Appendix B

Tough Times 2012 – Summary

Councils' financial health in challenging times
Report of the Audit Commission (November 2012)

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% of councils' 2010/11 revenue spending.[1]

- **Impact of cuts in government funding vary across the country**

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

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

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.[2]
  - Planned savings from planning and development have fallen from an average of 27.2% to 6.9% for single tier and County Councils (STCCs).
- Children's social care continues to be protected. This may reflect the very sharp recent interest 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% among STCCs, and 8.9% for District Councils (DCs) – against planned cuts of 6% and 9% 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:

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[1] 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.
[2] A 3.4% real-terms reduction is planned for 2012/13 compared to 2.2% 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.

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

- 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 challenge 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% 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% 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.
- Councils facing large financial challenges in 2012/13 – high cuts and/or low reserves – are more likely to be seen as a high 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[3] or unplanned use of reserves.

Future reports

[3] These are capitalisations requested under exceptional circumstances.

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.