National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

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Department for Communities
and Local Government

Financial sustainability of local authorities

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National Audit Office

Department for Communities and Local Government

Financial sustainability of local authorities

Report by the Comptroller and Auditor General

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Comptroller and Auditor General
National Audit Office

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This report examines central government's approach to local authority funding, and reviews local authorities' financial sustainability against a background of changes to their funding.

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This report can be found on the National Audit Office website at www.nao.org.uk/financial-sustainability-local-authorities-2013

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Key facts

£147bn	**£103bn**	**£44bn**
local government revenue income, 2010-11	central government grant funding to local government, 2010-11	other local government revenue income, 2010-11

353	local authorities in England
24 per cent	local government expenditure as proportion of total managed public spending in the UK in 2010-11
£7.6 billion	real-terms reduction in funding from central government to local authorities, 2010-11 to 2014-15, planned at 2010 spending review
14 per cent	real-terms reduction in local authority income, 2010-11 to 2014-15, estimated at 2010 spending review
0.2 per cent	increase in average band D council tax rates in cash terms, 2010-11 to 2012-13
£3.6 billion	total local authorities' unallocated general reserves, at 31 March 2012
4 per cent	total local authorities' unallocated general reserves as a proportion of total local authorities' revenue expenditure, at 31 March 2012
1,335	statutory duties on local authorities as at June 2011

Summary

1 There are 353 local authorities in England, providing a diverse range of services. Local government's revenue income was £147 billion in 2010-11, of which £103 billion was central government grants and £44 billion was other revenue income, including council tax of £22 billion. Local authority spending in England accounts for around a quarter of total public spending in the UK.

2 Local authority councillors are elected by, and accountable to, the people in their local authority. However, central government fundamentally influences the funding system for local authorities and is responsible for the statutory framework for the services they deliver. Local authorities are required to deliver 1,335 statutory responsibilities and, to be financially sustainable, must meet their service obligations within their available funding. A number of government departments are responsible for policy and funding for local authorities; the lead department is the Department for Communities and Local Government.

3 This report examines central government's approach to local authority funding, and reviews local authorities' financial sustainability against a background of changes to their funding. It has three parts:

- **Part One: Funding local authority services,** sets out the background to the current funding arrangements and the reduction in local authority funding from the government's 2010 spending review.
- **Part Two: Local authority budget management,** sets out how local authorities have responded to their reduced income.
- **Part Three: Maintaining financial sustainability,** covers the growing challenges to local authorities' financial sustainability; managing financial risks and opportunities; and the increasing need for central government to make informed decisions as financial and service pressures increase.

4 We have drawn in this report upon work done by the Audit Commission in its report *Tough Times 2012*. In line with our current statutory audit remit, we have not undertaken detailed fieldwork at individual local authority level, nor have we engaged directly with local auditors to assess the response of individual local authorities to the recent funding changes. We outline our audit approach and evidence base in Appendices One and Two.

5 The government is introducing a Local Audit Bill in 2013. This will provide for the abolition of the Audit Commission, clarify the NAO's powers to carry out value-for-money work on local authorities, and provide the NAO with statutory access to information held by local authorities in support of such work.

Key findings

6 **As part of its fiscal deficit reduction plan, central government planned at the 2010 spending review to reduce funding of local authorities by 26 per cent (£7.6 billion) in real terms, between April 2011 and March 2015 (excluding police, school and fire). Including council tax, the overall reduction of local authority income was forecast to be 14 per cent in real terms.** The effects on local authorities vary. In 2012-13, the overall reduction in spending power ranges from 1.1 per cent to 8.8 per cent in cash terms. Twelve local authorities experienced the highest reduction in spending power of 8.8 per cent in 2011-12 and 2012-13 (paragraphs 1.14 to 1.15).

7 **By reducing ring-fencing of its grants, central government aims to give local authorities greater spending flexibility.** In addition, from April 2013, local authorities will have a financial incentive to achieve growth in business rates and will be able to decide which council tax payers should benefit from council tax support. Central government has also introduced policies that reduce local authorities' flexibility, for example by requiring those that wish to raise council tax by more than a set percentage to hold a local referendum (paragraphs 1.10, 2.7, 3.12 to 3.19).

8 **So far, local authorities have absorbed reductions in central government funding but there is some evidence that services have been reduced.** Using data from the Audit Commission we estimate that local authorities are planning to make £4.6 billion of savings by April 2013. The majority of local authorities have so far not drawn on financial reserves to make up for reduced income. Although 93 used reserves in 2011-12, the remaining 260 either made no changes to their reserves or added to them. There is evidence that local authorities are reducing services, for example in adult social care and libraries (paragraphs 2.2, 2.10, 3.7 and 3.10).

9 **Local authorities may find it harder over the rest of the spending review period to absorb funding reductions and maintain services.** We estimate that local authorities still need to find about half of the savings to be made before March 2015 after considering the latest figures for inflation, council tax and government grants. At the same time, demand for high-cost services, such as adult social care and children's services, is increasing. The scope for absorbing cost pressures through reducing other, lower cost, services is reducing, as authorities have already reduced spending on these services. Nationally, the largest percentage reductions so far have been to services such as planning and development, where total spending by local authorities has reduced by 36 per cent. In contrast, adult social care has reduced by 6 per cent (paragraphs 2.3 to 2.4, 3.30).

10 **The government is making changes that create financial opportunities for local authorities but also increase their financial risks and uncertainty.** Two of the most important changes – the partial localisation of business rates and the arrangements for council tax benefit – come into effect in April 2013. The business rates change will incentivise local authorities to promote local business growth, as they will keep a share of increased business rate income. They will also be more exposed if income falls, although they will receive some protection from this. The changes to

council tax support mean that instead of paying benefits according to rules that the Department for Work and Pensions sets, local authorities can have their own schemes but nationally they will have 10 per cent less money to do so. The opportunities and risks of both changes will be influenced by wider economic conditions, which are inherently uncertain (paragraphs 1.12, 3.11 to 3.20).

11 Local authorities' ability to make savings while maintaining service levels depends on local circumstances. Using information from local auditors, the Audit Commission identified 12 per cent of local authorities as at risk of not balancing future budgets. We surveyed local authority finance directors with most of the 52 that responded expected to make the largest savings through efficiency improvements. However, nearly all saw reducing the services their local authorities provided as contributing to their savings requirements (paragraphs 3.4 to 3.5, 3.34).

12 While individual government departments assessed the impact of the changes being made, their approach was not comprehensive. We looked at the information three departments provided for the 2010 spending review. One, the Department for Education, could not estimate the scope for savings across the entirety of their service area (children's services), but it did consider the pressures and scope for efficiencies in a number of major areas of spend, such as caring for 'looked after' children. In addition, all three departments did not identify regional or other variations in the demand for, or cost of, services (paragraphs 3.25 to 3.32).

13 With a range of changes to local government funding being implemented over the spending review period, it becomes increasingly important to understand the cumulative effects of the changes as these may affect local authorities differently. For example, local authorities that do not experience economic growth might, simultaneously, see a fall in their business rates and a rise in council tax benefit claimants. The Department for Communities and Local Government has recently started to provide the basis for such an analysis, by assessing the combined impacts of a range of changes on the financial risk profile of individual local authorities (paragraphs 3.20 to 3.21).

14 The accountability framework for local government to address widespread financial failure is untested. The framework, as described in the Department for Communities and Local Government's *Accountability System Statement*, relies heavily on the long-established safeguards and assurances within local authorities. The framework has not yet faced a case of widespread financial failure and where there have been 'one-off' failures requiring central government intervention, the failure regime has managed to resolve them. However, past failures in the local government sector have generally related to services or corporate governance, or both, and not financial failure. How the system responds in the case of multiple financial failures during possibly more challenging times for local authorities is therefore, at present, untested (paragraphs 3.35 to 3.42).

Conclusion

15 So far, local authorities have generally been able to absorb central government funding reductions. However, there is emerging evidence that some service levels are reducing. Funding reductions are continuing, along with changes to the resourcing mechanism of local authorities. These changes increase financial uncertainty and more local authorities are facing the challenge to avoid financial difficulties while meeting their statutory responsibilities. This risk will not manifest itself evenly across the sector, with some local authorities being more affected than others.

16 This risk must be identified early so it can be managed effectively. The Department for Communities and Local Government will need arrangements to detect where risks will emerge. Its response will need to be flexible and coordinated with local and sector-wide support mechanisms. Central government must also satisfy itself that it understands the cumulative impact of funding changes and can make informed decisions about the funding required for local authority services.

Recommendation

17 **The Department for Communities and Local Government should build on previous work and, together with other government departments, better evaluate the impact of decisions on local authority finances and services – before and after implementation.** With other departments, the Department has assessed the impact of funding reductions and other changes to the system of local authority financing, such as business rates. To develop its approach the Department should:

- work with other departments to understand the information needs to support decisions affecting local authority finances and services. This may not mean requiring more information, but understanding what is the right information for that purpose. For transparency, it should discuss and share the framework with local authorities;
- ensure that decisions on financing local authorities are made with an assessment of their service obligations including statutory responsibilities; and
- satisfy itself that the assurances provided by the accountability framework are robust enough for the more challenging financial and service delivery conditions facing local authorities. Informed decision-making requires a feedback loop so the Department can make adjustments in the light of performance; and identify evidence of potential difficulties early enough to intervene.

Part One

Funding local authority services

1.1 This part covers:

- the services local authorities provide and how central government has influenced their funding;
- local authority funding and spending at the beginning of the 2010 spending review;
- the main funding changes between April 2010 and March 2015; and
- funding reductions central government planned at the 2010 spending review and how these affect local authorities differently.

Local authorities and their services

1.2 Local authorities are democratically elected and provide a range of services to their communities in the broad areas of education, housing, social care, environmental services, and corporate functions such as collecting council tax.[1] They have 1,335 statutory duties, including child protection, provision of libraries, environmental health and trading standards – but within this framework have discretion to decide how they provide services according to local priorities.

1.3 Central government directly influences local authority funding for these services. Local authorities are required by law to balance their budgets. To remain financially sustainable, they must meet their service obligations with the available funding. Introducing the 'general power of competence' in the 2011 Localism Act increased local authorities' discretion over the range of services they provide.

The relationship between central and local government

1.4 The financial and statutory relationships between central and local government have a long and complex history, mostly concerning the degree of central government control. Central government policies are implemented through statutory service obligations on local authorities, which receive funding from different parts of government.

1 This report only covers councils, not other types of authorities such as police and fire authorities unless otherwise stated.

1.5 Before April 1990, local authorities retained locally raised taxes, in the form of rates levied on businesses (shops, offices, and factories) and households, and received central government funding in the form of the Rate Support Grant. Following funding changes in 1990 and up to April 2013, local authorities collect business rates, and pay them to central government, which redistributes them back through the grant system. Central government sets business rates, but local authorities have discretion to reduce individual bills by granting rate relief. Local authorities set, collect and retain council tax, using an administrative framework set by central government.

1.6 There have been periods when central government has sought to direct or influence increases in local tax levels through measures such as council tax capping. This is no longer in place but currently there is a requirement to hold a local referendum for increases above a certain level. There is also a Council Tax Freeze Grant which is distributed to those authorities that do not increase their council tax level (paragraph 2.7).

Local government funding at the beginning of the 2010 spending review

1.7 In 2010-11, total local government revenue income was £147 billion.[2] Of this, £103 billion was central government grant funding and £44 billion was other revenue income, principally income raised locally by local authorities through council tax (£22 billion) and sales, fees and charges (£12 billion).[3]

1.8 A large proportion of central government grants were not available for local authorities to spend directly on providing services as they choose and this report does not directly consider those:

- About thirty billion pounds of funding was the Dedicated Schools Grant, which local authorities pass directly to schools.
- A further £23 billion was passed directly by local authorities to third parties to administer (such as funding for adult and community learning) or to benefit recipients.

1.9 This report focuses on general revenue funding for local authorities, of which the largest elements are the Formula Grant (£29 billion in 2010-11) and council tax.[4] Local authorities can decide how to spend both funding streams in meeting their responsibilities. The last year of the Formula Grant is 2012-13. We describe the arrangements that replace it in paragraphs 3.12 to 3.17.

2 The figures in paragraphs 1.7 to 1.10 include income for all local authorities, including police and fire authorities. In addition to their revenue income, local authorities also receive capital income and rent income from social housing. This is not covered in this report.
3 The figures in paragraphs 1.7 to 1.10 may not add up due to rounding.
4 The Formula Grant consists of redistributed business rates (£21.5 billion in 2010-11), a central government 'top-up' added to business rates called the Revenue Support Grant (£3.1 billion), and the Police Grant paid directly to police authorities (£4.4 billion). Its allocation was the subject of a separate NAO report. Comptroller and Auditor General, *Formula funding of local public services*, Session 2010–2012, HC 1090, National Audit Office, July 2011.

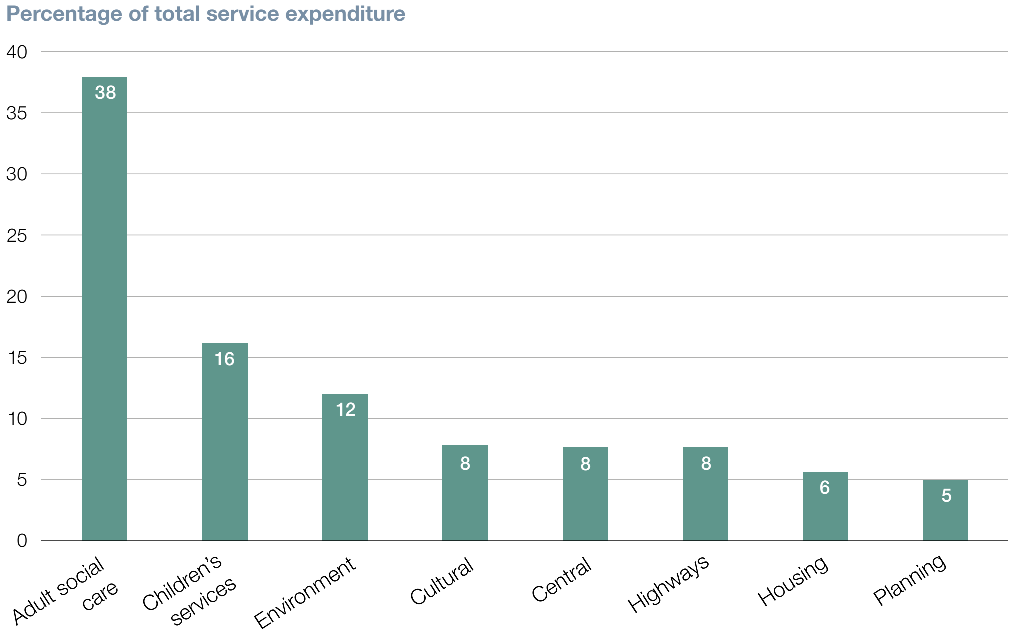
1.10 In 2010-11, central government also passed on £20 billion in grants for specific services, for example, for homelessness services. The extent to which local authorities had discretion in the use of such funding varied. Following the 2010 spending review, the Department for Communities and Local Government has merged several specific grants into the Formula Grant, while removing ring-fencing from most of those which remain, giving local authorities more spending flexibility.

Local authority spending on services

1.11 **Figure 1** shows how local authorities spent their income in 2010-11. Most money was spent on adult social care and children's services, with the least going to housing and planning services.

Figure 1
Spending on local services in 2010-11

In 2010-11, more than 50 per cent of local authority spending was on social care



NOTE
1 Education spending is excluded.

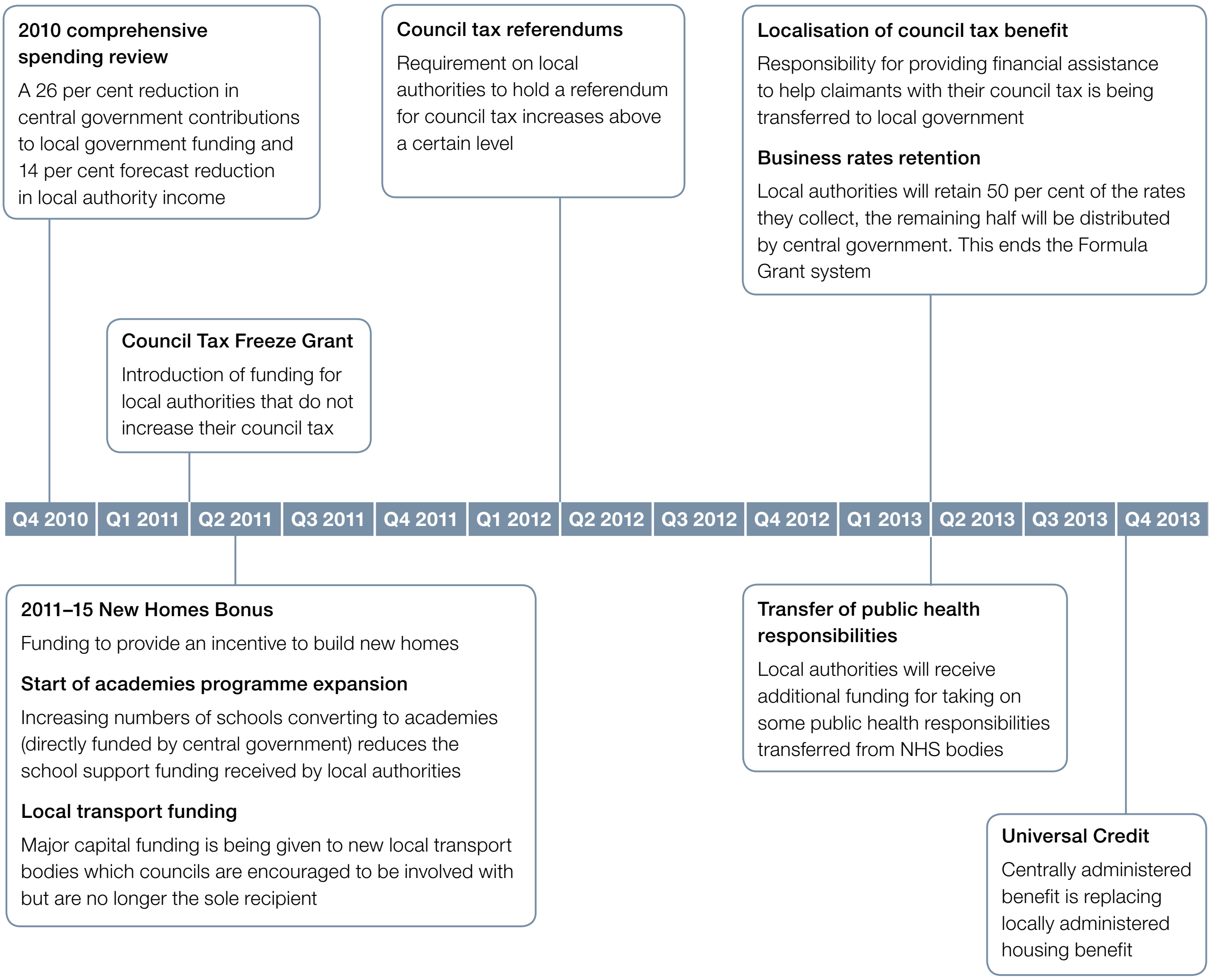
Source: Audit Commission analysis of local authority revenue outturn data 2010-11, in 2012-13 prices

Changes to local authority funding

1.12 A number of changes taking place between April 2010 and March 2015 will affect local authorities' financial position as illustrated in **Figure 2**.

Figure 2

Timeline of major changes to local authority funding



Source: National Audit Office

1.13 Two key objectives underpin current government policy for local authority funding. One is localism, which means that local authorities have greater discretion over their decision-making. The other is deficit reduction through local economic growth and reducing spending. These objectives are driving a number of changes on which our report focuses:

- Reduced central government grant funding (paragraphs 1.14 to 1.15).
- Council Tax Freeze Grant and the requirement to hold a referendum for council tax increases above a certain level (paragraph 2.7).
- The way local authorities benefit from growth in business rates which is being introduced in April 2013 (paragraphs 3.12 to 3.17).
- Providing local authorities discretion over the levels of support working-age people receive with their council tax bill from April 2013 (paragraphs 3.18 to 3.19).

Funding reductions planned at the 2010 spending review

1.14 In its June 2010 Budget, the government set out a five-year plan to reduce the structural deficit over the course of this Parliament, specifying the greatest contribution would come from spending reductions. In *Spending Review 2010*, HM Treasury set out details of the government's plan to reduce local government funding for the four years 2011-12 to 2014-15.[5] Central government financial support for local authorities was planned to reduce over that period by 26 per cent in real terms,[6] from £29.7 billion to £22.1 billion. HM Treasury forecast that, after considering inflation and council tax, the effect would be a decrease in overall local authority income of 14 per cent in real terms (£51.8 billion to £44.8 billion).[7] **Figure 3** overleaf shows the greatest reductions were planned to occur in the first two years of the spending review.

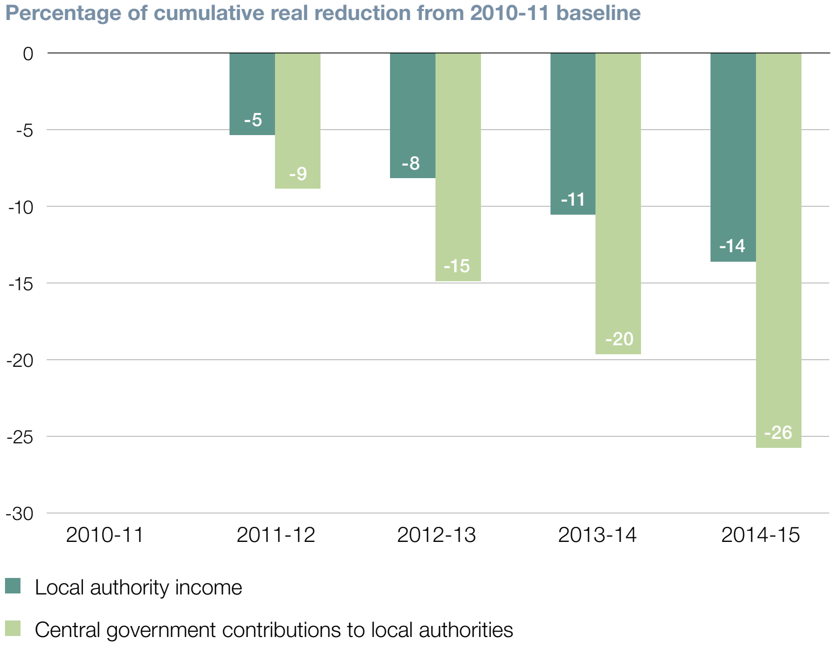
1.15 The funding reductions do not have a uniform effect across local authorities. The Department for Communities and Local Government allocated a Transition Grant to all local authorities, totalling £116 million over 2011-12 and 2012-13, so that no local authority's annual reduction in spending power is more than 8.8 per cent in those years.[8] **Figure 4** on page 15 shows the distribution of spending power reductions across local authorities after the Transition Grant has been allocated in 2012-13. In 2012-13 the reduction in spending power ranges from 1.1 per cent to 8.8 per cent.[9] Twelve local authorities had reduced spending power of 8.8 per cent in both 2011-12 and 2012-13.

5 HM Treasury, *Spending Review 2010,* October 2010, available at: http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf
6 Figures in real terms are in 2010-11 prices, unless otherwise stated.
7 Local authority income refers to the line 'local government spending' in HM Treasury, *Spending Review 2010*, Table 1, p. 10, and includes central government contributions to local authorities and council tax.
8 Spending power is calculated by taking account of central government contributions to local authorities, council tax, and NHS social care funding.
9 These figures are in cash terms.

Figure 3

Planned decrease in central government funding and the overall effect on local authority income, April 2010 to March 2015

At the 2010 spending review, the government planned to reduce central government contributions to local authorities by 26 per cent over the spending review period, and forecast that overall local authority income will reduce by 14 per cent



NOTES

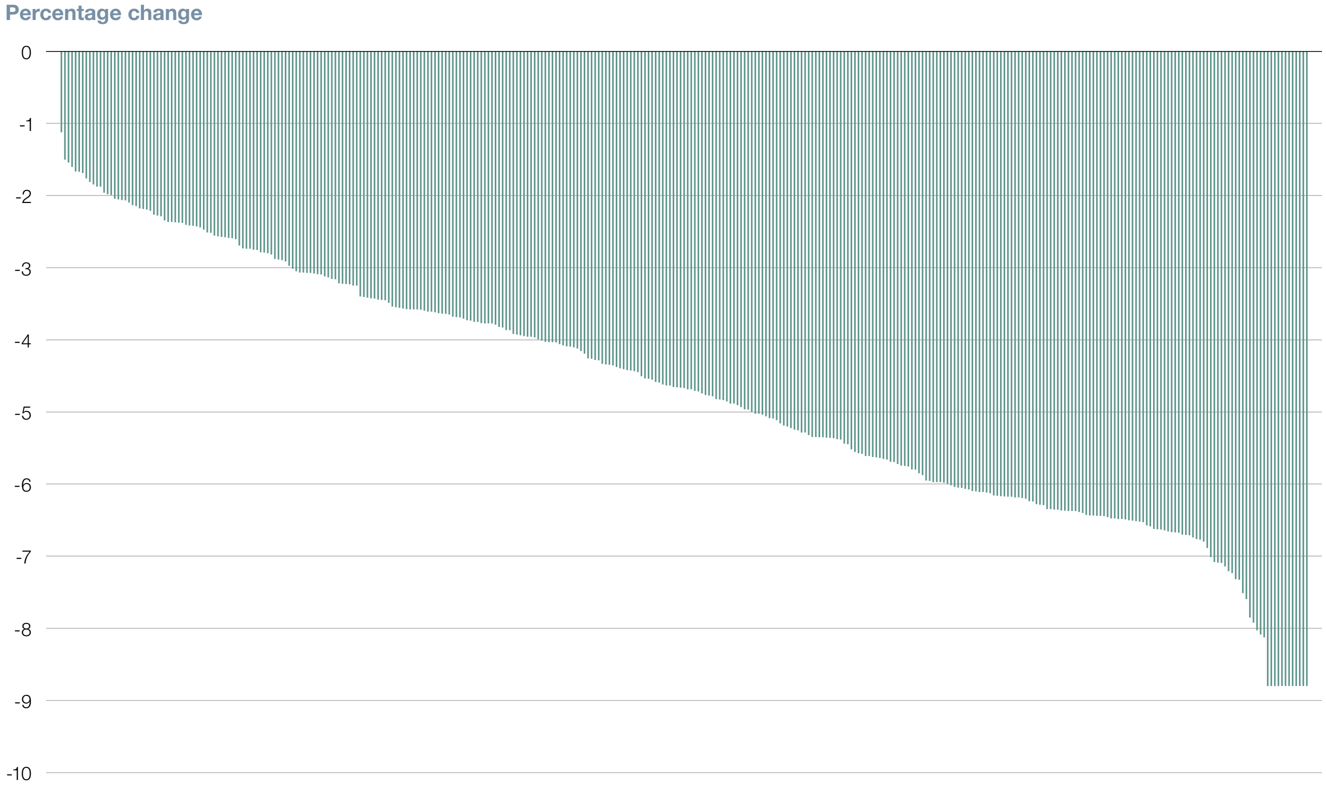
1 Local authority income includes the Office for Budget Responsibility's council tax forecast at the time of the 2010 spending review.

2 The figures are in real terms and have been rounded to the nearest percentage point.

Source: HM Treasury, Spending Review 2010

Figure 4

Distribution of the annual reductions in spending power across local authorities, 2012-13



NOTES

1 The Isles of Scilly is excluded from this analysis due to lack of comparability with other councils.

2 Figures are in cash terms.

Source: National Audit Office analysis based on Department for Communities and Local Government spending power figures

Part Two

Local authority budget management

2.1 Part One describes the challenge local authorities face in this spending review, setting out major changes and reductions to local authority income. This part examines how local authorities have managed budgets over the first half of the 2010 spending review, looking at how they have:

- reduced spending;
- increased income;
- used reserves on a one-off basis; and
- performed against budget.

Reducing spending

2.2 Using Audit Commission data, we estimate that local authorities are planning to reduce spending by £4.6 billion in real terms by March 2013, after absorbing additional costs from increased demand for local authority services.[10]

2.3 Central government estimated at the 2010 spending review that the overall reduction in local authority income would be £7 billion (14 per cent) in real terms from April 2010 to March 2015 (paragraph 1.14). Since then, the government has announced further changes affecting local government, including a funding reduction of £445 million for 2014-15 in the 2012 *Autumn Statement*. Council tax income is also expected to be lower and inflation higher than forecast at the 2010 spending review. This creates difficulties in estimating precisely how much local authority income will reduce by March 2015, but we estimate that the £4.6 billion reduction of spending represents about half of the savings required by March 2015.

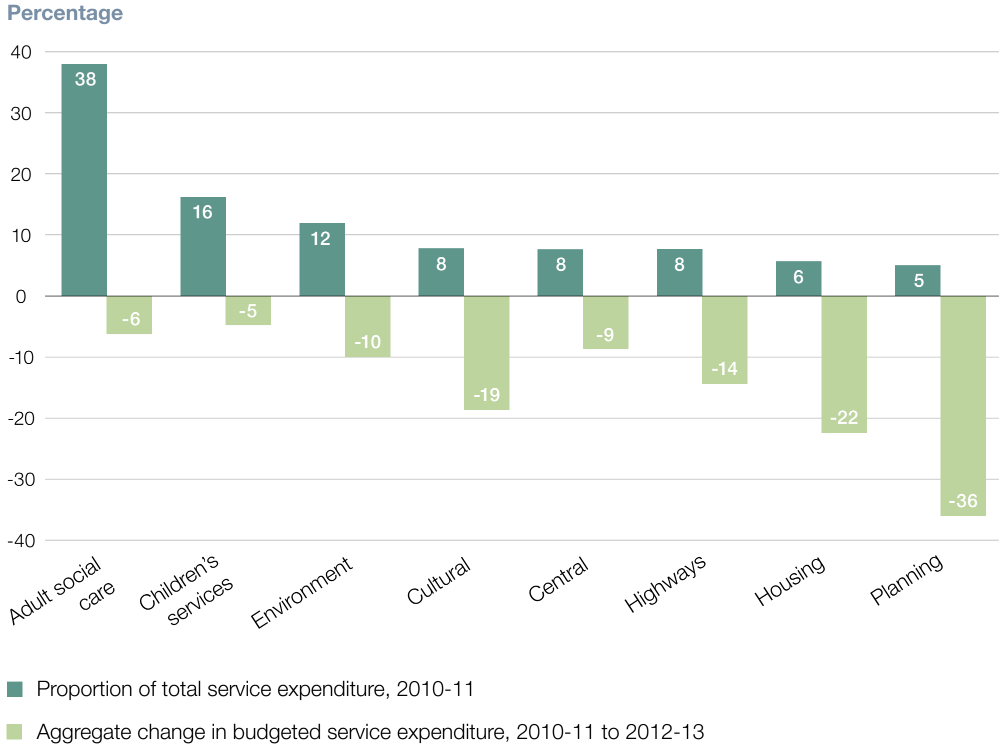
2.4 **Figure 5** shows where local authorities have made savings on individual services. The largest percentage reductions have been in areas with relatively low levels of spending. For example, total spending on planning and development represented 5 per cent of spending in 2010-11 and is planned to fall by 36 per cent between April 2010 and March 2013 in real terms. At the other extreme, adult social care represented 38 per cent of spending in 2010-11 and is planned to fall by 6 per cent in real terms between April 2010 and March 2013.[11]

10 See Appendix Two for more details.
11 These real-terms figures are in 2012-13 prices.

2.5 If local authorities cannot reduce costs through making savings while maintaining services, they must consider managing demand or reducing services. There is evidence of increasing pressures on local authorities to do this (paragraphs 3.7 to 3.8).

Figure 5
Local authority planned real-term reductions in spending, April 2010 to March 2013

In the first two years of the 2010 spending review period local authorities focused their savings on planning and housing in relative terms



NOTES

1 In its *Tough Times 2012* report the Audit Commission reported service expenditure figures for 2011-12. This explains why the Audit Commission reported different figures on service expenditure proportions.

2 Education spending is excluded.

Source: Audit Commission analysis of local authority revenue outturn data 2010-11 and revenue account data 2010-11, 2011-12, 2012-13, in 2012-13 prices

Increasing income

2.6 Council tax is the main source of locally raised income. Council tax levels are set in eight bands, at rates local authorities decide. The bands themselves are determined by central government. The fourth (band D) is usually used for comparisons. In 2012-13, it ranges from £684 to £1,696, with the national average being £1,469. These arrangements have been in place with the current rate valuations since 1993. This shows that individual authorities are starting from different positions on council tax levels. A certain percentage increase will yield more in cash terms in a high-tax than in a low-tax authority.[12]

2.7 Between April 2010 and March 2013, the average total band D council tax level increase was 0.2 per cent in cash terms, compared with 5 per cent since the introduction of council tax. Two measures have influenced the comparatively low increase in the last two years:

- In 2010, central government introduced the Council Tax Freeze Grant. This grant rewards local authorities that do not increase council tax. In 2011-12, the grant was equivalent to a 2.5 per cent rise in council tax, and this level of grant is available for the full spending review period. In October 2011, the government announced it would provide a further year's Council Tax Freeze Grant in 2012-13 and this was equivalent to a 2.5 per cent increase in 2011-12 council tax. Then, in October 2012, it announced another Council Tax Freeze Grant, at a level equivalent to a 1 per cent rise in 2012-13 council tax, available in both 2013-14 and 2014-15. All local authorities received the 2011-12 grant; 316 (90 per cent) received the 2012-13 grant. These arrangements present an incentive for authorities not to increase the level of tax.
- The Localism Act 2011 requires local authorities wanting to raise council tax by more than a set percentage to hold a local referendum. The threshold for the current financial year was 3.5 per cent, and it will be 2 per cent next year.[13] Since the introduction of the act, no local authority has held a referendum.

Using reserves

2.8 In addition to the legal requirement to balance budgets, local authorities must maintain adequate reserves to manage financial risks. The level of reserves is a matter for individual local authorities to decide. As of 31 March 2012, local authorities held total reserves of £13.5 billion. They held earmarked reserves for specific purposes (£9.9 billion). These are held for a range of contingencies, for example to cover insurance liabilities or the costs of debt financing. They held unallocated general reserves of £3.6 billion (4 per cent of local authority spending). These provide a provision against general risk but are not allocated for specific purposes.

12 The relative size of the tax base also has a bearing on the cash increase.

13 The referendum thresholds for the financial year 2012-13 apply to all councils except the Greater London Authority. In December 2012, following the 2012 *Autumn Statement*, the government announced that district councils whose 2012-13 council tax was in the lowest quartile will be able to raise council tax by more than 2 per cent without a referendum provided the increase is not more than £5 in the average band D amount.

2.9 We focused our analysis on unallocated general reserves. These protect against unforeseen events, so are particularly important for financial sustainability. Local authorities can fund overspends by using these reserves. However, this is not a sustainable approach to balancing budgets in the longer term.

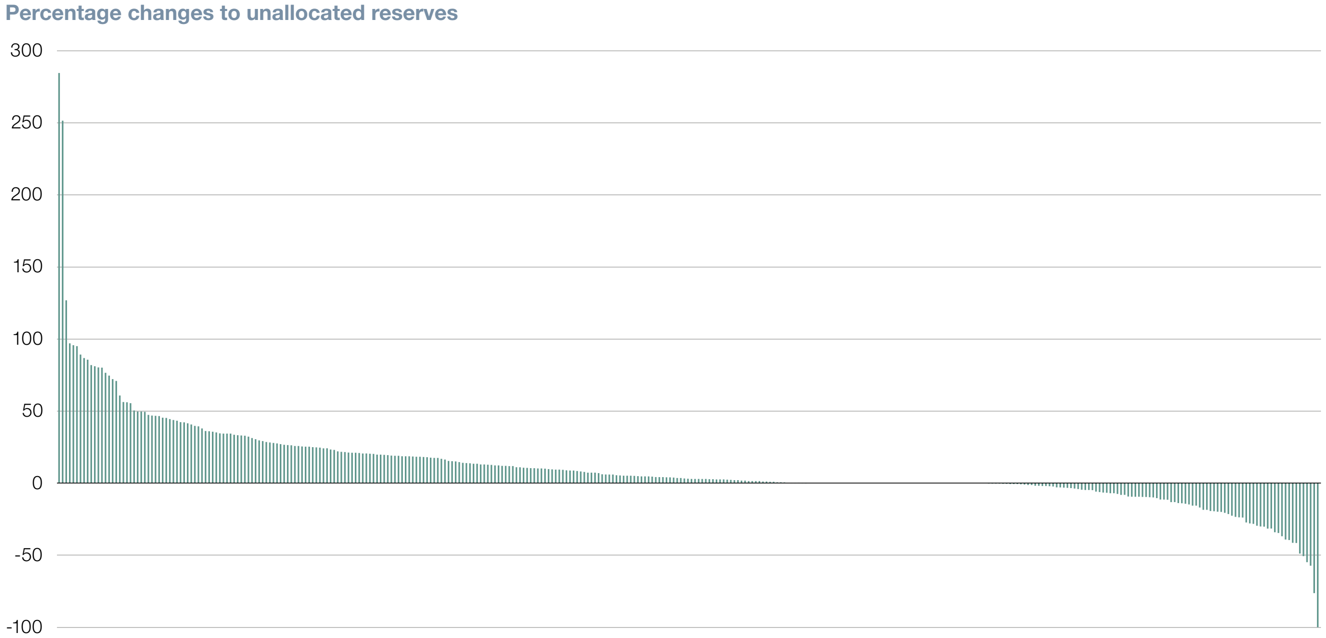
2.10 Local authorities have increased their unallocated general reserves over the last three years, adding £0.7 billion in 2011-12. **Figure 6** shows that the majority of local authorities (209) added to their general reserves in 2011-12. In 2011-12, 93 local authorities used reserves, with 32 (9 per cent) using reserves in both 2010-11 and 2011-12. Local authorities that have used their reserves may, however, not have used them to balance their budgets but to earmark them for specific purposes. This suggests that for most local authorities the primary method of balancing their budgets was reducing spending.[14]

2.11 We looked at whether local authorities using reserves were those with lower levels to begin with. There is no universally accepted level of reserves for a local authority, but we looked at those in the lowest quartile in terms of reserves as a proportion of revenue spending in 2009-10. Five of the 88 authorities in that quartile used reserves in 2010-11 and 2011-12.

Figure 6

Net change to unallocated general reserves as a proportion of total general reserves, 2011-12

Local authorities have increased their levels of unallocated general reserves, but there is considerable variation among local authorities



Source: Local authority revenue outturn data 2011-12

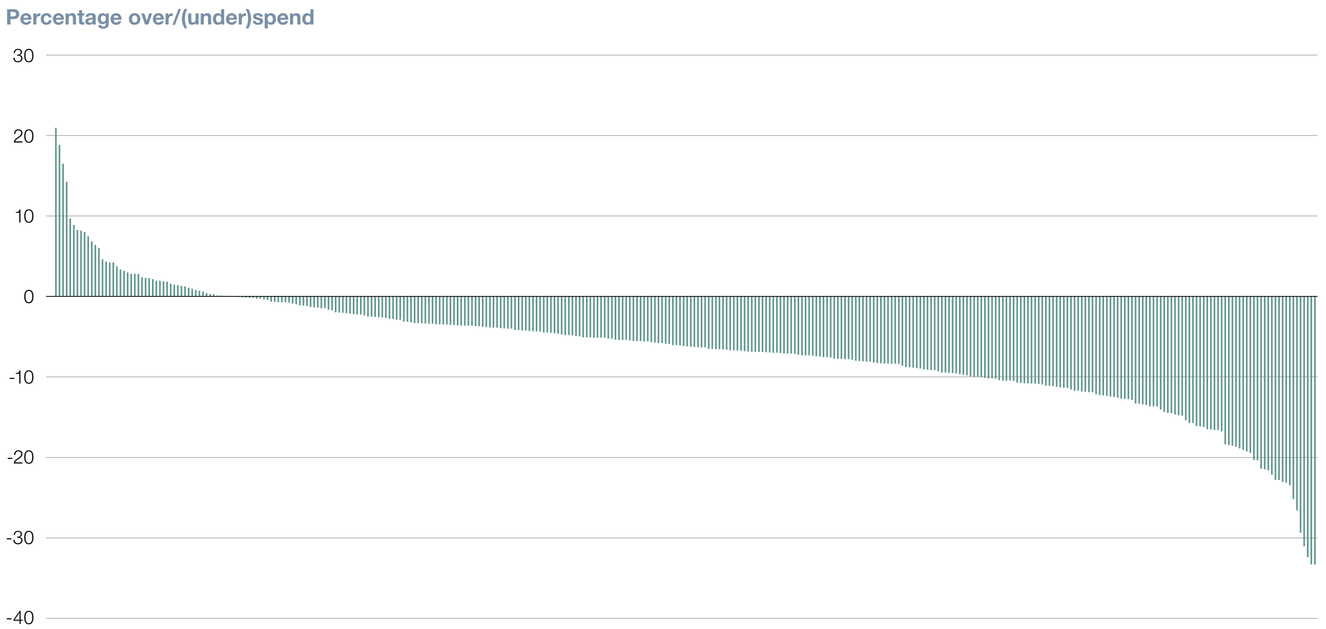
14 The figures in this paragraph are in cash terms.

Local authority performance against budget

2.12 Overspend against budget may show an authority is struggling to make planned reductions; this could, for example, reflect unexpected demand, or financial management difficulties. Local authorities in England underspent on average by 5.4 per cent against budget in 2011-12. **Figure 7** shows the distribution of over and underspends across local authorities. More than 300 local authorities underspent, but looking at performance over time provides a clearer indication of how well local authorities are managing. Some 24 overspent in both 2010-11 and 2011-12.

Figure 7
Local authorities' performance against budget, 2011-12

More than 300 local authorities underspent in 2011-12 against their budget



NOTE
1 One local authority has been excluded due to a data error.

Source: Local authority net revenue expenditure figures in revenue account and revenue outturn data, 2011-12

Part Three

Maintaining financial sustainability

3.1 This part sets out factors influencing medium-term local authorities' financial sustainability. As with the wider economy, local authorities face significant financial challenges, and these pressures are likely to increase. In the December 2012 *Autumn Statement*,[15] HM Treasury announced that public spending to 2017-18 will continue to be reduced at the same rate as over the 2010 spending review period. At the same time, demands for higher-cost local services – social care, for example – are increasing.

3.2 Local authority financial sustainability will depend increasingly on:

- Central government and local authorities managing the financial risks and opportunities.
- Central government making informed funding decisions, by understanding the financial and service delivery circumstances of local authorities, and responding in the light of performance.

Managing the financial risks and opportunities

3.3 This section of the report identifies factors that, depending on how well they are managed, could affect local authorities' financial sustainability. It focuses on:

- having to make savings while demand rises; and
- changes to the system of government funding for local authorities.

The need for savings in the face of rising demand

3.4 Local authorities are continuing to reduce spending to make the savings required in the spending review period to March 2015, and still have to make about half the savings required (paragraph 2.3). This is broadly consistent with information from our contacts with local authorities. Although not necessarily representative, 52 local authorities that responded to our survey estimated that 36 per cent of the total savings identified over the spending review period remain to be delivered, between April 2013 and March 2015. In addition, 34 had not identified how they were going to balance their budgets in 2014-15 with, where they were able to estimate it, the gap ranging from 1 per cent to 14 per cent.

15 HM Treasury, *Autumn Statement 2012*, December 2012, available at: http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf

3.5 Most local authorities expected to achieve the largest savings through efficiencies, though nearly all expected reductions to services to make at least some contribution to their savings targets. Our discussions with local authorities produced a number of examples of steps taken to make savings (**Figure 8** shows three of these).

3.6 The demand for local authority services is affected by factors such as population growth and economic circumstances. One of the ways to manage these pressures for a local authority is to change the eligibility criteria for a given service.

3.7 Local authorities can, for example, change adult social care provision from a service eligibility threshold of 'low' or 'moderate' to a higher threshold of 'substantial' or 'critical'. There has been an upward trend in the last eight years of local authorities raising these eligibility thresholds. By 2012-13, 85 per cent of local authorities had set eligibility at the highest two thresholds (**Figure 9**). This limits the scope for those authorities to find future savings by managing demand in this way.

Figure 8

Examples of local authority savings programmes gained from discussions with senior local authority officers

Norwich City Council

Between 2009-10 and 2012-13, Norwich City Council reported that its transformation programme made savings of £20 million (equivalent to more than a 33 per cent reduction in its general fund spend). Measures to make savings include renegotiating its IT contract, sharing back-office functions, reducing the number of council offices, and reducing non-core services such as grass verge cuttings.

Cambridgeshire and Northamptonshire County Councils: Local Government Shared Services

In 2010, Cambridgeshire and Northamptonshire County Councils (combined revenue expenditure £807 million in 2011-12) formed Local Government Shared Services, a venture designed to share services with each other and other local authorities. The councils forecast to have made cumulative savings of £9.5 million by the end of 2012-13, some 11.4 per cent of the venture's initial running costs. They are making savings by reducing staff, reducing the amount of leased office space, and re-tendering IT contracts. During 2012, Local Government Shared Services entered into partnership agreements with Norwich City Council to provide finance and IT services, and claimed to have secured immediate annual savings of £1.5 million.

London Borough of Brent

Brent's 'One Council' programme was reported to enable Brent to deliver £15.6 million in savings in 2010-11, representing 6 per cent of Brent's total general fund budget of £265.5 million. Brent is forecasting annual savings of £2.6 million by bringing all staff under one roof. It has also joined a group of six local authorities, which are making savings by jointly purchasing adult social care.

NOTE

1 All figures are in cash terms.

Source: National Audit Office

Figure 9

Local authorities setting eligibility thresholds for adult social care of ‘substantial’ or ‘critical’, April 2005 to March 2013

An increasing number of local authorities since 2005-06 only offer social care to residents with ‘substantial’ or ‘critical’ needs

NOTE

1 This figure only applies to those 152 local authorities which deliver social care.

Source: National Audit Office analysis of Commission for Social Care Inspection, Care Quality Commission and Association of Directors of Adult Social Services data

3.8 When local authorities change their service levels, they must be able to show they are meeting their statutory obligations. As part of a wider package to save £300 million over four years, Birmingham City Council planned in 2011 to fund adult social care only for those whose needs were judged to be ‘critical’. A judicial review found the Council undertook inadequate analysis to understand the impact of this decision versus the alternatives for making savings elsewhere. It ruled that the decision-making and consultation processes failed to ask the right questions, and found the decision to be unlawful. This led to the Council reinstating its adult social care services for people with ‘substantial’ needs and looking for savings elsewhere.

3.9 Service level changes in one area can affect another. Recent research has demonstrated, for example, that greater spending on social care is related to lower delayed hospital discharge rates and emergency readmissions.

3.10 Library services are also coming under pressure. In a recent report, the House of Commons Culture, Media and Sport Committee drew attention to findings of a local authority survey carried out by the Chartered Institute of Library and Information Professionals.[16] This showed that across the 82 authorities which responded, in 2011-12, library budgets were reduced by £37.7 million (a 7.3 per cent drop in cash terms from the year before). Of those that responded, 84 per cent expected to reduce staff, with 14 per cent expecting to close libraries, in 2011-12. The Committee noted that a number of local authorities faced judicial reviews as a result of deciding to close libraries.

Changes to the system of funding local authority services

3.11 Paragraph 1.12 and Figure 2 show many changes that will alter the local government financial landscape. In the following paragraphs we focus on two major reforms planned for April 2013:

- Financially the most significant change is that, as a result of the local government resource review, the Department for Communities and Local Government (the Department) is ending the Formula Grant system and changing how it distributes business rates (£21.5 billion in 2010-11) to local government.
- Council tax support will be localised, replacing council tax benefit (£4 billion in 2010-11), and funding for it will 'roll into' the funding system replacing the Formula Grant.

Business rates

3.12 The objective of the local government resource review is to give local authorities greater power over their funding and reduce reliance on central government as the major provider of financial support. Business rates are one of the main sources of funding for local authorities. These are collected locally then pooled nationally, to be redistributed to local authorities through the Formula Grant. The Formula Grant is allocated according to a formula that considers local authorities' needs and ability to raise resources through council tax.

3.13 The Department is changing this system. From April 2013, local authorities will keep a share of any growth in business rates in their area as an incentive to promote local business growth. Local authorities as a whole[17] will retain approximately fifty per cent of business rate income (the 'local share'). They will pay the remaining amount into a central government pool (the 'central share') to be redistributed to local authorities through a grant called Revenue Support Grant.

16 HC Committee of Culture, Media, and Sport, *Library closures*, Third Report of Session 2012-13, HC 587, November 2012.
17 This includes fire authorities.

3.14 The Department is aiming to smooth the transition from the old system. It will ensure that each local authority's allocation for the first year (2013-14) is similar to what it would have received in that year, had the Formula Grant continued. For this the Department calculated for each individual local authority its Revenue Support Grant entitlement and, for the purpose of establishing a funding baseline for the new rates retention scheme, the amount of business rates that it should retain. Authorities expected to collect more business rates than their baseline will pay the difference to central government as a tariff, which will be used to pay for a top-up for authorities estimated not to raise enough business rates relative to their funding baseline. These tariffs and top-ups will be increased by inflation but otherwise are fixed until 2020.

3.15 As tariffs and top-ups are fixed under the new funding arrangements, local authorities that achieve business rate income above their baseline will benefit from the new arrangements. Those authorities that see a fall to below their baseline will have to absorb it. There will be a safety net mechanism so that no local authority's business rate income falls below a certain threshold. The Department is planning to set the threshold in 2013-14 at 7.5 per cent of authorities' baseline funding levels. This baseline figure will in future years be increased in line with inflation.

3.16 The Department modelled the effects of the business rates change to understand the impact of varying the split between the central and the local share, which local authorities would likely receive top-ups and which would pay a tariff, and the costs to central government of the safety net proposals. The main aims were to design the scheme so that there would be an optimum balance of tariff and top-up authorities,[18] and to assess how the safety net mechanism could be set to make it self-financing.

3.17 The new arrangements increase the incentives and opportunities for local authorities. There are also risks that local authorities will need to manage, and the Department will need to monitor. The Department intends to revisit the risks and terms of the new system in 2020:

- Under the current system the short-term risk associated with forecasting business rates rests with central government. From 2006-07 to 2010-11, the Office for Budget Responsibility has overestimated the net yield of business rates in four out of five years. In 2010-11, for example, aggregate business rates were £23.8 billion, £1.1 billion (4.5 per cent) lower than forecast. In 2011-12 receipts were again lower than forecast, though by a smaller amount (£0.4 billion or 1.7 per cent). From 2013-14, local authorities will share the risk associated with any overestimates in the national forecast of business rate.

18 In addition, the Department of Health undertook its own modelling at local authority level to understand the effect of the tariff and top-up system on individual local authorities' ability to provide adult social care.

- Under the current system costs from increased service needs are spread among all local authorities, with those local authorities judged to have higher needs receiving more funding. After the 2013-14 transitional year, allocations to local authorities from the central share will no longer be recalculated annually to include changes in relative need, including the ability to raise council tax. Local authorities with rising service needs and low or negative growth in their business rates will have to manage this within their individual budgets.
- Business rates income has been volatile across individual local authorities. Local authorities will soon have to manage the impact of volatility for half of its impact from business rates (the local share) up to the safety net. This increases the income uncertainty for local authorities and increases their planning challenge and financial risk which may impact on the level of reserves needed.

Localisation of council tax support

3.18 In 2010-11 the Department for Work and Pensions provided funding of £4 billion for council tax benefit. From April 2013, local authorities must implement their own council tax support schemes instead of paying benefits set by the government. In preparation, the Department for Communities and Local Government modelled, for individual local authorities, how much they could save if they reduced council tax discounts for non-pensioners. It also analysed the impact of reducing funding for council tax benefit by 10 per cent on local authorities' budgets.

3.19 Under the new arrangements the central government funding available nationally to local authorities will be 90 per cent of what it would have been in 2013-14. Rather than being paid as a demand-led grant as under the current system, this funding will be 'rolled into' the new revenue funding system replacing the Formula Grant system. This presents risks local authorities will need to manage:

- Council tax benefit claimant numbers have been on a rising trend, including a rise of 10 per cent from April 2009 to March 2011, which has levelled off in the last year. In future, local authorities will have to manage any changes in council tax benefit claimant numbers. The forecasts published by the Office for Budget Responsibility show a fall in council tax benefit claimant numbers, due to factors such as increased pension age and projected recovery from recession.
- Local authorities have flexibility about how much of the 10 per cent funding reductions they absorb themselves, and how much they pass on as benefit reductions to working age claimants. To the extent they maintain existing entitlements they will have to find corresponding savings elsewhere. Where they pass on some or the entire shortfall to claimants, they will face difficult decisions in how they design their schemes. One potential risk, highlighted to us in interviews with local authority finance directors, was that if they reduce the support they give unemployed claimants, this might lead to collecting small amounts of council tax from residents who were previously exempt. This would increase the cost of council tax collection.

Cumulative effect of changes

3.20 The cumulative effects of these changes will vary and depend on wider economic conditions. Local authorities with higher economic growth may experience a rise in business rate income and a fall in council tax support claimants. Conversely, if local authorities experience economic decline business rates income may fall, and the number of council tax support claimants may rise. It will therefore be increasingly important to evaluate and monitor the combined effects of changes that affect local authorities as a whole and individually.

3.21 The Department for Communities and Local Government has recently started to provide the basis for such an analysis, by assessing the combined impacts of a range of changes, such as the reform to the distribution of business rates and the localisation of council tax support, on the financial risk profile of individual local authorities. The Department should further build on this work to understand the impact of funding changes on local authorities' overall financial position.

Informed decision-making

3.22 Central government's decisions have a fundamental impact on the financial position of local authorities and the services they provide. The levels and methods of government funding, and restrictions on local authorities' flexibility to increase council tax without seeking the approval of the local electorate, directly influence the spending power of local authorities. In addition, central government policies are implemented through statutory service obligations on local authorities. Central government has sought to reduce the information burdens from central departments on local government, for example by abolishing the Comprehensive Area Assessment. It is therefore important that departments understand whether the information they collect is the right information they need to assess the potential and actual effects of their decisions.

3.23 Our work shows departments have worked to assess the potential effects of business rates reform and council tax support localisation (paragraphs 3.16 and 3.18). Departments were also engaged in the thinking that led to the funding reductions as a result of the 2010 spending review.

3.24 HM Treasury, the lead department for the spending review, asked departments to propose a range of savings options. The Department for Communities and Local Government coordinated the spending review input on local government funding. The Department liaised with other departments with policy responsibilities for the local services that central government funds – the Department of Health, the Department for Education, the Department for Environment, Food and Rural Affairs, and the Department for Transport.

Information used for the spending review

3.25 The Department for Communities and Local Government asked the other departments to estimate local authorities' funding pressures, and how they could reduce spending by 25 per cent and 40 per cent. Departments modelled pressures on costs, how much could be saved through efficiency measures, and how much local authorities could save if they reduced or changed services while meeting their statutory responsibilities. Understanding the scope for efficiency savings is important to assess the level of funding reductions that can be absorbed without affecting services.

3.26 We looked at the information that three of the five departments involved in this exercise used. We did not assess the detailed methods used; our focus was on the scope of their analysis.

3.27 Consistent with our report on *Managing budgeting in government*,[19] which looked at a larger sample of spending review submissions, not all these departments could give the full range of information (see **Figure 10**). For example, the Department for Education could not give an estimate of cost pressures and the scope for savings across the entirety of children's services. The Department for Education told us that while it monitors national and local spending on children's services, it considered that it was not appropriate to model cost pressures and potential savings for the spending review at an aggregate level, as local authorities have discretion in how they discharge many of their statutory duties.[20] It did, however, consider pressures and scope for efficiencies in a number of major areas of spend, such as services for 'looked after' children. In this case, therefore, the Department for Communities and Local Government assumed that the aggregate cost pressures for children's services would not be greater than inflation, and that local authorities could make savings at a flat rate of 15 per cent over the spending review period.

3.28 In addition, departments did not break down their analyses to identify regional or other variations. For example, they did not consider the demand for, or cost of, services and therefore how far individual local authorities could make the estimated savings.

3.29 The Department for Communities and Local Government assessed the scope for local efficiencies in setting the overall level of the Formula Grant. However, it was not based on explicitly assessing local authorities' statutory service obligations. This is a complex area. There is no direct link between statutory obligations and the cost of services, because local authorities mostly have freedom to decide how to provide services and the priority they give them.

19 Comptroller and Auditor General, *Managing budgeting in government*, Session 2012-13, HC 597, National Audit Office, October 2012, available at: www.nao.org.uk/publications/1213/managing_budgeting.aspx

20 Separate to the spending review, the Department for Education has worked with the Association of Directors of Children's Services to share good practice in reducing the costs of providing children's services.

Figure 10
Information used as part of the 2010 spending review

Departments provided a range of information to HM Treasury and Department for Communities and Local Government during the 2010 spending review process

	Department of Health	Department for Education	Department for Environment, Food and Rural Affairs
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	✔	✓	✓
Analysis broken down by region or types of local authorities	✗	✗	✗

✔ department provided a monetary or quantitative description

✓ department provided a non-monetary or qualitative description

✗ department did not provide this analysis

NOTE

1 While the Department for Education did not provide quantitative descriptions on an aggregate level for children's services, it undertook cost modelling for individual children's services, such as costs associated with services for 'looked after' children.

Source: National Audit Office analysis of departments' submissions to HM Treasury during the 2010 spending review

Deciding the priorities

3.30 An important part of the government's work in deciding the level of the Formula Grant, in total and for individual local authorities, was to decide policy priorities and the weight attached to individual service areas. The pressures on providing care for adults and children are increasing, along with increases in other areas such as households falling within the statutory definition of homeless (up 45 per cent from 2010). In July 2011, the Commission on Funding Care and Support projected that, without change to the current system of adult social care, the cost of this service would rise from £14.5 billion in 2010-11 to £19.0 billion by 2020-21. In addition, in the period 2007 to 2012, local authorities saw an 11.8 per cent increase in 'looked-after' children.[21]

21 'Looked after' refers to those children who are taken care of by the state.

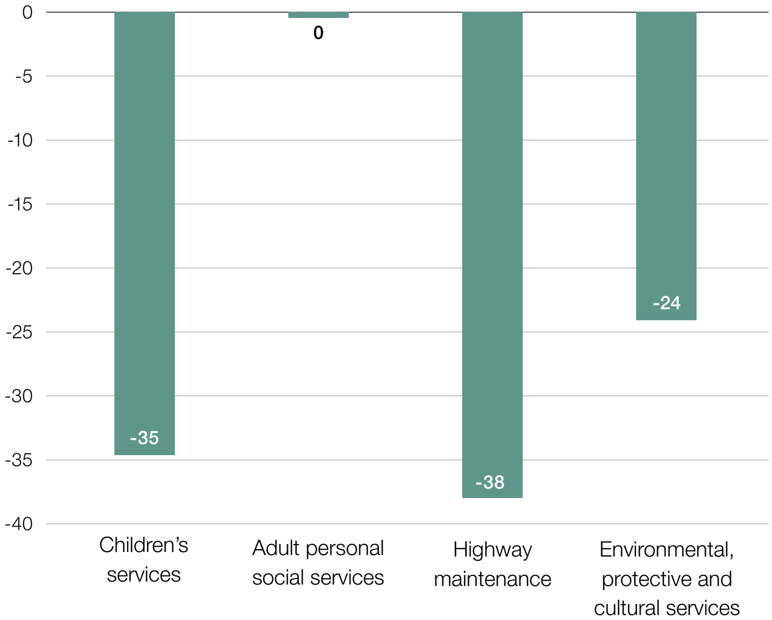
3.31 Figure 11 shows that the government attached the highest priority to adult social services in deciding on one of the key elements of the formula determining the distribution of the Formula Grant, the weight given to the various relative service needs.[22] In practice, local authorities decided to spend their income differently. For the three years ending in 2012-13, the lowest reduction in local authority spending is for children's services (Figure 5). Some local authorities we spoke to attributed this to increased demand for children's services and their concern to avoid the human and reputational risks attached to the failure of that service.

Figure 11

Changes to the weight given to the relative service needs in the Formula Grant formula, April 2010 to March 2013

The government decision to 'protect' the relative needs in adult social care in the calculation of the Formula Grant allocation led to larger reductions in the weight given to other relative service needs

Percentage change in the shares of relative service needs in the Formula Grant formula over the period April 2010 to March 2013



NOTE

1 Figures rounded to the nearest percentage point.

Source: National Audit Office calculation using Annex E from the annual local government finance reports for 2010-11 to 2012-13

22 The government allocates the Formula Grant to local authorities, among other factors, based on the relative needs of each local authority by service. Each service has its own relative needs formula, which takes into account the different factors affecting the cost of the delivery of the various local services. This relative needs formula allows each local authority's relative need share to be calculated. The percentage reduction in the shares of each local service do not equate to a specific grant reduction for these service areas, because the relative needs formulae are only one component of the elements that determine the Formula Grant a local authority receives. The final allocation of the Formula Grant depends also, for example, on the relative ability of the local authority to raise council tax, and on other grants being rolled into the Formula Grant.

3.32 As the Formula Grant paid to local authorities is 'un-hypothecated' (meaning they have complete discretion over how to spend it in meeting their responsibilities), local authorities do not have to spend it in line with central government priorities. Central government also does not expect local authorities to spend their resources in line with its priorities. It will be important, however, for the Department for Communities and Local Government to understand why local authority spending patterns are different from central government priorities to be able to adequately inform future funding decisions.

Maintaining financial sustainability and understanding financial failure

3.33 We considered a range of indicators, such as levels of local authority reserves and projections of service demand, to see what they showed about financial sustainability. Individually and collectively, however, they proved inconclusive. Moreover, financial sustainability depends on factors that go beyond the financial balance sheet. These include the strengths of financial management and governance arrangements. Coming to a view of the likely financial sustainability of a local authority using a single set of indicators is therefore problematic, and needs to consider local circumstances.

3.34 The Audit Commission surveyed local authority auditors and analysed budget outturns. It estimated that, in 2011-12, 9 per cent of local authorities experienced 'high financial stress' – meaning that they undertook unplanned in-year financial actions, for example using reserves, and were considered by their auditors as having had financial problems. Local auditors identified 12 per cent of local authorities were at an ongoing risk of being unable to balance their budgets in future financial years.[23]

3.35 In its *Accountability System Statement*, the Department for Communities and Local Government's (the Department's) Accounting Officer (the Permanent Secretary) sets out arrangements for giving accountability to Parliament for its spending on local government.[24] In addition, other departments that give grants to local authorities have also produced statements about local government which set out the accountability arrangements for the local services within their policy responsibility.

3.36 The Department's *Accountability System Statement* emphasises preventing failure through local government systems. Most important of all of these is the role of democratically elected members of local authorities acting in full council, cabinet or, in the case of a directly elected mayor, using their executive powers. To support this, there is the role of scrutiny committees, local authority audit committees, and systems of internal control captured in the council's standing orders and associated regulations.

23 See Audit Commission, *Tough Times 2012*, November 2012, p. 36, available at: www.audit-commission.gov.uk/nationalstudies/localgov/Pages/toughtimes2012.aspx

24 Department for Communities and Local Government, *Accounting Officer Accountability System Statement for Local Government*, March 2012, available at: www.gov.uk/government/uploads/system/uploads/attachment_data/file/6264/2110027.pdf

3.37 This structure is supported by the council's appointed officers. In particular, at the core of the council there are three corporate officers that each local authority must have by statute. These are the head of paid service (usually the chief executive), the monitoring officer (usually the chief legal officer), and the chief financial officer as determined by section 151 of the Local Government Act 1972 (usually the Director of Finance or Resources).

3.38 The section 151 officer is particularly important for financial sustainability. If a local authority does not set a balanced budget or spending materially exceeds the budget, the section 151 officer is obliged to make a report (called a section 114 report). The council is required to meet to discuss the report. This power has the effect of forcing the council to take action to bring the budget back to balance. Section 114 reports have rarely been made in recent years and are, generally, considered to be an action of last resort. The power has been in place for more than 20 years. That it has rarely been used may suggest that the mechanisms in place for managing financial pressure locally have been reasonably effective against the circumstances local authorities have faced so far.

3.39 Informed decision-making requires a feedback loop so that adjustments can be made in the light of performance, with evidence of potential difficulties being identified early enough to allow timely intervention. The Department has a range of information to help identify the impending financial failure of a local authority:

- In our 2012 report, *Central government's communication and engagement with local government*,[25] we found that local authorities viewed positively the Department's arrangements for around 70 'locality leads'. These senior officials spend between 5 and 10 per cent of their time familiarising themselves with authorities in a region, sharing information and good practice, and facilitating access including to other government departments. The informal contacts they make give them insight into the challenges, including financial challenges, local authorities are facing.
- The Local Government Association[26] coordinates support to local authorities, including peer challenges to help them improve performance. The Association has also developed an online tool, LGInform, which draws together comparative data across all local authorities. The tool is currently available to all local authorities but from summer 2013 will be available to the public and allow all users to compare performance and spend information. The Association meets with departmental officials to discuss matters of general concern to local government.
- Local auditors give an annual conclusion on arrangements to secure value for money and financial resilience which is published as part of the auditor's report on the accounts. The auditor will report to the council if there are any issues arising from their value-for-money work. The Department does not systematically review all audit reports but may consider them on an ad hoc basis if serious issues arise.

25 Comptroller and Auditor General, *Central government's communication and engagement with local government*, Session 2012-13, HC 187, National Audit Office, June 2012, available at: www.nao.org.uk/publications/1213/central_and_local_government.aspx

26 The Local Government Association is a voluntary membership organisation representing councils and councillors, funded by government grants and member subscriptions.

3.40 Under section 15 of the Local Government Act 1999, the Secretary of State has powers to intervene by directing an authority to take particular actions, and ultimately by directing another body to take over a council's specific functions. Such intervention is the last resort. The last time this happened was in the case of Doncaster Metropolitan Borough Council following a corporate governance investigation by the Audit Commission in 2010.

3.41 This, and other past cases of central government intervention, have generally related to failures in services or corporate governance, or both, rather than to councils being in financial difficulty. Within the past year evidence of councils at risk of becoming financially unviable has emerged, but it is too early to say whether this represents a trend of councils becoming financially unsustainable. The most widely reported examples so far are:

- West Somerset District Council, which is at risk of being unable to provide its statutory services to an acceptable minimum; and
- Birmingham City Council, which has indicated that a potential liability of over £750 million in equal pay claims against the Council would impact on its financial resilience and the resources available to provide services.

3.42 The interventions to date have largely dealt with individual local authorities. To date there has not been widespread financial failure in the sector. How the system responds in the case of multiple failures during possibly more challenging times for local authorities is therefore at present untested.

Appendix One

Our audit approach

1 This study gives an overview of the reductions and reforms to the funding of local authorities during the 2010 spending review period. Its focus is on the implications of these changes to funding on the financial sustainability of local authorities, which we define as meeting their financial and service obligations.

2 There were three main elements to our work:

- We analysed the key implications of these funding reductions and reforms on local authority income.
- We analysed how local authorities have managed their budgets in the first two years of the spending review.
- We reviewed what information government departments have to understand the impact of the reforms and local authorities financial sustainability.

3 Our audit approach is summarised in **Figure 12**. Our evidence base is summarised in Appendix Two.

Figure 12
Our audit approach

The objective of government

Central government's objective

Over this spending review period, the government intends to reduce funding of local government while giving local authorities more spending flexibility and incentives to promote local growth.

Local government's objective

Local authorities are subject to statutory requirements to provide a range of services while balancing budgets, and remaining accountable to their local electorate.

How this will be achieved

The government is reducing funding for local authorities while reforming business rates, and removing the ring-fencing for some grants.

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

Our study

The study examined the implications of funding reductions and reforms on local government financial sustainability, and the information central government has on the impact of funding changes and about local government financial sustainability.

Purpose of our examination

To determine the implications for local authority finances.

To review how far departments understand the impacts of funding changes.

To analyse how local authorities are responding to funding changes.

Our evidence

(see Appendix Two for details)

We examined departmental documents, nationally available data sets on local authority finance and interviewed officials.

We interviewed officials and reviewed departmental documents.

We interviewed finance directors, treasurers' societies, and stakeholders; analysed local authority financial positions; and surveyed finance directors.

Our conclusions

So far, local authorities have generally been able to absorb central government funding reductions. However, there is emerging evidence that some service levels are reducing. Funding reductions are continuing, along with changes to the resourcing mechanism of local authorities. These changes increase financial uncertainty and more local authorities are facing the challenge to avoid financial difficulties while meeting their statutory responsibilities. This risk will not manifest itself evenly across the sector, with some local authorities being more affected than others.

This risk must be identified early so it can be managed effectively. The Department for Communities and Local Government will need arrangements to detect where risks will emerge. Its response will need to be flexible and coordinated with local and sector-wide support mechanisms. Central government must also satisfy itself that it understands the cumulative impact of funding changes and can make informed decisions about the funding required for local authority services.

Appendix Two

Our evidence base

1 Our independent conclusions arising from our report on financial sustainability of local authorities were reached following our analysis of evidence collected between June and December 2012.

2 We applied a range of quantitative and qualitative techniques in our examination. Our audit approach is outlined in Appendix One.

3 We analysed key national data sets for local authority finances, including the Department for Communities and Local Government *Local Government Finance Statistics England* and local authority revenue account and revenue outturn data which the Department for Communities and Local Government collects.[27] The *Local Government Finance Statistics England* contains the latest authoritative figures on local government grants. However, as the most recent publication (June 2012)[28] only covers 2010-11, we could only provide figures for that financial year in our overview of local government finances in Part One.

4 We estimated the proportion of 2010 spending review savings that local authorities achieved by comparing their planned reduction in their revenue expenditure between April 2010 and March 2013 with HM Treasury's forecast reduction in local government spending announced during the 2010 Spending Review. The Audit Commission provided us with local authorities' revenue spending figures, based on their analysis of local authorities' revenue account data. This showed that local authorities reduced their spending by £4.6 billion from April 2010 to March 2013. In their *Tough Times 2012* report the Audit Commission provides a figure of £5 billion for the equivalent period. This difference is due to the Audit Commission including 2010-11 in-year cuts and local authorities' planned use of reserves in their calculation, presenting the figures at 2012-13 prices, and excluding council tax.

27 For 2011-12, we used provisional revenue outturn data.
28 Department for Communities and Local Government, *Local Government Finance Statistics England*, Number 22, June 2012, available at: www.gov.uk/government/publications/local-government-financial-statistics-england-no-22-2012

5 We report the proportion of total expenditure for each local service area and the change in service expenditure by local authority service area based on analysis and data provided by the Audit Commission. In their *Tough Times 2012*, the Audit Commission used the same data to calculate change in service expenditure by local authority service area. However, the Audit Commission presented median changes in service area spend rather than aggregate changes across all local authorities. As a result the figures presented in *Tough Times 2012* differ slightly from the figures presented in our report.

6 We examined departmental documents setting out the details of a number of funding reductions and reforms:

- Reductions in overall central government funding to local government over the spending review period.
- Reforms to business rates.
- Localisation of council tax support.

7 We reviewed how government departments modelled and monitored the impacts of these funding reductions and reforms on local authority financial sustainability.

8 We conducted 27 semi-structured interviews with central government staff to understand:

- how far departments monitor local authorities' financial sustainability and statutory service delivery; and
- departmental accountability and assurance regimes.

9 We reviewed files of published and internal departmental documents to assess how departments considered local authorities' financial sustainability and statutory service delivery, including:

- accountability system statements;
- business planning papers and spreadsheets;
- consultation documents and impact assessments; and
- modelling of reforms to funding.

10 We conducted analysis on data of local authorities' eligibility thresholds for adult social care collected from Commission for Social Care Inspection, Care Quality Commission and Association of Directors of Adult Social Services. We are aware that Age UK has published data on eligibility thresholds for adult social care by local authority.[29] This data shows minor differences in some years when compared to the data we used. However, Age UK does not provide data for the years 2008-09, 2009-10 and 2012-13 which is why we have used different data sources. Please also note that in 2008-09, 2010-11 and 2011-12, the Care Quality Commission and the Association of Directors of Adult Social Services received a 98 per cent response rate, while in 2012-13, the Association of Directors of Adult Social Services received a 95 per cent response rate. We have also used research carried out by Jose-Luis Fernandez and J. Forder which demonstrates that greater spending on social care is related to lower delayed hospital discharge rates and emergency readmissions.[30]

11 We conducted eight semi-structured interviews with local authority financial directors (and one chief executive). The purpose of the visits was to understand each local authority's financial position and operating context, and how they responded to central government funding changes. We visited:

- Boston Borough Council (District);
- Brent Council (London Borough);
- Cheshire East Council (Unitary);
- Kirklees Council (Metropolitan);
- Norwich City Council (District);
- Nottinghamshire County Council (County);
- Wandsworth Borough Council (London Borough); and
- Westminster City Council (London Borough).

12 We conducted semi-structured interviews with representatives from the five societies of local authority treasurers to hear their views about central government funding changes:

- Society of District Council Treasurers
- Society of County Treasurers
- Society of London Treasurers
- Society of Municipal Treasurers
- Society of Unitary Treasurers

29 Age UK, Social care eligibility thresholds briefing, available at: www.ageuk.org.uk/Documents/EN-GB/For-professionals/Research/Eligibility_thresholds_briefing.pdf?dtrk=true.
30 Jose-Luis Fernandez and J. Forder, 'Consequences of local variations in social care on the performance of the acute health care sector', *Applied Economics*, vol. 40, Issue 12, 2008, pp. 1503–18.

13 We do not have the access right to local authorities. However, in an effort to capture the range of views across the local government sector we surveyed for the first time all local authority finance directors across England to understand existing and planned revenue expenditure and anticipated savings and budget gaps. We received 52 responses, a response rate of 15 per cent:

- London Councils: 15 responses;
- Unitary Councils: 10 responses;
- Shire County Councils: 10 responses;
- Shire District Councils: 8 responses; and
- Metropolitan District Councils: 9 responses.

14 We conducted semi-structured interviews with stakeholders with knowledge and expertise in local government finance to understand the implications of a range of funding reductions and reforms. We interviewed representatives from:

- the Local Government Association;
- the New Local Government Network;
- the Special Interest Group of Municipal Authorities;
- Grant Thornton;
- The Association of Chartered Certified Accountants;
- The Institute of Fiscal Studies;
- Local Government Futures; and
- London Councils.

15 Throughout the landscape review, we set up an expert panel that provided independent scrutiny and advice to the study team.

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