National Audit Office

Report
by the Comptroller
and Auditor General

Ministry of Housing, Communities & Local Government

Financial sustainability of local authorities 2018

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Report by the Comptroller and Auditor General

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This report reviews developments in the sector and examines whether the Department, along with other departments with responsibility for local services, understands the impact of funding reductions on the financial and service sustainability of local authorities.

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Key facts

49.1%

real-terms reduction in government funding for local authorities, 2010-11 to 2017-18

28.6%

real-terms reduction in local authorities' spending power (government funding plus council tax), 2010-11 to 2017-18

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number of authorities since 2010-11 where a section 114 notice has been issued that indicates they are at risk of spending more than the resources they have available

3.0%	real-terms reduction in local authority spending on social care services, 2010-11 to 2016-17
32.6%	real-terms reduction in local authority spending on non-social-care services, 2010-11 to 2016-17
£901 million	overspend on service budgets by local authorities in 2016-17
66.2%	percentage of local authorities with social care responsibilities that drew down their financial reserves in 2016-17
10.6%	percentage of local authorities with social care responsibilities that would have the equivalent of less than three years' worth of reserves left if they continued to use their reserves at the rate they did in 2016-17
13	number of departments asked by the Ministry of Housing, Communities & Local Government to provide information as part of the 2015 Spending Review

Summary

1 Since 2010, successive governments have reduced funding for local government in England as part of their efforts to reduce the fiscal deficit. Changes in funding arrangements and new pressures on demand have created both new opportunities and further pressures for the sector.

2 Local authorities deliver a range of services. The government sets statutory duties for them to provide services, ranging from adult social care to waste collection. Local authorities also provide discretionary services according to local priorities. The Ministry of Housing, Communities & Local Government (the Department) views authorities' ability to deliver their statutory services as the defining test of their financial sustainability.

3 The Department has overall responsibility in central government for local authorities' funding. This includes:

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

4 Government policy dictates the overall levels and distribution of funding provided to the sector, and local authorities' statutory responsibilities.

5 While the Department is responsible for the financial framework for local government and developing an overview of the overall service cost pressures faced by local government, responsibility for statutory services delivered by local authorities is spread across government departments. Each department is responsible for establishing its own arrangements to assure itself that services remain sustainable and that statutory responsibilities are being met. These departments are also responsible for giving the Department information on services to support decision-making at major fiscal events.

6 In our previous work, we described the complex position of the Department in terms of delivering its functions in the context of the localism agenda.[1] Localism gives local authorities greater control over spending decisions, but consequently, the Department has less oversight over their financial sustainability.[2] The same challenge is faced by other departments with responsibility for local services.

7 This report reviews developments in the sector and examines whether the Department, along with other departments with responsibility for local services, understands the impact of funding reductions on the financial and service sustainability of local authorities. It is entirely compatible with the principles of localism to assess whether the Department and other government departments have enough information to make good decisions about the level and nature of funding provided to local authorities. While we recognise that departmental roles vary, we expect the Department and other government departments to have oversight and assurance mechanisms in place for their policy areas that enable them to understand when local authorities are under threat of being unable to discharge their statutory duties.

Our report

8 We reported on the financial sustainability of local authorities in 2013[3] and 2014.[4] This report updates and builds on that work. It has four parts:

- Part One sets out the financial and non-financial challenges faced by local authorities since 2010-11 and examines how they have responded.
- Part Two examines service sustainability by exploring changes in patterns of service spending and activity in local authorities.
- Part Three assesses levels of financial pressure and their implications for financial sustainability in the sector.
- Part Four assesses whether the Department and other departments are sufficiently informed about the risks and impacts from pressures in the sector and are managing those risks. This assessment is informed by our independent analysis of risks and impacts presented in the preceding parts.

A standalone methodology is available at: www.nao.org.uk/report/financial-sustainability-of-local-authorities-2018/.

1 Comptroller and Auditor General, *Financial sustainability of local authorities 2014*, Session 2014-15, HC 783, National Audit Office, November 2014.
2 Comptroller and Auditor General, *Local government funding: Assurance to Parliament*, Session 2014-15, HC 174, National Audit Office, June 2014.
3 Comptroller and Auditor General, *Financial sustainability of local authorities*, Session 2012-13, HC 888, National Audit Office, January 2013.
4 See footnote 1.

Key findings

Financial, demand and cost pressures

9 Government funding for local authorities has fallen by an estimated 49.1% in real terms from 2010-11 to 2017-18. This equates to a 28.6% real-terms reduction in 'spending power' (government funding and council tax). In the 2015 Spending Review and the 2017 Budget, the government provided extra funding to relieve growing spending pressures in adult social care. Consequently, the rate of reductions has levelled off since 2016-17 for social care authorities and is predicted to remain relatively flat until 2019-20 (paragraphs 1.4 to 1.6 and 1.10 to 1.13, and Figures 1 to 3).

10 Alongside reductions in funding, local authorities have had to deal with growth in demand for key services, as well as absorbing other cost pressures. Demand has increased for homelessness services and adult and children's social care. From 2010-11 to 2016-17 the number of households assessed as homeless and entitled to temporary accommodation under the statutory homeless duty increased by 33.9%; the number of looked-after children grew by 10.9%; and the estimated number of people in need of care aged 65 and over increased by 14.3%. Local authorities have also faced other cost pressures, such as higher national insurance contributions, the apprenticeship levy and the National Living Wage (paragraphs 1.15 to 1.21 and Figure 4).

11 Local authorities have changed their approach to managing reductions in income, shifting away from reducing spending on services to looking for other savings and sources of income. Local authorities have faced funding reductions for six years. For the first three years, authorities as a whole reduced spending on services at a rate in excess of their income reductions, allowing them to build up reserves. In the second three-year period, net reductions in service spending accounted for less than half of the required savings. Instead, in aggregate, local authorities have increasingly offset funding reductions by reducing other spending – including reducing the cost of servicing debt – reducing their net contributions to reserves or drawing them down, and increasing alternative income such as commercial trading profits or external interest (paragraphs 1.22 to 1.29 and Figures 5 and 6).

Service sustainability

12 Local authorities have protected spending on service areas such as adult and children's social care where they have significant statutory responsibilities, but the amount they spend on areas that are more discretionary has fallen sharply. Adult and children's social care services have seen a reduction of 3.3% and an increase of 3.2% in real terms, respectively. In contrast, spending on planning and development fell by 52.8% in real terms, with spending on housing services and highways and transport falling by 45.6% and 37.1% respectively. Spending on cultural and related services fell by 34.9% (paragraphs 2.2 to 2.3 and Figure 7).

13 **Local authorities now spend less on services, and their spending is more concentrated on social care.** Since 2010-11, spending on services has fallen by 19.2% in real terms. This is the net outcome of a 3.0% fall in spending on social care and 32.6% fall in spending on non-social-care services. Consequently, social care now accounts for 54.4% of service spend, compared with 45.3% in 2010-11 (paragraphs 2.8 to 2.9).

14 **Local authorities have tried to protect front-line services in their savings plans; while this has been successful in some areas, there are signs that services have been reduced in others.** In adult social care, the number of users accessing services fell steeply in the early years of funding reductions, and there is evidence that funding pressures in local authorities are adding to pressures within the wider health care system and adult care provider markets. Service provision in some non-social-care services has changed, including reductions in weekly domestic waste collection (a 33.7% reduction in the number of households receiving at least a weekly service between 2010-11 and 2016-17), miles of subsidised bus journeys (a 48.4% reduction from 2010-11 to 2016-17 in England outside of London) and libraries (a 10.3% reduction in the number of service points from 2010-11 to 2016-17). For many service areas, a lack of data on outputs and outcomes means it is difficult to assess the impacts of spending reductions (paragraphs 1.29, 2.21 to 2.28 and 2.32 to 2.33 and Figures 14 to 16).

Financial sustainability

15 **Compared with the situation described in our 2014 report, the financial position of the sector has worsened markedly, particularly for authorities with social care responsibilities.** We noted in 2014 that the sector had coped well financially with funding reductions, but our current work has identified signs of real financial pressure. A combination of reduced funding and higher demand has meant that a growing number of single-tier and county authorities have not managed within their service budgets and have relied on reserves to balance their books. These trends are not financially sustainable over the medium term (paragraphs 3.4 to 3.19 and Figures 17 to 23).

16 **Financial resilience varies between authorities, with some having substantially lower reserves levels than others.** Levels of total reserves in social care authorities as a whole are higher now than in 2010-11. However, there is variation in individual authorities' ability to build up their reserves and differences in the rate at which they have begun to draw them down. Some 10.6% of single-tier and county councils would have the equivalent of less than three years' worth of total reserves (earmarked and unallocated combined) left if they continued to use their reserves at the rate they did in 2016-17 (paragraphs 3.14 and 3.20 to 3.23, and Figures 20 and 24).

17 **A section 114 notice has been issued at one authority, which indicates that it is at risk of failing to balance its books in this financial year.** In February 2018, the statutory financial officer for Northamptonshire County Council issued a section 114 notice, indicating that it was at risk of spending more in the financial year than the resources it has available, which would be unlawful. The authority has effectively placed itself in special financial measures in order to ensure that it avoids unlawful expenditure. The Department had already appointed an inspector in January 2018 to look into financial management and governance at the authority (paragraphs 3.25 to 3.27).

The role of government in securing financial and service sustainability

Assessing funding need

18 **The Department's work to assess the sector's funding requirements as part of the 2015 Spending Review was better than the work it undertook for the 2013 Spending Review.** The Department's advice to ministers in 2015 drew on a more comprehensive evidence base, including data returns from 12 departments. At the conclusion of the Spending Review ministers took a cross-government view on the level of funding for local government, taking into account the other calls on government resources and the evidence provided by departments about potential risks of financial and service failure (paragraphs 4.3 to 4.8).

19 **As part of its work for the 2015 Spending Review, the Department identified adult social care as a key area of pressure in the sector.** Outcomes from the Spending Review included a new flexibility to increase council tax to pay for social care and the introduction of the Improved Better Care Fund. Since the Spending Review, the Department has continued to monitor pressures in this area alongside the Department of Health & Social Care. This has led to further funding to support social care. This funding has conditions associated with it which might limit some local authorities' flexibility to spend social care funding on local priorities (paragraphs 4.9 to 4.11 and Figure 3).

The financial model for the sector

20 **The government has announced multiple short-term funding initiatives in recent years and does not have a long-term funding plan for local authorities.** In 2016-17, the Department offered a four-year settlement to all authorities to enable better financial planning. However, there have been many changes to funding streams outside this core offer, such as the adult social care support grant and a second tranche of funding within the Improved Better Care Fund. The Department's view is that these are responses to new pressures and risks that have been identified by their monitoring. Ultimately, however, the funding landscape following the 2015 Spending Review has been characterised by one-off and short-term funding initiatives. There is also uncertainty over the long-term financial plan for the sector. The absolute scale of future funding is unknown until the completion of the next Spending Review. The government has confirmed its intention to implement the results of the Fair Funding Review in 2020-21 and to allow local authorities to retain 75% of business rates. However, the implications of these changes are not yet clear. Financial uncertainty, both short term and long term, creates risks for value for money as it encourages short-term decision-making and undermines strategic planning (paragraphs 4.19 to 4.24 and Figure 3).

The assurance system for financial sustainability

21 **The Department has improved its understanding of the extent to which local authorities are at risk of financial failure.** Since our 2014 study, it has improved its oversight of the financial sustainability of the sector. There is evidence that it is systematically collecting and using data and other forms of information and developing relationships with other key departments. It has robust internal reporting mechanisms and engagement from the highest level of management. There remain areas that can be strengthened, however. These include developing analytical work further and engaging more widely with other departments. Understanding and responding to the risk of failure protects value for money, as intervening after failure is likely to be more costly than preventing it in the first place (paragraphs 4.28 to 4.39).

The assurance system for service sustainability

22 **There is a lack of ongoing coordinated monitoring of the impact of funding reductions across the full range of local authority services.** The interdependent and connected nature of service delivery in local authorities is not reflected at the level of government departments. Individual government departments have an understanding of the service areas for which they are accountable, but not necessarily of the potential implications of pressures in other service areas locally. The Department has a role in developing an overview of the overall service cost pressures faced by local government. However, to date it has focussed its attention on priority areas such as social care rather than on understanding the impact of funding reductions across local authority services as a whole (paragraphs 4.38, 4.42 to 4.45, and 4.50 to 4.53).

23 **As funding continues to tighten for local authorities and pressure from social care grows, there are risks to statutory services.** In certain areas where data are limited, it may not be possible to ascertain whether service levels are being maintained. In other services where there are concerns about performance, departments need to coordinate actions to influence local authorities' prioritisation rather than simply place competing demands on authorities' diminishing resources (paragraphs 4.46 to 4.49, 4.51 and 4.54).

Conclusion on value for money

The Department

24 The sector has done well to manage substantial funding reductions since 2010-11, but financial pressure has increased markedly since our last study. Services other than adult social care are continuing to face reducing funding despite anticipated increases in council tax. Local authorities face a range of new demand and cost pressures while their statutory obligations have not been reduced. Non-social-care budgets have already been reduced substantially, so many authorities have less room for manoeuvre in finding further savings. The scope for local discretion in service provision is also eroding even as local authorities strive to generate alternative income streams. The current pattern of growing overspends on services and dwindling reserves exhibited by an increasing number of authorities is not sustainable over the medium term. The financial future for many authorities is less certain than in 2014. The financial uncertainty created by delayed reform to the local government financial system risks longer-term value for money.

25 The Department's performance has improved since our last study. The Department's work on the 2015 Spending Review was an improvement on its predecessors and the Department has improved its oversight of the sector's financial sustainability. However, conditions in the sector have worsened and the Department must continue to strengthen its oversight and assurance mechanisms to protect against risks to value for money from financial failure in the sector. It must also set out at the earliest opportunity a long-term financial plan for the sector that includes sufficient funding to address specific service pressures and secure the sector's future financial sustainability.

Wider government

26 The Department's capacity to secure the sector's financial sustainability in the context of limited resources is shaped by the priorities and agendas of other departments. The Department's improvements in understanding and oversight are necessary but not enough. Equally, because responsibility for services is dispersed across departments, each department has its own narrow view of performance within its own service responsibilities. There is no single central understanding of service delivery as a whole or of the interactions between service areas. To date, the current spending review period has been characterised by one-off and short-term funding fixes. Where these fixes come with restrictions and conditions, this poses a risk of slowly centralising decision-making. This increasingly crisis-driven approach to managing local authority finances also risks value for money.

27 The current trajectory for local government is towards a narrow core offer increasingly centred on social care. This is the default outcome of sustained increases in demand for social care and of tightening resources. The implications for value for money to government from the resulting re-shaping of local government need to be considered alongside purely departmental interests. Departments need to build a consensus about the role and significance of local government as a whole in the context of the current funding climate, rather than engaging with authorities solely to deliver their individual service responsibilities.

Recommendations

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

- work with other departments to develop more robust methods for assessing savings and efficiency options available for local authorities; and
- ensure that other departments are informed of the outcomes of the Department's final analysis and are aware of the possible implications for their service areas, to assist them in discharging their responsibilities for those service areas.

b **The Department, together with the Department for Education, should consider whether their current plans to improve their understanding of ongoing cost pressures in children's social care:**

- will provide a genuine understanding of developments in the sector; and
- are being carried out quickly enough given the current pressures in this service area.

c **The Department should work with the sector to ensure that the Department's current activity in areas such as retaining local business rates and the Fair Funding Review will enable it to develop a long-term plan that is genuinely able to address the current financial and demand pressures in the sector and to secure its financial sustainability.** As part of this, the Department should:

- engage with the sector to ensure that current plans are sufficiently timely, and assess whether interim measures are required in the meantime;
- use the next spending review to ensure that any new funding framework is based on a review of unfunded service pressures within the sector and an assessment of the absolute level of funding required to meet statutory responsibilities; and
- set out its long-term plans for the flexibility to increase council tax to raise money for adult social care and for the funding currently provided through the Improved Better Care Fund.

d **The Department should continue to build on its improved oversight of the sector's financial sustainability by:**

- continuing to develop its analytical work and subjecting this to external scrutiny where possible;
- ensuring that its risk analysis and reporting strike a balance between specific instances of leadership or governance failure in poorly performing individual authorities and systemic issues affecting broader elements of the sector; and
- broadening its engagement with other departments in order to understand pressures on funding and demand in a wider range of service areas.

e **The government, led by the Department, should:**

- develop a clear understanding of the role and significance of local authorities as a whole in the context of the current funding climate; and
- create an understanding of how funding pressures and increased demand for services are interacting locally and impacting on different services, improving the availability of service outcome data as necessary, and establish a coordinated approach to cross-government engagement with local authorities.