



National Audit Office

Report

by the Comptroller
and Auditor General

Department for Communities and Local Government

Financial sustainability of local authorities 2014

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.