

Tough times

Councils' responses to a challenging
financial climate

November 2011

The Audit Commission is a public corporation set up in 1983 to protect the public purse.

The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

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Foreword

Councils face significant cuts in funding from central government, as well as reductions in other sources of income. To assess the implications for services, and for councils' financial resilience, we need to understand the actions taken by councils to deliver their budgets.

The Audit Commission's new financial analysis in this report provides a comprehensive picture of the impact of changes in funding for councils, and councils' responses to those changes. We have quantified the extent of government cuts, changes in other income, the use of reserves and impacts on service spending. Our auditors have provided information on how councils' plans will affect service provision. We have drawn on auditors' expertise to assess how well councils are coping, and to highlight some of the shared characteristics of councils deemed to be 'at risk'.

Councils are at the start of a difficult and uncertain period for their finances. But, despite the challenges, auditors felt most were coping well so far. They expected 90 per cent of councils to balance their 2011/12 budget. To do this councils have improved efficiency, cut services, increased fees and charges, and have used reserves. Although almost all councils planned to make service cuts, there is variation in how councils have balanced these approaches, with some protecting services more effectively than others.

Councils are trying to minimise spending cuts in priority areas such as adult social care, but this has meant potentially unsustainable levels of cuts in smaller services, such as planning. Services protected this year may need to make bigger contributions to future savings.

Ten per cent of councils were at risk of not balancing their budgets. These councils were not simply those facing the biggest cuts. The councils at highest risk faced a combination of significant financial challenges and poor financial management. Well-managed councils appear able to cope, even with severe cuts in funding.

This report should help senior officers and members in councils review and challenge their current plans to maintain financial resilience and to assess their readiness to meet future challenges.

Summary

Government funding to councils has fallen in real terms by £3.5 billion, 11.8 per cent, since 2010/11.

- The 2010 emergency budget cut £805 million of government funding to councils in 2010/11.
- The 2010 Spending Review announced that support to councils would fall by a further 26 per cent by 2014/15.

Impacts of falls in government funding vary across the country.

- The average cut for single tier and county councils (STCCs) was equal to 6.3 per cent of 2010/11 revenue spending, 7.8 per cent for district councils (DCs):
 - 27 STCCs will see cuts equivalent to over 10 per cent of 2010/11 revenue spending; but
 - 22 STCCs will see cuts of less than 3 per cent.

Councils in deprived areas were most affected.

- Deprived areas in the north, the midlands and inner London saw the highest cuts.
- But, after the cuts, these councils still receive more government funding per resident than less deprived areas.

Local income is also falling, adding a further loss of £1.2 billion to the government cuts. Councils face a total reduction of £4.7 billion.

- Councils expect income from fees and charges to fall by 5 per cent in real terms – an estimated loss of over £700 million.
- The council tax freeze for 2011/12 means a real-terms loss of £476 million in council tax income.
- These constraints on local income increase the funding gap by £1.2 billion, in addition to the £3.5 billion government cuts.

Councils hold significant levels of reserves: most are earmarked for specific purposes.

- At the start of 2011/12, councils held almost £12 billion in reserves, equivalent to 30 per cent of revenue spending.
- Of this, 71 per cent was earmarked for known future liabilities.

There may be scope to use reserves more to support spending, but this should be as a short-term measure within a sound financial plan.

- Planned use of reserves will not make a big contribution to meeting the funding gap in 2011/12.
 - Overall, STCCs plan to take £351 million more out of reserves in 2011/12 than in 2010/11. This covers 8 per cent of their total fall in income, and represents 18 per cent of their unallocated reserves.
 - DCs plan to take £23 million less from reserves than they did in 2010/11.

Spending on services will fall by an average of 6.5 per cent in STCCs and 8.5 per cent in DCs in real terms. Councils are trying to protect priority services.

- Spending on adult social services will fall by an average of 2.5 per cent.
- But spending on planning and development will fall by 28 per cent in STCCs and 16 per cent in DCs on average.

Some smaller services face big reductions in 2011/12. Services protected this year will need to contribute to future savings plans.

- Almost half of the savings needed in STCCs will come from planning, housing and cultural services. But these services made up only 16 per cent of service spending.
- Adult social care is over 40 per cent of STCCs' spending, but will contribute just 18 per cent of the 2011/12 savings.
- STCCs facing the biggest cuts are most likely to target smaller services. Planning and development budgets will fall 50 per cent on average in these councils in 2011/12.
- Large savings in small services are not sustainable.

Auditors considered that most councils were well prepared to meet the financial challenge.

- Our survey showed that most auditors (90 per cent) felt their councils would deliver their 2011/12 budgets.
- Council leadership teams understand the financial situation and effective challenge has been provided by elected members during budget setting.

Auditors were also positive about councils' arrangements to deliver efficiency savings.

- Most councils were using benchmarking information to identify efficiency improvements and were challenging how services are delivered.

But auditors had concerns about a few councils.

- Auditors doubted whether a minority (10 per cent) of councils would achieve their 2011/12 budget.
- There is a risk that emergency in-year measures, such as additional spending cuts, could be needed in these councils.

Big expenditure cuts are always hard but auditors feel that well-managed councils can deliver their 2011/12 budgets.

- Facing big cuts is not, on its own, enough to worry auditors.
- It is councils with big cuts and weak management that are at higher risk of not achieving their budget.
- Good financial management is helping most councils cope in 2011/12.
- Future years will provide a continuing, and possibly tougher, test of councils' financial management skills.

Although budgets will be delivered in most councils, there will be some impacts on service levels.

- Despite generally good arrangements to identify efficiency savings:
 - most councils will reduce the quantity or frequency of some services and will raise fees and charges; and
 - in around a quarter of STCCs the impacts will be more widespread, including changes to quality and eligibility criteria.
- Local performance is still a factor. We found no link between the size of cuts and the extent of impacts on services. Some councils are better at minimising service impacts than others.

Recommendations

Most councils prepared well for 2011/12, but the future will be challenging for all councils.

Councils should:

- ensure they have up-to-date medium-term financial plans for the remainder of the current spending review period and beyond;
- ensure that future savings plans are sustainable – despite growing demand, identifying greater savings in areas such as adult and children’s social care may be necessary in many councils;
- subject their savings proposals to rigorous appraisal and evaluation to ensure they will deliver planned savings, and do not have unanticipated consequences for local people and the local economy;
- challenge and review policies on the level and use of reserves - focusing particularly on the assumptions and policies underlying the purpose and size of earmarked reserves;
- use the Audit Commission Value for Money profiles ([link](#)) to see how their council compares to the national picture set out in this report, identify councils facing similar challenges, and learn from others’ approaches.

Councils should also:

- review their financial planning and management arrangements – see good practice in *Strategic Financial Management* (Ref 1);
- assess their portfolio of services and activities – see local challenge in *Strategic Financial Management* (Ref 1);
- review their collection and use of information for decision-making – see standards in *Is There Something I Should Know?* (Ref 2); and
- consider the guidance in the forthcoming joint report, *Work in Progress: Meeting Local Needs With Lower Workforce Costs*, from the Commission and the Local Government Association. The report will examine how councils have already made immediate savings by reducing workforce costs, and the transformational change that may be required over the longer term.

Chapter 1: Introduction

Background

1 Councils faced reductions in government funding following the 2010 Spending Review and Emergency Budget (Refs 3, 4). Whether a council remains financially stable in these changing circumstances depends on the quality of its financial management, and the size of the challenge it faces. This report, based on new analysis of council budget data, and a survey of all appointed auditors, focuses on how councils dealt with these issues in preparing for 2011/12.

2 This report is relevant for council leadership teams, both officers and members, as they prepare their spending plans for 2012/13. It allows them to compare their circumstances and their actions against the national picture. It also provides policy-makers and other stakeholders with a broad picture of the implications of councils' 2011/12 spending plans for service funding and provision.

Objectives

3 The reduction in government funding to councils is a challenge for councils' financial management. It presents a potential risk to their financial health and to service provision. Our overall aim was to quantify the challenges and assess how councils have responded. Our objectives were to:

- measure the challenges to council finances in 2011/12, including the size and distribution of cuts in government funding;
- understand changes in important sources of local income such as fees and charges;
- identify councils' financial management actions to balance their budgets, including use of reserves;
- build up a picture of how falls in government funding will affect service spending and service provision; and
- use the expertise of local auditors to assess councils' ability to cope in challenging circumstances and to identify the key risks to financial resilience.

Data in the report

4 We have used revenue account (RA) data provided by councils. This sets out the funding information councils used when setting their budgets, and also details their plans for spending and use of reserves. Our analysis of RA data is presented in real terms at 2011/12 prices.

5 We also surveyed all Audit Commission appointed auditors in May 2011 to gather their emerging views on the impact of falls in government support, and councils' responses, as they prepared their plans for 2011/12.ⁱ

6 Our new analysis of the RA data, supplemented by information from our auditor survey, enabled us to build an overall picture, comparable across all councils, of:

- the cuts in government funding;
- trends in other sources of income;
- the total size of the funding gap; and
- the tactics used to meet that gap.

7 The methodology paper ([link](#)) describes the research methods and provides detailed definitions of the financial variables used in this report.

Comparability with Department for Communities and Local Government (DCLG) data

8 Our use of RA data means that the figures in this report are not directly comparable with those published by DCLG at the time of the settlement. DCLG's data is a comprehensive account of the settlement but it does not include the in-year cuts in 2010/11 or any details on council spending plans. DCLG data is also in cash values while ours is in real terms.

9 Any disparities between our analysis and DCLG's are driven by differences in data sources and reporting (particularly the difference between real-terms and cash values) rather than any disagreement over the size of reduction faced by councils (see methodology – [link](#)).

ⁱ The survey was completed by auditors between March and May 2011 as part of their Value for Money (VFM) conclusion work. The results were reported back to auditors in July. There was a 100 per cent response rate.

Chapter 2: The size of the challenge

National deficit reduction

10 The government's deficit reduction plan involves significant cuts in public spending. So far, for councils this includes:

- £805 million of in-year cuts to specific grants (1.5 per cent of 2010/11 revenue spend) during 2010/11 (Ref 5); and
- a further 26 per cent reduction in government support by 2014/15 announced in the 2010 Spending Review (Ref 6).ⁱ

Challenging and uncertain times for council finances

11 Councils have entered a period of financial uncertainty. 2011/12 is the first of four years of cuts in government funding. Almost 60 per cent of the total planned reduction in DCLG funding to local authorities is yet to come between 2012/13 and 2014/15 (Ref 3).ⁱⁱ

Councils also face other changes and challenges in the medium term including:

- proposals for the retention of business rates and the localisation of council tax benefit, which raise uncertainties about future funding; and
- the impact of the ending of one-year funding for a council tax freeze in 2012/13.

12 This report focuses on how councils have prepared for 2011/12.

ⁱ Funding from DCLG to councils will fall by 28 per cent by 2014/15. If funding from other government departments is included the reduction is 26 per cent, but this also includes funding to police and fire bodies as well as councils.

ⁱⁱ This is the fall in the DCLG Departmental Expenditure Limit (Ref 3). This includes police and fire funding, and excludes some specific grants from other government departments.

Reduction in government funding in 2011/12

13 Councils reported that central government funding fell by £3.5 billion between 2010/11 and 2011/12 – a reduction of 11.8 per cent. The fall varies between types of councils – Table 1.

Table 1: **Central government support to STCCs fell by 12 per cent and to DCs by 16 per cent in real terms**

	Change in central government funding 2010/11 – 2011/12 (%)
County Councils	-8.1
Unitary Authorities	-12.3
London Borough Councils	-12.2
Metropolitan District Councils	-13.4
Single Tier & County Councils	-11.6
District Councils	-15.7
All Councils	-11.8

Source: Audit Commission analysis of RA data

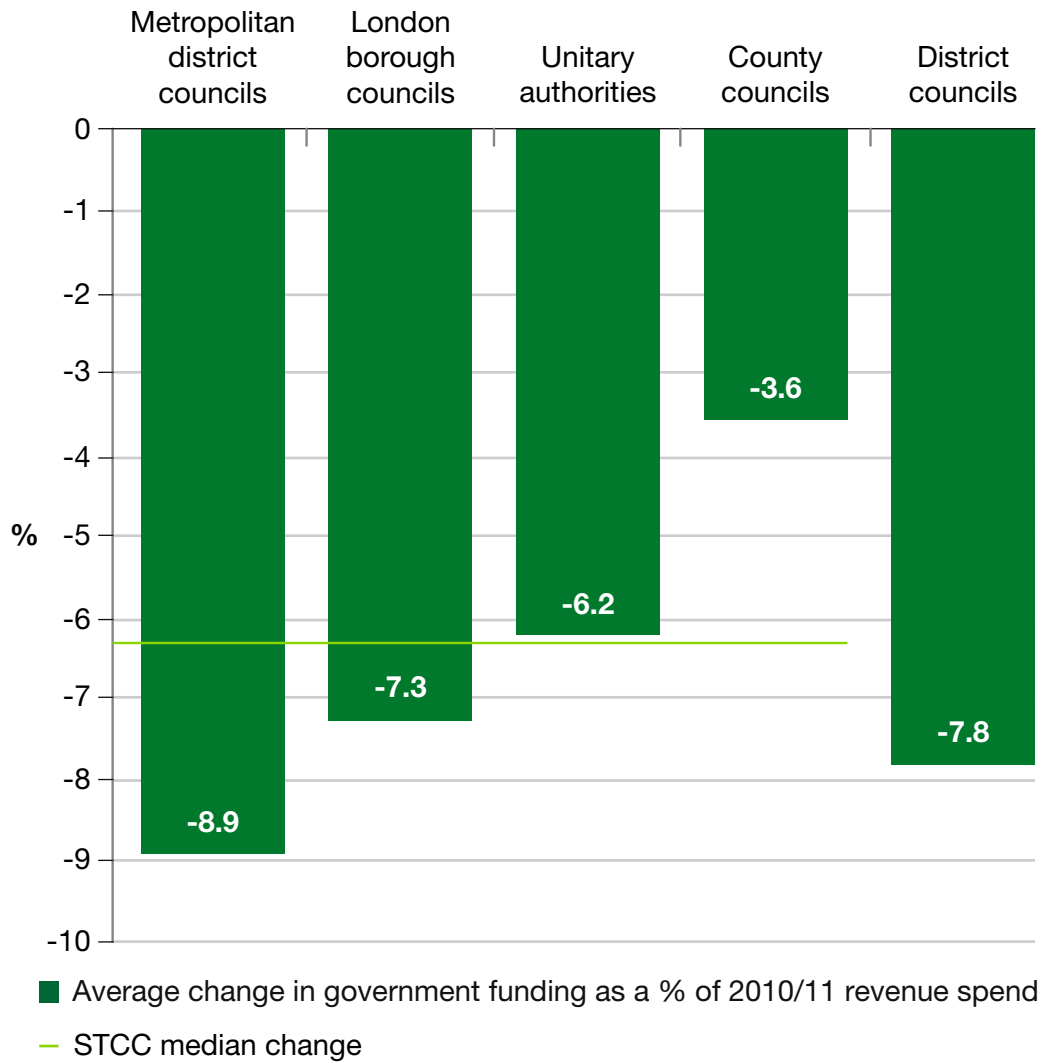
Impact of cuts on councils' spending

14 Central government is only one source of council funding, and the proportion of spending funded by this source varies among councils from 16 to 76 per cent (Ref 7). So to get a meaningful and comparable measure of the significance of reductions in government support, we compared each council's cut with their 2010/11 revenue spending.

15 Figure 1 shows the loss of government funding as a proportion of the planned 2010/11 revenue spending by council type.ⁱ For STCCs, the average cut in government funding represents 6.3 per cent of 2010/11 revenue spending. In DCs this is 7.8 per cent. One of the reasons for this difference is that government provided additional funding for adult social care; an STCC responsibility.

ⁱ Fees and charges income is excluded from this definition of revenue spending. It is not recorded on the RA forms.

Figure 1: **The impact of cuts varies by council type**

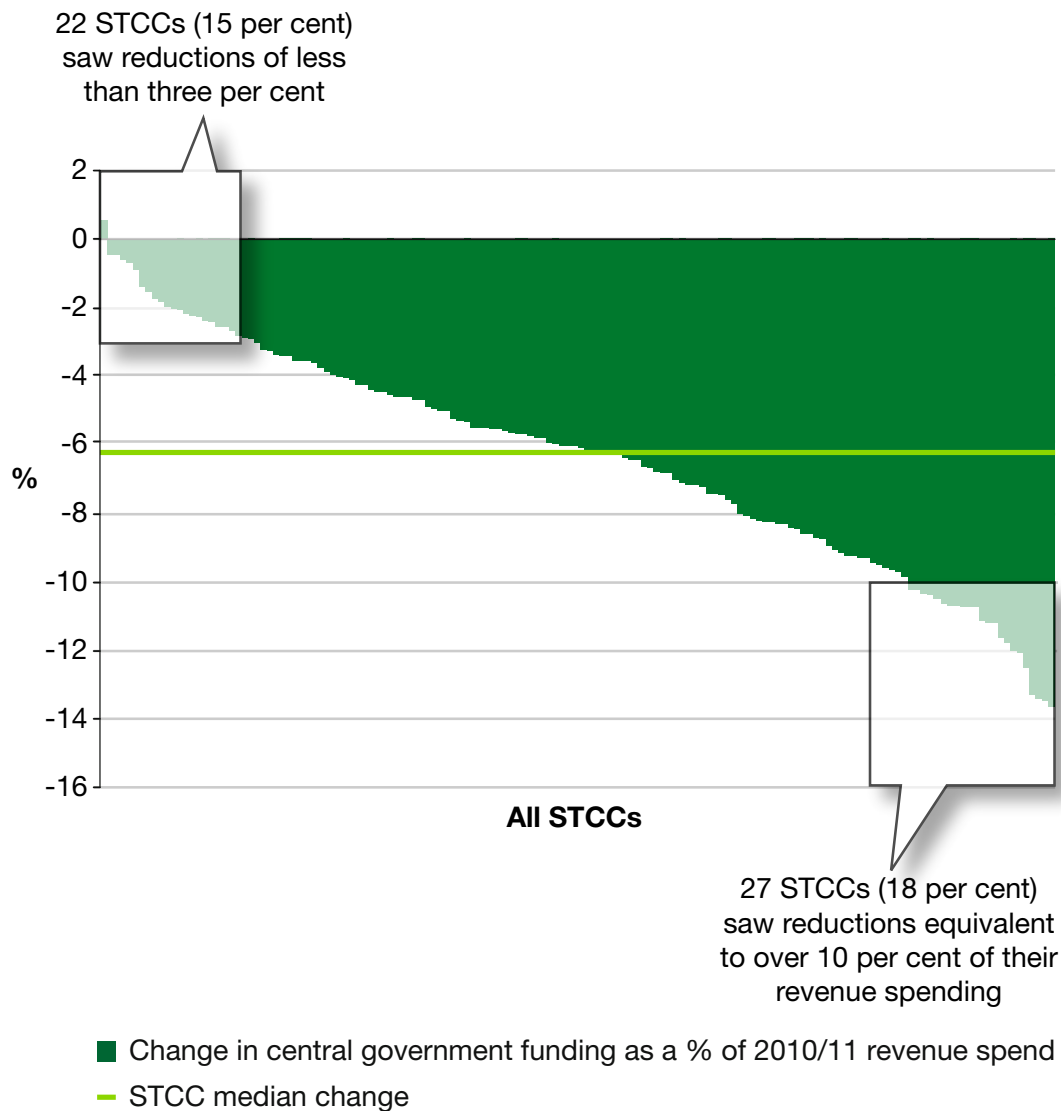


Source: Audit Commission analysis of RA data

Distribution of cuts

16 The local impact of cuts in government funding varied significantly. Some councils are largely unaffected, while others face reductions of 14 per cent (Figure 2).

Figure 2: **27 STCCs lost government funding equivalent to over 10 per cent of their 2010/11 revenue spendingⁱ**



Source: Audit Commission analysis of RA data

ⁱ Note this is not the same as DCLG's change in revenue spending power calculations. See methodology paper ([link](#)) for details.

- 17** The variation in impact among STCCs is due to two main factors:
- the extent of each council's reliance on government support as a source of income; and
 - the significance of specific grants to a council's income.

Reliance on government funding

18 Government funding to councils is a combination of formula grant and a range of specific grants.ⁱ Some areas are more dependent on central government grant than others. These tend to be more deprived areas because specific grants often focus on need, and formula grant is also distributed to reflect need. This means deprived areas have historically received more government support per capita, and are more reliant on it as a source of income.ⁱⁱ Hence they are relatively more affected by changes in government funding.

Significance of specific grants

19 Councils that are more dependent on specific grants have experienced larger reductions in overall funding. The most deprived councils were protected in the allocation of formula grant, but not for specific grants (Ref 8).

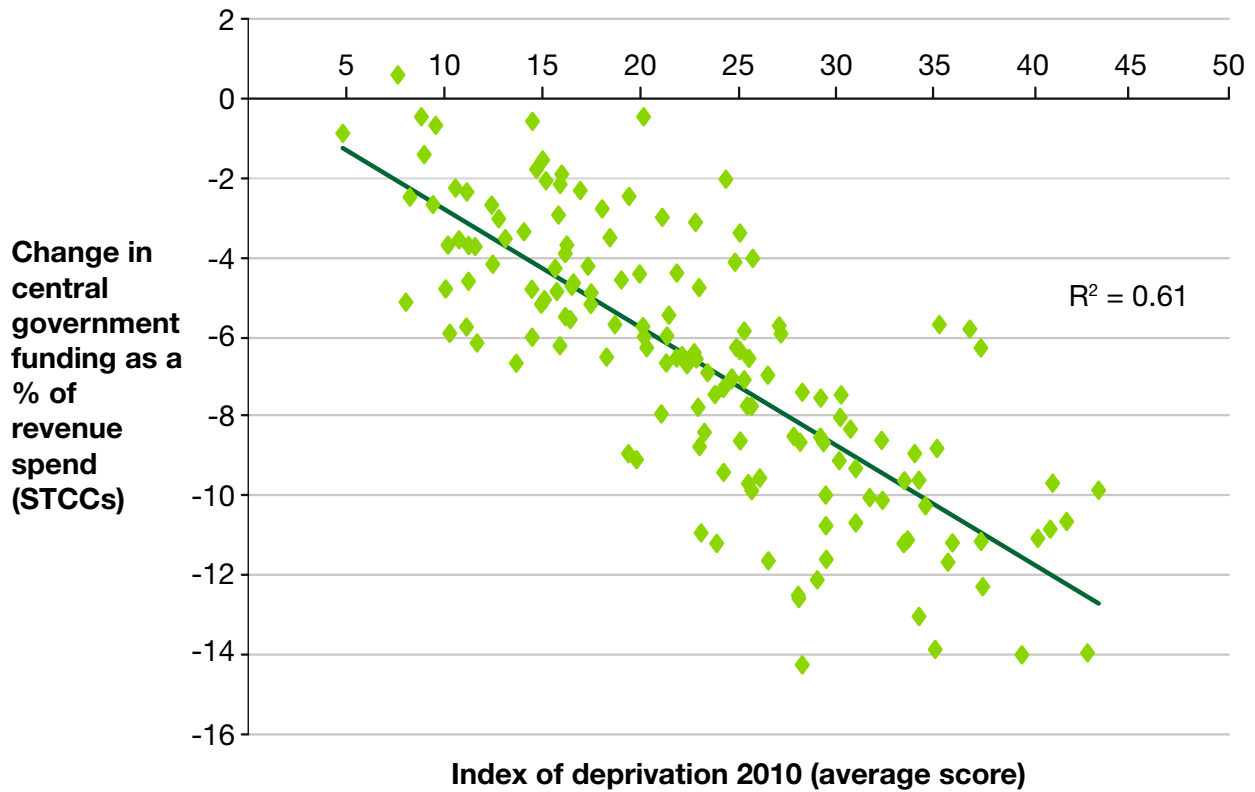
ⁱ Formula grant is distributed using a formula, weighted to give areas with greater needs more funding, and is adjusted to take account of ability to raise income through council tax. Specific grants are provided to individual councils for defined purposes and are distributed in a variety of ways. They have often been focused on tackling social needs.

ⁱⁱ Government support in 2010/11 funded 72 per cent of revenue spending for councils in the 25 per cent most deprived areas compared to 41 per cent in the least deprived areas.

Deprived areas have been hardest hit

20 The impact of the reductions in central funding will be felt most strongly in deprived areas (Figure 3).

Figure 3: **There is a strong link between local deprivation and the scale of funding reductions (STCCs only)**



Source: Audit Commission analysis of RA data: Indices of Multiple Deprivation 2010 (IMD)

21 The links between specific grants, deprivation and reliance on government funding give a clear geographical pattern to the impact of the cuts. The biggest reductions in government support as a share of revenue spending are in urban areas in the north, the midlands and inner London.

Hardest hit councils still receive more funding per head

22 Inner London boroughs have lost £155 of government support per resident (a 14.2 per cent fall), compared to just £20 (an 8.1 per cent fall) in East of England (Table 2). But even with these reductions inner London boroughs, and other deprived regions, still receive higher government financial support for each resident than more affluent areas.

Table 2: **Change in total amount of central government support by regionⁱ**

	Government support per capita in 2010/11 (£)	Government support per capita after the cuts (2011/12) (£)	Change in government support per capita (£)
Inner London	1094	939	-155 (-14%)
North East	744	632	-112 (-15%)
North West	556	481	-75 (-14%)
Yorkshire & Humber	546	478	-68 (-13%)
Outer London	590	527	-63 (-11%)
West Midlands	461	405	-56 (-12%)
East Midlands	294	258	-36 (-12%)
South West	313	282	-31 (-10%)
South East	232	206	-22 (-10%)
East of England	245	225	-20 (-8%)

Source: Audit Commission analysis of RA data: 2010 Mid-Year Population Estimates (ONS)

What affects the scale of the financial challenge?

23 The local impact of the national reduction in government support varies significantly. The most severely affected councils are more likely to share the following (linked) features:

- higher dependence on government funding;
- more government funding per capita;
- higher levels of deprivation; and
- are most likely to be in urban areas in the north, midlands and inner London.

ⁱ Includes STCC and DC income.

Chapter 3: Balancing the budget

24 Councils have three main ways to balance their budgets:

- increasing local income – council tax and fees and charges;
- using reserves; and/or
- reducing spending.

Increasing local income

Council tax

25 DCLG encouraged councils to freeze 2011/12 council tax. All councils complied.ⁱ The freeze, and the impact of inflation, resulted in a real-terms loss in the value of council tax income of £476 million.

26 The government provided council tax freeze grant, equivalent to a 2.5 per cent council tax increase, to all councils that complied. This totalled £551 million. As council tax freeze grant is central funding we have included it in the net £3.5 billion cut in government grant (Paragraph 13). This £3.5 billion cut, plus the £476 million loss in the real value of council tax, means councils have lost £4 billion of grant and council tax income in total.ⁱⁱ

27 The council tax freeze grant will continue throughout the spending review period to make up the revenue foregone by freezing council tax in 2011/12. There is a further grant on offer to encourage another council tax freeze in 2012/13. However, that grant will be for one year only, so will not make up the ongoing loss in the tax base arising from the 2012/13 freeze in future years.

28 The outcome of the council tax freeze is that a central government grant has replaced an element of locally raised tax income. As each year passes, and the value of frozen council tax reduces through inflation, it will be harder for councils to make up the revenue foregone should the freeze grant end.

ⁱ No council raised council tax. A few (3 STCCs and 24 DCs) reduced council tax by between 0.1 and 3.6 per cent.

ⁱⁱ The fall in government grant is £4 billion if the extra freeze grant is instead treated as council tax income. This is illustrated in Table 6, page 23.

Fees and chargesⁱ

29 Income from fees and charges is significant in many councils.ⁱⁱ Increasing income from this source could offset reduced government funding. Although many councils planned to increase charges for specific services, total income from fees and charges is expected to fall because:

- demand for some fee-earning services, such as planning and car parking, has fallen (Ref 7);
- council-funded, fee-earning activity will fall as spending is cut, so fee income will also fall; and
- some councils are using increases in fees and charges to reduce demand for services – resulting in falls in total fees and charges income (Ref 9).

30 Councils expect income from fees and charges to decline by between 3.9 and 6.6 per cent on average (Table 3). However, 16 per cent of STCCs and 20 per cent of DCs expect increases in fees and charges income.

Table 3: **Councils expect less income from fees and charge**

	Median change in expected income from fees and charges (%)
County councils	-6.6
Metropolitan district councils	-5.3
Unitary authorities	-5.2
London borough councils	-3.9
Single tier and county councils	-5.3
District councils	-4.1
All councils	-5.0

Source: *Audit Commission Financial Resilience Auditor Survey*

Note: Base - 93 STCCs and 129 DCs

ⁱ Data on fees and charges is based on survey returns from auditors covering 62 per cent of STCCs and 64 of DCs.

ⁱⁱ Income from fees and charges was equivalent to 14 per cent of total service spending for STCC and 28 per cent for DCs (Ref 7).

31 STCCs expect to lose £648 million in total in income from fees and charges. DCs will lose £75 million.ⁱ

Use of reservesⁱⁱ

32 Councils can also use money they hold in reserves to reduce the need for spending reductions. We consider:

- the amounts held in reserves;
- planned use of reserves; and
- patterns in planned use.

How much is held in reserves?ⁱⁱⁱ

33 At the start of 2011/12 councils held £11.8 billion in reserves (Table 4). On average, 29 per cent of councils' holdings were unallocated.^{iv}

Table 4: **Amounts held in reserves are significant when compared to revenue spending, but unallocated reserves are smaller**

Reserves	Total reserves (£ billion)	Total reserves as a % of 2010/11 revenue spending (average holding)	% of reserves unallocated (average holding)	Unallocated reserves as a % of 2010/11 revenue spending (average holding)
STCCs	9.9	19	23	4
DCs	1.9	48	37	15
All councils	11.8	30	29	8

Source: Audit Commission analysis of RO and RA data

ⁱ Extrapolated from the survey data on fees and charges covering 62 per cent of STCCs and 64 per cent of DCs.

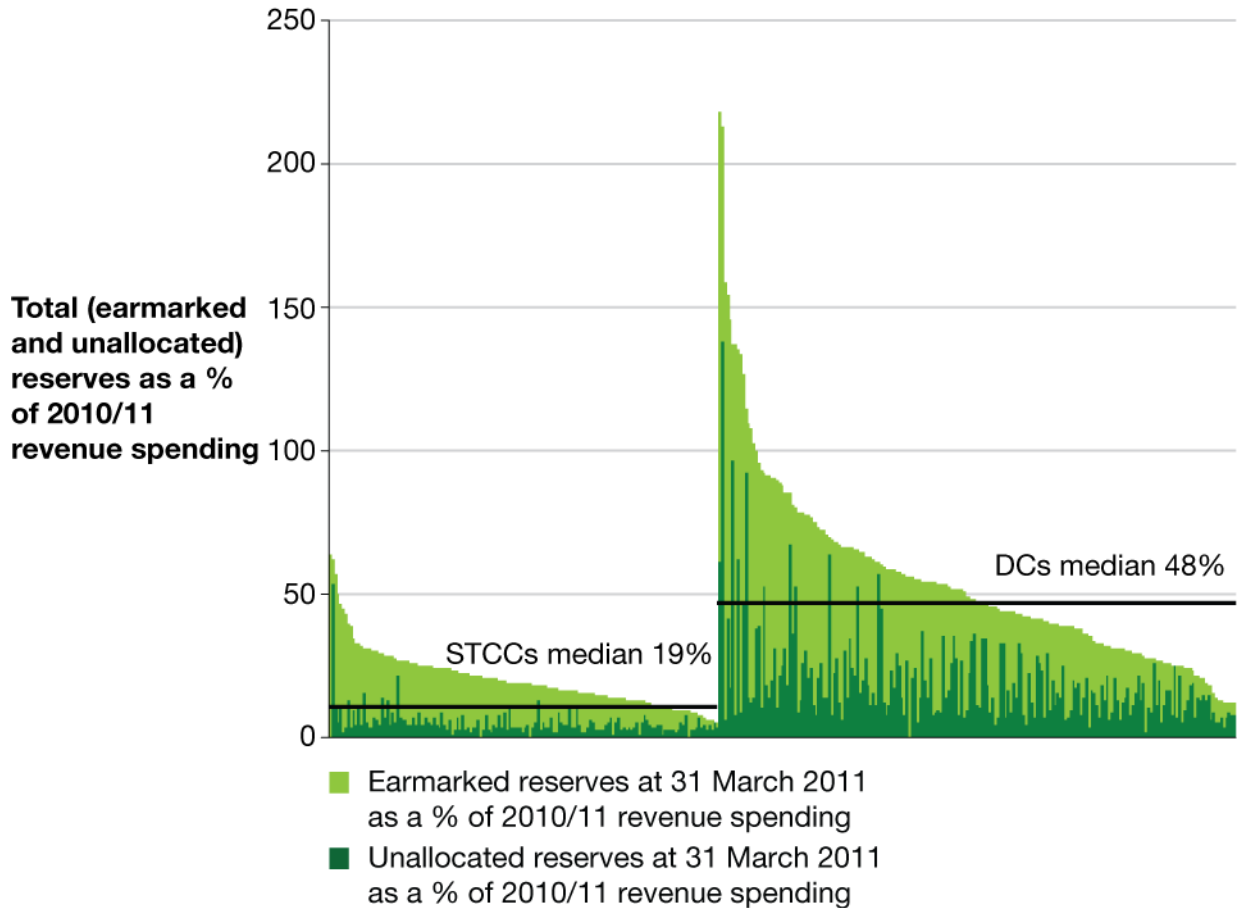
ⁱⁱ All data is for revenue reserves only and excludes schools reserves.

ⁱⁱⁱ This section uses Revenue Outturn data for 2010/11 published by DCLG in 2011.

^{iv} Some reserves are set aside for specific purposes such as equal pay claims, the costs of retirements or redundancies associated with internal reorganisations, or self-insurance funds. These are 'earmarked' reserves: the 'unallocated' remainder is for general use.

34 There is wide variation around these averages – 15 STCCs have total reserves of less than 10 per cent of revenue spending, but 15 DCs have reserves higher than their total annual spend (Figure 4).

Figure 4: **The level of reserves varies significantly. Generally DCs have higher reserves compared to their spending than STCCs.**



Source: Audit Commission analysis of RO data

35 Reserves have increased in recent years – by £2.6 billion (30 per cent) in real terms between 31 March 2007 and 31 March 2011.

36 This trend continued in 2010/11 even though councils faced emergency in-year cuts. In 2010/11:

- STCCs' total reserves increased by almost £900 million (10 per cent) with three-quarters of STCCs adding to their reserves; and
- DCs' total reserves increased by almost £100 million (5 per cent) with almost two-thirds of DCs adding to their reserves.

Reserves compared to size of cutsⁱ

37 Reserves can be used, as a short-term measure, to support spending and offset cuts. On average, STCCs held unallocated reserves equivalent to two-thirds of what they lost in government support. DCs held unallocated reserves of twice the value of their cuts.

38 The picture is different if earmarked reserves are included. In DCs the total reserves are six times the value of the cuts. For STCCs the average holding is nearly three times the size of a council's cut.

Will councils use reserves to offset cuts in 2011/12?ⁱⁱ

39 To assess whether reserves are being used to reduce the funding gap we looked at how planned use of reserves has changed between 2010/11 and 2011/12. The picture is mixed, with STCCs generally planning to use reserves more in 2011/12, and DCs using reserves less than they had planned to in 2010/11 (Table 5).

- STCCs plan to take £351 million more from reserves in 2011/12 than they planned to in 2010/11.
- DCs plan to take £23 million less from reserves than in 2010/11. Their use of reserves in 2010/11 supported that year's spending, so taking less in 2011/12 will add to their financial pressures.

40 Overall, 40 per cent of STCCs and 50 per cent of DCs will not use reserves to offset falls in funding in 2011/12.ⁱⁱⁱ

ⁱ This analysis uses Revenue Outturn data for 2010/11 published by DCLG in 2011.

ⁱⁱ This analysis uses 2011/12 and 2010/11 Revenue Account data. This data is estimated. Revenue Outturn data for 2010/11, which is actual rather than estimated, shows that RA estimates tend to understate the size of councils' reserves. However, the RA estimates are used here as they underpinned 2010/11 and 2011/12 budget setting.

ⁱⁱⁱ They are either adding more to their reserves or taking less from them than in the previous year.

Table 5: **STCCs plan to take more from reserves in 2011/12. DCs plan to take less.**

	STCCs			DCs		
	2010/11 (£m)	2011/12 (£m)	Change in planned use of reserves (£m)	2010/11 (£m)	2011/12 (£m)	Change in planned use of reserves (£m)
Adding to reserves (+)	+229	+174		+15	+16	
Taking from reserves (-)	-367	-663		-152	-130	
Net change in reserves – adding to (+) or taking from (-)	-138	-489	Taking £351m more	-137	-114	Taking £23m less

Source: Audit Commission analysis of RA data

Patterns in the use of reserves

41 Councils' use of reserves is not linked to size of the funding gap, or to the level of reserves. Those with below average cuts and limited reserves are just as likely to be planning to use reserves as those with large cuts and big reserves.

Overall picture on reserves

42 The overall picture on reserves is complicated:

- holdings are high, but most are earmarked for specific purposes;
- STCCs overall plan to increase withdrawals from reserves and many will use reserves to offset some of their reduction in funding; but
- planned use of reserves remains low relative to holdings, particularly in DCs;
- half of DCs and 40 per cent of STCCs do not plan to use reserves to offset cuts; and
- plans for the use of reserves are not explained by the size of cuts, or by the size of holdings.

43 A significant proportion of reserves is earmarked, but this does not necessarily mean earmarked reserves are unavailable to support spending. Councils can move money from earmarked to unallocated by re-examining the assumptions underpinning the decisions on earmarking.

44 There may be scope to use more reserves to offset funding reductions, but this should only be a short-term measure, as part of a sound medium-term financial plan (MTFP). Councils should review their plans for reserves, including challenging current assumptions about use and categorisation.

Falls in other sources of income increased the funding gap

45 The total falls in local income and the relatively limited use of reserves mean that a funding gap remains. In fact the total size of the reduction facing councils is substantially greater than just the loss of central government support.

46 Table 6 shows that, in total, expected reductions in other income streams added £1.2 billion, 34 per cent, to the reduction in government funding.

47 Changes in planned use of reserves offset the fall in income by £329 million meaning councils face a net loss of £4.4 billion.

Table 6: **Councils expect other income streams to fall by £1.2 billion on top of the £3.5 billion cut in government support**

	STCCs 2010/11 – 2011/12 (£m)	DCs 2010/11 – 2011/12 (£m)	All councils 2010/11 – 2011/12 (£m)
Change in government funding ⁱ	-3,265	-278	-3,543
Change in council tax income ⁱⁱ	-445	-31	-476
Estimated change in income from fees and charges	-648	-75	-723
Change in total income – total size of funding gap	-4,358	-384	-4,742
Contribution to meeting the gap from change in use of reserves ⁱⁱⁱ	+351	-22	+329
Net funding gap remaining after use of reserves	-4,007	-406	-4,413

Source: Audit Commission analysis of RA data: Audit Commission Financial Resilience Auditor Survey

Note: Base – fees and charges calculation is an extrapolation from 93 STCCs and 129 DCs; other figures are based on 150 STCCs and 201 DCs.

ⁱ The £551 million from council tax freeze grant is included as part of central government funding – reducing the cut from £4 billion to £3.5 billion.

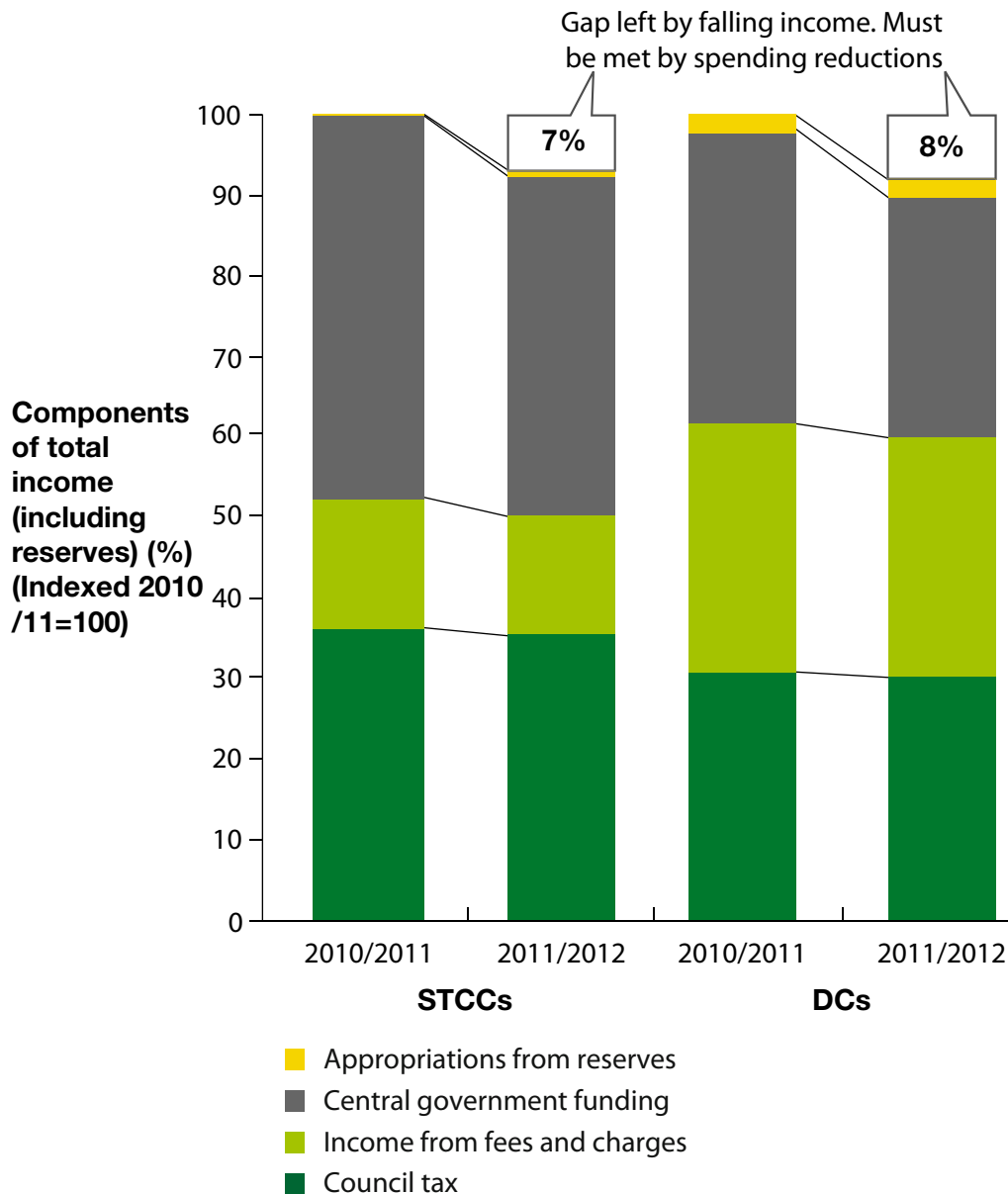
ⁱⁱ This is a genuine real-terms loss, as council tax freeze grant has been included in the government funding total.

ⁱⁱⁱ + means increased use of reserves.

Spending reductions will be needed

48 Figure 5 shows that the cuts in government support, falls in local income and changes in use of reserves leave a net gap of 7 per cent in total income available to fund services for STCCs and 8 per cent for DCs compared to 2010/11.ⁱ

Figure 5: **The combination of cuts in government funding and falls in other income mean spending reductions will be needed**



Source: Audit Commission analysis of RA data: Audit Commission Financial Resilience Auditor Survey

Note: Base – fees and charges calculation is an extrapolation from 93 STCCs and 129 DCs; other figures are based on 150 STCCs and 201 DCs.

ⁱ The percentage fall across all forms of income is lower than the fall in central government support, as other forms of income are not expected to reduce as sharply as central funding.

Local circumstances and decision-making varies

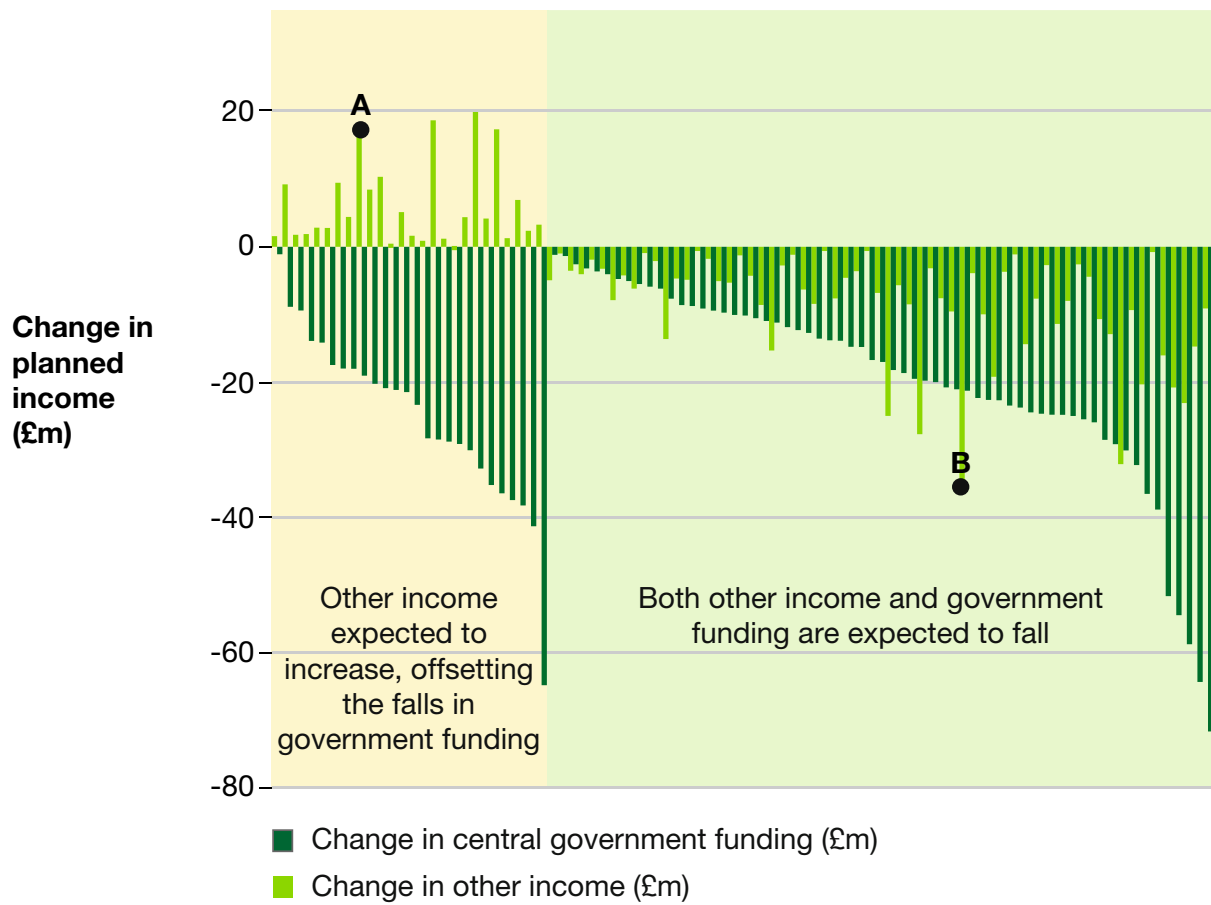
49 Within this overall picture each council faces different challenges. STCCs expect changes in overall income from +0.3 per cent to -13.9 per cent. For DCs the range is +6.8 per cent to -22.9 per cent.

50 The scale of government cuts is the key driver of differences between councils, but decisions taken by councils, for example on use of reserves, are also a factor. Figure 6 compares the changes in other income (fees and charges, council tax) and contributions from reserves with the falls in government support. It shows that about a third of STCCs expect to offset falls in government income to a degree through increases in fees and charges income, and/or additional use of reserves.

51 To illustrate: the two councils, A and B, highlighted in Figure 6 each face cuts of around £20 million of government support. The councils are otherwise in different positions, and have made different decisions in response to their circumstances.

- Council A faces a cut in central funding of £19 million and a fall in council tax income of £2 million, but it has increased its use of reserves by £17 million and budgeted for an increase of £3 million in fees and charges income. It has a budget gap of £1 million compared to 2010/11.
- Council B expects a £21 million cut in central funding, a reduction in council tax income of £10 million, and a fall in fees and charges income of £21 million. It will reduce its use of reserves by £5 million. It faces a total budget gap of £57 million.

Figure 6: **Two-thirds of STCCs expect their total incomeⁱ (including use of reserves) to fall by more than they have lost in government funding**



Source: Audit Commission analysis of RA data: Audit Commission Financial Resilience Auditor Survey

Note: Base - 93 STCCs

ⁱ Use of reserves is not income, but it does contribute to funding spending, so has been included here to provide a full picture.

Chapter 4: How will cuts affect spending on services?

52 Across all services spending is expected to fall on average by 6.5 per cent in real terms in STCCs and 8.5 per cent in DCs.ⁱ But cuts are not uniform (Figure 7). In STCCs:

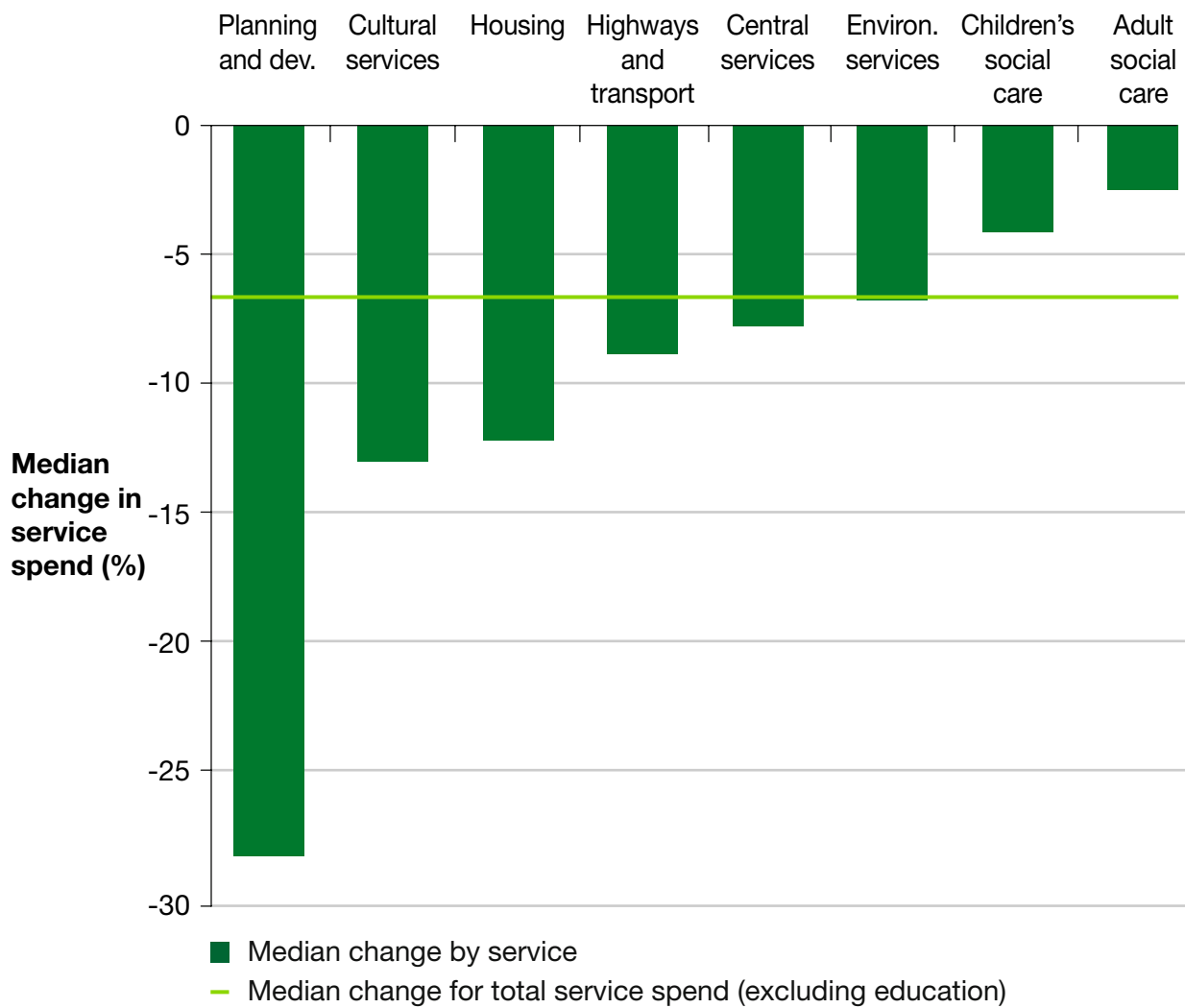
- adult social care is being protected, with planned 2011/12 spend 2.5 per cent less than 2010/11;ⁱⁱ but
- planning and development services face cuts of 28 per cent; and
- housingⁱⁱⁱ (12 per cent) and cultural services (13 per cent) are also significantly affected.

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. Inconsistencies in the recording of Learning Skills Council grant by councils in 2010/11 mean that no analysis of education spend was possible. Service spend data is not directly comparable with previous data on income and spend as it includes 'grants outside AEF'. See methodology ([link](#)).

ⁱⁱ This includes NHS funding to support social care and benefit health – £648 million in 2011/12.

ⁱⁱⁱ Non Housing Revenue Account.

Figure 7: **Planning and Cultural Services face the largest reductions in spend in STCCs**

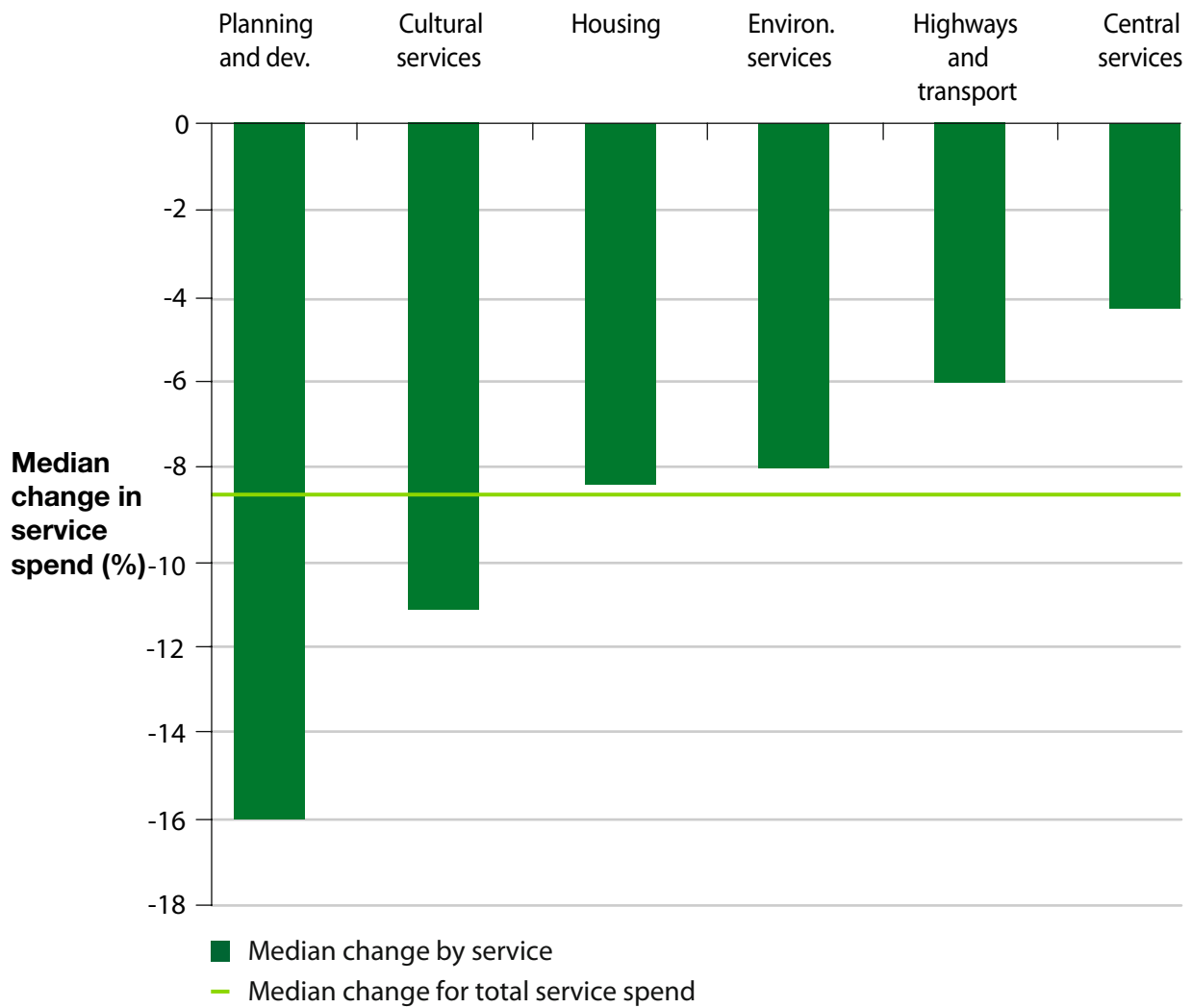


Source: Audit Commission analysis of RA data

Note: Base – 112 STCCs

53 In DCs planning (16 per cent) and cultural services (11 per cent) see the biggest average falls (Figure 8).

Figure 8: **Planning and Cultural Services are most affected in DCs**



Source: Audit Commission analysis of RA data

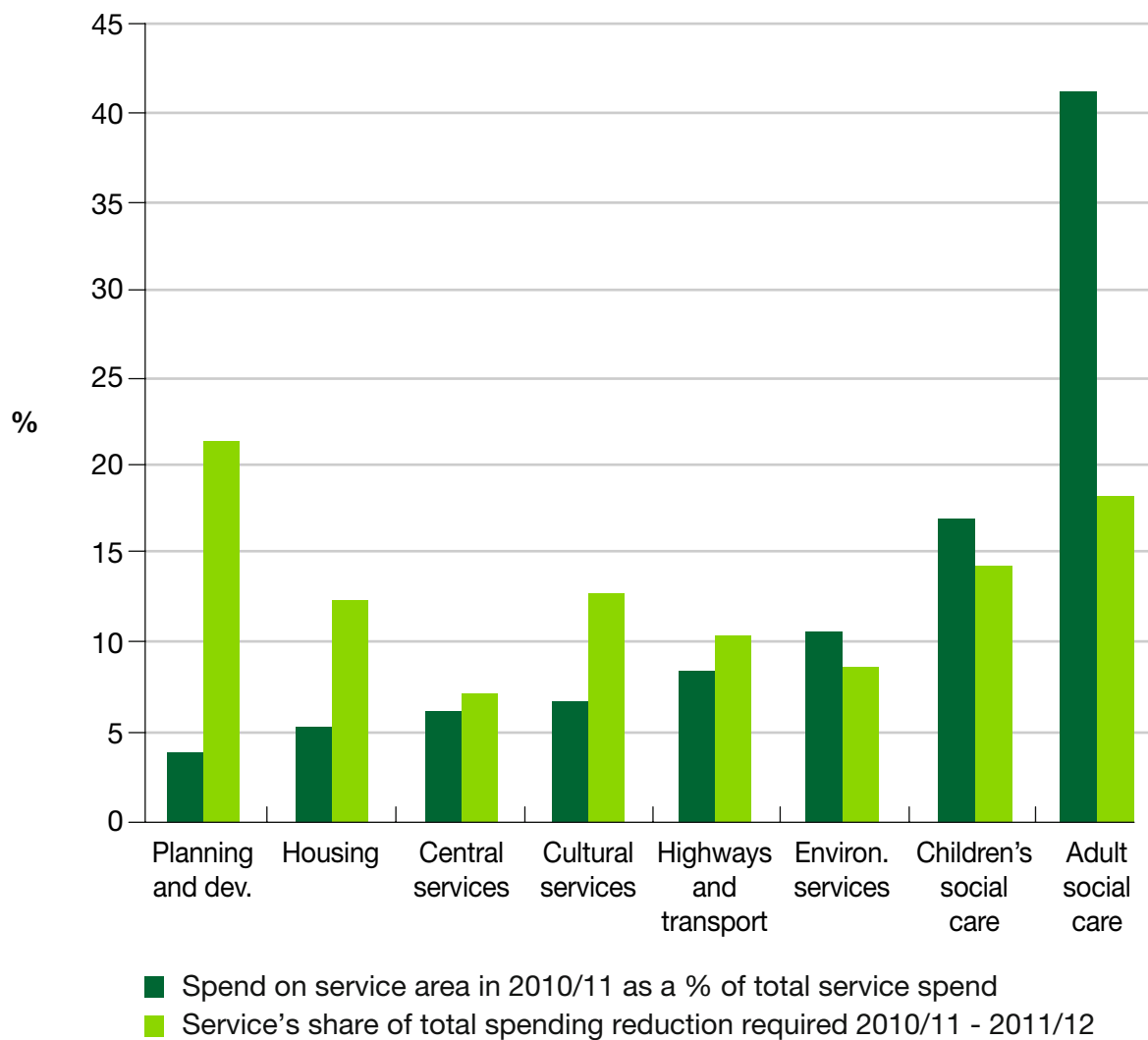
Note: Base - 139 DCs

54 There are significant differences between the sizes of services.

Figure 9 shows the proportion of the required cut each service contributes compared to its share of spending.

- Planning represents 4 per cent of council spend but will provide 22 per cent of the required savings.
- Adult social care accounts for 41 per cent of spend but only 18 per cent of the required saving.
- Planning, housing, and cultural services will contribute 47 per cent of total savings, but represented only 16 per cent of service spend in 2010/11.

Figure 9: **Smaller services are making a big contribution to the savings needed in STCCs**



Source: Audit Commission analysis of RA data

Note: Base – 112 STCCs

Different decisions on spending reductions

55 STCCs facing the highest levels of cut (reductions equal to over 8 per cent of revenue spending)ⁱ are planning bigger cuts to service spending (Figure 11). But there are differences in how they are making cuts. They are:

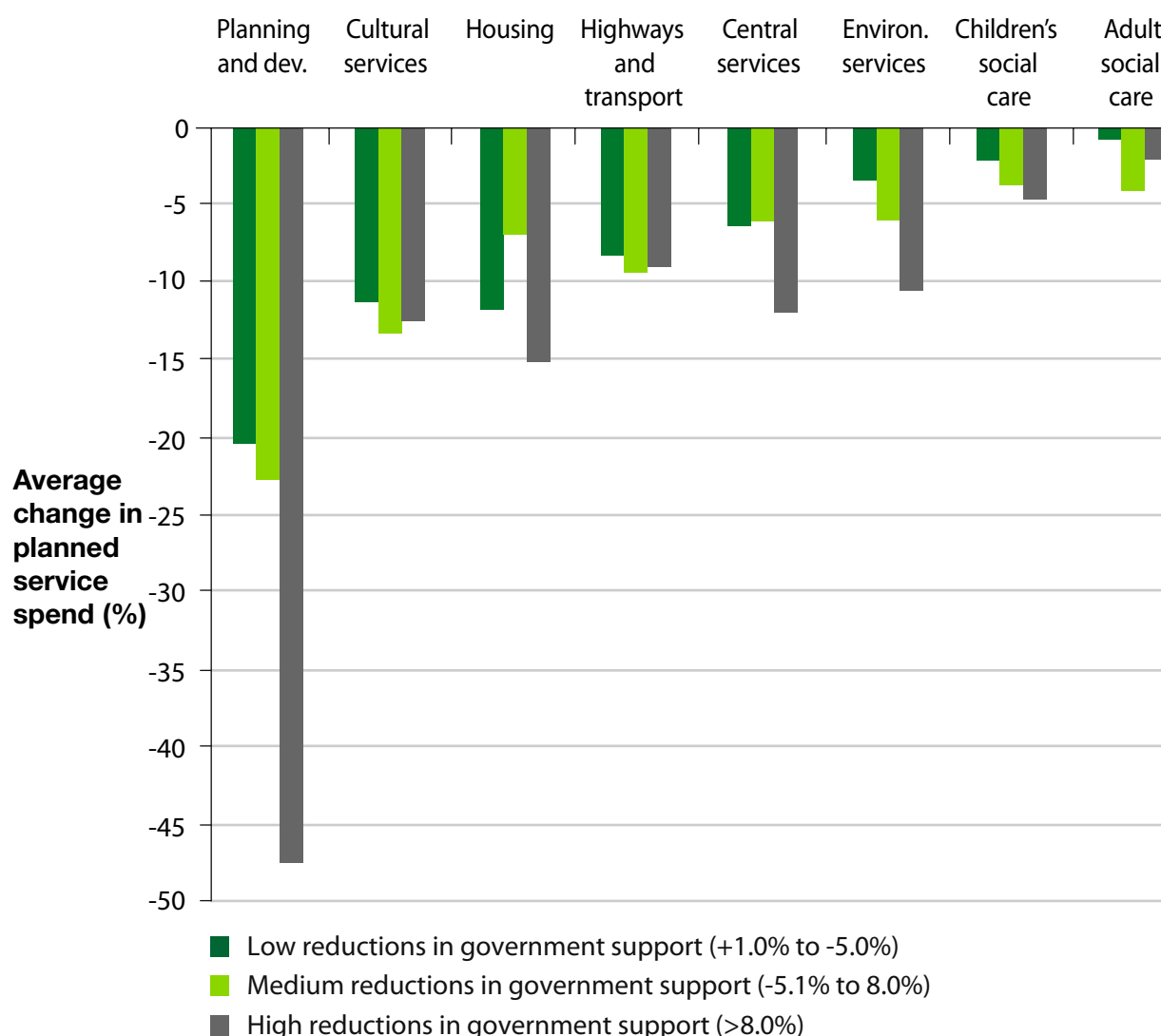
- protecting spend in adult social care to the same extent as councils with the lowest reductions; but
- focusing reductions to a far greater degree on planning and development in particular, and environmental services and central servicesⁱⁱ to a lesser extent.

56 Budgeted reductions in planning and development spending in the highest cuts STCCs will be severe – nearly 50 per cent on average (Figure 10). This is unlikely to be sustainable in the medium term.

ⁱ More than half a standard deviation above the mean: a third of STCCs.

ⁱⁱ This is mainly corporate management, emergency planning, local tax collection and democratic services (which includes supporting councillors and official meetings).

Figure 10: **Planning and development spending will be cut by almost half in STCCs facing the biggest cuts**



Source: Audit Commission analysis of RA data

Note: Base – 112 STCCs

A question of sustainability

57 Generally, councils have tried to protect the main public-facing services; particularly adult and children’s social care and environmental services.ⁱ Also, adult and children’s social care are facing rising demand due to the ageing population (Ref 10), and policy-related pressures (Ref 7), making reducing spending in these areas more difficult.

ⁱ Environmental services include includes refuse collection and street cleaning.

58 Many savings plans rely heavily on large cuts in small service areas, particularly in councils facing the biggest losses in government support. This approach may not be sustainable beyond 2011/12. The opportunities for big future savings from these smaller services will be limited. This is a particular problem for those councils in the 'high cuts' group. A further 50 per cent cut in planning spending is highly unlikely to be possible in 2012/13, and even if it was, such a cut would deliver much smaller savings. The bigger services may need to make a greater contribution to future savings.

Chapter 5: How will cuts affect service users?

59 Spending on services can be reduced with minimal impact on service users by improving efficiency. However, it is unlikely that all councils will find their required savings through this route. Other ways of cutting spending, for example by reducing quality, will be more noticeable to service users.

60 This chapter examines impacts on services planned by councils that will affect service users, and identifies groupings of councils with different patterns of impacts.

61 Data comes from the Commission's survey of auditors. Each auditor stated, based on their knowledge of council plans,ⁱ whether councils were planning the following impacts on the services:

- cuts in volume or frequency of services;
- changes in quality or minimum service standards;
- restrictions in eligibility; and/or
- new or increased fees and charges.ⁱⁱ

Impacts on services

62 Figure 11 shows the distribution of these impacts across different service areasⁱⁱⁱ for STCCs:

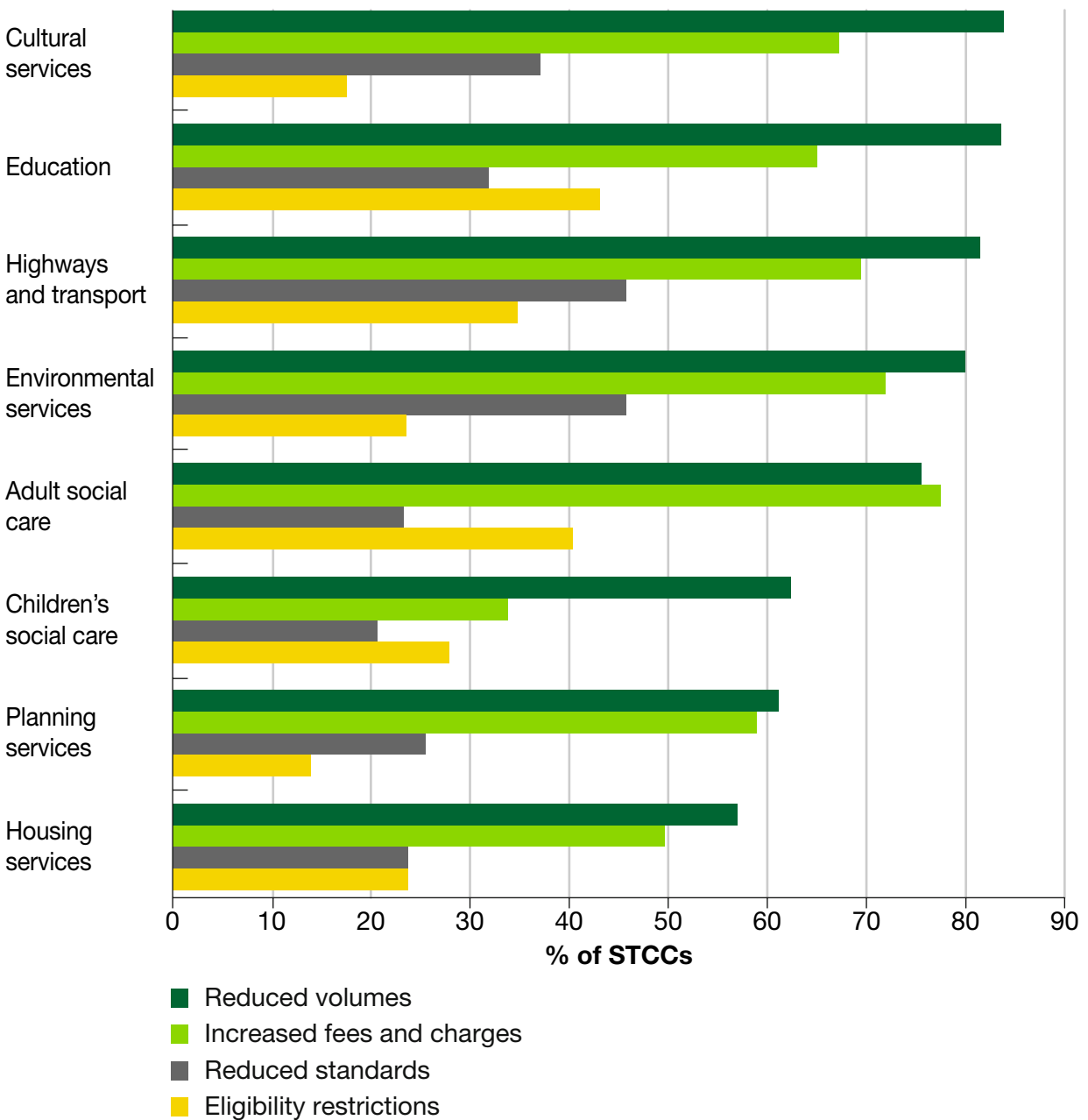
- over 80 per cent planned to reduce the quantity or frequency of some services within education, highways and transport, cultural services and environmental services;
- over 70 per cent planned to increase charges within adult social care and environmental services;
- 40 per cent planned to tighten eligibility criteria in adult social care; and
- 40 per cent planned to reduce some service standards in environmental services, and in highways and transport.

ⁱ Auditors stated whether these impacts would apply to each service, and gave an indication of the extent of changes within a service area. They stated whether impacts would be seen in 'a minority' or 'about half or more' of the activities within each service area.

ⁱⁱ This refers to councils increasing unit fees and charges. Overall income may still be falling as demand falls.

ⁱⁱⁱ Slightly different sectors are used in this analysis to those in Chapter 4. As data was provided by auditors, rather than from the RA, analysis of education (non-frontline schools services) is possible.

Figure 11: **Most STCC service areas will see some reductions in service volumes and increases in fees and charges**



Source: Audit Commission Financial Resilience Auditor Survey

63 Service impacts planned in DCs were substantially lower, with increases in fees and charges being the main tactic. Over 40 per cent planned to increase fees and charges for cultural services, environmental services, highways and transport, and planning. Few planned changes in service standards or eligibility criteria.

Patterns of impact

64 STCCs fall into one of four groups, characterised by different levels and patterns of planned service impact (Figure 12).ⁱ

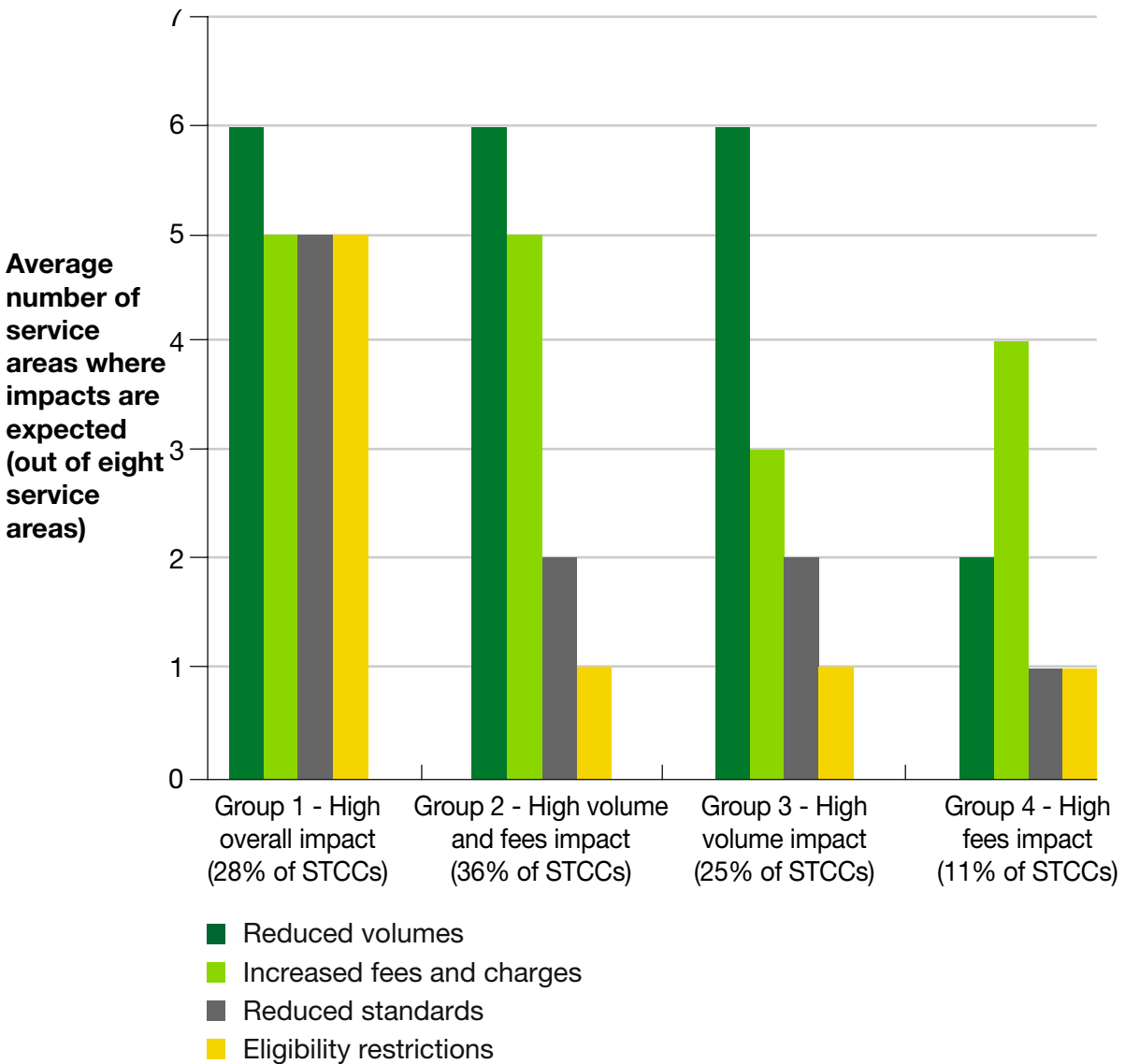
- **High overall impact group** (28 per cent): all four types of impact (Paragraph 61) were expected in five or more service areas out of a possible eight.
- **High volume and fees impact group** (36 per cent): the main impacts will be in reduced quantity or frequency of services and higher fees and charges.
- **High impact on volume only group** (25 per cent): reduced quantity or frequency in five or more service areas.
- **High impact on fees only group** (11 per cent): higher fees and charges across four service areas.

65 This analysis takes into account the size of service area where impacts are expected, so impacts on adult social care are weighted more strongly than those on planning. It also gives more weight where an impact is expected in ‘about half or more’ activities within a service area, rather than just a ‘minority’ of activities. This means that councils in a high impact group are more likely to see impacts:

- on a greater number of service areas;
- in larger service areas; and
- on more activities within each service area.

ⁱ Based on hierarchical cluster analysis.

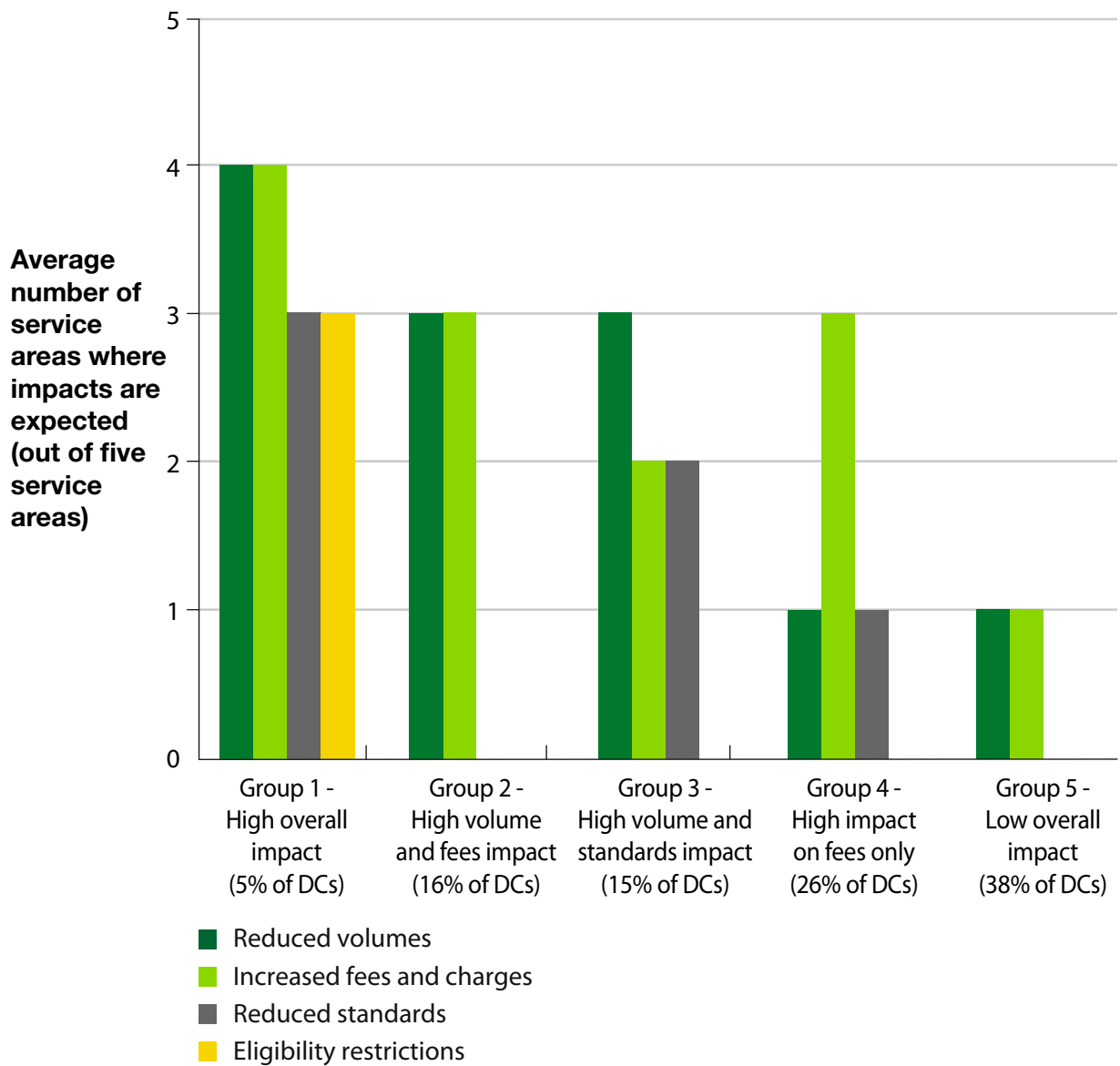
Figure 12: **Most STCCs will cut the volume of services and increase charges. In around a quarter, quality and eligibility criteria will also be affected.**



Source: Audit Commission: Financial Resilience Auditor Survey

66 The pattern was different in DCs (Figure 13) where five groups were present. In almost two-thirds of DCs (groups 4 and 5) few services will be affected apart from some changes to fees and charges.

Figure 13: In DCs the impacts on services will be lower; mainly higher fees and charges



Source: Audit Commission Financial Resilience Auditor Survey

Good local decision-making is key

67 We found no link between the extent of service impacts and the size of cuts. A council facing large cuts is as likely to be in a group where the impact on services is high, as in a group where the impact is low. This is due to differences in local decision-making on how much to protect services, and what councils plan to achieve through efficiency savings.

68 Table 7 compares the planned impacts on services in two similarly sized STCCs. Council A faces a funding cut of 6 per cent and falls in Group 1 – High overall impact. Council B faces a 13 per cent cut but falls in Group 4 – High impact on fees only. Despite a more substantial cut, Council B’s plans will affect service users less than those of Council A.

Table 7: **A large cut does not always lead to substantial impacts on services**

	Council A – Group 1 6% funding reduction ⁱ		Council B – Group 4 13% funding reduction	
	Changes to a ‘minority’ of activities	Changes to ‘about half or more’ of activities	Changes to a ‘minority’ of activities	Changes to ‘about half or more’ of activities
	Number of service areas affected			
Reduction in volume	1	6	2	0
Lower standards	3	2	1	0
Change in eligibility	3	1	0	0
Higher fees and charges	4	2	6	0

Source: *Audit Commission Financial Resilience Auditor Survey: Audit Commission analysis of RA data*

ⁱ Reduction in budgeted central government funding expressed as a share of 2010/11 revenue expenditure.

Chapter 6: Will councils secure financial resilience and value for money?

69 The capacity of councils to mitigate financial challenges through good management is an important factor in assessing resilience. We have used information from auditors on the financial management processes supporting councils' spending plans to assess whether they can achieve financial resilience and deliver value for money services.

70 We gathered auditors' preliminary views on councils' 2011/12 budgets in spring 2011. Responses were based on their early work on the annual Value for Money (VFM) conclusion which covers two main elements:

- securing financial resilience; and
- securing economy, efficiency and effectiveness.

Securing financial resilienceⁱ

Indicators of good financial management

71 The survey of auditors covered seven indicators of financial resilience and good financial management relevant to the challenges facing councils. These are drawn from the Commission's VFM conclusion guidance for auditors.ⁱⁱ Table 8 sets out the indicators and auditors' views on each.

ⁱ Financial resilience is a measure of the robustness of a council's systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

ⁱⁱ These are available at www.audit-commission.gov.uk/audit-regime/codes-of-audit-practice/Pages/valueformoneyconclusion

72 Auditors were broadly positive about councils' arrangements to secure their financial resilience in 2011/12. The great majority have a good track record of making efficiency savings, good financial modelling and strong leadership and challenge.

Table 8: Auditors were positive about councils' arrangements to secure financial resilience

Indicators of good financial management	Auditors' views % Agreed ⁱ		
	STCCs	DCs	All councils
A 2010/11 savings and efficiency plan was in place and on target	89	93	91
The council had accurately predicted the level of government support in its planning for 2011/12 ⁱⁱ	67	51	58
The council had reviewed its MTFP to reflect its 2011/12 settlement	73	58	64
Leadership understood the financial management challenges facing the council in setting its 2011/12 budget	100	100	100
Council had undertaken appropriate modelling of key financial data in setting its 2011/12 budget	89	93	91
There had been effective formal challenge by members of the financial assumptions in the 2011/12 budget	91	94	93
Council had avoided short-term financial management approaches in its 2011/12 budget compared to 2010/11	68	75	72

Source: Audit Commission Financial Resilience Auditor Survey: VFM Conclusion Guidance

ⁱ % that said 'Yes' or 'Agreed/Strongly agreed'.

ⁱⁱ Some councils could not accurately predict the size of their funding cut due to unexpected changes; for example in the funding of academies' central functions, and funding transfers for concessionary fares. But whatever the reason for the incorrect assumptions, this will have meant last-minute budget changes, making financial management more challenging.

But there are some concerns

73 Over a third of councils failed to record positive results on two or more of the seven indicators – in particular:

- councils' capacity to avoid short-term financial fixes; and
- their predictions of the falls in government support.

Short-term financial fixes

74 A third of STCCs and a quarter of DCs had switched to short-term financial fixes in setting their 2011/12 budget. These are one-off solutions to budget problems; for example selling assets and using reserves. They are not necessarily a cause for concern, and there may be good reasons for short-term actions as part of a strategic approach. But if hurriedly introduced in response to severe financial pressures, they can indicate problems in bringing spending into line with income, or unwillingness to take difficult decisions.

75 STCCs that have switched to short-term approaches were more likely to face big reductions in central government support.ⁱ This pattern was not present in DCs.

Anticipating falls in government funding

76 Predicting their change in government support was difficult for some.ⁱⁱ However, councils that made accurate forecasts and planned accordingly, were better prepared for 2011/12. We found that:

- a third of STCCs had not accurately predicted their reductions – STCCs with above-average cuts were twice as likely as those below average to have made inaccurate estimates; and
- only half of DCs had accurately predicted their reduction in government support.

77 One in four STCCs and one in ten DCs had to change priorities in their MTFP due to differences between their projections and their final allocations. Common changes to plans included:

- additional use of reserves;
- accelerating savings plans;
- increasing planned staff cuts. One council increased planned redundancies by a third;
- reviewing eligibility criteria, fees and charges, or delivery mechanisms in children's social care and adult social care services; and

ⁱ 49 per cent of STCCs in the top quartile in terms of cut as a proportion of 2010/11 revenue spending have switched to short-term approaches. In each of the other three quartiles between 29 and 27 per cent of STCCs have switched.

ⁱⁱ For some councils accurate predictions of falls in government support were difficult due to the impact of a number of changes of functions and funding; for example for academies' central functions, and transfers for concessionary fares.

- reducing or ending grant-funded activity. One council planned to stop their music services, teenage pregnancy prevention services, and youth play schemes. Others reduced grants to the voluntary, arts and cultural sectors.

Securing value for money

78 Actions needed to balance the budget can affect services. But councils need to ensure value for money services that are delivered economically, efficiently, and effectively. As public spending falls, this means prioritising resources, reducing costs, and improving productivity.

79 Auditors were asked whether councils had measures in place to achieve value for money services in their 2011/12 budget process. Table 9 sets out the indicators and auditors' views on each. Again, the picture was positive, although DCs were slightly weaker. Auditors felt that most councils were well placed to make efficiency savings. They were challenging the way services are delivered, using benchmarking to identify and address high-cost areas, and decisions were informed by information on local needs.

Table 9: **Auditors were positive about arrangements to secure value for money service**

Indicators of securing efficient, effective services	STCCs	Auditors' views % Agreed ⁱ	
		DCs	All councils
The council used responses to public consultations to inform the 2011/12 budget	91	74	82
Budget decisions were based on appropriate information on local needs and delivery costs	95	89	91
Options appraisal or similar techniques were used to evaluate proposals for spending reductions	80	76	78
The council challenged how services are delivered (for example, considering whether services are best delivered in-house, outsourced or through shared service arrangements)	88	93	91
The council used comparative and benchmarking information to identify opportunities to improve efficiency	86	72	78

Source: Audit Commission Financial Resilience Auditor Survey: VFM Conclusion Guidance

ⁱ % that 'Agreed/Strongly agreed'

But there are some concerns

80 Within this generally good picture is a group of councils, particularly DCs, with problems across several indicators. Overall, 15 per cent of STCCs and 27 per cent of DCs failed to record positive results on two or more of the five indicators in Table 9.

What do auditors views tell us?

81 Auditors felt most councils were taking the right steps to deliver financial resilience. But balancing the budget is only part of the challenge. The spending cuts required can affect services. Arrangements to achieve savings through efficiencies rather than service cuts were generally good, but most places have still had to make some cuts in service levels.

82 Although the general picture is positive, not all councils are doing well on all aspects of financial management. Two in five STCCs and half of DCs have performed poorly on two or more financial resilience indicators (Table 8) or VfM indicators (Table 9).ⁱ

83 Not anticipating the size of the cuts, having to amend MTFPs, and switching to short-term measures imply a small number of councils have had to take a reactive and last-minute approach to 2011/12.

ⁱ 9 per cent of STCCs and 15 per cent of DCs have more than one issue in both the financial resilience and VfM indicators.

Chapter 7: How councils are coping – reading the warning signs

84 Auditors provided a preliminary view of the likelihood that each council will deliver their 2011/12 budget. Analysis of the characteristics of councils where auditors expressed concerns allows us to identify common risk factors.

Can councils deliver the 2011/12 budget?

85 Auditors stated how far they agreed that:

'based on the council's previous financial performance and the quality of its financial management, the council is well placed to deliver its 2011/12 General Fund revenue account budget.'

86 Most auditors (88 per cent of STCCs and 92 per cent of DCs) agreed or strongly agreed that their councils would deliver their 2011/12 budgets.

87 However, that leaves 12 per cent of STCCs and 8 per cent of DCs, where the auditor did not agree the council was well placed to deliver the 2011/12 budget.

88 It is very rare for a council to fail completely to live within its budget. Councils are legally required to have adequate financial arrangements to monitor their financial affairs.ⁱ They must have a range of financial planning, management and monitoring measures in place to ensure delivery against budget.

ⁱ These include the requirement for councils to: maintain a balanced budget (section 32, 43 and 93 of the Local Government Finance Act 1992); retain adequate reserves (Local Government Act 2003); and make proper arrangements for proper financial administration of their affairs (section 151 of the Local Government Act 1972). In the most critical cases councils may be subject to Section 114 of the Local Government Finance Act 1988. This can have very serious implications for a council, such as preventing it from entering into any new agreements that incur expenditure (Ref 11).

89 Even where an auditor is concerned, it is still likely that these measures will ensure the budget is delivered. However, in councils that appeared ill-prepared and at risk at the start of 2011/12, the actions needed to do this may require drastic corrective measures such as additional in-year spending cuts. Such unplanned, emergency actions are likely to be more damaging to services, and less effective than a properly prepared spending plan set out at the start of the year.

Identifying the risk factors

90 This section identifies key risk factors, and how they combine, that make it more likely for a council to be in the 'at-risk' group where auditors were not confident of budget delivery.

Risky combinations

91 The group of councils where auditors were concerned about budget delivery had issues with four important risk factors compared to other councils. They were more likely to have:

- higher falls in central government support as a percentage of revenue spending;ⁱ
- lower levels of total reserves as a percentage of revenue spending;
- issues with two or more financial resilience indicators (Table 8) identified by auditors; and
- issues with two or more value for money indicators (Table 9) identified by auditors.

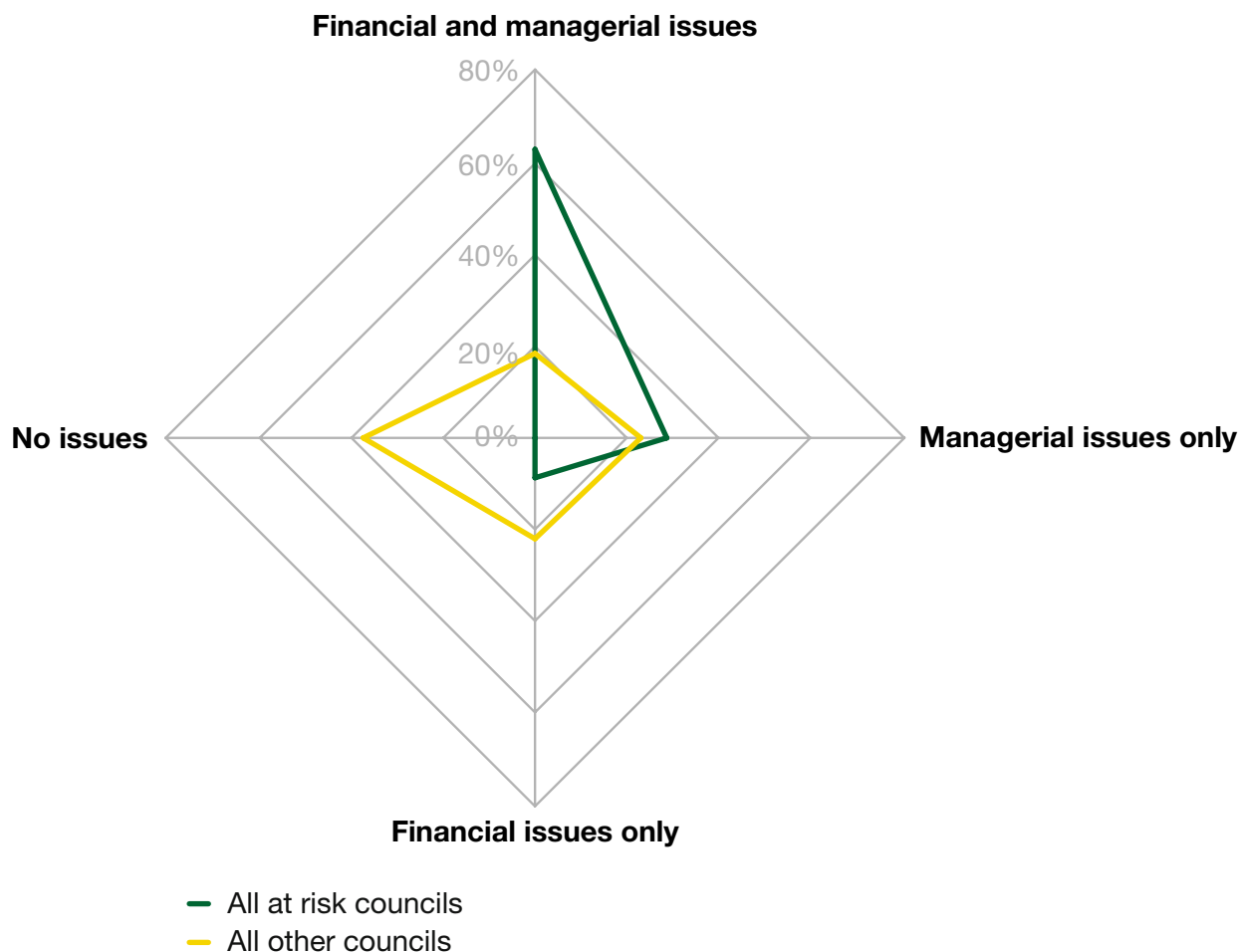
92 The defining feature of councils in the at-risk group is a combination of financial and managerial problems. Figure 14 shows that 63 per cent of at-risk councils have both financial and managerial problems.ⁱⁱ These councils face substantial financial challenges without the robust managerial arrangements to mitigate them.ⁱⁱⁱ

ⁱ This was a factor for STCCs in the at-risk group, but not DCs.

ⁱⁱ Only 18 per cent of other councils have a similar profile.

ⁱⁱⁱ There are councils with this combination of issues that were not considered a risk by auditors. Having a combination of financial and managerial issues does not automatically mean that a council will be viewed as a concern by auditors, but it does increase the likelihood that this will happen.

Figure 14: Councils at risk are more likely to have both financialⁱ and managerial issuesⁱⁱ



Source: Audit Commission Financial Resilience Auditor Survey: Audit Commission analysis of 2010/11 and 2011/12 RA data

Some specific managerial issues

93 Within the 12 managerial issues (Tables 8 and 9) there were five that were symptomatic of at-risk councils.ⁱⁱⁱ

- ⁱ Defined as having cuts in government support as a percentage of revenue spending in the upper quartile, and/or having reserves as a share of revenue expenditure in the lower quartile.
- ⁱⁱ Defined as having issues with two or more of the seven financial management indicators in Table 8, and/or two or more issues with the five value for money indicators in Table 9.
- ⁱⁱⁱ All had statistical significant relationships at the 90 per cent level or higher using one ANOVA or Chi-square.

94 They were less likely to have:

- an efficiency plan in place and on target in 2010/11;
- reviewed their MTFP as part of the settlement process;
- used appropriate financial modelling in setting their 2011/12 budget; and
- used option appraisals or similar techniques to evaluate proposals for spending reductions in 2011/12.

95 They were more likely to have switched to short-term financial management approaches.

96 Auditors were especially concerned about options appraisals and short-term approaches. These were particular issues in at-risk councils.

What puts councils at risk?

97 You might expect that councils facing the highest cuts would be at greatest risk of financial problems. But actually a council's ability to cope financially is a combination of the scale of the spending reductions it faces, its level of reserves, and the quality of its financial management. Good management can mitigate the challenges of major funding losses.

98 So councils with a combination of management weaknesses and financial challenges give auditors cause for concern.

- Councils facing high cuts in government support are less at risk if financial management is sound.
- Councils with poor financial management are less at risk if they do not have to make big savings and if they have healthy reserves.

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Stock code: LNR3697

10_0384



Audit Commission

1st Floor

Millbank Tower

Millbank

London

SW1P 4HQ

Telephone: **0844 798 3131**

Fax: 0844 798 2945

Textphone (minicom): 0844 798 2946

www.audit-commission.gov.uk