Tough Times 2013

Councils' responses to financial challenges from 2010/11 to 2013/14

November 2013

The Audit Commission's role is to protect the public purse.

We do this by appointing auditors to a range of local public bodies in England. We set the standards we expect auditors to meet and oversee their work. Our aim is to secure high-quality audits at the best price possible.

We use information from auditors and published data to provide authoritative, evidence-based analysis. This helps local public services to learn from one another and manage the financial challenges they face.

We also compare data across the public sector to identify where services could be open to abuse and help organisations fight fraud.

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Executive summary

This is the Audit Commission's third and final report examining the financial resilience of English councils. It is based on our latest analysis of financial data supplied by councils to government, and responses to a survey of the appointed auditors for all 353 single-tier, county and district councils.

Our research over the last three years has been set against the backdrop of a significant reduction in central government funding to councils as part of the government's overall deficit reduction programme. These funding reductions will continue beyond 2013/14, although their full extent is not yet known. Councils have also experienced real-terms reductions in other income, such as council tax, and face uncertainty from 2013/14 about the level of income from locally retained business rates.

Alongside reduced income, councils have been contending with rising demand for some services, especially social care. From 2015/16, councils will be expected to work in a more integrated way with local health partners to improve care services and achieve greater efficiency.

Our conclusion this year is that, in the face of financial challenges from 2010/11 to 2013/14, almost all councils have demonstrated a high degree of financial resilience. A small minority of councils, however, have found it harder to cope than others as funding levels have reduced. A few of these have been a source of concern to auditors in successive years.

With uncertainty about the future funding available to deliver services, councils cannot be sure what savings they will need to make. Auditors report that at least one in ten councils do not yet have plans for how they will address the expected gap between funding and spending in coming years. It is understandable, therefore, that auditors are less confident about the medium-term financial prospects of one third of councils.

Our research shows councils have already adopted a wide range of strategies in response to financial challenges. They have valuable learning to share from their savings initiatives to date. Where conventional strategies can no longer be relied on to deliver the savings needed, councils will need to innovate to develop new approaches to public service delivery that rely less on funding from government.

Councils must adapt in order to continue to provide services that meet their statutory obligations and the needs of their local communities with reduced levels of income. There will be ongoing risks for councils as they do so. As the Audit Commission is expected to close in March 2015, it will be for the government and others to find alternative ways to draw on the insights auditors can provide about the financial resilience of England's councils and remain vigilant for signs of financial stress.

Councils' spending in 2012/13

We examined councils' spending on non-education services in 2012/13 and how this differed from 2011/12.

- Councils spent £38.0 billion (net of fees, charges and other income) on services in 2012/13. More than half was used to fund social care services for adults and children.
- On average, single-tier and county councils (STCCs) spent 2.4 per cent less on services in 2012/13 than in 2011/12.
- District councils (DCs) spent 2.8 per cent less on average in 2012/13 than in 2011/12.
- During 2012/13, 63 per cent of councils increased reserves while 37 per cent reduced them.
- In aggregate, councils increased reserves by £0.9 billion in 2012/13 – a smaller increase than in 2011/12.

Financial stress in 2012/13

We asked auditors whether councils experienced significant difficulties, or took unplanned actions, in delivering the budgets they agreed for 2012/13.

- In the view of auditors, 89 per cent of councils experienced no significant difficulties in delivering the budget they agreed for 2012/13; but agreeing the budget and identifying how savings would be delivered was challenging for some councils.
- Auditors indicated that 17 per cent of STCCs and 6 per cent of DCs experienced significant difficulties in delivering their agreed budgets in 2012/13. The main difficulties were: overspending due to additional service demand; shortfalls in income; and not achieving planned savings.
- Three in ten councils (29 per cent) needed to take one or more unplanned actions during the year to deliver their budget.
  - Councils that took unplanned actions to deliver their budgets in 2011/12 were more likely to do so again in 2012/13.
- The unplanned actions most commonly taken in 2012/13 were:
  - reductions in service spend;
  - re-profiling/re-evaluation of the savings from major savings initiatives; and
  - reductions in staffing levels or restrictions on recruitment.
- Based on auditors' responses, three in ten councils (29 per cent) exhibited some form of financial stress in 2012/13; experiencing significant difficulties, needing to take unplanned actions, or both.
  - One in five councils (18 per cent) exhibited financial stress in both 2011/12 and 2012/13, including 25 per cent of metropolitan district councils and 24 per cent of unitary authorities.
  - 4 per cent of councils exhibited high financial stress in both years.

Councils' income in 2013/14

We looked at what income councils expected for 2013/14 when they were setting their budgets, compared with earlier years.

- From 2010/11 to 2013/14, government funding to councils reduced by £6 billion (19.6 per cent) in real terms.
  - Metropolitan district councils saw the largest aggregate reduction – 22.5 per cent.
  - County councils' saw the smallest reduction over this period – 16.4 per cent.
- Funding reductions have been proportionally greater for councils that are more dependent on government income to fund spending. Reductions in funding to STCCs are equal to 12.1 per cent of their 2010/11 spending, on average. For DCs, reductions are equal to 10.5 per cent of their 2010/11 spending, on average.
- One in five councils (20 per cent of STCCs and 23 per cent of DCs) have seen reductions in funding that were greater than 15 per cent of their planned revenue spending in 2010/11.
- Councils serving the most-deprived areas have seen the largest reductions in funding relative to spending since 2010/11.
  - In almost half the councils (49 per cent) serving the most-deprived 20 per cent of areas, the reduction in funding from 2010/11 to 2013/14 exceeded 15 per cent of their spending in 2010/11.
  - Of the councils serving the least-deprived 20 per cent of areas, fewer than one in ten (8 per cent) saw funding reductions as large.
- Council tax income fell by £0.3 billion (1.7 per cent) in real terms from 2010/11 to 2013/14, after council tax freeze grant is taken into account.
  - The 63 per cent of councils that froze or reduced council tax in each of the last three years saw the largest overall reduction in council tax income from 2010/11 to 2013/14 – 2.2 per cent in real terms.
  - The 8 per cent of councils that only froze or reduced council tax in 2011/12 saw a real-terms net increase in council tax income of 1.6 per cent from 2010/11 to 2013/14.

Councils' spending plans for 2013/14

We looked at what councils planned to spend on non-education services in 2013/14 compared with earlier years.

- From 2010/11 to 2013/14, service spending by STCCs reduced by 9.4 per cent on average. Service spending by DCs reduced by 16.6 per cent on average.
- Spending on planning and development services by STCCs reduced by 37.6 per cent on average from 2010/11 to 2013/14. The average reduction for DCs was 19.3 per cent.
- Spending by STCCs on cultural services reduced by 24.4 per cent on average. For DCs the average reduction was 19.4 per cent.
- Children's social care spending has increased by 1.2 per cent on average since 2010/11.

- The contribution of reductions in spending on adult social care to total spending reductions has increased over time. This service accounts for 52 per cent of the total spending reduction from 2012/13 to 2013/14.
- There have also been large increases in the share of total spending reductions that come from:
  - cultural and related services – 31 per cent of the total service spending reduction for all councils in 2013/14; and
  - environment and regulatory services – 22 per cent of the total 2013/14 spending reduction.
- As a result of councils' spending decisions, social care services in STCCs and central services in DCs account for a larger share of their total service spending in 2013/14 than they did in 2010/11.

Councils' responses to financial challenges since 2010/11

We asked auditors what strategies councils had adopted since 2010/11 in response to financial challenges, and which of these had made the greatest contribution to achieving their financial objectives.

- STCCs adopted a wider range of strategies in response to their financial challenges from 2010/11 to 2013/14 than DCs.
- The three strategies most widely adopted by councils were:
  - reducing overall staff numbers (96 per cent of STCCs and 86 per cent of DCs);
  - delivering some services more efficiently (91 per cent of STCCs and 81 per cent of DCs); and
  - reducing or restructuring the senior management team (79 per cent of STCCs and 69 per cent of DCs).
- The three strategies that made the greatest financial contribution were:
  - reducing overall staff numbers (for 76 per cent of STCCs that did so and 61 per cent of DCs);
  - delivering some services more efficiently (60 per cent of STCCs and 59 per cent of DCs); and
  - entering into new service delivery arrangements with other public bodies (25 per cent of STCCs and 52 per cent of DCs).
- Our financial analysis shows that from 2010/11 to 2012/13, reduced spending on staff accounted for 48 per cent of councils' total spending reductions.

Financial resilience in 2013/14 and beyond

We asked auditors how well placed councils were to deliver their budgets in 2013/14 and their medium-term financial plans.

- Auditors reported that nine out of ten councils were well placed to deliver their budget in 2013/14; a small increase on last year.
- Auditors were unsure about budget delivery in the remaining one in ten councils, mainly due to: concerns about councils' ability to deliver savings of the scale required by funding reductions; rising cost pressures; weaknesses in financial controls; and uncertain prospects for income.
- About two-thirds of councils (64 per cent) were well placed, in the view of auditors, to deliver their medium-term financial plans. But auditors had

concerns about the medium-term financial prospects of the other third of councils (36 per cent). Auditors were more likely to be concerned about the future financial prospects for:

  - unitary authorities (47 per cent of auditors had concerns);
  - London boroughs (45 per cent); and
  - metropolitan district councils (42 per cent).

- Councils where auditors were concerned about the delivery of medium-term financial plans had seen larger average reductions in government funding from 2010/11 to 2013/14 than those which auditors thought were well placed to deliver in the medium term.
- Based on auditors' responses, we consider two thirds of councils (63 per cent) to present a low financial risk. Three in ten (28 per cent) present a future financial risk. Nearly one in ten (8 per cent) present a current and ongoing financial risk.
  - At least two in five London boroughs, metropolitan districts and unitary authorities are in the ongoing or future risk categories.
  - Metropolitan district councils present the highest level of ongoing risk in 2013 with 14 per cent in this category.
- Councils that present an ongoing or future financial risk in 2013 were more likely to have experienced high in-year financial stress in 2012/13.

Chapter 1: Introduction

1 This is the Audit Commission's third and final[i] report examining the scale and impact of reductions in funding from central government to councils since 2010/11. As with our previous reports on this subject [Refs 2 and 3] our aim is to provide central government, councils, their appointed auditors and other interested stakeholders with an independent and authoritative analysis of:

- changes in central government funding to councils; and
- changes in councils' actual and planned spending on services.

2 The report also presents the findings of our 2013 survey of councils' appointed auditors concerning:

- how councils have coped with their recent financial challenges; and
- councils' prospects for financial resilience.

Background

3 Our research into councils' financial resilience over the last three years has been set against a backdrop of reducing central government funding to councils. Since May 2010, the government has been implementing a programme of public spending reductions with the aim of reducing the UK's budget deficit. The main local government budget[ii] is expected to reduce by 35 per cent from 2010/11 to 2015/16 [Ref 4].[iii]

4 Public spending reductions are set to continue beyond 2015/16, although their extent is not yet clear. In the Budget 2013 [Ref 7], the government set out its assumptions for further deficit reduction in 2016/17 and 2017/18. How this could be achieved has not been decided. The Institute for Fiscal Studies [Ref 4] estimates that to achieve the goals stated in the Budget, public spending will need to reduce by a total of £25 billion in these two years. This would require the government to increase taxes, reduce social security spending, reduce departmental spending (including central government funding for local government), or use a combination of these measures.

i The Commission is expected to close in March 2015 following enactment of the Local Audit and Accountability Bill [Ref 1].

ii The Local Government Departmental Expenditure Limit.

iii Funding reductions have been announced in: the Budget 2010 – 1 per cent of funding for 2010/11 [Ref 5]; the Spending Review 2010 – 26 per cent of funding from 2011/12 to 2014/15 [Ref 6]; the Budget 2013 – an additional 1 per cent of funding for 2014/15 [Ref 7]; the Spending Round 2013 – 10 per cent of funding for 2015/16 [Ref 8].

5 Alongside reductions in funding from central government, councils face other significant financial challenges. These include:

- growing demand for some services, for example, rising numbers of older people in the population requiring social care [Ref 9]; more children that need to be looked after by the local authority; and higher numbers of people facing homelessness due to economic conditions;
- below-inflation increases in council tax income for most councils, with the majority accepting the government's council tax freeze grants since 2011/12 and no councils exceeding the thresholds agreed by Parliament to trigger local council tax referenda;
- reductions in some other income streams due to, for example, low returns on financial investments and lower use of some charged-for services;[i]
- the transfer to councils from April 2013 of responsibility for helping some households pay council tax bills; together with a 10 per cent reduction in the funding they receive from government related to this;
- the introduction, also from April 2013, of local business rates retention, which provides an incentive for councils to promote economic growth but creates uncertainty about the level of income they will receive;[ii]
- changes, in 2015/16, to the way social care and health services are funded,[iii] with councils and clinical commissioning groups expected to agree how they will develop joint services that better serve local people; and funding linked to improved performance on, for example, numbers of emergency hospital admissions and delayed discharges from hospital [Ref 12]; and
- an increase in the number of adults that will be eligible for council-funded social care due to changes proposed by the Care Bill [Ref 13], including:
  - the introduction of national eligibility criteria for services, and new duties on councils to meet the needs of carers, from 2015/16; and
  - a cap on the amount people will contribute towards the costs of their care, and an increase in the amount of savings people can hold before having to fund their own care, from 2016/17.[iv]

i Our data briefing on income from charging [Ref 10] reported a real-terms reduction in total income from charging of 11 per cent from 2009/10 to 2011/12.

ii Prior to April 2013, councils collected business rates on behalf of government and received back a share of the total based on their local circumstances. A more detailed explanation of the changes is provided in our data briefing on business rates [Ref 11].

iii Some council and NHS funding will be pooled to create a £3.8bn Integration Transformation Fund.

iv The government has estimated the cost of these changes to be more than £12 billion over a ten-year period [Ref 14].

6 The effects of these funding reductions and other financial challenges are not felt equally by councils. Some councils are more dependent than others on government income to fund services. Differences in their local populations and local economic circumstances mean councils experience different levels of demand for services and unequal opportunities to generate income locally.

7 In November 2012 [Ref 3] we reported that the majority of councils had coped well with their financial challenges up to the end of 2011/12.

- Many councils had met or exceeded their savings targets and been able to increase their financial reserves as a result.
- Auditors reported that only 9 per cent of councils had experienced high levels of in-year financial stress in 2011/12 – that is, they experienced significant difficulties in delivering their agreed budget and had to take unplanned actions as a result. Where councils had struggled, our analysis suggested this was largely a result of the size of the financial challenge they faced.

8 However, auditors expressed greater levels of concern about the ability of councils to cope in the future with:

- 12 per cent of councils thought likely to struggle to deliver their budgets in 2012/13; and
- a further 25 per cent of councils representing a financial risk in the medium term.

About this report

9 This report presents the findings of our latest research and analysis to provide an up-to-date picture of:

- how councils coped financially in 2012/13;
- councils' expected funding and spending for 2013/14; and
- auditors' views on councils' short- and medium-term financial resilience.

10 The findings are based on:

- our analysis of financial data on English councils' actual spending in 2012/13 [Ref 15] and spending plans for 2013/14 [Ref 16], carried out between July and October 2013; and
- a survey of councils' appointed auditors that we undertook in June and July 2013[i] to which we received responses for all 353 single-tier, county and district councils in England.[ii]

i The Department for Communities and Local Government's (DCLG) consultation on the local government finance settlements for 2014/15 and 2015/16 [Ref 17] was published on 25 July. The majority of auditor survey responses were submitted prior to this.

ii A separate paper published on the Commission's website [Ref 18] provides further details of the approach we have taken to financial data analysis and the auditor survey.

11 We pay particular attention this year to the cumulative effect of changes in funding and spending from 2010/11 to 2013/14 – and comment on how auditors' views of councils' financial resilience have changed over time. Allied to that, we also report this year what auditors have told us about the prevalence and impact of the different strategies councils have adopted in response to financial challenges since 2010/11.

12 The remainder of this report looks in turn at:

- what councils spent in 2012/13 (Chapter 2) and the extent of financial stress councils experienced in delivering their spending plans that year (Chapter 3);
- the changes in 2013/14 in funding to councils (Chapter 4) and in councils' plans for spending (Chapter 5);
- the strategies councils have adopted in response to financial challenges since 2010/11 (Chapter 6); and
- auditors' views on the prospects for councils' financial resilience in 2013/14 and over the medium term (Chapter 7).

About the financial analysis

13 As with our earlier reports, the analysis of councils' funding and spending in this report:

- takes account of inflation – unless otherwise stated, data are shown at 2013/14 prices;
- is net of fees, charges and other income;
- excludes funding and spending related to education services;[i]
- excludes councils' Housing Revenue Account expenditure;
- excludes the Council of the Isles of Scilly and the Corporation of London; and
- incorporates a number of other general and specific adjustments related to changes in the funding and responsibilities of councils over time[ii] to enable us to present changes over time on a like-for-like basis.

14 Another notable exclusion from our analysis this year is funding and spending related to councils' public health responsibilities which came into effect in 2013/14. Our analysis is mainly focused on changes in funding and spending from one year to another and we are unable this year to make comparisons with earlier years for this service area.

15 Our analysis of change in central government funding is consistent with the approach used in our earlier reports [Refs 2 and 3]. It is fundamentally different to the measure of change in councils' revenue spending power published annually by DCLG. Our respective methods include different components of councils' income and use different underlying data.

i Due to inconsistencies in the way funding data has been recorded and complications in the analysis of spending data following the introduction of academies.

ii For example, changes in 2013/14 related to funding for council tax support.

Chapter 2: Councils' spending in 2012/13

This chapter looks at changes in councils' spending in 2012/13 compared with 2011/12 and the changes councils made to their financial reserves during the year.

Key points:

- **On average, single-tier and county councils (STCCs) spent 2.4 per cent less on services in 2012/13 than in 2011/12.**
- **District councils (DCs) spent 2.8 per cent less on average.**
- **During 2012/13, 63 per cent of councils increased reserves.**
- **In aggregate, councils increased non-schools reserves by £0.9 billion (7 per cent) – a smaller increase than in 2011/12.**

16 English councils' net spending on non-education services in 2012/13 was £38.0 billion. Social care services for adults and children accounted for more than half the total (Table 1).

Table 1: **Council net spending by service area in 2012/13**

Service area	STCCs (£bn)	DCs (£bn)	All (£bn)	% of total
Adult social care	14.8	0.0	14.8	39%
Children's social care	6.7	0.0	6.7	18%
Environmental and regulatory	3.8	0.9	4.7	12%
Cultural and related	2.3	0.6	2.9	8%
Central services[i]	2.1	0.7	2.8	7%
Highways and transport[ii]	2.9	-0.1	2.8	7%
Housing (General Fund)	1.5	0.3	1.8	5%
Planning and development	1.0	0.4	1.4	4%
Other[iii]	0.1	0.0	0.1	<1%
Total	**35.3**	**2.8**	**38.0**	**100%**

Note: Columns and rows may not add due to rounding.

Source: Audit Commission analysis of DCLG revenue outturn (RO) data. Data at 2013/14 prices.

i Includes democratic and electoral services, management and support services, revenues and benefits administration, registration services, emergency planning, court services and unattributable overheads.

ii This service makes a net contribution to DCs' spending.

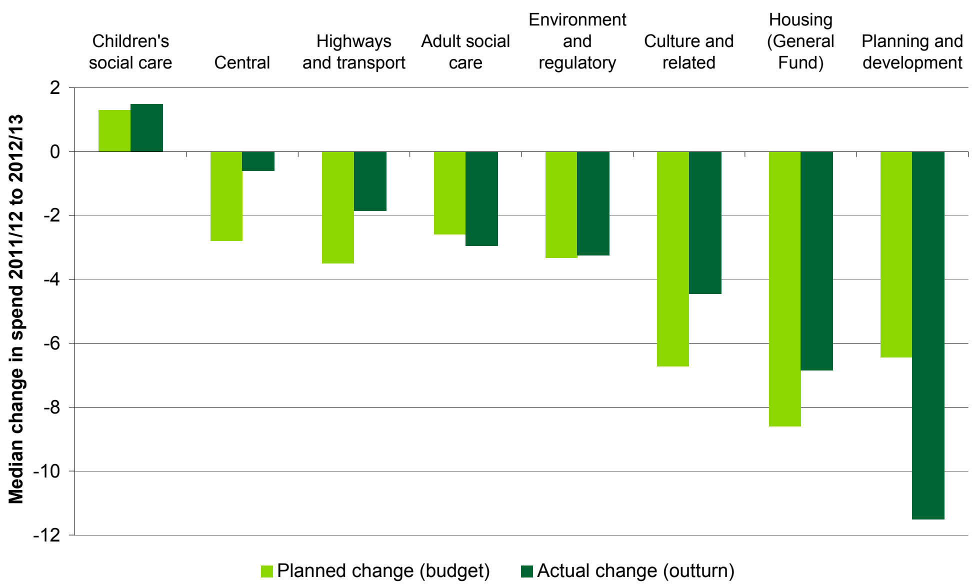
iii Spending is recorded exceptionally when not attributable to another service area. We exclude this category from the rest of the report.

Changes in spending from 2011/12

17 Total non-education service spending by STCCs was 2.4 per cent lower on average in 2012/13 than in 2011/12, allowing for inflation. DCs' service spending was 2.8 per cent lower, on average. There was some variation between types of council. London boroughs reduced spending by 3.2 per cent on average, while county councils reduced spending by just 1.1 per cent on average.

18 STCCs made a larger reduction in spending on planning and development services (11.5 per cent, on average) in 2012/13 than they had budgeted for. Reductions in spending on central management, highways and transport, cultural and housing services were smaller, on average, than expected. Average changes in spending on children's social care (a 1.5 per cent increase), adult social care and environmental services were in line with councils' plans (Figure 1).

Figure 1: Planned and actual changes in service spending from 2011/12 to 2012/13 – STCCs

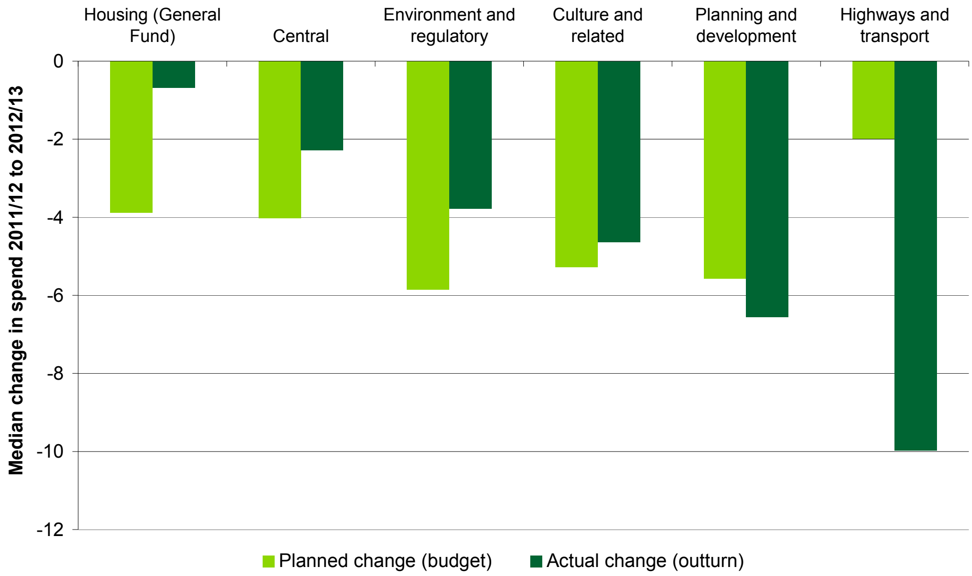


Source: Audit Commission analysis of DCLG RA and RO data. Data at 2013/14 prices

19 DCs made significantly larger reductions in spending on highways and transport services (10.0 per cent), on average, in 2012/13, than they had budgeted for (Figure 2). This difference is the result of income – from parking charges and fees for maintaining roads on behalf of other bodies – reducing at a lower rate (4.4 per cent) than spending (9.3 per cent) compared with 2011/12.

20 Average spending reductions in planning and development (6.6 per cent) were also larger than expected. Reductions in spending in all other service areas were smaller, on average, than DCs had budgeted for.

Figure 2: Planned and actual changes in service spending from 2011/12 to 2012/13 – DCs



Source: Audit Commission analysis of DCLG RA and RO data. Data at 2013/14 prices

Changes in councils' reserves in 2012/13

21 Reserves are an essential part of councils' strategic, financial and risk management. Councils hold reserves either as a contingency fund in the event of unforeseen circumstances, such as unexpected demand for services or a shortfall in income, or to smooth the impact of planned spending requirements over time, for example, setting aside funds for staff redundancies or to invest in large-scale capital projects. Our 2012 report on councils' decision making on reserves [Ref 19], encouraged councils to:

- examine routinely how much they hold in reserves, and the purposes for which reserves are held; and
- ensure their decisions on reserves are clearly explained to local taxpayers to promote accountability.

22 At the end of 2012/13 councils held reserves[i] totalling £14.2 billion. STCCs increased reserves by a total of £0.7 billion (7 per cent) compared with the end of 2011/12. DCs increased reserves by £0.2 billion (8 per cent).

23 Overall, 63 per cent of councils increased their reserves in 2012/13 (68 per cent of STCCs and 60 per cent of DCs). The other 37 per cent of councils reduced their reserves.

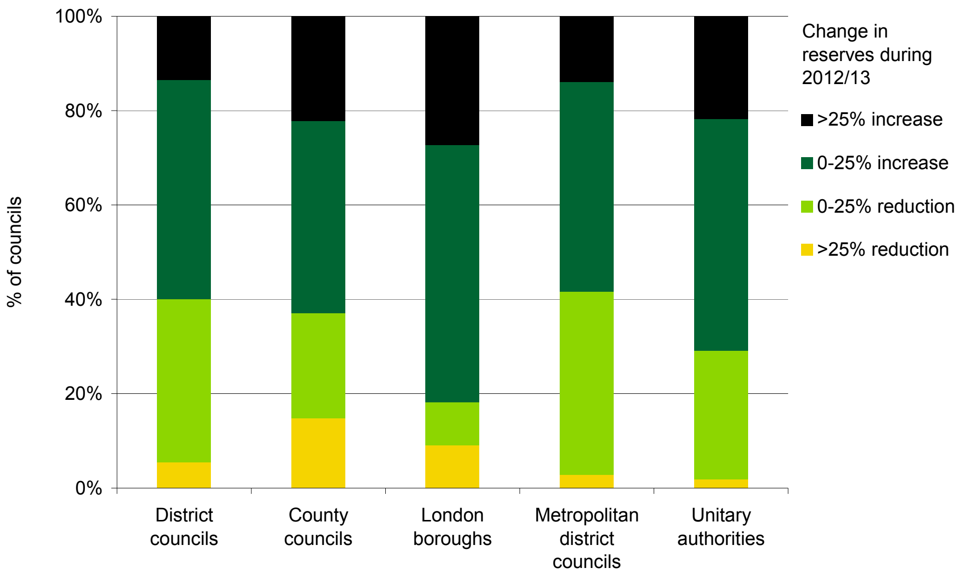
24 There was considerable variation in the changes made to reserves by different types of council in 2012/13.

- Reserves held by London boroughs increased by 14 per cent in real terms compared with the level at the end of 2011/12. Over a quarter (27 per cent) of these councils increased reserves by more than 25 per cent.

i Excludes schools' reserves.

- County councils' reserves fell by nearly 1.5 per cent in real terms. This was the only group to see total reserves fall in 2012/13. About one in seven (15 per cent) of these councils reduced their reserves by more than 25 per cent in 2012/13.
- Metropolitan district councils were most likely to reduce their reserves in 2012/13 – 42 per cent did so (Figure 3).

Figure 3: Level of change in reserves from 31 March 2012 to 31 March 2013



Source: Audit Commission analysis of DCLG RA and RO data. Data at 2013/14 prices

25 The overall increase in reserves in 2012/13 was lower than the increase in 2011/12 (£1.2 billion), when 67 per cent of councils added to their reserves.

Chapter 3: Financial stress in 2012/13

This chapter uses data supplied by auditors to describe:

- **the extent to which councils experienced significant difficulties in delivering their agreed budgets in 2012/13;**
- **the unplanned actions some councils took to deliver their budgets; and**
- **combining those factors, the levels of financial stress exhibited by councils in 2012/13.**

Key points:

- **In the view of auditors, 89 per cent of councils experienced no significant difficulties in delivering their agreed budget for 2012/13.**
- **However, 17 per cent of STCCs and 6 per cent of DCs experienced significant financial difficulties in delivering their budgets in 2012/13.**
- **Three in ten councils (29 per cent) needed to take one or more unplanned actions during 2012/13 to deliver their budget.**
- **Three in ten councils (29 per cent) exhibited financial stress in 2012/13 – experiencing significant difficulties, taking unplanned actions, or both.**
- **One in five councils (18 per cent) exhibited financial stress in both 2011/12 and 2012/13, including 25 per cent of metropolitan district councils and 24 per cent of unitary authorities.**

Councils that experienced significant difficulties

26 As last year, we asked auditors for their views on whether councils had experienced significant difficulties in delivering their agreed General Fund Revenue Account (GFRA) budget for 2012/13. Auditors were not asked to comment on whether councils had experienced difficulties in agreeing a budget for the year, although a small number noted in their survey responses that identifying how savings could be delivered and reaching agreement on spending reductions had been challenging for councils.

27 In the view of auditors, the majority of councils (89 per cent) experienced no significant difficulties in delivering their agreed budgets in 2012/13 (Table 2). The proportion of STCCs experiencing no significant difficulties fell slightly in 2012/13 (to 83 per cent) and was again lower than for DCs (94 per cent).

Table 2: **Percentage of auditors who agreed or strongly agreed with the statement 'The Council experienced no significant difficulties in trying to deliver its [year] GFRA budget.'**

	2011/12 (%)	2012/13 (%)
Single-tier and county councils	86	83
District councils	94	94
All councils	**90**	**89**

Source: Audit Commission analysis of auditor survey responses

28 This left 11 per cent of councils (17 per cent of STCCs and 6 per cent of DCs) where auditors' responses indicated councils had experienced significant financial difficulties in delivering their budget in 2012/13. Notably, this was the case for 28 per cent of metropolitan districts councils.

29 The main cause of significant difficulties, affecting about two-thirds of these councils, was overspending in some service areas. This was the result of, for example, additional demand for adult social care or children's safeguarding, increasing numbers of homelessness applications, higher-than-expected revenue costs for private finance initiative (PFI) schemes, or a high-cost planning appeal. Spending pressures were more commonly reported as a significant difficulty for single-tier authorities.

30 Lower-than-expected income had been a problem for about three in ten of the councils experiencing significant difficulties. This included shortfalls in income from investments, commercial rents, and from services (such as building control, planning, and car parking). In a small number of cases it included lower-than-expected levels of recovery for fraud, error and debt. Income shortfalls were more commonly reported as a difficulty for district councils.

31 Around one fifth of the councils experiencing significant difficulties did not achieve the savings they had expected. Specific examples given by auditors included slippages in the timetables for closing residential care homes and delays in staff restructuring. Not achieving expected savings was more commonly a cause of difficulties in metropolitan and unitary authorities.

Unplanned actions needed to deliver budgets

32 Councils have a statutory duty to set a budget each year that balances expected outgoings with income – including any additions to or use of reserves. We asked auditors if councils had taken any of a number of unplanned actions during 2012/13 in order to deliver the budgets they had agreed.

33 Auditors reported that 71 per cent of councils (64 per cent of STCCs and 76 per cent of DCs) had not taken any unplanned actions to deliver their agreed budgets. This was slightly higher than for 2011/12, when 68 per cent of councils (60 per cent of STCCs and 74 per cent of DCs) took no unplanned actions.[i] However:

- 12 per cent of councils needed to take one unplanned action to deliver their agreed budget in 2012/13; and
- 17 per cent (25 per cent of STCCs and 11 per cent of DCs) took two or more unplanned actions.

34 Councils that took unplanned actions to deliver their budgets in 2011/12 were more likely to do so again in 2012/13. Four in ten metropolitan district councils (39 per cent) and three in ten unitary authorities (31 per cent) took one or more unplanned actions in both years. Councils that took no unplanned actions in 2011/12 were over five times more likely not to have taken unplanned actions in 2012/13.[ii]

Most commonly taken unplanned actions

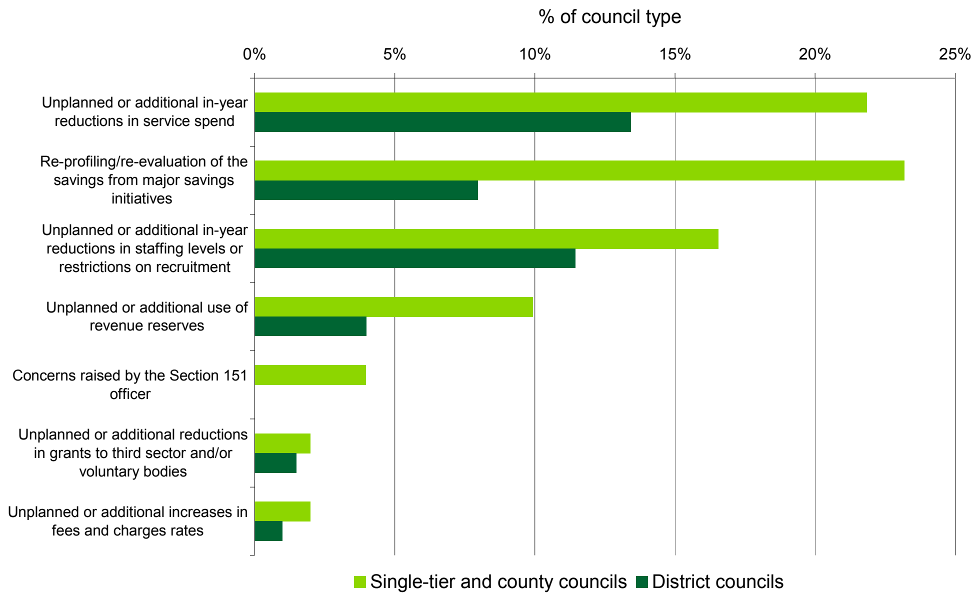
35 The unplanned actions most commonly taken by councils in 2012/13 were:

- additional in-year reductions in service spend (22 per cent of STCCs and 13 per cent of DCs);
- re-profiling/re-evaluation of the savings from major savings initiatives (23 per cent of STCCs and 8 per cent of DCs); and
- unplanned or additional in-year reductions in staffing levels or restrictions on recruitment (17 per cent of STCCs and 11 per cent of DCs) (Figure 4).

i In our last report [Ref 3] the analysis of unplanned actions in 2011/12 included 41 councils making exceptional requests to DCLG for capitalisation of revenue spending. No funding was available for revenue capitalisation in 2012/13 so figures for 2011/12 have been recalculated, excluding capitalisation requests, to provide a like-for-like comparison.

ii Of those taking no unplanned actions in 2011/12, 84 per cent also took no unplanned actions in 2012/13.

Figure 4: Unplanned actions taken by councils to deliver their budgets in 2012/13



Source: Audit Commission analysis of auditor survey responses

36 One third of metropolitan district councils and one fifth of unitary authorities took all of the three most common unplanned actions in 2012/13.

37 Compared with 2011/12, councils were slightly more likely in 2012/13 to make unplanned reductions in service spend, unplanned reductions in staffing levels and unplanned use of reserves. They were much less likely to be re-evaluating the potential of major savings initiatives.

38 Auditors noted that some unplanned actions taken by councils that experienced significant financial difficulties in 2012/13 had consequential effects. For example:

- where councils had brought forward savings planned for future years, such as allowing staff already identified for early retirement or voluntary redundancy to leave earlier than planned, this resulted in pressure to deliver additional savings in later years; and
- reducing spending through non-replacement of vacant posts increased the workload for remaining staff.

Financial stress

39 Combining auditors' responses on whether councils experienced significant difficulties in delivering their budgets with responses on unplanned actions taken to address problems gives an indication of the extent of financial stress councils exhibited in 2012/13.

40 In our 2012 report [Ref 3] we identified three levels of financial stress based on the information supplied by auditors:

- no in-year financial stress – councils that took no unplanned actions and experienced no significant financial difficulties;
- medium in-year financial stress – councils that took unplanned actions but experienced no significant financial difficulties; and
- high in-year financial stress – councils that both took unplanned actions and experienced significant financial difficulties.[i]

41 Using the same method,[ii] our survey this year shows the proportion of all councils exhibiting no in-year financial stress increased slightly from 67 per cent in 2011/12 to 69 per cent. This reflects the increasing number of councils taking no unplanned actions in 2012/13 (Table 3).

Table 3: **Levels of in-year financial stress in 2012/13 compared with 2011/12**

	No in-year financial stress (%)		Medium in-year financial stress (%)		High in-year financial stress (%)	
	2011/12	2012/13	2011/12	2012/13	2011/12	2012/13
Single-tier and county councils	59	63	28	21	12	15
District councils	73	74	20	20	6	4
All councils	**67**	**69**	**23**	**20**	**9**	**9**

Note: Rows do not add to 100 per cent due to excluded councils.[i]

Source: Audit Commission analysis of auditor survey responses

42 This largely unchanged picture masks two notable variations from last year:

- diverging fortunes for metropolitan district councils, with both:
  - an increase in the proportion of these councils that exhibited no in-year financial stress in 2012/13 (from 33 to 53 per cent) although they remain under-represented in this category; and
  - an increase in the proportion exhibiting high in-year financial stress (from 19 to 28 per cent); and
- a rise in the proportion of unitary authorities in the high-stress category (from 11 per cent to 16 per cent).

i A very small number of councils (1 per cent in 2011/12 and 2 per cent in 2012/13) were reported by auditors to have had difficulties delivering their budgets but had not taken unplanned actions. They are excluded from the stress analysis.

ii For comparison, the categorisations for 2011/12 have been recalculated to exclude capitalisation requests, as explained in footnote i on page 17. This reduces the level of stress reported for some councils last year.

43 For the majority of councils the categorisation of in-year financial stress has remained unchanged from 2011/12 to 2012/13 with:

- 56 per cent of councils experiencing no in-year financial stress in both years;
- 11 per cent experiencing medium stress in both years; and
- 4 per cent experiencing high stress in both years.[i]

44 The level of financial stress reduced for 13 per cent of councils in 2012/13 and increased for 14 per cent.

45 One in five councils (18 per cent) experienced medium or high in-year financial stress in both 2011/12 and 2012/13. Metropolitan and unitary authorities were more likely to have experienced sustained financial stress with 25 per cent and 24 per cent, respectively, having either medium or high in-year financial stress in both years.

i One county council, one London borough, four metropolitan district councils, four unitary authorities and four district councils.

Chapter 4: Councils' income in 2013/14

This chapter looks at the cumulative effect of changes in government funding to councils since 2010/11. It also examines changes in councils' other main source of income, council tax.

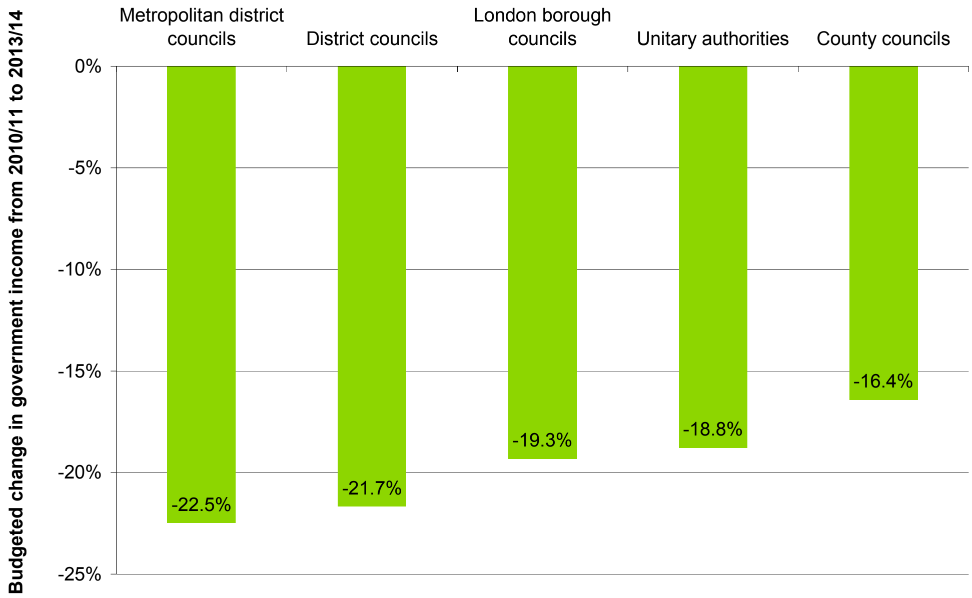
Key points:

- **From 2010/11 to 2013/14, government funding to councils reduced by £6.0 billion (19.6 per cent) in real terms. Metropolitan district councils saw the largest aggregate reduction – 22.5 per cent.**
- **Reductions in funding to STCCs are equal to 12.1 per cent of their 2010/11 spending, on average. For DCs, reductions are equal to 10.5 per cent of their 2010/11 spending, on average.**
- **Councils serving the most-deprived areas have seen the largest reductions in funding relative to spending since 2010/11.**
- **Council tax income fell by £0.3 billion (1.7 per cent) in real terms from 2010/11 to 2013/14, after council tax freeze grant is taken into account.**

Changes in government funding

46 Compared with 2010/11, councils' budgets in 2013/14 show an aggregate real-terms reduction in government income of £6.0 billion (19.6 per cent). Metropolitan district councils' budgets show the largest aggregate reduction in government funding – 22.5 per cent. County councils' budgets show the smallest reduction over this period – 16.4 per cent (Figure 5).

Figure 5: Budgeted change in government income 2010/11 to 2013/14



Source: Audit Commission analysis of DCLG RA data. Data at 2013/14 prices

Funding changes relative to council spending

Changes since 2010/11

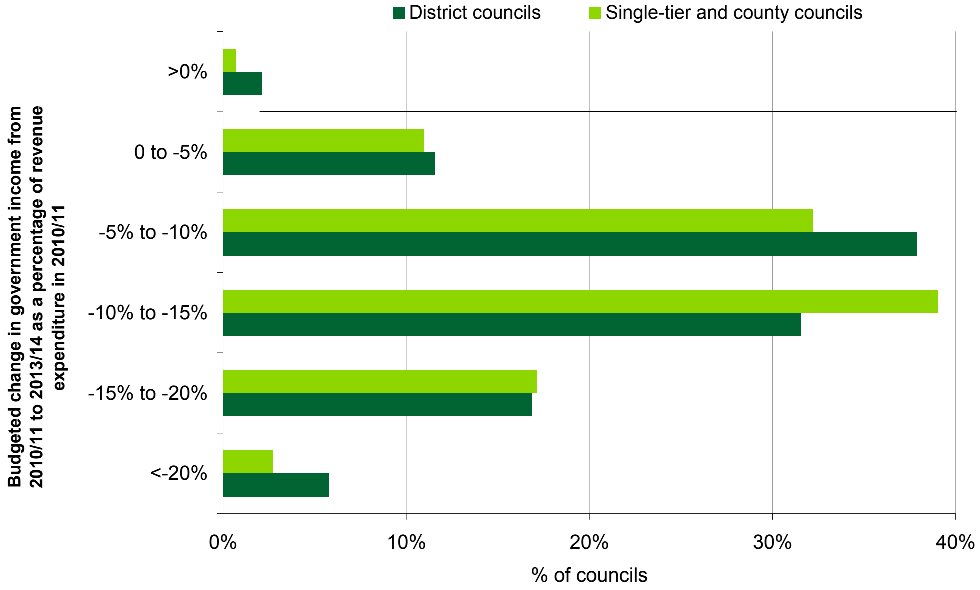
47 We compared councils' expected government income for 2013/14 with their planned spending for 2010/11.[i] On average, STCCs saw government income reduce by 12.1 per cent of their 2010/11 spending. DCs' funding reduced by 10.5 per cent of their 2010/11 spending, on average.

48 Over this period, 71 per cent of STCCs and 69 per cent of DCs show a real-terms reduction in government funding of between 5 and 15 per cent of their spending in 2010/11 (Figure 6). Of the remainder:

- one in five councils (20 per cent of STCCs and 23 per cent of DCs) have seen reductions in funding that were greater than 15 per cent of their planned revenue spending in 2010/11, in real terms;
- one in ten councils (11 per cent of STCCs and 12 per cent of DCs) have seen reductions in funding of less than 5 per cent of their 2010/11 spending; and
- 1 per cent of councils saw a real-terms increase in government funding relative to planned spending in 2010/11.

i Prior to the in-year funding reductions announced in the 2010 Budget [Ref 4].

Figure 6: Budgeted change in government income from 2010/11 to 2013/14 as a percentage of revenue spending in 2010/11 – by council type



Source: Audit Commission analysis of DCLG RA data. Data at 2013/14 prices

The impact of funding changes on deprived areas[i]

49 Our previous reports [Refs 2 and 3] have highlighted that councils serving more-deprived areas have seen larger reductions in funding than other councils. Councils serving more-deprived areas tend to be:

- more dependent on government funding to support services, having more limited opportunities to raise income by other means; and
- more reliant on specific grants[ii] which have seen larger reductions than formula funding.[iii]

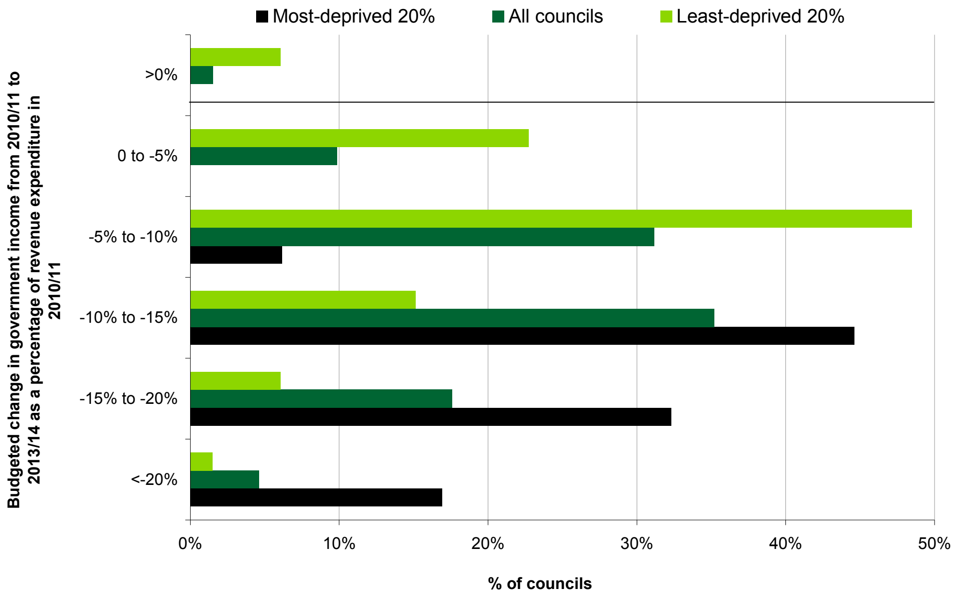
50 From 2010/11 to 2013/14, councils serving the most-deprived areas are much more likely to have seen larger reductions in funding relative to spending than other councils. In almost half the councils (49 per cent) serving the most-deprived 20 per cent of areas, the reduction in funding from 2010/11 to 2013/14 exceeded 15 per cent of their spending in 2010/11 (Figure 7). Of the councils serving the least-deprived 20 per cent of areas, fewer than one in ten (8 per cent) saw funding reductions as large.

i Analysis based on the Indices of Multiple Deprivation rank of average ranks [Ref 20] for single-tier and district councils.

ii Specific grants are provided to individual councils for defined purposes and are distributed in a variety of ways. They have often been focused on tackling social needs.

iii Formula funding is distributed to councils using a formula that takes account of the relative needs of the population served and the ability of the council to raise income through council tax.

Figure 7: Budgeted change in government income from 2010/11 to 2013/14 as a percentage of revenue spending in 2010/11 – by levels of deprivation



Source: Audit Commission analysis of DCLG RA data and Indices of Multiple Deprivation 2010. Data at 2013/14 prices

51 Despite these larger funding reductions, areas with higher levels of deprivation continue to receive more funding per head of population than less-deprived areas.

Impact of council tax policies on council income

52 Council tax is the main source of locally generated income for four out of five councils [Ref 10]. Since 2011/12, councils have been encouraged by the government to freeze or reduce council tax levels. Councils that did so in any year were eligible for a council tax freeze grant. The freeze grants available to councils each year have varied both in the amounts of the grant and the number of years for which they would be paid. For example, the 2011/12 freeze grant was equal to a 2.5 per cent increase on the Band D council tax in 2010/11, payable for the whole of the period covered by the 2010 Spending Review, while the 2012/13 grant was payable for only one year (Table 4). Fewer councils (65 per cent) accepted the council tax freeze grant in 2013/14 than in either of the previous two years.

Table 4: **Value and duration of council tax freeze grants since 2010/11**

Year	% increase on Band D council tax	Years in which grant paid				% of councils accepting
		2011/12	2012/13	2013/14	2014/15	
2011/12	2.5% of 2010/11	✓	✓	✓	✓	100
2012/13	2.5%* of 2011/12		✓			90
2013/14	1% of 2012/13			✓	✓	65

*2.75 per cent for City of London

Source: Audit Commission analysis of DCLG council tax freeze grant allocations.

53 Councils can be divided into four groups depending on which combination of council tax freeze grants they have accepted. About two-thirds of councils (63 per cent) have accepted all three council tax freeze grants. Just over a quarter (27 per cent) accepted freeze grants in both 2011/12 and 2012/13. County councils and London boroughs are most likely to have accepted all three freeze grants. Less than half of unitary authorities did so (Table 5).

Table 5: **Acceptance of council tax freeze grants by council type**

		Group 1	Group 2	Group 3	Group 4
Council tax freeze grants accepted	2011/12	✓	✓	✓	✓
	2012/13	✓	✓		
	2013/14	✓		✓	
Single-tier and county councils (%)		63	28	2	7
County councils (%)		89	4	0	7
London boroughs (%)		82	18	0	0
Metropolitan district councils (%)		56	42	3	0
Unitary authorities (%)		45	36	4	16
District councils (%)		63	26	2	9
All councils (%)		**63**	**27**	**2**	**8**

Source: Audit Commission analysis of DCLG council tax freeze grant allocations.

54 Councils that chose to increase the level of council tax in 2012/13 or 2013/14 did so subject to the provisions of the Localism Act 2011. This requires any council setting an 'excessive' level of council tax[i] to have this agreed by a local referendum. For 2012/13 the level of council tax increase

i Determined by the Secretary of State for Communities and Local Government and approved by the House of Commons.

to trigger a local referendum was 3.5 per cent.[i] For 2013/14, the level of increase to trigger a referendum was 2 per cent. This was lower than the prevailing rate of inflation – 2.3 per cent.[ii] Councils with low levels of council tax, where an increase in excess of the threshold for 2013/14 would result in a Band D council tax increase of less than £5, did not need to hold a referendum. No councils increased council tax for 2012/13 or 2013/14 by a level that required a local referendum.

Financial impact

55 To assess the financial impact of councils' decisions on council tax increases over the last three years, we compared their expected income from council tax (and freeze grants where applicable) in 2013/14 to that expected in 2010/11.[iii] Councils' total expected income from council tax in 2013/14 was £19.4 billion. This was £1.1 billion less, in real terms, than they expected in 2010/11 – a 5.2 per cent reduction. Councils received a total of £712 million in council tax freeze grant in 2013/14[iv] making a net real-terms reduction of £347 million from 2010/11 to 2013/14 – 1.7 per cent (Table 6).

56 After council tax freeze grant is taken into account, the 63 per cent of councils that froze or reduced council tax in 2011/12, 2012/13 and 2013/14 (Group 1) saw the largest overall reduction in council tax income from 2010/11 to 2013/14 – 2.2 per cent in real terms. The 8 per cent of councils that only froze or reduced council tax in 2011/12 (Group 4) saw a real-terms net increase in council tax income of 1.6 per cent from 2010/11 to 2013/14.

Table 6: **Change in council tax income 2010/11 to 2013/14**

Group*	% of councils	Change in council tax income 2010/11 to 2013/14 (excluding freeze grant) Aggregate (£m)	%	(including freeze grant) Aggregate (£m)	%
1	63	-872	-6.0	-324	-2.2
2	27	-166	-3.8	-48	-1.1
3	2	-7	-3.3	1	0.6
4	8	-14	-1.0	23	1.6
All	**100**	**-1,059**	**-5.2**	**347**	**-1.7**

*See Table 5 for group composition

Source: Audit Commission analysis of DCLG council tax freeze grant allocations and CIPFA Finance and General Estimates Statistics

i 3.75 per cent for the City of London in 2012/13.
ii Office for Budget Responsibility's Gross Domestic Product (GDP) deflator forecast for 2013/14 [Ref 6].
iii Based on their 2013/14 taxbase and adjusted for inflation.
iv Combining freeze grants for 2011/12 and 2013/14.

Future council tax policies

57 Policies to encourage councils to reduce or freeze council tax will continue in 2014/15 and 2015/16 [Ref 8], including:

- an extension of council tax freeze grants for 2011/12 and 2013/14 into 2015/16;
- funding for further council tax freeze grants in 2014/15 and 2015/16 – councils can choose to accept either or both – equal to a 1 per cent increase on the council's Band D council tax; and
- a continuation of the requirement for councils to hold a referendum where council tax increases exceed 2 per cent – although the basis on which increases will be calculated is set to change[i] to include increases in council tax arising from levies set by other public bodies such as parish councils and local transport boards.[ii]

58 Councils continue to face difficult choices in balancing their need for council tax income to fund spending plans, in both the short and longer term, with affordability for local council tax payers.

i Subject to the passage of the Local Audit and Accountability Bill [Ref 1].

ii The Local Audit and Accountability Bill also proposes that the calculation of council tax increase in 2014/15 takes into account increases in levies that occurred in 2013/14.

Chapter 5: Councils' spending plans for 2013/14

This chapter looks at how councils' plans for spending in 2013/14 differ from 2010/11.

Key points:

- **From 2010/11 to 2013/14, planned service spending by STCCs reduced by 9.4 per cent on average. Service spending by DCs has reduced by 16.6 per cent on average.**
- **Planning and development and cultural and related services saw the largest average reductions in spending from 2010/11 to 2013/14.**
- **Children's social care spending has increased by 1.2 per cent on average since 2010/11.**
- **The contribution of reductions in spending on adult social care to total spending reductions has increased over time and account for 52 per cent of the total spending reduction from 2012/13 to 2013/14.**
- **As a result of councils' spending decisions, social care services in STCCs and central services in DCs account for a larger share of their total service spending in 2013/14 than they did in 2010/11.**

Changes in spending on services[i]

59 From 2010/11 to 2013/14, STCCs' budgets show an average real–terms reduction in total service spending of 9.4 per cent. Total service spending by DCs is budgeted to reduce by 16.6 per cent, on average, over this period.

60 Service areas where councils have more discretion over service provision have seen greater reductions in spending than those which are largely statutory.

61 From 2010/11 to 2013/14, the largest average real-terms spending reductions by STCCs were in:

- planning and development services – 37.6 per cent;
- cultural and related services – 24.4 per cent; and
- General Fund housing services – 23.4 per cent (Figure 8).

62 Children's social care has been largely protected from spending reductions from 2010/11 to 2013/14. On average, STCCs increased their spending by 1.2 per cent in real terms.

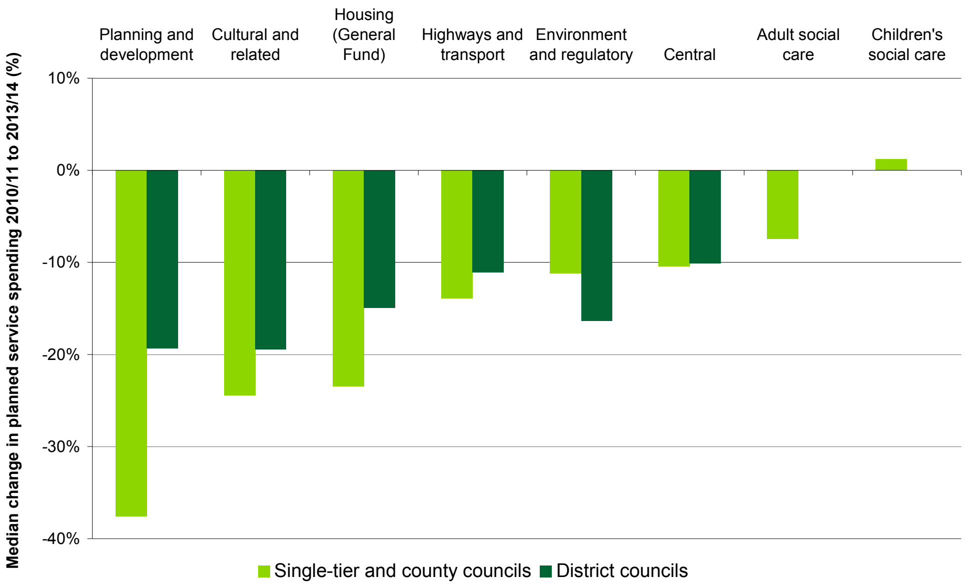
i Due to changes in the recording of revenue expenditure funded from capital by statute (RECS) in 2011/12, service-level analysis is only presented for councils where no or very little RECS spend was recorded in 2013/14 – 75 per cent of STCCs and 66 per cent of DCs.

63 Spending on adult social care services has also been protected more than other service areas, reducing by 7.5 per cent in real terms, on average, from 2010/11 to 2013/14.

64 The largest average real-terms reductions by DCs over this period were in:

- cultural and related services – 19.4 per cent;
- planning and development services – 19.3 per cent; and
- environment and regulatory services – 16.4 per cent.

Figure 8: Change in planned service spending from 2010/11 to 2013/14 by council type



Source: Audit Commission analysis of DCLG RA data. Data at 2013/14 prices

65 While the reductions reported here take account of inflation, they do not reflect the effect of increasing demand for some services.

Service contributions to total spending reductions

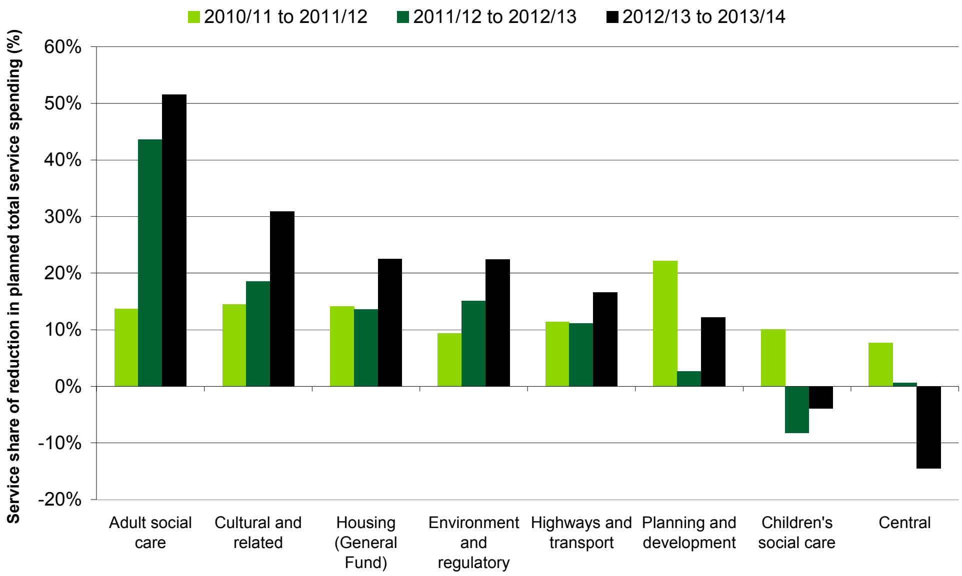
66 While average reductions in spending on adult social care services are smaller in 2013/14 than in either of the two previous years, the aggregate savings from this service area make up a growing proportion of total spending reductions. From 2012/13 to 2013/14, reductions in spending on adult social care services make up the largest share of the total spending reductions (52 per cent, compared with only 14 per cent of the total reduction from 2010/11 to 2011/12) (Figure 9). There have also been large increases in the contribution of spending reductions in:

- cultural and related services – 31 per cent of the total planned spending reduction in 2013/14 (14 per cent in 2011/12); and
- environment and regulatory services – 22 per cent of the 2013/14 total (9 per cent in 2011/12).

67 Reductions in spending on planning and development services accounted for 22 per cent of total spending reductions in 2011/12 but only 12 per cent of total spending reductions in 2013/14.

68 Aggregate spending on children's social care is set to increase by 0.4 per cent from 2012/13 to 2013/14. Central services spend will increase by 2.9 per cent in aggregate. These increases are equal to 4 per cent and 15 per cent, respectively, of the spending reductions planned in other service areas in 2013/14.

Figure 9: Service share of planned annual reduction in total service spending



Source: Audit Commission analysis of DCLG RA data. Data at 2013/14 prices

Changes in the pattern of service spending

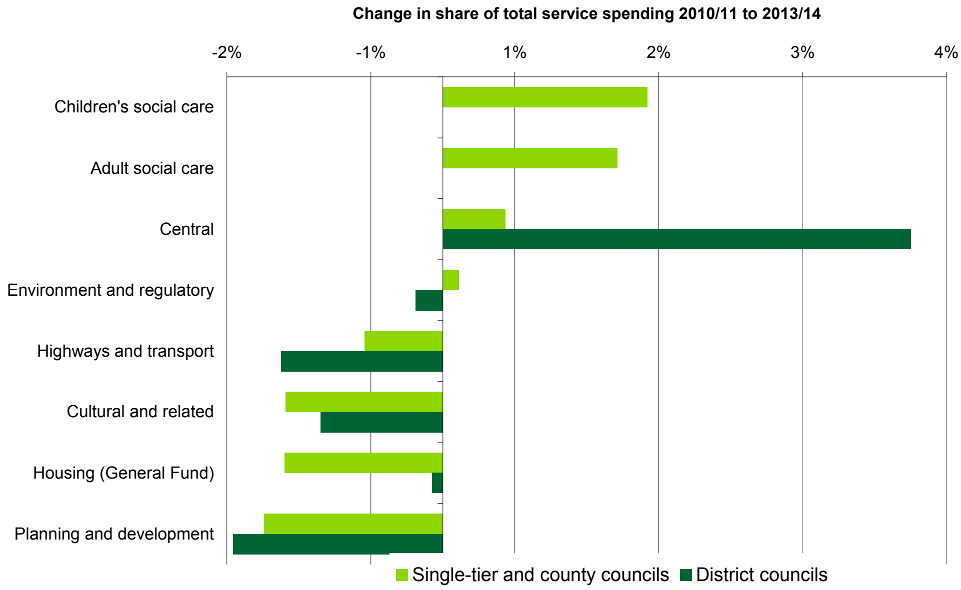
69 As councils have reduced spending on services at different rates from 2010/11 to 2013/14, the balance of spending on individual services has changed.

70 Planning and development, General Fund housing services, cultural, and highways and transport services have all seen their share of service spending reduce in STCCs from 2010/11 to 2013/14. These reductions have resulted in a larger proportion of STCCs' service spending being taken up by social care services for adults and children (Figure 10).

71 The reductions in spending by DCs in planning and development, highways and transport, and cultural services over this period have resulted in a larger proportion of their service spending being taken up by central services.

72 The share of spending on environmental and regulatory services has remained broadly unchanged over this period for both types of council.

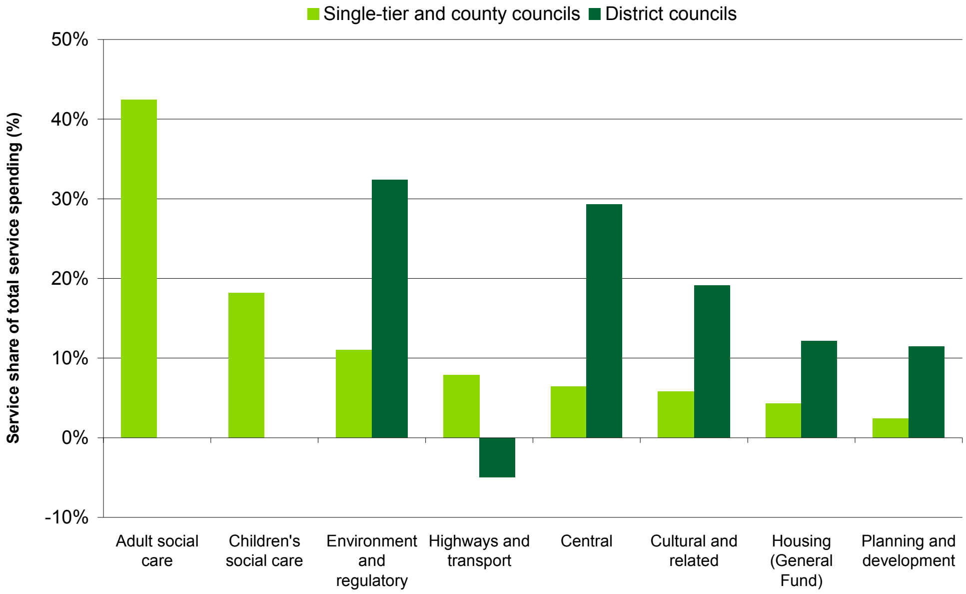
Figure 10: Change in service share of planned total service spending 2010/11 to 2013/14



Source: Audit Commission analysis of DCLG RA data. Data at 2013/14 prices

73 Social care services account for the largest share (61 per cent) of total service spending by STCCs in 2013/14 (70 per cent for county councils) (Figure 11). The two largest service areas for district councils in 2013/14 are environmental and regulatory services (32 per cent) and central services (29 per cent). Highways and transport services make a net contribution to total spending in DCs.

Figure 11: Service share of planned total service spending 2013/14



Source: Audit Commission analysis of DCLG RA data. Data at 2013/14 prices

Chapter 6: Councils' responses to financial challenges since 2010/11

This chapter looks at the prevalence and impact of different strategies councils have adopted in response to financial challenges since 2010/11.

Key points:

- **STCCs adopted a wider range of strategies in response to their financial challenges from 2010/11 to 2013/14 than DCs.**
- **The three most widely adopted strategies were reducing overall staff numbers, delivering some services more efficiently, and reducing or restructuring the senior management team.**
- **The three strategies that made the greatest financial contribution were reducing overall staff numbers, delivering some services more efficiently and entering into new service delivery arrangements with other public bodies.**
- **Our financial analysis shows that from 2010/11 to 2012/13, reduced spending on staff accounted for 48 per cent of councils' total spending reductions.**

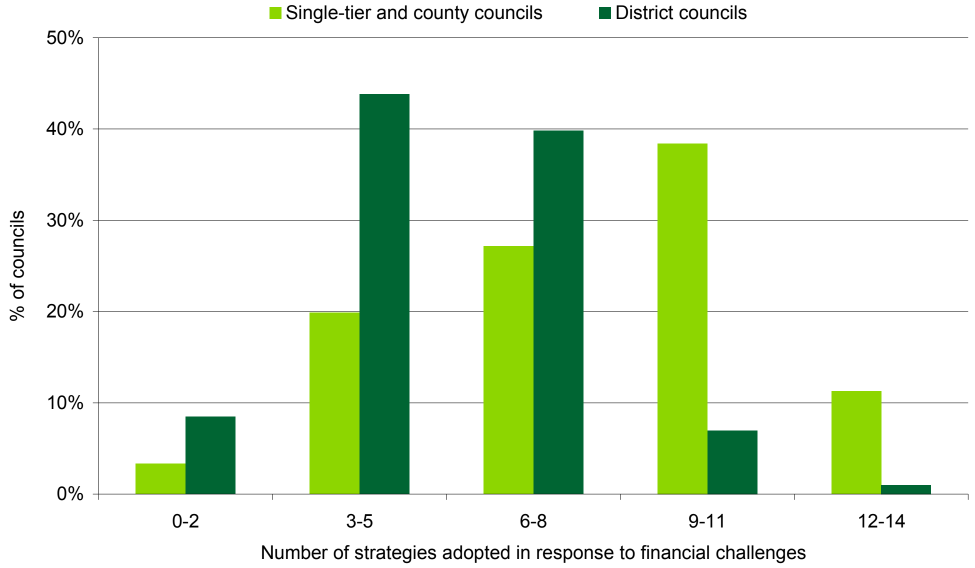
Strategies in response to financial challenges

74 This year our survey asked auditors to identify which of 14 strategies councils had adopted since 2010/11 in response to their financial challenges. It also asked them to indicate which of the adopted strategies had made the greatest contribution to achieving the council's financial objectives.

Number of strategies adopted

75 STCCs appear to have taken a more wide-ranging approach to addressing their financial challenges than DCs. They were most likely to have adopted nine to eleven of the strategies in our survey while DCs were most likely to have used three to five of the strategies (Figure 12).

Figure 12: Number of strategies adopted in response to financial challenges since 2010/11



Source: Audit Commission analysis of auditor survey responses

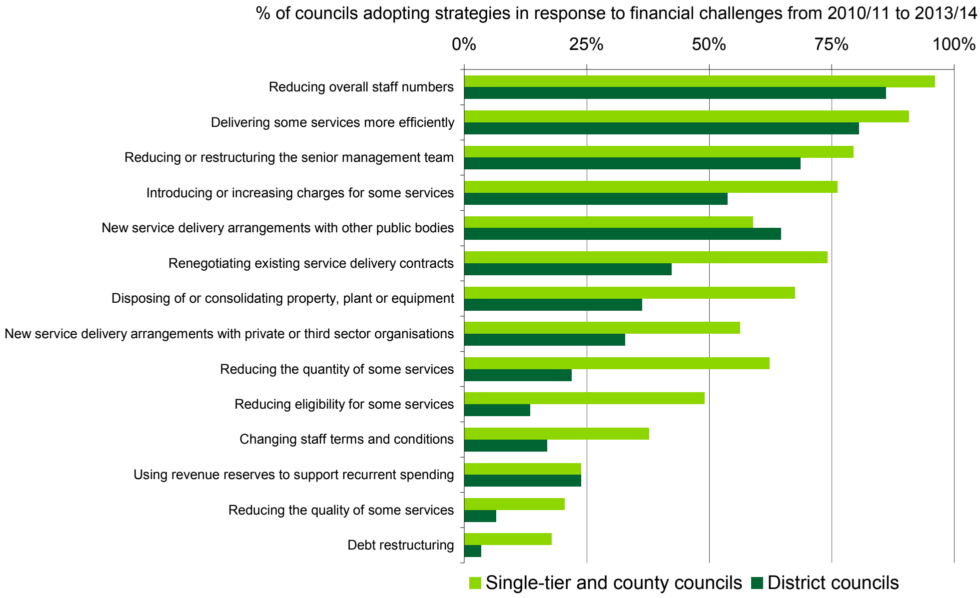
Prevalence of different strategies

76 Auditors' responses on which strategies councils have employed support the recent findings of many other local government commentators. They reveal notable differences, however, in the use of strategies by different types of council.

77 The three most commonly adopted strategies for both STCCs and DCs were (Figure 13):

- reducing overall staff numbers (96 per cent of STCCs and 86 per cent of DCs);
- delivering some services more efficiently (91 per cent of STCCs and 81 per cent of DCs); and
- reducing or restructuring the senior management team (79 per cent of STCCs and 69 per cent of DCs) – notably, this strategy was adopted by 91 per cent of unitary authorities.

Figure 13: Prevalence of strategies taken in response to financial challenges since 2010/11



Source: Audit Commission analysis of auditor survey responses

78 Auditors also reported that more than half of all councils had:

- introduced or increased charges for services:
  - adopted by 76 per cent of STCCs, but only 54 per cent of DCs;
- entered into new service delivery arrangements with other public bodies:
  - the only strategy to be more commonly adopted by DCs (65 per cent) than STCCs (59 per cent); and
  - much less likely to have been adopted by metropolitan district councils (42 per cent); and
- renegotiated existing service delivery contracts:
  - more common among STCCs (74 per cent) than DCs (42 per cent).

79 Two-thirds of STCCs (68 per cent) had disposed of or consolidated property, plant or equipment – though only 45 per cent of London boroughs had done so; and 36 per cent of DCs. Over half of STCCs (56 per cent) had entered into new service delivery arrangements with private or third sector organisations – 78 per cent of county councils had done so – but only 33 per cent of DCs adopted this strategy.

80 Fewer councils overall (although twice as many STCCs than DCs) had:

- reduced the quantity or quality of services, or reduced eligibility for them;
- changed staff terms and conditions; or
- undertaken debt restructuring.

81 Nearly one in four councils (24 per cent of both STCCs and DCs) had been strategically using revenue reserves to support recurrent spending – not simply as an unplanned measure to help them deliver the budget (as discussed in Chapter 3). County councils (44 per cent) were most likely to have done so, while just 13 per cent of unitary authorities had. As we reported in 2012 [Ref 19], the finite nature of reserves means that using them to support recurrent spending can only be a short-term strategy.

Impact of different strategies

82 We asked auditors to identify up to three of the strategies taken by councils that had made the greatest contribution to addressing financial challenges from 2010/11 to 2013/14.

83 The two most widely adopted strategies were also those that auditors most commonly reported had made a significant financial contribution to addressing financial challenges in both STCCs and DCs.

- Reducing overall staff numbers made a significant contribution for 68 per cent of councils that had adopted this strategy – but more commonly for STCCs (76 per cent) than for DCs (61 per cent). This strategy was less likely to have made a significant contribution for London boroughs (58 per cent).
- Delivering some services more efficiently made a significant contribution for similar proportions of STCCs (60 per cent) and DCs (58 per cent) that took this approach.

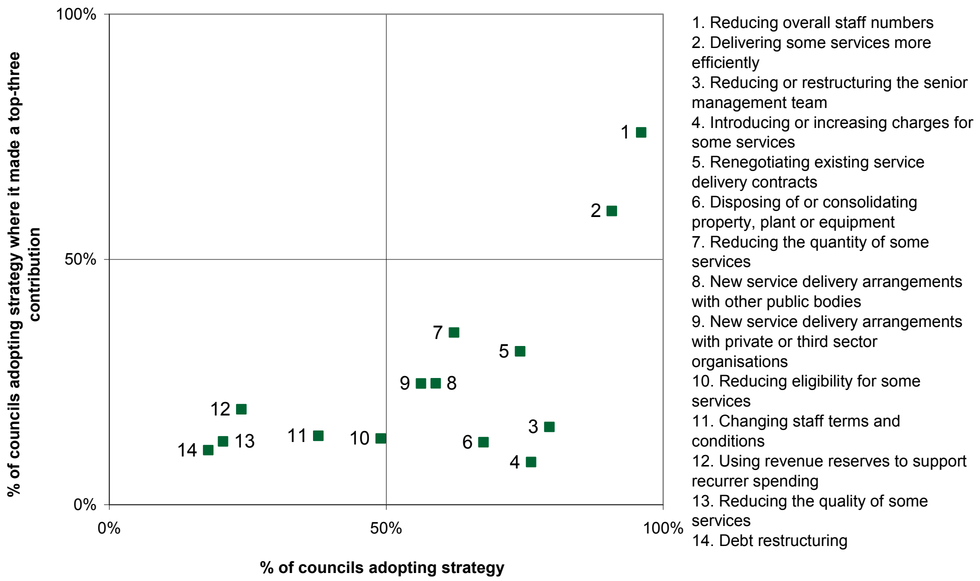
84 Only four of the other twelve strategies were reported by auditors to have made a significant contribution for more than a quarter of the STCCs adopting them (Figure 14). These were:

- reducing the quantity of some services (35 per cent of adopters) – which was more likely to have made an impact in London boroughs (59 per cent) than county councils (17 per cent);
- renegotiating existing service delivery contracts (31 per cent);
- entering into new service delivery arrangements with other public bodies (25 per cent) – though notably this made a significant contribution for only 7 per cent of metropolitan district councils that did so, compared with 45 per cent of county councils; and
- entering into new service delivery arrangements with private or third sector organisations (25 per cent).

85 Three strategies, though widely adopted by STCCs, were less likely to be identified as making a significant financial contribution:

- reducing or restructuring the senior management team (16 per cent of adopters);
- introducing or increasing charges for some services (9 per cent); and
- disposing of or consolidating property, plant or equipment (13 per cent).

Figure 14: Prevalence and impact of strategies to addressing financial challenges since 2010/11 – STCCs



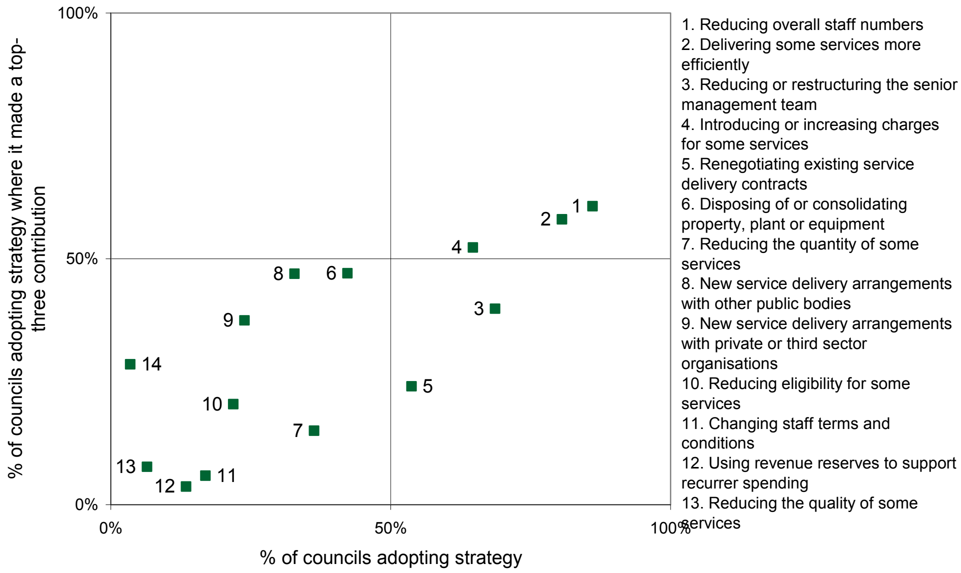
Source: Audit Commission analysis of auditor survey responses

86 As DCs adopted fewer strategies, the strategies they adopted were more likely to have made a significant contribution to addressing financial challenges (Figure 15). The increased likelihood that strategies made a significant contribution may also be a reflection of the different scale of the financial challenges faced by these councils.

87 In addition to the strategies mentioned in paragraph 83, three strategies made a significant contribution for about half of the DCs that adopted them:

- entering into new service delivery arrangements with other public bodies (52 per cent of adopters);
- renegotiating existing service delivery contracts (47 per cent); and
- entering into new service delivery arrangements with private or third sector organisations (47 per cent).

Figure 15: Prevalence and impact of strategies to addressing financial challenges since 2010/11 – DCs



Source: Audit Commission analysis of auditor survey responses

88 Our survey findings show that as councils consider how to address their ongoing financial challenges, some have a wider range of options still available to them than others. Those that have adopted only a small proportion of the strategies we identified can learn from the experiences of others to ensure they secure the maximum potential from future savings initiatives. Those that have already adopted a large proportion of the strategies we identified may be faced with a greater challenge as financial pressures continue. They will need to consider whether and how they can:

- apply already-used strategies more widely or to greater effect – bearing in mind that some of the strategies, such as using reserves or restructuring the senior management team, have more limited potential than others;
- apply as-yet-unused strategies – the least-used strategies in our survey include some that:
  - are likely to be unpopular with, or have a negative impact on, service users or staff, such as reducing the quality of services or changing staff terms and conditions; and
  - may not lead to sustainable savings in the long term, such as reducing eligibility criteria for services; or
- as a small number of councils already appear to be doing, adopt more innovative, transformational solutions to providing services that meet their statutory obligations and the needs of local people in ways that are less reliant on funding from government.

Reductions in spending on staff

89 In response to the findings of our auditor survey on the prevalence and impact of reducing overall staff numbers, we sought to quantify the contribution of staffing changes using published financial data.[i]

90 In 2012/13, total council spending on non-education[ii] employees was £18.4 billion. Allowing for inflation, councils' spending on employees reduced by 15 per cent from 2010/11 – the start of the period referred to in our auditor survey.

91 Spending on employees by STCCs reduced from 31 per cent of their total service spending in 2010/11 to 29 per cent in 2012/13. The proportion of total spending on employees by DCs increased marginally, from 36 per cent to 37 per cent, over this period.

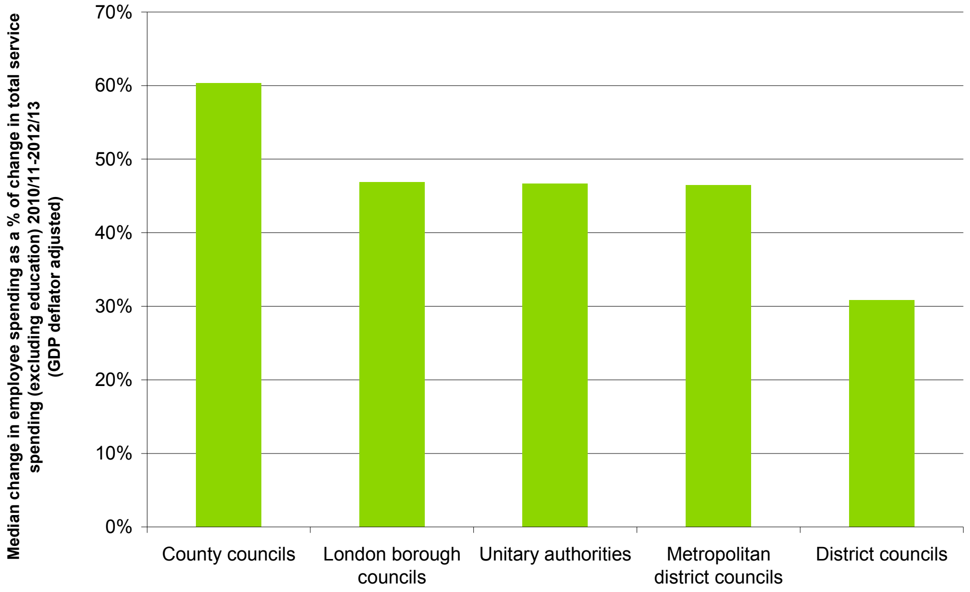
92 From 2010/11 to 2012/13, reductions in spending on employees accounted for 48 per cent of councils' total spending reductions, allowing for inflation. Employee spending reductions made the greatest contribution to total spending reductions for county councils – accounting for 60 per cent of the total spending reduction over this period, on average. They accounted for only 31 per cent of total spending reductions made by DCs, on average (Figure 16).

93 Our analysis shows that reduced spending on non-education employees has made a significant contribution to the overall spending reductions achieved by many councils. On average, employee spending by STCCs reduced by a larger proportion than running expenses from 2010/11 to 2012/13. DCs' employee spending reduced by a smaller proportion than running expenses over the same period.

i Our analysis is based on annual revenue outturn service expenditure summary data published by DCLG, which defines 'total expenditure' for service areas as the sum of spending on 'employees' and 'running expenses'. Employee spending includes direct and indirect employee expenses (excluding agency staff costs) and contributions to employee-related provisions. The 2012/13 data are provisional. Data are shown at 2013/14 prices.

ii To be consistent with the main financial analysis in this report we have excluded spending on education employees and services. Spending on education employees was £26.4 billion in 2012/13; 62 per cent of total education spending and 59 per cent of total spending on employees.

Figure 16: Change in non-education employee spending as a percentage of change in service spending 2010/11 to 2012/13 by council type



Source: Audit Commission analysis of DCLG revenue outturn service expenditure summary data. Data at 2013/14 prices

94 We have not examined the effect that staffing-related responses to financial challenges have had on councils' capacity to deliver services and manage change. A small number of auditors identified staff reductions as a challenge for councils, but these appear to have had less effect on others.

Chapter 7: Financial resilience in 2013/14 and beyond

This chapter describes:

- **the extent of auditors' concerns this year about councils' short- and medium-term financial resilience; and**
- **the characteristics of the councils that were thought to be most at risk by auditors.**

Key points:

- **Auditors reported that nine out of ten councils were well placed to deliver their budget in 2013/14, a small increase on last year.**
- **About two-thirds (64 per cent) of councils were well placed to deliver their medium-term financial plans, but auditors had concerns about the financial prospects of the other third (36 per cent).**
- **Based on auditors' responses, two thirds of councils (63 per cent) are considered to be a low financial risk. Three in ten (28 per cent) present a future financial risk. Nearly one in ten (8 per cent) present a current and ongoing financial risk.**

Delivering 2013/14 budgets

95 We asked auditors whether they thought councils were well placed to deliver their agreed budget in 2013/14, bearing in mind the council's financial performance to date and the quality of its financial management. Overall, auditors agreed that 91 per cent of councils were well placed to do so (89 per cent of single-tier and county councils; 92 per cent of district councils). This was a small increase from last year (Table 7).

Table 7: **Percentage of auditors who agreed or strongly agreed with the statement 'The Council is well placed to deliver its [year] GFRA budget.'**

	2011/12 (%)	2012/13 (%)	2013/14 (%)
Single-tier and county councils	88	87	89
District councils	92	88	92
All councils	**90**	**88**	**91**

Source: Audit Commission analysis of auditor survey responses

96 This left 9 per cent of councils where auditors were not able to agree the council was well placed to deliver its budget in 2013/14. The main factors that gave auditors cause for concern in these councils were:

- the ability of councils to deliver required savings, as:
  - savings plans had not yet been agreed, or were agreed late;
  - agreed plans may not deliver hoped-for savings; or
  - they had limited resources to invest in savings programmes;
- rising cost pressures, particularly in relation to social care for adults and children and homelessness;
- the scale of the reductions in revenue and capital funding from government, making the savings needed in 2013/14 more challenging than in previous years;
- weaknesses in councils' systems of financial reporting to identify budget variances, or concerns about the impact of staff changes in the finance function on financial controls;
- expected shortfalls in income from services;
- the unknown financial impact of changes in the mechanisms for business rates retention and for helping households pay council tax bills; and
- consequential effects for councils arising from wider welfare reforms.

97 The level of a council's financial reserves was rarely mentioned by auditors as a factor giving cause for concern, but our analysis shows that STCCs with a below average level of reserves relative to spending were three times as likely to feature in the group of councils where auditors had concerns.[i]

98 For most councils (77 per cent), auditors have agreed in all three of our surveys that the council was well placed to deliver its annual budget. In only four councils (1 per cent) were auditors unable to agree in all three surveys that the council was well placed to deliver its budget.[ii]

Delivering medium-term financial plans

99 Looking to the future, we asked auditors whether they thought councils were well placed to deliver their medium-term financial plans, bearing in mind the council's historic financial performance and the quality of its financial management. Overall, auditors agreed that 64 per cent of councils were well placed to do so (59 per cent of STCCs and 68 per cent of DCs). This was a marginal increase compared with our survey last year (Table 8).

100 This meant that, as they did last year, auditors had concerns about the future financial prospects of more than one third (36 per cent) of councils.

i Only 67 per cent of STCCs with below average reserves were thought well-placed to deliver their budget in 2013/14.

ii One London borough, one metropolitan district council, one unitary authority and one district council.

Table 8: **Percentage of auditors who agreed or strongly agreed with the statement 'The Council is well placed to deliver its medium term financial plan.'**

	2012 (%)	2013 (%)
Single-tier and county councils	57	59
District councils	67	68
All councils	**63**	**64**

Source: Audit Commission analysis of auditor survey responses

101 The group of councils that auditors thought were well placed to deliver their medium-term financial plans had typically seen smaller reductions in government income from 2010/11 to 2013/14 than those where auditors had concerns. For example, STCCs that were thought well placed to deliver medium-term plans expected reductions in government income of 18.3 per cent on average between 2010/11 and 2013/14, compared to an average reduction of 21.1 per cent for other councils. Similarly, DCs thought well placed in the medium term expected government income to reduce by 20.5 per cent on average from 2010/11 to 2013/14, compared to an average reduction of 23.6 per cent for other councils.

102 Auditors were more likely to be concerned about the financial prospects for unitary authorities (47 per cent of auditors did not agree they were well placed to deliver medium-term financial plans), London boroughs (45 per cent) and metropolitan district councils (42 per cent) than they were for DCs (32 per cent) or county councils (22 per cent).

103 The main issues giving auditors cause to doubt councils' ability to deliver their medium-term financial plans were an extension, in many cases, of the causes of concern for budget delivery in 2013/14. They included:

- future funding issues – including the impact of the additional reduction in funding for 2015/16 announced in the 2013 Spending Round; the uncertain scale of funding reductions beyond 2015/16; the withdrawal of other specific funding, such as PFI credits; and the reduction in New Homes Bonus funding on which some councils' plans were reliant;
- the anticipated scale of savings needed – which, in addition to the savings already achieved, would mean that councils' future cost reduction measures were likely to have a more noticeable impact on services than those made so far;
- the absence of plans to address budget gaps where these were known or could be anticipated – and concern that some councils would struggle to identify and implement further savings opportunities;
- business rates localisation – with uncertainty about income, councils' ability to drive business rates growth, and the impact of backdated valuation appeals;
- risks associated with plans to reconfigure service delivery – such as whether councils would successfully bring shared services back under

council control; realise savings from outsourcing and contract management; or cost-effectively implement joint working;
- councils' ability to manage increasing cost pressures – especially in relation to rising demand for services for vulnerable children and adults; demand for council tax support; and the consequential costs for councils of welfare reform, for example, in managing housing rent arrears; and
- concerns about other income – including the long-term impact of council tax policies on council tax income and the effect of interest rates on investment income.

104 The councils that gave auditors cause for medium-term concern in 2013 were more likely to also have been a source of medium-term concern in 2012. One in four STCCs (26 per cent) and one in five DCs (21 per cent) had uncertain medium-term prospects in both years.

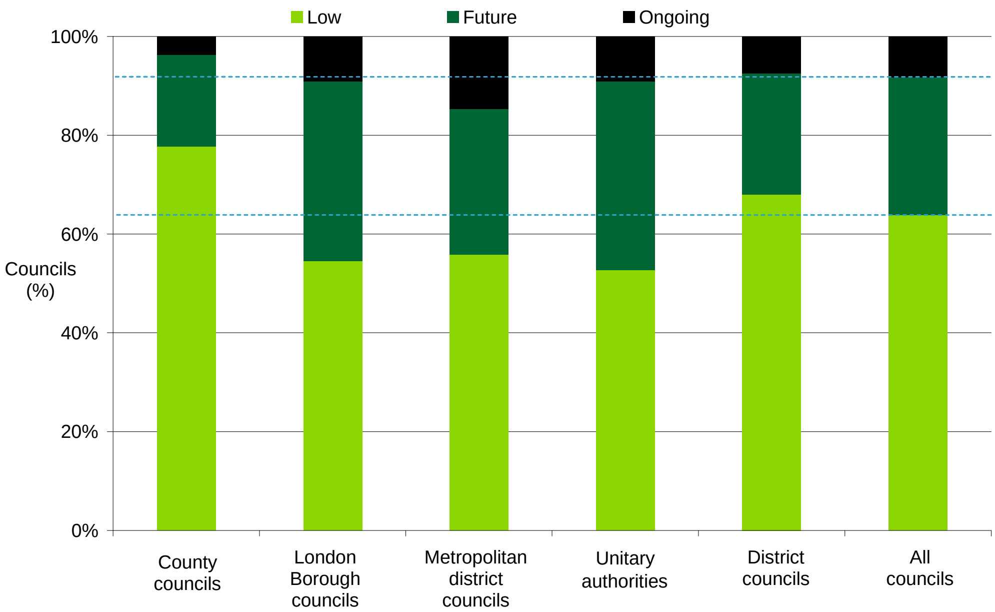
Councils at risk

105 Last year we used auditors' views on whether councils were well placed to deliver their current budget and medium-term financial plans to assign councils to one of three risk groups:
- a **low-risk** group – councils that were well placed to deliver their current budget and medium-term financial plans;
- a **future-risk** group – councils that were well placed to deliver their current budget but not their medium-term plans; and
- an **ongoing-risk** group – councils that were not well placed to deliver either their current budget or medium-term plans.[i]

106 Using the same approach, our research this year shows a broadly similar pattern of risk to last year for councils as a whole. The proportion of councils in the low-risk group has remained stable at 63 per cent. The proportion in the future risk group has increased from 25 to 28 per cent. The ongoing-risk group has fallen from 12 per cent to 8 per cent (Figure 17).

i This year, three councils (1 per cent) fall outside these categories, having been identified by auditors as a source of concern with regard to delivering the budget in 2013/14 but not in the medium term. They were excluded from the analysis.

Figure 17: Categorisation of financial risk in 2013 – by council type

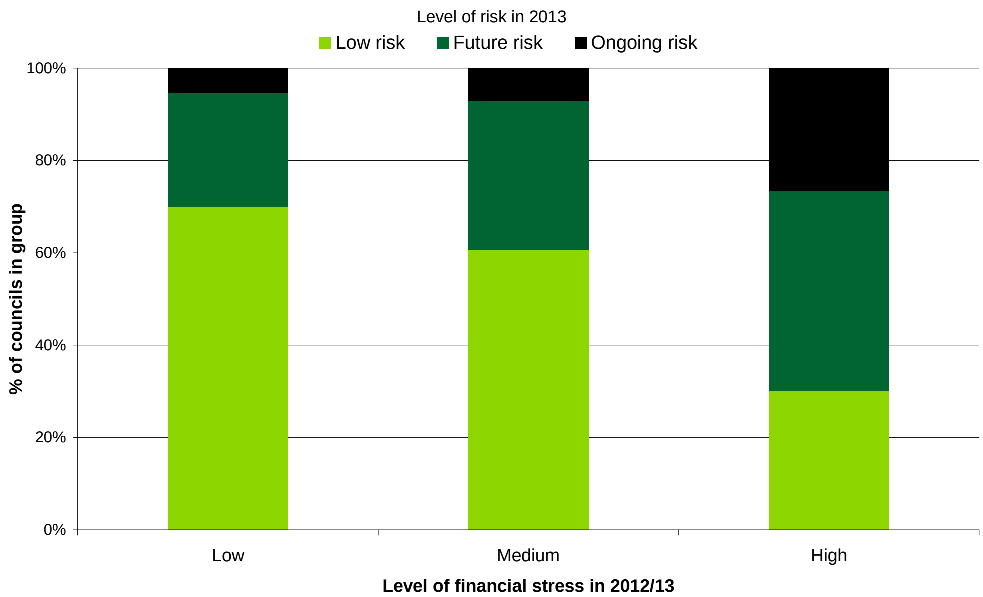


Source: Audit Commission analysis of auditor survey responses

107 County councils were least likely to be seen as a risk in 2013, with just 22 per cent in the future or ongoing risk categories. London boroughs, metropolitan districts and unitary authorities were more likely to be seen as a risk, with at least two-fifths of these councils in the future or ongoing risk categories. Metropolitan district councils presented the highest level of ongoing risk in 2013 with 14 per cent in this category.

108 Councils that present an ongoing or future financial risk in 2013 were more likely to have experienced high in-year financial stress in 2012/13. Of those with high financial stress in 2012/13, 70 per cent present an ongoing or future financial risk (Figure 18).

Figure 18: Relationship of financial stress in 2012/13 to financial risk



Source: Audit Commission analysis of auditor survey responses

109 Councils presenting an ongoing or future risk in 2013 were also more likely to have adopted a high number of strategies in response to financial challenges from 2010/11 to 2013/14. This suggests that auditors may be more likely to have concerns about councils that have already taken a wide-ranging response to financial challenges and have, as a result, fewer options for securing additional savings in the future.

Conclusions

110 In the face of financial challenges from 2010/11 to 2013/14, almost all councils have demonstrated a high degree of financial resilience. Auditors report that nine out of ten councils delivered their budgets in 2011/12 and 2012/13 without experiencing significant financial difficulties. Seven out of ten councils delivered their budgets in those years without needing to take unplanned actions. The prospects for delivering the budget in 2013/14 also appear good for about nine out of ten councils.

111 Our research also shows that funding reductions have not fallen equally. A small minority of councils have found it harder to cope than others, with one in ten experiencing significant difficulties in delivering the budgets they set in 2011/12 and 2012/13 and three in ten needing to take unplanned actions in those years to balance the books. One fifth of councils overall and a quarter of metropolitan and unitary authorities exhibited financial stress in both 2011/12 and 2012/13. Auditors have concerns about the ability of one in ten councils to deliver their budget in 2013/14. A few of these have been a source of concern to auditors in successive years.

112 In our first report on councils' financial resilience in 2011 we noted that councils were 'at the start of a difficult and uncertain period for their finances'. Our analysis this year shows councils' funding from government reduced by 19.6 per cent in real terms from 2010/11 to 2013/14 and council tax fell by 1.7 per cent. Central funding to councils will reduce further in 2014/15 and 2015/16 as part of the government's ongoing strategy to reduce the UK's budget deficit. Policies that aim to reduce or freeze council tax will continue in these years. There is uncertainty for councils about funding from government beyond that, and about the income they can expect from retained business rates in the future as the UK economy recovers from a period of low growth.

113 With uncertainty about the future funding available to deliver services, councils cannot be sure what savings they will need to make. Auditors report that at least one in ten councils do not yet have plans for how they will address the expected gap between funding and spending in coming years. It is understandable, therefore, that auditors are less confident about the medium-term financial prospects of one third of councils.

114 Our research shows councils have already adopted a wide range of strategies in response to financial challenges, although the long-term effect of these on councils' financial resilience or their ability to meet the needs of local communities is unknown. Councils, nevertheless, have valuable learning to share about how to secure the maximum benefit from their savings initiatives to date.

115 For about one in five councils, the available options to reduce spending in the future are becoming more limited. One in twenty auditors told us that councils are finding savings harder to identify, and harder to deliver with fewer resources. Where conventional strategies can no longer be relied on to deliver the savings needed, councils will need to innovate to develop new approaches to public service delivery that rely less on funding from government.

116 Councils must adapt in order to continue to provide services that meet their statutory obligations and the needs of their local communities with reduced levels of income. There will be ongoing risks for councils as they do so. As the Audit Commission is expected to close in March 2015, it will be for the government and others to find alternative ways to draw on the insights that auditors can provide about the financial resilience of England's councils and to remain vigilant for signs of financial stress.

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We welcome your feedback.

If you have any comments on this report, are intending to implement any of the recommendations, or are planning to follow up any of the case studies, please email: Public-Enquiries@audit-commission.gsi.gov.uk

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