

# **RESPONSE FROM CIPFA TO THE LYONS INQUIRY INTO LOCAL GOVERNMENT**

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AT THE HEART OF  
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## Response from CIPFA to the Lyons inquiry into local government

- 1 CIPFA welcomes the invitation from Sir Michael Lyons to further contribute to his review of local government under its extended remit. We hope very much that his assessment that “we are approaching a ‘tipping point’ towards consensus around the need for change for local government” proves to be the case and we are very keen to play a part in helping to shape robust and effective arrangements for the future of local services.
- 2 We have previously expressed our view of the need for reform in our earlier responses to the balance of funding review<sup>1</sup> and in our ‘Hallmarks’<sup>2</sup> discussion paper. There is much good practice and experience within local government but we consider that the current funding and regulatory frameworks are suboptimal for the delivery of the hallmarks that we have identified:
  - efficiency
  - subsidiarity and
  - appropriate governance arrangements.
- 3 Our response today draws upon our earlier work but does not repeat it. We address some of the specific questions posed by Sir Michael in his December 2005 consultation paper and interim report. We are happy for our response to be published and to work further with the review.

### **Qu1 What is the strategic role of local government? Is my description sufficient, or are there more elements you would add?**

- 4 CIPFA agrees that it is important to highlight the strategic role of local government. We broadly agree the description within the interim report of this strategic role, also termed ‘place shaping’. All of the elements in the current description are important.
- 5 We believe, however, that there is one other point that the final report could usefully tease out. Commonly, issues surrounding public services (of whatever type and whoever provides them) are addressed in terms of a user focus and professional and technical standards. However, whilst many issues can be usefully considered from these perspectives many also involve an important element of political choice. Such matters are commonplace within the public services, but are seldom explicitly addressed or acknowledged, either by the media or in audit and inspection regimes.

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<sup>1</sup> *Local Government Balance of Funding Review – response to invitation to comment*, CIPFA, September 2003, [www.cipfa.org.uk/pt/responses.cfm](http://www.cipfa.org.uk/pt/responses.cfm) and *Local Government Finance – Balance of Funding Review – papers* [www.local.odpm.gov.uk/finance/balance.htm](http://www.local.odpm.gov.uk/finance/balance.htm)

<sup>2</sup> *Hallmarks for delivering effective local public services*, CIPFA, 2005, [www.cipfa.org.uk/panels/lgpp/index.cfm](http://www.cipfa.org.uk/panels/lgpp/index.cfm)

- 6 A further key issue is the extent to which these choices will lie within each tier of government: neighbourhood, local, national or supra-national. The current relationship between central and local government is increasingly dominated by the principal/agent relationship, but this is often implicit rather than explicit. This encourages 'game playing', which can lead to sub-optimal results for all parties – central government, local government, and the public.
- 7 In setting up the review and other initiatives central government seems to be seeking a new constitutional settlement. This should clearly identify the responsibilities carried by each tier of government. We consider that the hallmark of subsidiarity<sup>3</sup> should be a strong determinant in addressing this question.

**Qu 2 What tools do councils need to perform the strategic role more effectively?**

- 8 In our view, the calibration of the balance of funding and also the non-hypothecation of funding are important factors for the strategic role of local government. A significant increase in the proportion of expenditure that is raised locally would assist in the revitalisation of local democracy and its strategic role. The hypothecation of central funding also works counter to a strategic role. We have made comment previously on the limited number of circumstances where we consider that specific grant [or hypothecation or passporting] is appropriate, for example where the authority is effectively acting merely as the local agent of central government.

**Qu 3 How important is the fact that local government is elected in relation to its ability and legitimacy to perform this role?**

- 9 There is a fundamental difference in terms of governance and accountability between an elected body and a quango or a single purpose organisation with a board of governors or trustees. Each have their place in society but an elected unit of government has a stronger legitimacy and therefore a qualitatively different capability to discharge the strategic role. This can be true at the neighbourhood, local, national and supra-national levels.

**Qu 4 Which services (or parts of services) should meet national standards in all areas of the country? Which should meet minimum standards? Which should be entirely down to local choice?**

- 10 This issue butts up against the dilemma of the 'postcode lottery'. There is a clear dichotomy between the desires – as articulated by the public and by Governments acting on their behalf – firstly for choice, diversity and innovation in public service delivery, and secondly for equality in service provision.

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<sup>3</sup> Subsidiarity: the devolution of power down to the most appropriate level of government for the type of decision in question.

11 We recommend that the dilemma of the postcode lottery should be addressed through the application of minimum standards rather than detailed prescription. Goodhart's Law<sup>4</sup> and the perverse effects of centralised targets are well known. Minimum standards with local discretion beyond them could offer a more fruitful way forward and combine subsidiarity with the fact that society will not accept standards of provision falling below certain norms in any area. Further, such a framework would encourage local innovation, and successful local innovation can lead to increases in minimum standards over time.

12 It should be noted here that CIPFA itself plays an important standard setting role in relation to financial reporting in local government. The SORP (statement of recommended practice) prepared by CIPFA/LASAAC is recognised in legislation as proper accounting practice. Local authorities are also required by legislation in England to have regard to other of CIPFA codes of professional practice:

- the Best Value Accounting Code of Practice (which covers the measurement of the cost of services)
- the CIPFA Treasury Management Code
- the CIPFA Prudential Code (for capital investment).

These codes play a vital role in the financial management and fiduciary responsibilities of councils and their chief financial officers.

13 We recognise that the concept implied in question (4) above, whereby some services might be subject to national prescription and others totally to local prescription, is an alternative paradigm to that of minimum standards. However, we doubt that the public would accept any service falling explicitly below certain minimum standards for example of safety or financial probity. We therefore suggest the paradigm of *minimum* national standards in appropriate cases.

14 There, of course, needs to be a relationship between standards and funding. Any system is likely to become unhinged if standards, however desirable, are prescribed at a level that is not resourced and/or is not affordable.

15 Public accountability is often confused by the argument about the proper funding of new local standards. Local authorities argue that they have taken on the burden of new responsibilities without receiving proper funding. Central government claim that adequate funding has been provided.

16 It may be that in the interests of clear accountability some sort of Grants/Funding Arbiter or Adjudicator should be established to vouch that new responsibilities are or are not properly funded. This role might be undertaken as part of a wider remit including decision making in relation to the distribution of Government grants between local authorities. The

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<sup>4</sup> Goodhart's Law: when a measure becomes a target it ceases to be a good measure.

delegation of this responsibility by Government to a demonstrably independent Grants Commission would dispel another of the recurring claims which undermine accountability – the argument that grant distribution is influenced by political bias.

**Qu 5 How has the government’s approach to devolution and decentralisation affected your area and your services?**

17 Approaches to decentralisation such as greater independence for schools and developments in community policing can lead to tensions on governance issues. Without prejudice to what the answers should be, basic questions are:

- who is accountable
- for what?
- to whom?
- is the final structure for the commissioning, leadership and provision of public services coherent?

If there are occasions when these questions cannot be answered simply, precisely and affirmatively, then this does not auger well for good governance.

**Qu 6 How can pressure on local services be managed more effectively?**

18 We agree that pressures on local services are often not well understood.

19 We note the comment in Sir Michael’s interim report that:

“There is some evidence from overseas that greater trust between levels of government can allow a more flexible finance regime to operate and also support the easier implementation of finance reforms.”

20 We also consider that, whilst they would not resolve the pressures, a change in the balance of funding towards local resourcing and the non-hypothecation of funds would assist in the management of pressures on local services.

21 The government currently uses ‘capping’ to limit increases in local taxation. However, this is widely acknowledged to confuse accountability for the management of pressures. Often, it leads to cuts in local services being laid at the door of central government.

22 It is important in relation to the management of pressures on local services to have a consistent and accepted measurement of the cost of those services. It is not helpful, for example, that the cost of schools’ expenditure in England is measured by the DfES in a manner that excludes depreciation, when the cost of services such as education are required to be measured in local authority accounts, and in central government resource accounts, in a manner which, rightly in our view, includes the cost of depreciation. Issues of measurement may seem arcane but they have a real impact on the ground. In our view the measurement of the cost of services should be based on proper accounting practice. We hope that the high level post-Atkinson review established by government, in

which CIPFA is participating, will resolve these issues.

- 23 We would also support work to identify appropriate service specific rates of inflation, and are aware that some work on this is being done as part of the efficiency agenda.

**Qu 7 How could responsibility for local services be made clearer between local government, central government and other agencies?**

- 24 Public bodies should be obliged to publicise the extent of these responsibilities widely and clearly. They should describe what they do and, equally importantly, what they do not do. This process is a cornerstone of good public governance. In the Good Governance Standard for Public Services this is described as a clear statement of purpose.

- 25 This principle is also extremely important when public bodies enter into partnerships. In these circumstances it is critically important to agree and publicise the purpose of the partnership and the roles and responsibilities of the individual parties.

- 26 Clearly the proper and effective stewardship of public money is vital. Necessary preconditions for this are proper accounting arrangements and good treasury management. To achieve these, reliance must be placed on individuals within the organisation concerned. However, even the most professional, skilled and experienced people will not be able to operate well unless there is a clear framework both legislatively and of professional standards in which they act. Central government departments and local authorities have clear frameworks for accounting and treasury management. Where special vehicles are created for service provision, or new types of organisations are developed, then care must be taken to ensure that appropriate arrangements exist, or are created where they do not exist.

- 27 We note Sir Michael's comments that

"My research has revealed a weak public understanding of how local government is funded, and confusion over how the responsibility for the delivery of local services is shared between central and local government, and has indicated a poor public understanding of the cost of public services. This is problematic because if people do not understand how much services cost to deliver, they may have unrealistic expectations about what council tax pays for, and how much local government can do with the level of resources currently available. My research also suggests that there is a high degree of public confusion about who is responsible for setting the level of council tax and the reasons behind the annual increases in the tax."

- 28 These are critically important issues for public accountability. Understanding the full cost of services, and how they are funded and who takes decisions is fundamental to good accountability.

- 29 One area in which it may be possible to help clarify these matters concerns the arrangements for reporting specific grants. Such grants currently reduce the net cost of relevant services in the process obscuring the full gross cost. The case for this treatment is stronger in some circumstances than in others. Where ring fencing rules have been significantly relaxed the justification for this treatment is questionable. It may be more appropriate to see such grants as a subsidy to the taxpayer rather than a subsidy to the service. We would be pleased to work further with the review and other stakeholders on the development of better summary financial presentation pertinent to budget setting and narrative reporting generally.
- 30 We have responded to the ODPM's consultation *Inspection reform: the future of local services inspection*.

### **Local Government Funding**

- 31 In his interim report Sir Michael also asks for any comment on his work to date on local government funding and the issues he identifies from it. Our comments on this are given below, cross referenced to the relevant paragraphs of the interim report. Our comments should be read in the context that it is CIPFA's view, as previously submitted to the Committee on the Office of the Deputy Prime Minister's inquiry into local government revenue<sup>5</sup>, that what is needed is a fundamental shift in the balance between local and central tax raising towards a situation where more than half of local authority spending is financed locally.

### **Council Tax**

#### *Paragraph 2.42*

*"My work to date suggests that the public do not have a strong understanding of these objectives or of the tensions between them. I am interested in receiving further views on the balance between council tax as a 'fair' source of local taxation and a property tax, and the issues raised by the need to balance these objectives in one tax."*

- 32 In CIPFA's view it is right that a proportion of tax raising capacity in the UK is based on a property tax or taxes. It is widely accepted that such taxes are relatively stable, predictable and easy to collect, and these are commonly quoted as advantages of such taxes. Their lack of fairness, or at least their perceived lack of fairness, is commonly quoted as a disadvantage. However, in our view it is a mistake to see property taxes as inherently unfair. Income is not the only form of wealth: land and property are also forms of wealth, if less easily realised by property holders. If income, and in particular earned income, were the only source and basis for taxation nationally the rate of tax would be very high and also unfair. It is in our view necessary to look at the fairness of taxation in the round and not solely at the particular characteristics of any one tax.
- 33 If, as we suggest, there should be a tax on property, then in our view it is

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<sup>5</sup> *Submission to the Committee on the Office of the Deputy Prime Minister's Inquiry into Local Government Revenue*, CIPFA, March 2004, [www.cipfa.org.uk/pt/responses.cfm](http://www.cipfa.org.uk/pt/responses.cfm)

logical for it to be a tax for local services. We believe this to be the case for both domestic and non-domestic property.

- 34 In our view, the current real and perceived unfairness of the council tax is due to two main reasons: first, the fact that the council tax has been allowed to rise significantly faster than inflation in recent years; and second, particular concerns for the impact of this on people on low fixed incomes, especially the elderly. The former is a matter of national policy that could be ameliorated if wished in the future. We agree with the interim report that the latter could be tackled by a review of council tax benefit. We would specifically recommend that the name and ethos of this be changed from a 'benefit' to a 'rebate' or 'allowance' and that the current low savings cut-off be significantly increased.

### **Balance of funding and gearing**

#### *Paragraph 2.51*

*"I am concerned that this [gearing] effect can lead to a distorted focus on the marginal pound rather than the total budget of an authority. But changing the balance of funding for an authority will not in itself address the pressures on local services, which come from many sources, including demographic changes, new legal and policy responsibilities of local government, centrally set targets, and rising public expectations. I therefore welcome the opportunity presented by my extended remit to consider these broader issues."*

- 35 We agree with and welcome this analysis. However, if more radical solutions are in the event not found to be possible we recommend that Government consider other methods of tackling gearing as outlined in our earlier report to the balance of funding review.<sup>6</sup> In addition, CIPFA in Scotland is currently undertaking more detailed work in respect of gearing in Scotland.

### **Council tax and ability to pay : Council Tax Benefit**

#### *Paragraphs 2.58 – 2.64*

- 36 Please refer to comments made in paragraph 34 of this response.

### **Local income tax**

#### *Paragraph 2.86*

*"The work conducted for the Balance of Funding Review and afterwards by CIPFA and discussions with and submissions from tax experts and employers' representatives, show that it would be possible to introduce a local income tax alongside council tax. It would, however, be a substantial task with associated administrative costs and implications for local authorities, taxpayers and employers, and would require a considerable*

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<sup>6</sup> *The Balance of Funding and Gearing*, CIPFA, Balance of Funding Review Paper 14, 2003

*time to implement.*<sup>7</sup>

- 37 In our further work, "A taxing issue", we exemplified how the assessment of the local income tax could be simplified and the administrative burden could be substantially removed by the introduction of personal tax allowances relating to the area of residence. Although we do not advocate the introduction of a local income tax to replace the Council Tax, we do believe that the obstacles that might have previously existed to prevent it becoming a realistic supplement to the Council Tax would now be surmountable because of improved technologies.

### **Business interests and business rates**

#### *Paragraph 2.91*

*"Businesses benefit from the actions of successful local authorities, and the investment in public services and infrastructure that they can make. I will continue to explore the interactions between business and local government in many of the areas my remit covers. This will include further consideration of how changes to business rates could improve the ability of, and incentives on, local authorities to support and promote economic development, including looking at current exemptions and discounts.*

- 38 CIPFA has consistently argued for the return of non-domestic rates from being a national tax to a local tax. We believe this is right in principle for the reasons outlined in 2.91 of the interim report, quoted above. It would enhance and underscore the inter-relationships between local authorities and their local businesses. Further, if this change is politically acceptable, it would be technically the simplest way to shift the balance of funding significantly.
- 39 We also recommend that the consequences and fairness of the policy of pegging business rates to inflation should be re-examined. It has resulted, over time, in a lower proportion of local expenditure being funded by business, which in turn has put greater pressure on government grant and the council tax.
- 40 We would also suggest that in terms of fairness of business taxation, taxation should be seen in the round. We are mindful of reports that for big business corporation tax can be difficult to assess and collect due to the potential to 'move profits around' between countries. Property tends not to shift between countries in the same way.

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<sup>7</sup> CIPFA, *Reviewing the Case for a Local Income Tax*, Balance of Funding Review paper 19, 2004; CIPFA, *Reviewing the Case for a Local Income Tax : Supplementary Report*, Balance of Funding paper 25, 2004; CIPFA, *A Taxing Issue : Local Income Tax Exemplified* 2005.

## **Land taxation**

### *Paragraph 2.93 second bullet point*

*"it would provide an incentive for the effective and efficient use of land because all land would incur a charge, even when it was not being used for productive activity, thus making the cost to society of its under-use clear to owners;"*

- 41 The advantages of a land tax are, in theory, substantial. However, these are largely untested in practice internationally and there would be difficulties in its introduction here, as noted in the interim report, notably the lack of a national land register. Nevertheless, we suggest that the potential advantages warrant further investigative work in the medium to long term. Also, it may be both technically easier and more appropriate to consider a land tax for non-domestic property only (ie land not used for housing).

### *Paragraph 2.97*

*"I am particularly interested in exploring taxes which could improve the incentives faced by local authorities by providing a link between resources and local development and population change. Whilst the new prudential borrowing powers are an important new flexibility, local authorities may be constrained in making full use of them by current constraints on revenue to finance additional borrowing. Revenues from taxes linked to the success of the local area may provide such revenue streams and enable authorities to make beneficial long-term investments, though they may vary with the economic cycle. I will consider these options further over the next year."*

- 42 CIPFA was pleased to develop the CIPFA Prudential Code, which underpins and enabled the prudential borrowing powers. This is an important new freedom that is being used to benefit many local areas. It is however certainly true that its use is limited by resources. If the increased value to a local area that would result from, for example, major public transport investment (Crossrail?) and economic regeneration initiatives, could be harnessed in part to support the public investment necessary, this would help realise the fuller potential of the new prudential system to great benefit. We would be pleased to work with the Inquiry on further investigation of this.

## **Other taxes and charges**

### *Paragraph 2.106*

*"The work I will be undertaking on the role of local government will be important in setting a context against which to judge which of these revenue sources might potentially be useful and appropriate for local government in the future. I will return to this in my final report."*

- 43 We support this further investigation. We would however caution against the hypothecation of such taxes and charges, since greater benefit would result from greater flexibility.

- 44 In respect of charging for services, research undertaken by Professor Bailey, recently published on the CIPFA/IPF TIS website<sup>8</sup>, illustrates the extent of charges currently made by local authorities and raises issues about possible future usage/constraints to usage of charging for services.

### **International comparisons**

- 45 It may be of interest to the future work of the review that during 2006, CIPFA is arranging with GFOA, the Government Finance Officers Association of the USA and Canada, an international exchange between our two organisations in May and June. CIPFA will be particularly looking at the different income sources available in the USA and Canada; the use of bond issues for capital schemes; and alternative revenue sources including sales, income, property and other taxes and fees that are used in North America local governments.

### **Exemplifications**

- 46 Our commercial arm, IPF, has a large database of local government statistics and extensive knowledge in this area. If the review wishes to commission detailed exemplifications of alternative scenarios for funding, this could be an appropriate and extensive resource.

### **Concluding, over-arching comment**

- 47 Sir Michael has spoken of a 'tipping point' towards consensus around the need for change for local government. Certainly, at present all major aspects of local government – funding, functions, structure, role – are under review. We would strongly urge that Government finds a way of ensuring that a clear constitutional settlement emerges from its current work and that mechanisms are put in place – such as a change in the balance of funding, an independent Grants Commission, and a clear distinction between neighbourhood, local and central responsibilities – to allow the changed system to become embedded, stable and practical.

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<sup>8</sup> For a copy of CIPFA's *Local Authority Charging* written by Professor Stephen Bailey and published by CIPFA's Technical Information Services at [www.tisonline.net](http://www.tisonline.net) please contact Nicholas.campbell@ipf.co.uk