines whether the Department understands the impact of funding reductions on the financial and service sustainability of local authorities. We do not think it is a contradiction to the government's policy of localism to assess whether the Department and other government departments have enough information to make good decisions about the level of central funding provided to local authorities. In particular, we think it reasonable that the Department should put itself in a position to understand when local authorities are under threat of being unable to discharge properly the statutory duties placed on them by central government.

Our report

7 In January 2013 we reported on central government's approach to reducing local authority funding.[2] For this report, we analysed 2 more years of local authority financial and service data. This provides a clearer picture of the impact of the Department's decisions on local authorities. We also considered whether the Department has improved its understanding of the impact of its funding reductions on local authorities' income and ability to deliver services. The report has 3 parts:

- **Part One** summarises the evidence on the impact of funding reductions on local authorities.
- **Part Two** assesses how well the Department keeps itself informed of the risks and impacts arising from its funding changes.
- **Part Three** assesses whether the Department is managing the risk that its funding reductions will lead to local authorities failing to deliver their statutory services effectively.

8 This report complements *The impacts of funding reductions on local authorities*, our companion report that analyses in detail the impact of funding reductions on local authorities.[3]

Key findings

Impact of funding reductions since 2010

9 **The government will reduce its funding to local authorities by 37% in real terms between 2010-11 and 2015-16.** This equates to 25% of local authorities' total income when taking into account council tax receipts. The Department has changed the funding system to allow local authorities to keep a share of locally raised business rates. The Department intends these changes to provide local authorities greater flexibility and incentives to increase their income (paragraphs 1.3 to 1.6).

2 Comptroller and Auditor General, *Financial sustainability of local authorities*, Session 2012-13, HC 888, National Audit Office, January 2013.
3 Comptroller and Auditor General, *The impact of funding reductions on local authorities*, National Audit Office, November 2014. Available at: www.nao.org.uk/report/impacts-funding-reductions-local-authorities/

10 **Local authorities as a whole have coped well in financial terms with the reductions.** So far, there have been no financial failures, whether in the form of a local authority failing to agree a balanced budget at the start of the year or being unable to finance expenditure in-year. Many local authorities have also increased their financial reserves (paragraphs 1.13 and 1.19).

11 **While local authorities have tried to protect service users, there is emerging evidence that funding reductions have led to a fall in service volumes.** Local authorities have tried to protect spending on core areas such as adult social care and children's social care, and to make savings through efficiencies rather than reducing services. Nonetheless, and despite increased demand, provision of core services such as homecare and day care for adults and residential care for adults and children has reduced since 2010-11. Levels of reduction in services tend to be greatest among authorities facing the highest funding reductions. However, a reduction in the volume of activity does not necessarily imply a worsening in the quality of provision or outcomes for service users (paragraphs 1.15 to 1.18, Figures 3 and 4).

12 **Local auditors are increasingly concerned about the future financial sustainability of some authorities and their capacity to make further savings.** Auditors report that 16% of single tier and county councils (those authorities responsible for social care and education) are not well placed to deliver their 2014-15 budgets. Auditors are also concerned about the longer-term financial sustainability of single tier and county councils, reporting that 52% of these authorities are not well placed to deliver their medium-term financial strategies. Auditors' responses reflect their concerns over the capacity of certain authorities to identify and make further savings given the scale of savings they have already made (paragraphs 1.19 to 1.21 and 1.25 to 1.26 and Figures 5 and 6).

The Department's understanding of funding changes

13 **The Department's main indicator of the change to local authority income does not give it a measure of the scale of the financial challenge facing local authorities over time.** The Department uses 'spending power' – an indicator that combines government funding with council tax income. Spending power gives a broadly accurate picture of the distribution of funding reductions across local authorities. However, it does not measure overall changes in funding as not all funding streams are reflected in the data, often because allocations have not been announced. The Department has not developed a way of showing the extent of funding reductions over more than one year at a time. This reflects the complexities of producing a genuinely like-for-like time series due to a number of changes in the duties placed on local authorities over this period (paragraphs 2.2 to 2.6).

14 Authorities that depend most on government grants have been affected most by government funding reductions and reforms. This is an outcome of policy decisions to tackle the fiscal deficit by reducing public spending. The Department's modelling of different scenarios for future local government income suggests that the most grant-dependent authorities would still have the largest cuts in spending power, even if they experience strong local growth in business rates (paragraphs 2.8 and 2.15).

15 The Department expects local authorities to manage future funding reductions by transforming the way they deliver services, but has limited understanding of the size and timing of resulting savings. Through initiatives such as the Transformation Challenge Fund and the Public Service Transformation Network, the Department is supporting a number of local authorities to redesign selected services and join up with other local service providers. Its aim is to expand the design of services around the user to improve their effectiveness and efficiency. The Department expects that local authorities would need to adopt ambitious programmes of service transformation in order to maintain services if funding reductions continue. However, it has not yet assessed whether such projects could deliver savings which are large and timely enough to enable local authorities to maintain services (paragraphs 2.17 to 2.21).

16 The Department used partial information to comment to HM Treasury on a proposed 10% reduction in the main component of government funding to local authorities in 2015-16. At the 2013 spending round the government agreed to implement a 10% reduction in 2015-16 in the local government departmental expenditure limit, the main government budget for local authority revenue funding. This decision was supported by a cross-government assessment of how local authorities would find the required savings, and of the potential impact on services. This exercise was coordinated by the Department. While the submissions it obtained from other departments were better overall than at the 2010 spending review, they still varied in quality and completeness. Service areas such as libraries, youth services and trading standards were not covered. None of the submissions assessed the capacity of different types of authority to manage further reductions (paragraphs 2.24 to 2.30 and Figure 7).

The Department's assurance on financial and service sustainability

17 Local authorities are subject to a legal framework that makes it difficult in practice for them to fail financially. Local authorities have a statutory duty to balance their budgets. Chief finance officers also have the power to issue a Section 114 report to the full council in the case that a balanced budget cannot be agreed. This framework has a powerful influence on local authorities to reduce their spending in step with any decline in their income (paragraphs 3.2 to 3.4).

18 **The Department has a limited understanding of the financial sustainability of local authorities and the extent to which they may be at risk of financial failure.** The financial framework for local authorities acts as a strong deterrent to prevent insolvency. The Department has assessed the financial sustainability of the sector using indicators such as the number of qualified accounts in the sector, or from published reports from the Local Government Association's (LGA) peer review process. These were not designed as a system to monitor financial sustainability. They do not give a robust indication of whether local authorities can absorb further funding reductions (paragraphs 3.5 to 3.11).

19 **Owing to the strength of the legal framework, the Department expects that stress from funding reductions will lead to service pressures rather than financial failure.** The requirement for local authorities to balance their budgets means they are likely to reduce spending on services in line with reductions to their income. In many cases, this will create pressure on services. The Department takes significant confidence that this legal framework will prevent financial failure. It recognises the likelihood that financial stress will pass through into service pressures, although it believes authorities could manage service pressures through transformation of the way they deliver services (paragraph 3.12).

20 **The Department emphasises the role of local democratic processes in holding councils to account, but there is a risk this in itself would not be enough to safeguard financial sustainability.** In line with the government's policy of localism, the Department has taken steps to strengthen the accountability of authorities to their local residents. It says it wants local authorities to focus more on reporting to local people rather than central government, and that councils which do not deliver for their local communities can be voted out. Local accountability mechanisms focus primarily on how councils use their resources, however, rather than the total resources available to them. In the event of continued funding reductions, there is an increased risk of local service failure being driven primarily by lack of funding. It is not clear that local accountability mechanisms would be sufficient either to avoid or respond successfully to the problem (paragraph 3.15).

21 **The Department does not monitor the impact of funding reductions on services in a coordinated way.** The Department is reliant on other departments and inspectorates to alert it to individual service failures. It prioritises its interest in service delivery on services where local authorities spend the most money, engaging more closely with relevant departments. However, its reliance on other departments, and selective focus on services, means it risks only becoming aware of serious problems with the financial sustainability of local authorities after they have occurred. The Department is the single point within government that should monitor the impact of funding reductions across the full range of local authority services on an ongoing basis, but does not do so robustly enough (paragraphs 3.13 to 3.20).

Conclusion on value for money

22 Local authorities have worked hard to manage the reductions in government funding through a mixture of efficiency measures and service transformation. At the same time, there is some evidence of reductions in service levels. Because of the legal requirement on local authorities to balance their budgets, it is unlikely that stress in local authorities will manifest itself in financial pressures. Instead, the Department will need to look for evidence of financial stress in local authorities' ability to deliver the services they are responsible for. Some services, such as adult social care, are also under pressure from demographic-led demand. Demands on children's services are also increasing.

23 The Department for Communities and Local Government has a central role in funding local authorities and establishing and maintaining contact between central and local government. It should be better informed in discharging this role, both in its information about the situation on the ground among local authorities across England, and about the various funding decisions and initiatives taken by departments in Whitehall. This is particularly important given the pressures on local government arising from austerity to date, and the fact that this is likely to continue for some years to come.

Recommendations

a **The Department should publish a real-terms time series of change in individual local authority income since 2010-11.** It should base this on revenue spending power and update it each year so that the cumulative impact of funding reductions on individual authorities is clear.

b **The Department needs to analyse savings so far from local authorities' transformational schemes and the timescales involved.** It should use this to update its assessment of the capacity of different local authorities to make more savings. The Department is clear that local authorities will need to transform the way they deliver services through greater joint working and integration. The Department must develop a more robust methodology for assessing the potential savings local authorities can make and the timescales involved.

c **The Department should have a clearer ongoing understanding of whether authorities' funding is sufficient to support their core services.** The government has taken a clear policy direction towards focusing on local accountability mechanisms with regard to authorities' spending and service quality. Other departments also retain responsibility for particular services. However, the Department continues to have a role in securing financial and service sustainability. The Department can discharge this role more effectively by making fuller use of existing information. The Department should:

- **strengthen oversight of the financial sustainability of local authorities.** The Department should develop a targeted approach to assessing the financial sustainability of particular local authorities it deems to be high risk; and

- **improve its engagement with other departments with an interest in local services, and systematically review data across a range of services.** The Department should use existing data more intensively to monitor for emerging signs of financial stress, which could indicate that certain services or types of authority were at greater financial risk.

d **The Department should strengthen its processes for assessing local authority funding requirements at future spending reviews. It should:**

- **focus on the impact of funding changes on all service areas which are underpinned by statutory duties.** In the 2013 spending round, the Department did not obtain information on a range of statutory services provided by local authorities;

- **work with other departments to develop, where possible, more robust methods for assessing the extent to which proposed funding will be sufficient to deliver services.** Analysis in previous spending reviews by other departments has often been limited and not based on a genuine understanding of the actual costs of providing services. Other departments should work with the Department in adopting a consistent approach to reviewing implications for local services at future spending reviews; and

- **ensure that, where practical, analysis submitted by other departments at future spending reviews includes sub-national analysis, ideally by individual local authority or local authority type.** To date, local authorities have received differing levels of funding reductions, which may affect each local authority's ability to make further savings. However, departments' submissions during the 2013 spending round did not reflect this potential variation between local authorities.

Part One

Challenges to the financial sustainability of local authorities

1.1 Since 2010-11, local authorities have faced challenges to their financial sustainability and ability to provide services. This part sets out:

- the challenges local authorities face from reductions in funding;
- their response to these challenges; and
- the outlook for local authorities' financial sustainability.

1.2 This section draws on the analysis set out in our report, *The impact of funding reductions on local authorities*.[4]

Challenges faced by local authorities

Reductions in government funding

1.3 Government funding to local authorities has fallen substantially since 2010-11, in line with government objectives to reduce the deficit. The 2010 spending review set out a 26% reduction by 2014-15 in the local government departmental expenditure limit (which excludes funding for schools and benefits claimants via local authorities). An extra 1% reduction in 2014-15 was announced in the 2013 Budget. The 2013 spending round included a further 10% reduction for 2015-16.

1.4 The Department for Communities and Local Government (the Department) measures the impact of reducing government funding on local authority income via 'spending power'. This indicator aims to capture the main streams of government funding to local authorities alongside council tax. It also includes some government funding streams that are not within the local government departmental expenditure limit.

4 Comptroller and Auditor General, *The impact of funding reductions on local authorities*, National Audit Office, November 2014. Available at: www.nao.org.uk/report/impacts-funding-reductions-local-authorities/

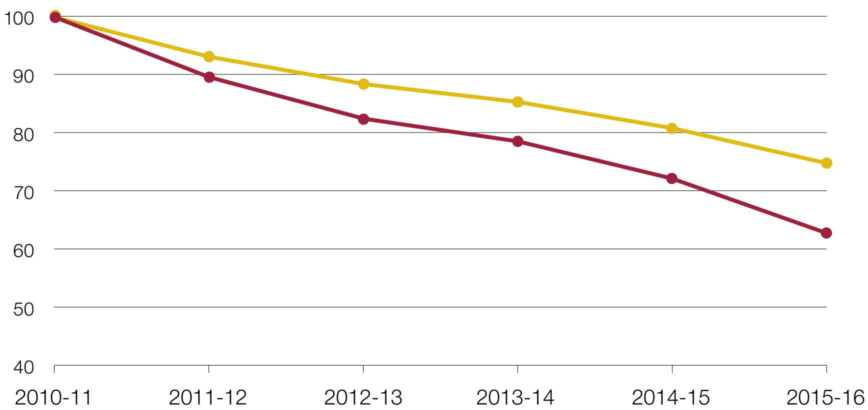
1.5 We found that spending power fell by 19.2% in real terms from 2010-11 to 2014-15 (**Figure 1**). Provisional data from the Department show that by 2015-16 spending power will have fallen by 25.2%.[5]

1.6 Spending power includes local authorities' council tax income alongside government funding. If council tax is removed, our analysis shows government funding to local authorities fell in real terms by 27.9% from 2010-11 to 2014-15, increasing to 37.3% by 2015-16.

1.7 Different types of local authority will see different rates of reductions (**Figure 2** overleaf). On average, metropolitan district councils will see a real-terms reduction of 29.7% by 2015-16, while the average fall for county councils will be 22.6%. There is also substantial variation within different types of local authority. Reductions among metropolitan districts, for example, range from 22.5% to 36.5%.

Figure 1
Change in spending power and government funding, 2010-11 to 2015-16

Government funding has been cut more steeply than local authority income once council tax is taken into account



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Government funding	100	89.64	82.48	78.53	72.10	62.67
Revenue spending power (government funding and council tax)	100	93.18	88.47	85.37	80.83	74.77

Note

1 Spending power includes both the core funding local authorities receive from central government and the council tax income they raise themselves.

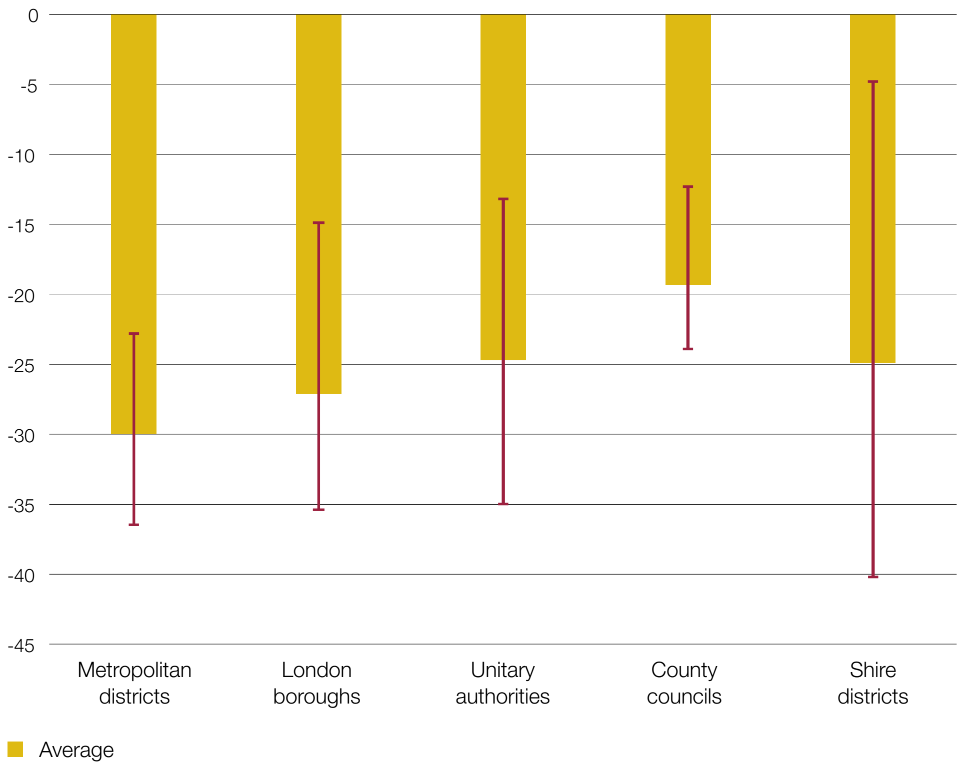
Source: National Audit Office analysis of Department for Communities and Local Government data

5 This excludes the public health grant and the Better Care Fund. We have calculated the change in government funding and spending power using a chain-linked index. The change figure shows change in the weighted index and cannot be used to estimate absolute change in funding. See the separate methodology: www.nao.org.uk/report/impacts-funding-reductions-local-authorities/

Figure 2
Change in spending power by local authority type, 2010-11 to 2015-16

Metropolitan districts had the biggest average reductions

Percentage of change in revenue spending power 2010-11 to 2015-16 (2012-13 prices)



Note

1 The vertical lines illustrate the range of reductions within each class of authority. The bars represent the average reduction for each class.

Source: National Audit Office analysis of Department for Communities and Local Government data

1.8 The variation in spending power reductions reflects differences in the level of grant dependency between local authorities. Local authorities that traditionally received a larger share of their income from government grants rather than council tax have seen a correspondingly larger reduction in their spending power.

1.9 Local authorities with the highest levels of deprivation have seen the greatest reductions in spending power. Grant-dependent areas tend to be those with higher levels of need. This is because government funding was based largely on an assessment of each area's needs prior to changes introduced during this Parliament. Even after the reductions in government funding, these authorities still receive more per head than other authorities, albeit this gap is narrowing (see paragraph 2.9).

Uncertainty over local authority funding

New financial arrangements

1.10 The Department has also introduced changes to the funding system for local authorities. Its aim is to give authorities greater flexibility in how they use their funding and incentivise local authorities to increase income and reduce the costs of meeting social needs. Core changes include:

- **Business rates retention scheme**

  From 1 April 2013 local authorities have retained around half of any local growth in business rates.[6] The Department also stopped revising its distribution of annual grant funding according to updated assessments of need.

- **New Homes Bonus**

  Since 2011-12, local authorities have received extra funding for every new residential property in their area. The Bonus is mostly funded by reallocating a portion of revenue support grant, meaning that while some authorities will gain, others will lose.[7]

- **Council tax support**

  In 2013-14 the Department devolved responsibility to local authorities for subsidising poorer households' council tax bills, while cutting funding by 10%.[8]

Increased financial uncertainty

1.11 The new funding arrangements have created opportunities for local authorities, but have also added financial uncertainty. Case study authorities we spoke to said there was increasing uncertainty over their future funding for a range of reasons. These include:

- **new incentive-based funding arrangements which increase uncertainty about local authorities' future income**. Local authorities have certainty about the rules of mechanisms such as New Homes Bonus, and thus know what an authority would need to do to have a chance of gaining from them. However, they have limited certainty about whether they will gain in practice or by how much. This depends on their ability to influence the local economy, or their performance against other local authorities. Our case study authorities also highlighted the uncertainty created by the appeals process within the business rates retention scheme;

- **a lack of clarity over funding for local authorities after 2015-16**, although all the local authorities we spoke to were planning for further funding reductions;

6 Comptroller and Auditor General, *Financial sustainability of local authorities*, Session 2012-13, HC 888, National Audit Office, January 2013, pp. 24–26.

7 Comptroller and Auditor General, *The New Homes Bonus*, Session 2012-13, HC 1047, National Audit Office, March 2013.

8 Comptroller and Auditor General, *Council Tax support*, Session 2013-14, HC 882, National Audit Office, December 2013.

- **uncertainty about the Better Care Fund (paragraph 2.19) due to delays in planning for its implementation**. The Better Care Fund task force published guidance in July 2014, which sets out how the Fund will work. It is now the responsibility of local areas to agree how the Fund will work locally;[9] and
- **delayed announcements** which have reduced the time authorities have to set their annual budgets and council tax rates. For example, the Department announced the annual local government funding settlement for 2014-15 three weeks later than for the 2010-11 settlement.

1.12 Financial uncertainty can create risks for value for money. In our 2013 report, *Financial management in government*, we highlighted how important it is for departments to act according to a plan designed to provide services with reduced resources. We also warned of the risks to value for money of making short-term decisions.[10] The same lessons apply within local authorities, and to the Department in its role as lead department for local government funding. Not only is it good practice for local authorities to adopt medium-term financial plans, they have a statutory duty to do so.[11]

Local authorities' responses

Raising income and reducing spending

1.13 Our analysis shows that local authorities have not been able to offset reductions in government funding from other income sources and funding streams. For example:

- Total income from council tax, once adjusted to account for the localisation of council tax support, fell by 2.5% in real terms from 2010-11 to 2013-14.
- Income from fees and charges fell by 0.6% in real terms from 2010-11 to 2013-14.
- In general, local authorities have not used reserves to offset reductions in funding. Between 2010-11 and 2013-14, local authorities increased unallocated reserves by 16.2% in real terms, while earmarked reserves increased by 36.5%. Several of our case study authorities told us they were building up their reserves because of increasing uncertainty about their finances.

9 Comptroller and Auditor General, *Planning for the Better Care Fund*, Session 2014-15, HC 781, National Audit Office, November 2014.
10 Comptroller and Auditor General, *Financial management in government*, Session 2013-14, HC 131, National Audit Office, June 2013, paragraphs 21 and 3.6.
11 Local authorities have a legal requirement to set a 3-year medium-term financial strategy under the Local Government Act 2003.

1.14 Local authorities' main response to reductions in government funding has been to reduce spending. Our analysis shows that between 2010-11 and 2013-14 local authorities reduced gross spending on:

- employees by 14.9% – local authority employee numbers (full-time equivalents), excluding school staff, fell by 16.6% between 2010 and 2013; and
- running costs by 6.7%.

Impact on service spending

1.15 Local authorities have tried to protect spending on statutory services for vulnerable groups. Their budgets show that spending on children's social care will rise by 6.8% in real terms between 2010-11 and 2014-15. Adult social care expenditure will fall by 8.7%. These figures compare with reductions of 46.4% in planning and development and 33.8% in housing services, for example.

1.16 There are variations between local authorities (**Figure 3** overleaf); however, authorities with big reductions in spending power have been less able to protect spending on key services. For example:

- between 2010-11 and 2014-15, budgeted real-terms spending on adult social care fell by 12.7% on average in local authorities with a high cut in spending power – this compared with a 1.2% fall in authorities with a low cut in spending power; and
- budgeted spending on children's social care fell by 4.3% on average in authorities with high cuts, compared with a real-terms increase of 14.8% in authorities with low cuts.

Impacts on service levels

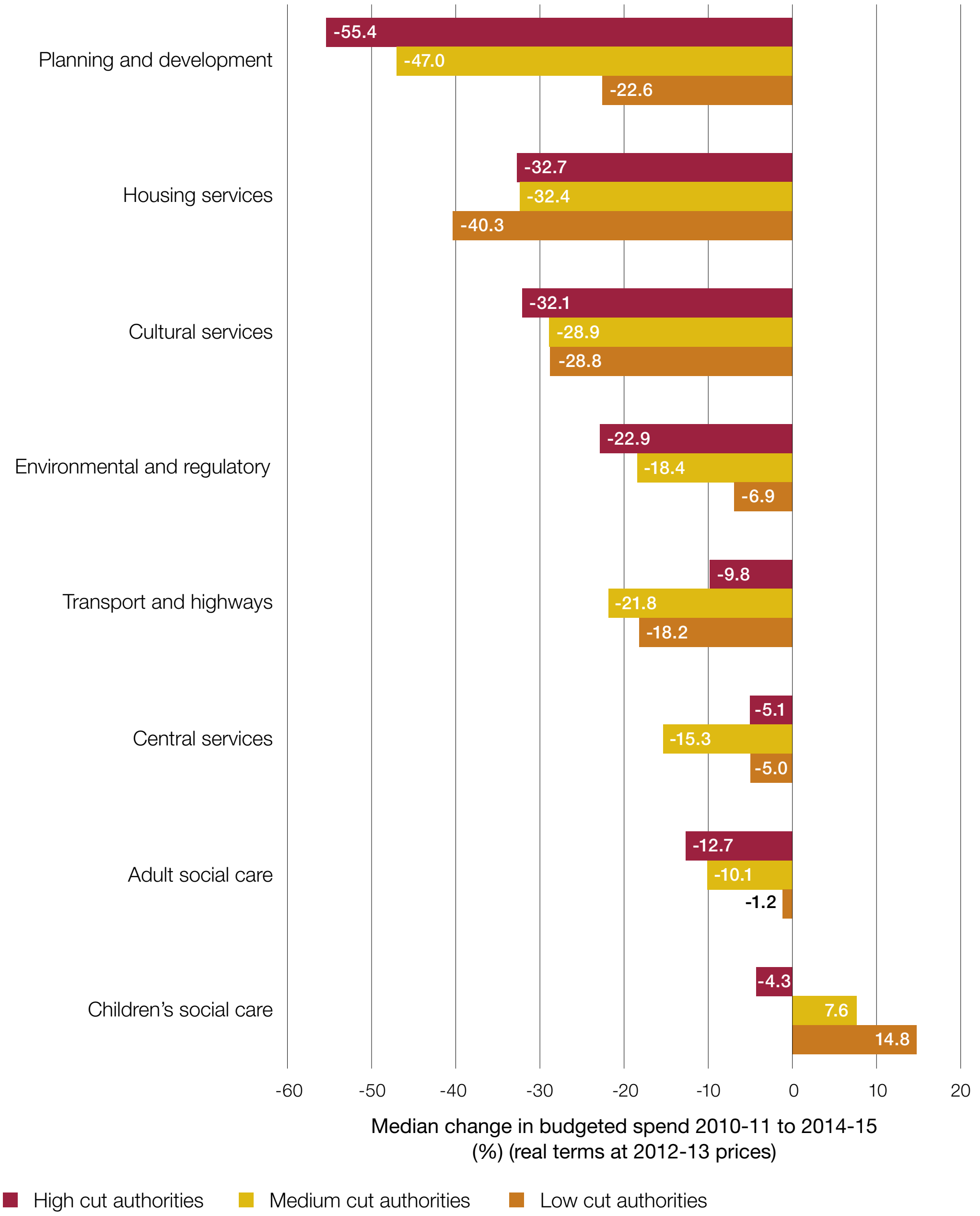
1.17 All the case study authorities we spoke to felt they had minimised the impact of funding reductions on service users. Nonetheless, there is evidence that local authorities have reduced services since 2010-11:

- Provision of residential, homecare, and day care services for adults fell between 2010-11 and 2012-13. This was falling before 2010-11, but the rate of decrease accelerated in the first two years of the 2010 Spending Review, particularly among local authorities that have faced the largest cuts. The rate of decrease appears to have slowed in 2013-14, however (**Figure 4** on page 19).
- Provision of residential care for children fell between 2010-11 and 2012-13 (-4.8%), compared with an increase in the previous two years (12.7%). Nights of foster care provision for children increased since 2010-11 (6.6%), but at a lower rate than the previous two years (10.8%).

1.18 However, for both adult and social care the change in the volume of activity does not necessarily imply any worsening in the quality of provision or outcomes for service users.

Figure 3
Change in budgeted spend, 2010-11 to 2014-15

Local authorities with high cuts have been less able to protect social care



Notes

1 Local authorities with high cuts are those with a real-terms reduction in spending power greater than 23.5% (one standard deviation below the mean) between 2010-11 and 2014-15. Those with low cuts saw a reduction in spending power of less than 15% (one standard deviation above the mean).

2 Central services include corporate management, emergency planning, local tax collection and democratic services (which includes supporting councillors).

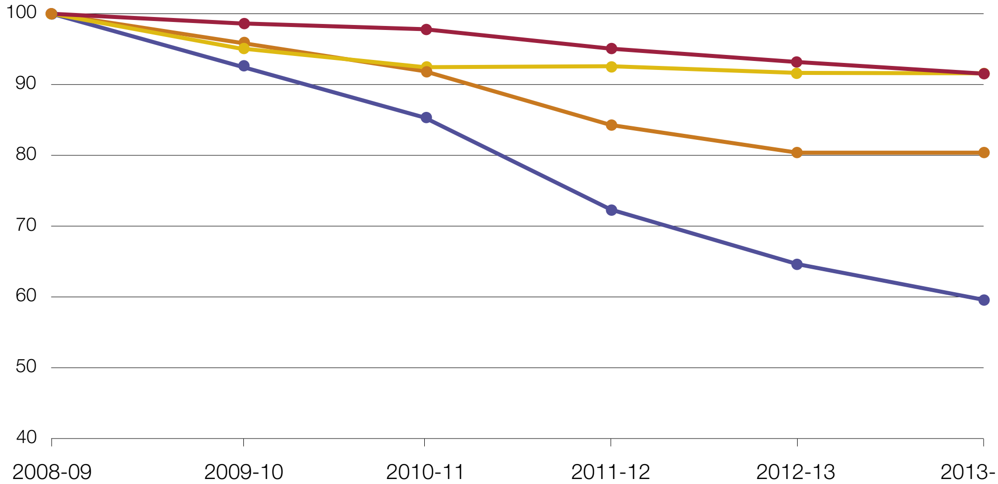
Source: National Audit Office analysis of Department for Communities and Local Government data

Figure 4

Change in local authority activity in adult social care before and after the 2010 spending review

Local authorities have reduced some social care services since 2010-11

Percentage of change in activity (person weeks of care), 2008-09 to 2013-14



	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Residential care	100	98.63	97.81	95.05	93.18	91.52
Nursing care	100	95.14	92.44	92.58	91.64	91.59
Homecare	100	95.93	91.85	84.27	80.37	80.38
Day care	100	92.67	85.34	72.33	64.64	59.59

Source: National Audit Office analysis of Department for Communities and Local Government data

Local authorities' financial sustainability

Financial sustainability to date

1.19 Local authorities have weathered the impact of the 2010 spending review well in financial terms. There have been no major financial failures to date and local authorities have increased reserves in response to financial uncertainty.

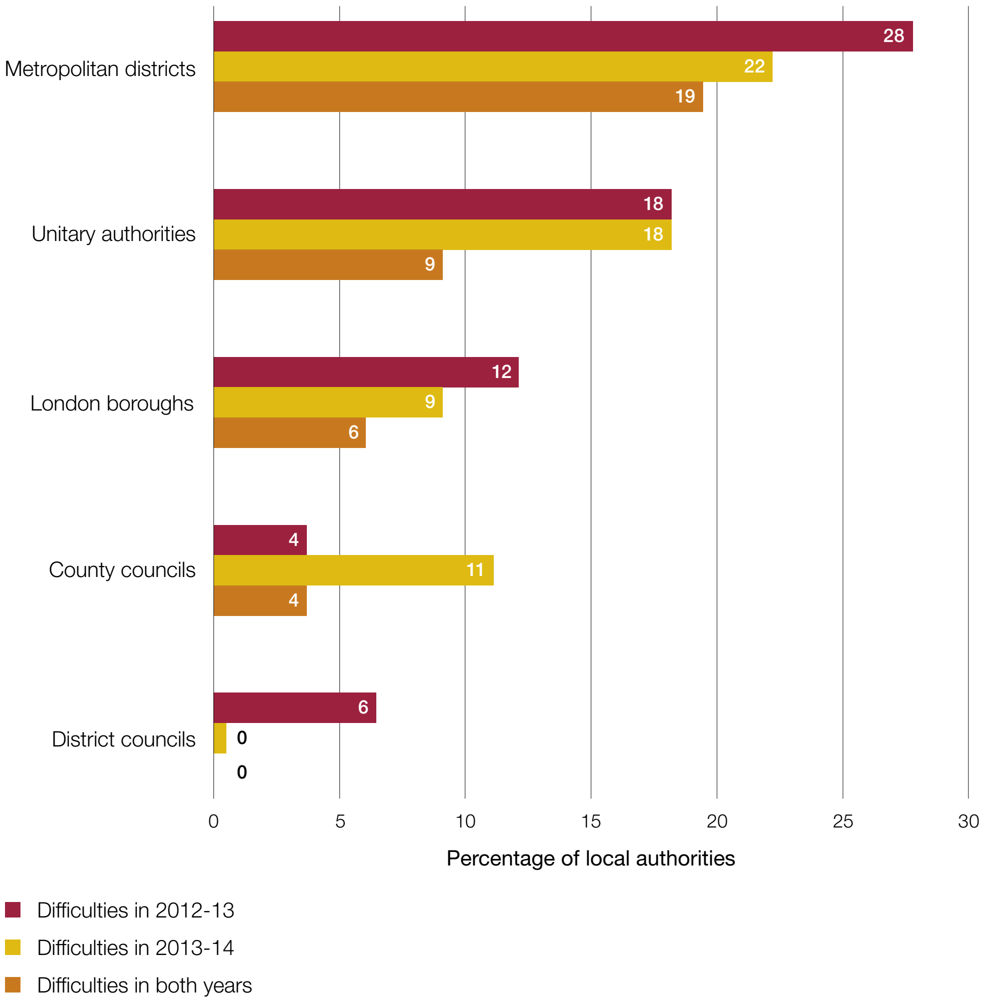
1.20 The latest annual survey of auditors suggests that some local authorities have been showing signs of financial stress. Auditors felt that 16% of single tier and county councils had difficulties delivering their budget in 2013-14. Auditors felt that no district councils had difficulties delivering their 2013-14 budgets.

1.21 The auditors' data show that metropolitan district councils and unitary authorities are much more likely to have had difficulties delivering their budgets to date. It also shows that there are local authorities with persistent signs of financial stress. In particular, roughly a fifth (19.4%) of metropolitan districts had difficulties delivering their budgets in both 2012-13 and 2013-14 (**Figure 5**).

Figure 5

Local authorities that have had difficulties delivering their budgets in the view of the local auditor

Auditors have identified metropolitan districts as experiencing greater difficulties



Source: National Audit Office analysis of Audit Commission data

Future financial sustainability of local authorities

1.22 The government has published illustrative funding figures for local authorities for 2015-16. The picture beyond 2015-16 for local government funding is less clear.

1.23 Nonetheless, local authorities expect funding reductions to continue beyond that point. A number of our case study authorities referred to the 2014 Budget, which makes it clear that funding reductions will be required for some time to tackle the deficit. HM Treasury forecasts that government resource budgets (less depreciation) will fall by £10.9 billion (3.8%) from 2015-16 to 2016-17, and by a further £11.4 billion (4.1%) by 2017-18. If the government continues to protect funding for education and health, local authorities will need to deliver savings well above these rates.

1.24 Some authorities we spoke to told us that scope for efficiency savings was diminishing. Barnet believed its proactive response to reduced funding had left it in a better financial position than some authorities. However, it still expected profound challenges in maintaining financial sustainability by 2018-19 if funding reductions continue. Birmingham City Council told us the reductions it faced were becoming increasingly hard to manage, and that even by 2015-16 it would be challenging to maintain statutory services to a minimum standard.

1.25 Many local auditors share local authorities' concerns. The 2014-15 survey shows that auditors are now less confident over local authorities' financial plans than before (**Figure 6** overleaf). Auditors:

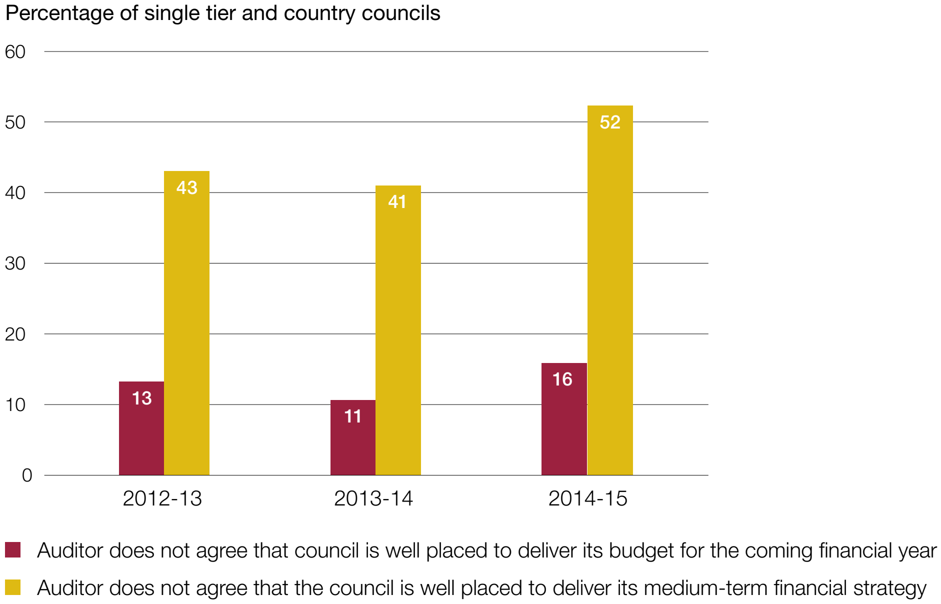
- raised concerns over 15.9% of single tier and county councils' capacity to deliver their budgets in 2014-15;
- had concerns about the capacity of 52.3% of these local authorities to deliver their medium-term financial plans, an increase from 41.1% in the 2013-14 survey; and
- were particularly concerned about metropolitan district councils and unitary councils, suggesting that 55.6% and 56.4% respectively are not well placed to deliver their medium-term financial strategies.

1.26 Analysis of the auditors' statements indicates they have growing concerns about the capacity of certain authorities to continue to identify savings given the scale of reductions they have already made. They have also raised concerns about the capacity of some authorities to make the savings they have already identified.

Figure 6

Auditors' views on the financial sustainability of local authorities (single tier and county councils)

Auditors have increased concerns about financial sustainability in 2014-15



Source: National Audit Office analysis of Audit Commission data

Part Two

The Department's understanding of changes in local authorities' income

2.1 The Department for Communities and Local Government (the Department) has a key role in overseeing the financial sustainability of local authorities as a whole. It is responsible for providing the government funding that local authorities need to deliver their core services. To take an informed view on whether this funding is sufficient, the Department must focus on how changes in funding affect individual authority incomes. It also needs to focus on how financial pressures affect individual service areas. In this part we examine how the Department:

- has managed the funding changes for local authority incomes to date;
- is helping local authorities cope in the event of future funding reductions; and
- informs itself of the funding pressures on individual local services.

Understanding funding changes to date

Changes to local authority incomes

2.2 In its 2013 report, the Committee of Public Accounts recommended the Department improve its understanding of how funding changes affect individual authorities, focusing on worst-affected councils and more vulnerable service users.[12] The Department accepted this recommendation, but said it had already implemented it by introducing its measure of each local authority's spending power.[13]

12 HC Committee of Public Accounts, *Department for Communities and Local Government: Financial sustainability of local authorities*, Third Report of Session 2013-14, HC 134, June 2013, p. 5.

13 HM Treasury, *Treasury Minutes: The Government responses on the First, the Third to the Fifth, the Seventh to the Twelfth, and the Fifteenth and Sixteenth Reports from the Committee of Public Accounts*, Session 2013-14, Cm 8697, September 2013.

2.3 There are some weaknesses in using spending power to measure change in local authority income. It may understate the scale of the pressures local authorities face, for example:

- it excludes changes to government funding that are decided after the annual announcement of the local government finance settlement such as Troubled Families grant and the Transformation Challenge Award;
- it excludes certain changes in funding that had a substantially negative impact on local authority income – this includes the £805 million funding reductions in 2010-11 following the emergency Budget in June 2010, the £300 million reduction linked to the localisation of council tax support in 2013-14, and the exclusion of the planned £200 million reduction in the Education Services Grant in 2015-16;
- it includes £3.46 billion revenue funding for the Better Care Fund (7% of total forecast spending power for that year) even though it is possible that much of this money might be spent on NHS rather than local authority services; and
- it does not account for the effects of inflation.

2.4 Revenue spending power does not show the change in funding over more than one year at a time. There are clear technical challenges to producing a like-for-like time series over this period due to changes in the duties placed on local authorities. Nonetheless, this means that there is no picture of the cumulative impact on local authorities over the entire 2010 spending review period.

2.5 Spending power lacks credibility in the sector and our case study authorities did not use it. Officers said they had to explain to councillors the difference between their published cut in spending power and the actual reduction they were facing. However, while the measure has shortcomings for assessing the absolute scale of funding reductions, it is more reliable in providing a picture of the relative distribution of reductions between authorities. Issues with the measure apply to most local authorities roughly equally, so it succeeds in identifying which authorities have had relatively higher or lower funding reductions.

Mitigating the impacts of funding reductions

2.6 The Department has aimed to soften the impact on those areas it understands to be worst affected by its funding reductions. Since 2011-12, it has set an upper limit on annual reductions to councils' spending power. From 2011-12 to 2013-14 this was set at an 8.8% annual drop in spending power; in 2014-15 this was lowered to 6.9%. The Department has implemented this limit by paying an efficiency support grant to the 7 councils that would otherwise have seen a larger reduction in spending power in 2014-15.

2.7 From 2011-12 to 2013-14 the Department gave smaller-than-average percentage grant reductions to the local authorities that are most dependent on it.[14] It has changed the way it distributes revenue support grant to limit the percentage reductions faced by the 25% of authorities that depend most on grants. It has also increased the balance of reductions going to those less dependent on government grants. It has also weighted the distribution of funding slightly towards those authorities with a comparatively low council tax base, as well as to some rural authorities.[15] In 2013-14 it also weighted funding towards authorities with higher service demands according to formulas which reflected the relative needs of different authorities.

2.8 The Department's mitigating actions will have provided some protection from the overall impacts of funding changes for the most grant-dependent authorities, although their effect will have reduced since they were implemented. More grant-dependent authorities are more likely to be affected by the totality of funding changes, since reductions make up a larger share of their budget.[16] This is the outcome of decisions taken to tackle the fiscal deficit by reducing public spending.

2.9 The Department points to the fact that more grant-dependent authorities still receive more government funding per head, though this gap is narrowing. However, it no longer updates the assessment of relative spending needs that informed the previous distribution. Nor does it estimate whether the absolute level of funding each authority receives is sufficient to meet its demand for services. It therefore does not have a way of demonstrating that the extra per capita funding for more deprived authorities is sufficient for all such authorities to meet the additional service demands they face.

14 Department for Communities and Local Government, *Accounting Officer Accountability System Statements for Local Government and for Fire and Rescue Authorities*, September 2013.

15 Department for Communities and Local Government, *Local Government Finance Report (England) 2013-14: Equality Statement*, February 2013.

16 Department for Communities and Local Government, *Equality Statement*, February 2013.

Mitigating impacts of financial uncertainty

2.10 The Department has taken steps to tackle issues relating to funding uncertainty resulting from the ongoing funding reductions and the changes in funding mechanisms. For example:

- The Department states it has designed the business rates retention scheme to give local authorities more certainty about funding. Notably, it created a safety net, which compensates authorities whose business rates income falls by more than 7.5%.
- Since 2010-11, the Department has rolled a large number of specific grants into the single unringfenced pot of revenue support grant.
- The Department provides a clearer outline in its summer consultations of the changes it intends to make at its annual financial settlements.
- Since 2013-14, it has also moved back to providing 2-year settlements, featuring indicative figures for the second year.

2.11 The Department is aware that the new settlement timetable puts pressure on local authorities' budget processes. It feels this is unavoidable, however, because of the timing of the Autumn Statement. The Department also stresses the importance of confirming funding allocations as early as possible to other departments that control specific grants.

Helping local authorities cope in the event of future reductions

2.12 The Department has set provisional funding allocations for local authorities to 2015-16. A future government will make funding decisions beyond this date. However, HM Treasury has published an indicative forecast for total government resource spending, showing a decline of 6.5% to 2017-18. All the case study authorities we spoke to anticipated further reductions beyond 2015-16.

2.13 The Department has recognised that local authorities need to be able to cope with ongoing reductions if they happen. It has identified 2 main ways of helping local authorities to do so:

- **Incentive-based funding mechanisms**

  The Department has introduced the business rates retention scheme, which it says enables local authorities to gain additional income.
- **Service transformation**

  The Department provides financial support and guidance to help local authorities redesign services, to improve outcomes and save money.

Incentive-based funding mechanisms

2.14 In 2013-14 the Department introduced the business rates retention scheme, allowing local authorities to keep up to 50% of additional revenue they raise locally. The Department anticipates that allowing local authorities to keep increases in their local business rates income will be an incentive for them to stimulate business growth.[17]

2.15 The Department has modelled local authorities' future incomes under high, low and medium scenarios of business rates growth. Its analysis suggests that the more grant-dependent authorities would still see a marked decline in their income, even if they enjoyed a relatively high business rates base and strong growth in local revenue. This is because of the relatively lesser share in the income of grant-dependent authorities made up by other sources, such as business rates. The Department says it sees business rates retention primarily as a means of rewarding authorities which support business growth, rather than a means of mitigating their reduction in other grants.

2.16 The Department has also introduced New Homes Bonus. While this is another incentive-based funding mechanism, the Bonus is not intended to help local authorities make up for other funding reductions. Rather it is intended to reward authorities which secure a growth in local housing. The Bonus is funded through reallocation of revenue support grant and does not increase overall funding for local authorities. In practice, this means that those authorities which do not see sufficient level of housing growth will see a greater reduction than if the Bonus did not exist. The Department sees the differential outcomes from the Bonus as essential to its policy objective, however, which is to incentivise local authorities to help create new housing.

Service transformation

2.17 If funding continues to be reduced throughout the next spending review period, the Department has identified that many local authorities would have to go beyond the efficiency measures used during this Parliament. The Department emphasises that service transformation projects that increase joint working and integration with other local service delivery bodies have the potential to meet increasing demands for services, especially in adult and children's social care. They may also secure better outcomes at lower cost.

2.18 We considered the challenges to successfully integrating services in our report on community budgets. We found that long-term success depends on a range of factors, including the capacity of each organisation to make integration work.[18] The Department has not yet estimated the capacity of local authorities to carry out widespread service transformation. Nor has it estimated yet the level of savings such projects could realistically make, how long this would take, or the potential impact on service users.

17 Department for Communities and Local Government, *Equality Statement*, February 2013.

18 Comptroller and Auditor General, *Case study on integration: Measuring the costs and benefits of Whole-Place Community Budgets*, Session 2012-13, HC 1040, National Audit Office, March 2013.

2.19 Recognising the need for service transformation, in 2013 the Department, along with the Department of Health, introduced the Better Care Fund. This aims to help join up NHS and adult social care services. The main objective of the Fund is to improve outcomes for adults with health and social care needs through joining up NHS and local government adult social care services. Both departments also intend for the Fund to lead to ongoing efficiencies. Recently we reported that the government's pause in planning for the Fund has threatened the value for money of its implementation. Our report highlighted the risk that transformation programmes, such as the Better Care Fund, may take time to deliver planned benefits.[19]

2.20 The Department has also created the Public Service Transformation Network. Its role is to encourage local authorities and other public services to collaborate and thereby deliver better outcomes for less money. The Network has a target to achieve £250 million of savings across all local service delivery bodies in 2014-15 and has a budget of £1.5 million for its activities. Around a fifth (15% to 20%) of these savings, if realised, are expected to fall to local authorities.

2.21 The Department has helped local authorities implement service transformation projects. In 2013 it introduced the Transformation Challenge Award, inviting local authorities to bid for funding for exemplar projects, such as increasing collaboration between authorities. In October 2013 the Department awarded £7 million to 18 winning bids, comprising 44 different authorities. The Department is running further rounds of this award, with £9 million available in 2014-15 and £105 million in 2015-16. There is also a £200 million fund for authorities to borrow from against the receipts they can raise from selling assets to fund service restructuring.

Understanding the implications of funding changes

2.22 The majority of local authorities' statutory duties are set by other departments, with councils' performance of these duties assessed by inspectorates in some cases. However, the Department is responsible for giving local authorities funding to provide all their core services. The Department should therefore understand the implications of funding changes, not just on local authorities' incomes, but on their capacities to continue delivering statutory services.

2.23 The Department has sought to fulfil this role via the 2 government spending reviews undertaken during this Parliament. Led by HM Treasury, spending reviews decide each department's resource budget over several years. The Department is responsible for agreeing the budget for local government as a whole. In carrying this out, the Department has consulted other departments with responsibilities for local authorities' statutory duties.

19 Comptroller and Auditor General, *Planning for the Better Care Fund*, Session 2014-15, HC 781, National Audit Office, November 2014.

2.24 In our last report, we examined this process for the 2010 spending review. We found that the information the Department obtained from other departments was variable and superficial. None of the departments we examined had analysed how funding changes might affect different regions or types of authority.

Spending round 2013

The spending round process

2.25 For this report, we examined spending round 2013, which set government budgets for 2015-16. The Department asked a number of departments to submit assessments relating to local services up to 2015-16. It asked them to estimate:

- upward cost pressures (for example, where a rising population might be expected to lead to rising service demand);
- the level of efficiency savings achieved since 2010, and potentially achievable to 2015-16; and
- in light of this information, the main impact on services in this period of a 10% reduction in government funding.

2.26 We found departmental submissions had improved overall, compared with those from spending review 2010. However, submissions still varied considerably in their quality and completeness of information (**Figure 7** overleaf). For example, some departments only described potential savings, rather than giving a quantitative estimate of their monetary value.

2.27 None of the departments broke its analysis down by region or type of authority. We analysed the impact of reductions on local authorities and found that some authorities have protected spending on services, while others have already made large reductions in core areas (see Part One). The capacity of different authorities to make further savings varies significantly depending on the actions they have had to take so far. The departments' sector-level analysis of local authorities' spending needs obscures these substantial differences between authorities. It risks departments' savings targets being unachievable for some.

Figure 7

Spending round 2013: departmental commentaries on a 10% reduction in funding for local government

Departments varied in their ability to provide quantitative estimates

	Department for Environment, Food & Rural Affairs	Department for Education	Department of Health	Department for Work & Pensions	Department for Transport
Estimated above-inflation spending pressures on local services	✔	✔	✔	✗	✓
Estimated efficiency savings or savings through reducing services offered, or both	✔	✓	✔	✓	✔
Estimated potential impacts of savings on local services	✔	✗	✔	✗	✗
Reference to joint working/collaboration	✓	✗	✓	✓	✓
Analysis broken down by region or types of local authorities	✗	✗	✗	✗	✗

✔ Department provided quantitative estimate

✓ Department provided qualitative description

✗ Department did not provide this analysis

Notes

1 The Department for Education worked with local authority finance directors' groups and had discussions with the Department about joint working and collaboration prior to the spending round process, although information from this work was not included in its submission.

2 The Department of Health says it aggregated its figures at a national level, because of the terms of the spending round process. However, its figures were based on the more detailed social care modelling it carries out on an ongoing basis, which takes differences between local authorities into account.

Source: National Audit Office analysis of departmental spending round 2013 submission documents

2.28 In practice the analysis which the Department collated at spending round 2013 did not cover all local services, including some where authorities have statutory duties. This was for a number of reasons, for example:

- The Department did not specify to other departments which of the local services under their remit they should comment on at spending round 2013. The Department for Work & Pensions says it did not include information on local authorities' duties for health and safety inspections as the guidance did not ask explicitly for this level of detailed information.

- The Department did not request a submission from the Food Standards Agency, and thus did not receive information on the impact of funding reductions on food safety and standards inspections.

- The Department for Education's submission did not cover specifically the statutory duty for local authorities to secure young people's access to sufficient leisure-time recreational activities alongside their educational ones. The Department considers that how local authorities approach this joint duty with providers of youth services is a matter for them.
- For similar reasons, while the Department for Culture, Media & Sport presented qualitative analysis of potential risks to a range of services, it did not attempt to quantify potential impacts on libraries or explicitly address their sustainability.
- The Department did not obtain analysis of other services where departments did not make a submission with a basic level of detail, including trading standards (which come under the Department for Business, Innovation & Skills).

2.29 For services where it did not obtain estimates of spending impacts, the Department assumed local authorities would make a flat reduction of 2.4%. This was in line with its then estimate of how the 10% reduction in government funding would translate into a cut in spending power across the sector as a whole.

2.30 The Department says there have been different levels of engagement across Whitehall, in terms of understanding how changes to the overall level of local government funding affect individual service areas. It is seeking to establish a culture within central government within which all relevant departments would share a sense of joint ownership of the budget for local government.

Assurance provided to the Department

2.31 At spending reviews, the Department looks to other departments to comment on the local services in which they have an interest. It says it relies on other departments to raise concerns about whether, in respect of these services, local authorities can cope with proposed reductions in government funding. The assurance which it can obtain from this process has intrinsic weaknesses, however. This is a by-product of the government's decision to unringfence the majority of local authorities' non-schools funding. Because local authorities have freedom in how to use this funding, central government can only be sure of the total funding available to local authorities, not how much they may choose to spend on any one service.

2.32 At the 2013 spending round, the Department's review of estimated reductions in service spending was based on notional spending totals, which it attributed to different services. In practice, within their overall budgets local authorities would be free to spend more or less than this on each service. This also means that the reductions in service spending could in each case be greater or smaller than estimated. Where, for example, local authorities protected certain services, the effect would be to reduce more steeply the funding available for other services. Some departments told us this made it difficult to comment on the potential impacts that an overall reduction in funding would make on the individual services under their remit. This indicates that, owing to policy decisions over the structure of government funding for local authorities, the assurance provided to the Department through its spending review consultations can only ever be partial.

Part Three

Preventing financial and service failure

3.1 The Department for Communities and Local Government (the Department) relies on the local government accountability system for assurance that reducing funding will not lead to financial or service failure. In this part we:

- describe how the system helps to prevent financial failure;
- assess how the Department monitors risks of financial failure; and
- evaluate the Department's understanding of the impact of funding reductions on services and the risk of service failures.

Preventing financial failure

3.2 A legal framework at the core of the local government accountability system effectively prevents local authorities becoming insolvent. Local authorities cannot borrow to finance revenue expenditure or run deficits. This is enforced by legal duties for:

- councils to set balanced annual budgets and ensure they have adequate reserves; and
- chief finance officers to issue a 'section 114' report if it appears an authority might spend more in a financial year than the resources available. These reports prevent authorities entering into new expenditure agreements for 21 days.

3.3 This framework influences local authorities to reduce their spending in line with any decline in their income, to avoid incurring unfinanced expenditure. Where an authority experiences financial difficulties, it may receive improvement support from the Local Government Association (LGA). Sometimes, the Department may offer financial assistance, for example by allowing an authority to meet one-off costs through borrowing or capital receipts. The Department sets out its reliance on this system to prevent financial failure in its local government accountability system statement.[20]

20 Department for Communities and Local Government, *Accounting Officer Accountability System Statements for Local Government and for Fire and Rescue Authorities*, September 2013.

3.4 In December 2013 the Department assessed the local government accountability system's effectiveness. It examined 5 cases where authorities had experienced governance and financial difficulties, finding in each case that the LGA's actions had been effective. In the Department's view, none of these cases arose from reductions in government funding. It concluded that the system was working effectively. However, it also cautioned that the system might need future adjustment in the event of increased concern about the ability of councils to manage their resources under growing financial pressure.

Detecting the risk of financial failure

3.5 The system has been effective to date in preventing financial failure, whether in the form of a local authority failing to agree a balanced budget at the start of the year or being unable to finance expenditure in-year. No section 114 notices relating to an unbalanced budget have been issued in the 2010 spending review period.

3.6 However, while the system seems robust in preventing financial failure it is weaker at highlighting the extent of financial pressure within authorities. If there is a financial failure within an authority, it is likely to be clear to the Department immediately, but its information on whether an authority is close to failure is weak.

3.7 A key factor is that local authorities cannot run deficits (unlike NHS bodies). This deprives the Department of a crucial indicator on the financial sustainability of authorities. Early warning information is important because:

- intervening after failure is likely to be more costly than preventing it in the first place; and
- local authorities' inability to run deficits means financial pressure is likely to manifest itself in reduced services – evidence of financial pressure is therefore a crucial indicator that services may be at risk of failure.

3.8 Despite the importance of early warning financial information, the Department uses limited information to monitor financial and service pressures in the sector. It relies for information on systems designed for different purposes. For example, the Department views the LGA as a key information source on the challenges faced by local authorities. The LGA provides improvement support to local authorities and maintains an overview of the performance of the sector. However, the LGA is not responsible for assuring the government or Parliament on the financial sustainability of councils. The LGA designs its activities to ensure that its services are effective, and that it can best represent its members' views, rather than to inform the Department on the performance of the sector. Furthermore, participation in LGA improvement support is voluntary. Between September 2011 and July 2014 only half (51%) of single tier and county councils had received it.

3.9 The Department's locality leads, a network of 70 senior officials who undertake occasional visits to local areas, are also not designed to fill the gap. While the Department may gain useful insights into financial challenges faced by the sector, this is not locality leads' main role. The Department mainly uses locality leads to understand more about how local authorities are implementing policies set by central government, with particular interest in policies which concern more than one department. The Department also uses these contacts to offer local authorities a means of communicating with central government. The Department's view is that locality leads and LGA peer reviews can generate important insights about the financial sustainability of authorities. However, it acknowledges that this is effectively an ad hoc consequence of these systems.

3.10 The Department cites the relative absence of qualified opinions on local authorities' accounts as evidence that the sector is coping well under financial pressure. Auditors' opinions include a judgement on whether local authorities have proper arrangements in place to deliver value for money. However, this on its own does not necessarily provide insight into an authority's financial sustainability, and may provide a misleading picture if used for this purpose.

3.11 Overall, the Department's view that the accountability system has been effective to date in preventing financial failure is reasonable. However, the Department is poorly placed to understand the scale of financial pressures within local authorities. As a result, it does not know enough about whether local authorities are close to failing financially and whether they are diverting financial pressures onto their services.

Impact on services

3.12 The Department recognises that financial pressures are more likely to manifest themselves in service rather than financial failure due to the strength of the accountability system. However, its knowledge of service sustainability is limited. The Department's update on the effectiveness of the system did not consider the impact that local authorities' strategies for balancing budgets were having on the services they provide. This creates the risk that the Department may not be aware of potential failures in statutory services that could generate significant costs to the public sector.

Oversight by the Department

3.13 In 2013 the Department told the Committee of Public Accounts it monitored local authorities' financial returns on service spending, and was therefore aware how far spending had fallen. However, while the Department said it believed local authorities had absorbed most of their funding reductions so far by increasing their efficiency, it had no way of verifying this. Consequently, it did not know the extent to which reductions in spending actually meant cuts in services.[21]

3.14 Since then the Department has cited responses to national user satisfaction surveys (commissioned, for example, by the LGA) as evidence that local authorities have been able to maintain their services despite funding reductions. There are substantial risks with using this type of data to draw these conclusions, for example:

- The surveys are national, and typically based on a sample of around 1,000. This does not reflect the significant levels of local variation in spending reductions.
- The surveys are not specifically of service users. Where analysis does focus on specific users, sample sizes tend to be small.
- Satisfaction scores are linked to the public's expectations of services; low expectations can deliver high satisfaction scores and vice versa.[22]

3.15 The Department says it does not monitor local services directly. It relies partly on local democratic processes to keep a check on the quality of council services. In line with the government's policy of localism, the Department says councillors are well placed to judge what communities really need and that councils that do not deliver for their local communities can be voted out.[23] What is less clear is what the local mechanism to deliver change is when the issue is a lack of funding rather than the performance of councillors. The Department says that if councils believe they need extra funding to maintain services they can increase council tax. Local authorities we spoke to pointed out that there are significant obstacles to doing this in practice. Hastings Borough Council told us the cost of holding a council tax referendum (required by the Department for rises of 2% and above in 2014-15) would itself have equated to a 1% rise in council tax.

21 HC Committee of Public Accounts, *Department for Communities and Local Government: Financial sustainability of local authorities*, Third Report of Session 2013-14, HC 134, June 2013, paragraph 14.
22 O James, 'Evaluating the expectations disconfirmation and expectations anchoring approaches to citizen satisfaction with local public services', *Journal of Public Administration Research and Theory*, 19(1), November 2007, pp. 107–123.
23 Department for Communities and Local Government, *Accounting Officer Accountability System Statements*, September 2013, p. 12 and p. 17.

Oversight by other departments

3.16 The Department also relies on other government departments to oversee the impact of funding reductions on the statutory services that fall under their remit. These departments have extra accountability mechanisms for ensuring local authorities provide their statutory services to an adequate level.

3.17 There are risks in the framework for monitoring the impact on services:

- **Oversight is robust in service areas such as social care, but less so in others**. Also, while failure can be defined and identified in social care, it is more complex in other areas, even where statutory duties are present, such as library services. This means there is the potential for service quality to fall significantly in a number of areas before central government takes notice. Overall, the extent to which other departments have a clear oversight that these statutory services are being delivered varies.
- **The Department's reliance on the work of social care inspectorates could obscure evidence of stress in service areas without inspection regimes**. Evidence shows that local authorities are protecting adult and children's services, often at the expense of other service areas. Consequently, if funding reductions have led to failures in adult or children's services, it is possible that other service areas are already failing.

3.18 The Department is not responsible for overseeing the delivery of services in which other departments have an interest. However, it does need to understand service sustainability to carry out its function as the coordinating department for local authority funding. The Department's position is that it prioritises its focus on service delivery primarily based on the largest areas of local authority spend (adult social care, children's services, and waste). Its approach includes closer engagement with selected departments, including regular meetings with working-level officials as well as more senior contact, such as some joint executive team meetings.

3.19 The Department is reliant on other departments and inspectorates to alert it to individual service failures. This approach means that, rather than systematically identifying signs of stress in advance, there is a risk the Department may only become aware of problems once they have occurred. Furthermore, the Department's reliance on other departments, and its selective focus on certain service areas, means it risks missing out on a concerted view of local authorities' financial sustainability.

3.20 The Department is the single point within government that should monitor the impact of funding reductions across the full range of local authority services, but it does not do so robustly enough. Its role means it should reflect the integrated nature of local authorities in which funding pressures can transfer between different service areas, and in which the sustainability of an individual service is often shaped strongly by decisions and pressures in other service areas.

Appendix One

Our audit approach

1 This study follows up our report from 2013, *Financial sustainability of local authorities*, which gave an overview of the implications of reductions and reforms to the funding of local authorities.[24] This report examines the interactions between local and central government, assessing how well the Department understands the impact of reforms on local government and how effectively central government supports local government financially.

2 There were 3 main elements to our work:

- We gathered information from local authorities, the Department and key local government groups to understand what has changed since our last report in 2012-13.
- We analysed how local authorities are responding to their budget cuts, and what they are doing to guarantee continuity of their statutory services.
- We reviewed what information government departments have to understand the impact of the reforms, local authorities' financial sustainability and local accountability systems.

3 Our audit approach is summarised in **Figure 8** overleaf. Our evidence base is summarised in Appendix Two.

24 Comptroller and Auditor General, *Financial sustainability of local authorities*, Session 2012-13, HC 888, National Audit Office, January 2013.

Figure 8
Our audit approach

The objective of government

Central government's objective

To reduce funding given to local authorities to £22.1 billion by 2014-15, and to give local authorities more freedom over income.

Local government's objective

Local authorities must provide services while balancing their budgets and remaining accountable to their electorates.

How this will be achieved

The Department has reduced funding, reformed business rates and removed the ringfencing for most grants.

Local authorities are pursuing a range of measures to reduce spending.

Our study

Our study examined evidence of the impact of funding reductions, and the Department's actions to inform itself of the likely impact on financial and service sustainability of local authorities.

Purpose of our examination

To assess how far departments' actions support local authorities in their long-term financial management.

To review the Department's understanding of the impact of reductions in funding.

To review the Department's understanding of effectiveness of local accountability systems to prevent financial and service failure.

Our evidence

(see Appendix Two for details)

We interviewed local authority finance directors and key local government groups, and analysed local authority financial information.

We interviewed officials and reviewed departmental documents.

We reviewed accountability system assurance mechanisms, examined case study examples of local authorities experiencing difficulties and interviewed key stakeholders.

Our conclusions

Local authorities have worked hard to manage the reductions in government funding through a mixture of efficiency measures and service transformation. At the same time, there is some evidence of reductions in service levels. Because of the legal requirement on local authorities to balance their budgets, it is unlikely that stress in local authorities will manifest itself in financial pressures. Instead, the Department will need to look for evidence of financial stress in local authorities' ability to deliver the services they are responsible for. Some services, such as adult social care, are also under pressure from demographic-led demand. Demands on children's services are also increasing.

The Department for Communities and Local Government has a central role in funding local authorities and establishing and maintaining contact between central and local government. It should be better informed in discharging this role, both in its information about the situation on the ground among local authorities across England, and about the various funding decisions and initiatives taken by departments in Whitehall. This is particularly important given the pressures on local government arising from austerity to date, and the fact that this is likely to continue for some years to come.

Appendix Two

Our evidence base

1 We reached our independent conclusions on the value-for-money risks of reducing local authority funding after analysing evidence collected between May and September 2014. Our audit approach is outlined in Appendix One.

2 **We interviewed officials from government departments**. We designed these interviews to focus on how the Department:

- informs itself of the impact of funding changes on local authorities' finances and services;
- assures itself that local authorities are financially sustainable; and
- liaises with other departments with respect to the services for which they have responsibility.

As well as the Department, we spoke to officials at the Department for Business, Innovation & Skills, the Department for Education, the Department for Environment, Food & Rural Affairs, the Department for Work & Pensions, the Food Standards Agency and HM Treasury. We also drew on evidence gathered from the Department of Health for our study *Planning for the Better Care Fund*.[25]

3 **We reviewed documents relating to the spending round 2013**. The Department set out proposed funding reductions to the end of 2015-16. It asked other departments to submit documents outlining the impact on local services for which they were responsible. We examined these documents, along with the Department's analysis of them, to assess how complete and detailed they were, and how much they had improved compared with the spending review 2010.

4 **We visited case study authorities**. We spoke to finance directors and other senior officers at 8 local authorities: London Borough of Barnet, Birmingham City Council, Blackpool Council, London Borough of Bromley, Hastings Borough Council, Leicestershire County Council, Liverpool City Council and West Oxfordshire District Council. We selected these in order to speak to a range of local authority types, located in different regions, facing different funding pressures. We used these visits to gain insight into the financial challenges the sector is experiencing, approaches some authorities are taking to managing reductions in funding, and the way some authorities are planning for the medium-term future.

25 Comptroller and Auditor General, *Planning for the Better Care Fund*, Session 2014-15, HC 781, National Audit Office, November 2014.

5 **We analysed quantitative data on local authority income, spending and service activity. A separate methodology setting out our approach to our quantitative analysis in detail is available at www.nao.org.uk/report/impacts-funding-reductions-local-authorities/. In brief:**

- We adapted the Department's data on spending power to construct a measure of the overall reduction in government funding, and local authority spending power, over the period 2010-11 to 2015-16.
- We collated data on service spend from the Department's Revenue Account and Revenue Outturn publications, the Department of Health's PSSEX publication and Department of Education's S251 publication, over the period 2010-11 to 2013-14 (2014-15 for the Revenue Account publication).
- We collated running cost data from the Department's Revenue Outturn and Provisional Revenue Outturn publications for 2010-11 to 2013-14.

6 **We analysed findings from the Audit Commission's annual survey of local auditors**. We looked for trends in auditors' concerns about the financial sustainability of local authorities, breaking down this analysis by different types of local authority.

7 **We consulted an expert panel and conducted interviews with stakeholders**. We organised an expert panel, with senior representation from local government, the accounting profession and academia. We drew on their expertise and experience to test our methodology, key evidence and emerging issues. We also spoke to representatives from the Local Government Association, the Chartered Institute of Public Finance and Accountancy, and Unison. We spoke to these stakeholders to capture their insights into how local authorities were responding to funding reductions, as well as issues about future financial sustainability.

8 **We reviewed departmental documents**. This included a review of the Department's accountability system statement for local government, as well as its advice to the Accounting Officer on the effectiveness of the system in December 2013. We used this review to establish the work the Department has done to assure itself that local authorities will remain financially sustainable.

9 **We carried out a review of our own research and external literature**. We focused on our recent research, which covered services delivered by local authorities, such as adult social care, food safety and standards inspections, trading standards and road maintenance. We also examined reports published by stakeholder groups on the reported impact of funding reductions on services and financial sustainability.

This report has been printed on Evolution Digital Satin and contains material sourced from responsibly managed and sustainable forests certified in accordance with the FSC (Forest Stewardship Council).

The wood pulp is totally recyclable and acid-free. Our printers also have full ISO 14001 environmental accreditation, which ensures that they have effective procedures in place to manage waste and practices that may affect the environment.

£10.00

ISBN 978-1-904219-50-7

9 781904 219507

National Audit Office

Design and Production by NAO Communications
DP Ref: 10562-001