# Tough times 2012

## Councils' financial health in challenging times

November 2012

audit commission

# Summary

## Impact of reductions in government support to councils

These are challenging and uncertain times for councils as they cope with the second year of the four-year Spending Review. The savings needed are lower in 2012/13 than in 2011/12, but the cumulative effect is significant for many.

Government funding to councils fell in real terms by £1.6 billion in 2012/13, compared to a cut of £3.4 billion in 2011/12. This two-year reduction in government funding of £5 billion is equivalent to 9.3 per cent of councils' 2010/11 revenue spending.[i]

**Impacts of cuts in government funding vary across the country.**

- The average reduction in government funding for single tier and county councils (STCCs) in 2012/13 was equal to 3.5 per cent of 2011/12 revenue spending, 2.8 per cent for district councils (DCs).
- Councils with the largest falls in government funding in 2012/13 often had the biggest reductions the year before, creating large cumulative differences between councils.
- Metropolitan district councils (MDCs) have been worst affected, with average two-year cuts equal to 12.4 per cent of their 2010/11 revenue spending, compared to only 5 per cent in county councils.

**Councils in deprived areas were most affected in both years.**

- Deprived areas in the north of England, the Midlands and inner London saw the highest cuts in both years of the Spending Review. Over two years, government funding as a proportion of 2010/11 revenue spending has fallen on average by:
  - 14.1 per cent among STCCs in the 20 per cent most deprived areas; and
  - 4.4 per cent among STCCs in the 20 per cent least deprived areas.
- But, after the cuts, councils in deprived areas still receive more government funding per resident than less deprived areas.

i Revenue spending is funded by government grants, council tax income and use of reserves. Expressing the cuts as a percentage of revenue spending gives a better picture of the local impact (see paras 23 and 24).

**The council tax freeze led to real-terms reductions in income in 2012/13, adding to financial pressures.**

- The second year of the council tax freeze saw a real-terms fall in council tax income of £400 million.
- The total real-terms reduction in income from government (£1.6 billion)[i] and council tax (£400 million) in 2012/13 is £2 billion.
- Councils that froze their tax rates in 2012/13 will face an ongoing reduction in their tax base, which is likely to increase financial pressures in future years.

## Councils' plans for 2012/13

**Councils are focusing cuts on a different mix of service areas than in 2011/12.**

- Councils protected adult social care (ASC) in 2011/12 by focusing cuts on smaller services, but this has not been possible for a second year as savings become harder to achieve over time.
  - Councils plan to increase savings from ASC in 2012/13 – the only service where spending reductions are planned to be greater than in 2011/12.[ii]
  - Planned savings from planning and development have fallen from an average of 27.2 per cent to 6.9 per cent for STCCs.
- Children's social care continues to be protected. This may reflect the very sharp recent increase in numbers of children in care.

## How councils coped financially in 2011/12

**Councils performed well in 2011/12 – meeting their savings targets, and in general building up their reserves.**

- Actual total service spend (excluding education) fell by 7.4 per cent among STCCs, and 8.9 per cent for DCs – against planned cuts of 6 per cent and 9 per cent respectively.
- Councils increased their reserves (by £1.3 billion in 2011/12) despite budgeting to reduce them. This has been a consistent trend over recent years.
- Two factors appear to have driven the growth of reserves in 2011/12:
  - some councils have been highly effective in meeting their savings targets, creating underspends which could be added to reserves; and
  - councils are putting money aside to mitigate the risks of the ongoing cuts programme and changes to council funding from April 2013.

i The £1.6 billion reduction is net of the 2012/13 council tax freeze grant. See para 21.
ii A 3.4 per cent real-terms reduction is planned for 2012/13 compared to 2.2 per cent in 2011/12.

**Although the majority of councils dealt well with the challenges in 2011/12, there were signs of financial stress among a sizeable minority.**

- Appointed auditors reported (in our survey) that only 9 per cent of councils experienced 'high in-year financial stress'.[i]
- However, a further 30 per cent showed 'medium' financial stress.[ii]
- In-year financial stress was mainly driven by the size of the financial challenge facing a council. In particular, those with high cuts and/or low reserves were most likely to have struggled in 2011/12.
- But there is evidence that good management helped councils overcome financial challenges and reduce in-year stress – while weaker management exacerbated problems raised by financial challenges.

**Councils' performance in meeting their 2011/12 savings targets was good – but this does not mean that services were unaffected.**

- Auditors only reported on councils' financial resilience – which has proved to be relatively strong in 2011/12.
- However, a balanced budget can sometimes be achieved only at the expense of reductions in service provision. Our research for this report did not look at services so we cannot comment here on whether they have been affected.

## Prospects for future financial health

**Looking forward, auditors feel that the majority of councils are well placed to cope financially, but there are some concerns.**

- Auditors identified 12 per cent of councils that represent an ongoing risk, as they are not well placed for 2012/13 or for the remainder of their medium-term plans.
- Auditors feel that there is a further 25 per cent of councils that represent a future risk, in that they are well placed to deliver their 2012/13 budget, but less so for the remainder of their medium-term financial plan.

**Auditors are most concerned by councils that struggled in 2011/12 and face significant financial challenges in 2012/13.**

- Councils that showed signs of financial stress in 2011/12 are significantly more likely to be viewed as an ongoing or future risk by auditors.

i Councils with high in-year stress were those where the auditor felt there had been financial difficulties in 2011/12, and the council had to take at least one unplanned financial action in-year (out of a possible seven different types) in order to deliver their budget.

ii Medium-stress councils undertook unplanned in-year actions, but were not felt to have been in financial difficulty in the view of the auditor.

- Councils facing large financial challenges in 2012/13 – high cuts and/or low reserves – are more likely to be seen as a risk by auditors.

**Auditors are particularly worried by councils that dealt with their 2011/12 financial problems by seeking additional revenue.**

- Councils that addressed in-year stresses in 2011/12 primarily through extra spending reductions and efficiencies were seen as less of a risk for future financial years.
- Auditors were more concerned about councils that tried to address their 2011/12 problems through capitalisations[i] or unplanned use of reserves.

## Future reports

The Audit Commission will publish a report on council reserves, later in 2012.

There will be another report in the *Tough Times* series in 2013 that will continue to monitor and report on councils' progress in dealing with the 2010 Spending Review.

i These are capitalisations requested under exceptional circumstances.