

ANNEX J

Town and Parish Councils

Introduction

- J1. The local government finance green paper is primarily concerned with the financial regime for the principal authorities – the unitary authorities, the county and district councils, and the fire and police authorities. There are four main reasons for this:
- The principal authorities spend more, and raise more in tax. Aggregate expenditure by the principal authorities was £53 billion, supported by £14 billion of council tax. Aggregate expenditure by local councils¹ is estimated at £270 million, supported by £180 million of precepts.
 - The responsibilities of the principal authorities cover issues which are also a top national-level priority for Government. This is particularly true of education.
 - Principal authorities receive a major part of their income in the form of Government grant. The Government must determine how this grant is allocated between authorities. It does not have to take any comparable decision in relation to town and parish councils.
 - There is considerable dissatisfaction with the existing finance system for principal authorities. There is little confidence in the grant distribution system. There are concerns about the variety of controls which Government exercises over local authorities' finances, and about the lack of transparency and the blurring of accountability which this produces. The local government finance system is complex and is not well understood by key stakeholders.
- J2. The funding of town and parish councils – the 'local councils' – does not raise the same concerns for Government as the financial regime for principal authorities. Nor does it give rise to the same level of complaint from the councils themselves, or from their taxpayers.
- J3. Nevertheless, at a time when the Government is engaged in a fundamental review of the local government finance system, it would be wrong not to take the opportunity to promote a debate about the funding of local councils. We are keen to establish whether there is scope to improve the system, to make it more responsive to the current needs and future aspirations of the councils, and of those who use and pay for the services which they provide. In paragraph 1.3 of the green paper (which is reproduced in the box below), we set out what the Government regards as the desirable characteristics of a local government finance system. Some are primarily of relevance to principal authorities, but others appear to be equally relevant to parishes – facilitating partnership working, promoting consultation, clarifying accountability, and ensuring that the system is intelligible to all stakeholders.

¹ In this annex the terms 'local council', 'parish and town council' and 'parishes' are interchangeable.

- To provide **adequate funding** to all authorities;
- To promote **continuous improvement**;
- To provide a reasonable degree of **predictability and stability**;
- To balance funding for local government's delivery of **national priorities and targets** with real financial **freedom and responsibility** for local authorities;
- To be **fair** to those who use and pay for local authority services;
- To clarify **accountability** for financial decisions;
- To be **intelligible and transparent** to all stakeholders;
- To facilitate **partnership working**; and
- To encourage **consultation**, particularly with local taxpayers.

- J4. There are also some aspects of the existing financial regime for parishes which do not work well, such as the treatment of parish precepts under council tax benefit subsidy limitation. There are other aspects which may need rethinking in the light of changes proposed for principal authorities, like controls on borrowing.
- J5. At the end of this annex, we pose some specific questions about the financial regime for town and parish councils. However, we would very much welcome broader comments on what sort of finance system is appropriate for them.

Sources of funding

- J6. Town and parish councils are essentially self-financing bodies. They do not receive general grant direct from Government, although some receive financial support from county or district councils (which are supported by Government grant). Many have also benefited from lottery funding. Their main source of revenue funding is the parish precept on the council tax. Some councils also have significant internal sources of revenue, particularly from property and car parks.
- J7. Like principal authorities, town and parish councils require Government approval for borrowing and are free to borrow commercially. However, parishes also have access to the Public Works Loans Board, which generally offers lower rates of interest. But unlike principal authorities, the borrowing approvals for parishes do not carry any entitlement to Government financial support to service the debt.

Financial controls on town and parish councils

- J8. Parishes have a general power to incur expenditure under section 137 (s137) of the Local Government Act 1972, as amended by the Local Government and Housing Act 1989. The latter added new controls on the use of by limiting it to expenditure, which was of 'direct benefit' to the area. It also said that the benefit must be 'commensurate with the

expenditure to be incurred'. Last but not least, s137 sets a ceiling on the amount which a town or parish council may spend per annum. This ceiling was last uplifted through the Local Government and Housing Act 1989, and currently stands at £3.50 per elector.

- J9. The Local Government and Rating Act 1997 created more headroom within existing s137 financial limits by introducing new specific powers to spend on community transport, crime prevention and traffic calming – and thus removing spending on these activities from s137. The Local Authority (Expenditure Powers) Order 1995 also gives more freedoms to operate within s137 limits – by allowing parish councils to discount s137 expenditure financed by contributions from principal authorities. Where there is a partnership arrangement between a parish and a principal authority, the expenditure incurred by the latter authority obviously does not score against the s137 ceiling. There has been a welcome increase in such partnership arrangements and in parishes undertaking work under contract to principal authorities.
- J10. The net effect of the reforms summarised in paragraph J9 is to create considerable freedom of manoeuvre within the £3.50 per elector ceiling. A report carried out for the Department of Environment, Transport and the Regions (DETR) by the Aston Business School in 1998 concluded that s137 arrangements were regarded as satisfactory by the vast majority of parish councils. However, it also noted that 'headroom' under the s137 limit was reducing rapidly and that even the perceived impact of the limit may pre-empt parishes' consideration of spending on additional activities. Where parishes seek to expand their services to support their community, the s137 limit may occasionally present an impediment. This is a particular issue for the larger and more ambitious town and parish councils.
- J11. The s137 control has no counterpart for principal authorities. They are constrained in other ways: their entitlement to a share of the business rate is determined by statute; Government decides how much grant they receive; and they are also subject to reserve capping powers to protect taxpayers from excessive increases in council tax.
- J12. The Government would welcome views on the appropriateness of the s137 control, on the case for reforming it, and on the case for increasing the £3.50 ceiling. However, any changes to s137 need to take account of the implications for taxpayers, which are dealt with in the next section of this annex.

Parish precepts

- J13. Parishes' access to council tax is via the precepts that they issue on the local billing authority. In most cases, this will be the shire district council, although there are also some parish councils within metropolitan boroughs. The billing authority exercises no control over the parish precept. It is simply required to add the parishes' demand to its own budget requirement. Naturally, the parishes' share of the council tax is charged only to households within the parish concerned.
- J14. The council tax increases of principal authorities are subject to **reserve powers to protect council tax payers from excessive increases**. If Ministers determine that a particular authority's budget and council tax increases are excessive, they may intervene to 'cap' the increase by requiring the authority to reduce its budget for the current financial year and to rebill council tax payers. Alternatively, they may determine the authority's budget for the following year, or they may set a notional budget for the current year which they will use as the basis for measuring the following year's budget increase.

- J15. Parish precepts account for less than 1½ per cent of total council tax collected. For most households, the parish precept is a very small component of the council tax bill. However, there are a few towns and parishes where the parish precept is larger than the council tax due to the district council. In these cases, it is illogical that taxpayers should have protection via the Government's reserve capping powers from excessive council tax increases made by the district, but no protection from excessive increases in the precept.
- J16. Areas where there is a substantial parish precept can also give rise to problems with **council tax benefit subsidy limitation** (CTBSL). This scheme was introduced so that local authorities making steep council tax increases should meet part of the escalating benefit bill resulting from their decisions. The Government sets a guideline increase in council tax, which is currently 4½ per cent or (if greater) the authority's SSA increase. When calculating a district council's council tax increase for CTBSL purposes, the parish precept is included. Some billing authorities have found that large parish precepts are adding late, unpredictable sums to council tax bills causing them to be caught by the CTBSL scheme. This is obviously unfair, since the billing authority has no control over the precept. It has therefore been suggested that parish precepts could be excluded from CTBSL calculations. The drawback is that there is no clear demarcation line between district council and parish responsibilities, which creates scope for evasion of CTBSL. An alternative suggestion is that parishes should be subject to CTBSL in their own right, in the same way that major preceptors (like police authorities) are. This could be administratively burdensome, unless the rule was applied only where the parish precept caused the billing authority's council tax increase to exceed the CTBSL threshold.
- J17. Paragraph 5.8 of the green paper deals with **billing arrangements**. This is an important issue, because people need to be clear which of their local authorities is responsible for the increases in their council tax bills. The green paper focuses on the most significant issue in this area, which is the fact that council tax bills are issued by district councils, whilst county councils account for the greater part of the bill. It invites views on placing the responsibility for council tax billing on counties rather than districts. We would welcome views on how parishes might be affected by such a change. But the green paper also raises the broader question of how it can be made clearer to taxpayers which authority is responsible for each component of the bill, and how much each authority has increased its demand by. This applies as much to the parish precept as to other components of the council tax bill, and we would welcome views from town and parish councils on this point.
- J18. Local taxpayers in parished areas can be subject to **double taxation**. This happens where a service is provided by the parish rather than the principal authority (usually the district council), but the district's council tax element is not reduced. In effect, this means that households pay to have the service provided in their area by the town or parish council, but also contribute to the cost of having it provided in other areas by the district. The Local Government Finance Act 1992 provides a remedy for this: authorities may decide only to charge taxpayers in those areas where the district council, itself, provides the service. This leads to a small reduction in district-level council tax for parish residents. There is no requirement for districts to act in this way, although they must as a full council resolve not to. District councils usually do this by making a blanket resolution that they have no 'special expenses'. There is no guidance to principal authorities on this. However, we could provide more effective protection against double taxation by making it a duty for them to apply 'special expenses' where appropriate. We would welcome views on this – and on any other potential financial impediments to promoting effective partnership working with principal authorities.

Fees and charges

- J19. Paragraphs 5.42 to 5.45 of the green paper deal with local authorities' ability to raise revenue through fees and charges. The Audit Commission has identified deficiencies in local authorities' use of their existing powers to charge and in their freedom to charge. We therefore expect authorities to develop a clear corporate policy on charging and to reflect this in the way in which they carry out Best Value reviews. We also propose to make regulations under section 150 of the Local Government and Housing Act 1989 to give local authorities powers to charge for discretionary services provided under statutory powers, including those to promote the well-being of their areas under the Local Government Act 2000. We will consult on the draft regulations and guidance on charging for discretionary services and consider what further work is needed on charging for mandatory services.
- J20. For some town and parish councils, income from fees and charges accounts for a much higher proportion of total revenue than it does for most principal authorities. We are therefore keen to have the views of such councils on how the approach proposed in the green paper might apply to them. We are particularly interested in how different town and parish councils could co-operate with one another and with their district or county council in cases where responsibilities for charging are split (eg for car-park use).

Parishes and the business rate

- J21. The business rate is set for the whole of England and the amount raised is limited to the level of inflation. The revenue is pooled centrally and distributed to principal authorities on the basis of their resident population. Town and parish councils do not receive any income from business rates.
- J22. Our proposals for a supplementary rate (see annex C) will only apply to principal authorities. However, we suggest that town and parish councils could be involved in the Partnership Arrangements that will decide how the income from the supplementary rate is used.

Funding capital investment

- J23. Like principal authorities, parish and town councils can fund capital investment either from their revenue account or by borrowing. (In principle, they could also enter into a private finance arrangement, but none has yet done so and very few projects would be large enough to justify using this approach.) Funding investment from revenue is purely a matter for the town and parish council. Borrowing requires Government approval.
- J24. Town and parish council borrowing is governed by the Local Government Act 1972. Parish councils have to seek approval from DETR for any borrowing in respect of individual capital projects. The Government determines the total level of town and parish councils borrowing that it is prepared to sanction. This figure has been set at £8 million for 2000/01. In allocating borrowing approvals between councils, DETR has considerable assistance from the National Association of Local Councils (NALC), for which the Government is most grateful. NALC help by processing applications from councils, by inviting councils who have not used their approvals to surrender them for use by other councils, and by

suggesting options for phasing borrowings in order to avoid breaching the Government's ceiling on total town and parish councils borrowing. However, even with NALC's assistance, the system can only work if supply and demand for borrowing approvals are kept broadly in line. If demand were to outstrip supply by a significant margin, there is no mechanism for deciding which projects should have priority.

- J25. Principal authorities also require Government approval to borrow. The green paper consults on options for lifting this restriction from them (see paragraphs 4.4-4.6). In principle, the case for lifting it from town and parish councils too is strong. However, in lifting the restriction from principal authorities, the Government is determined to ensure that those who use and pay for local services have adequate protection against their principal authority running up levels of debt which it is unable to sustain without cutting services or increasing council tax. The green paper briefly describes the prudential regime that would provide the necessary safeguards, and these are set out in more detail in annex B.
- J26. If it were to remove borrowing controls from town and parish councils, the Government would need to be satisfied that the interests of their residents were properly protected. Even a relatively modest debt could cause serious problems for a very small community. We should need to bear in mind that parish councils do not generally have access to the same financial expertise as principal authorities. Nor are they subject to the same statutory safeguards. For example, unlike principal authorities, parish and town councils are not required to appoint a qualified accountant to oversee their financial affairs and conduct them in accordance with professional codes of practice. Key elements of the prudential regime described in annex B rely on professional regulation and on the duties of specified statutory officers, many of which do not currently apply to parish and town councils.

Audit of local councils

- J27. The Audit Commission has recently published a 'think piece' on the audit of local councils. This work was undertaken in response to two sources of concern. On the one hand, local councils felt that audit fees were sometimes excessive in relation to the budgets of the councils being audited. On the other hand, those undertaking the audit felt that the fees were sometimes insufficient to cover the cost of doing the work.
- J28. The Audit Commission's paper suggests that both concerns may be justified, and that the solution may lie in relaxing the Accounts and Audit Regulations 1996 and/or exempting parishes up to a certain size from audit. Legislation would be needed to take forward these and other measures that could help create a 'lighter touch' approach to the audit of smaller local councils. Other options, such as changing the model of supply of local council audit, fall within the remit of the Audit Commission itself. The paper can be found at www.audit-commission.gov.uk.

Differentiating between local councils

- J29. In this annex, we have identified a number of respects in which the existing financial regime for town and parish councils appears to be illogical or unfair. However, there are about 8,000 town and parish councils in England², which vary enormously in terms of their

² There are also about 1,400 parish 'meetings' in areas which are not governed by a parish council. Meetings must be held annually in such areas. About 500 meetings are responsible for some income and expenditure.

size, responsibilities and democratic mandates. For the vast majority of these councils, the regime does not create any problems in practice, and there is little evidence of discontent from the parishes, their taxpayers or their billing authorities.

- J30. Accounting and audit concerns aside, the case for any reform appears to relate mainly to the larger local councils that have substantial budgets, precepts and revenues from charges, and which will occasionally have significant capital investments to fund. It is possible that these councils would benefit from a financial regime more closely in line with that which applies to principal authorities. In particular:
- the s137 restriction might be lifted from them, and they might be brought within the ambit of the reserve powers to limit excessive council tax increases;
 - the requirement for approval to borrow might likewise be lifted, and replaced by the same prudential regime that is envisaged for principal authorities.
- J31. Town and parish councils with expenditure of more than £500,000 a year are subject to the duty of Best Value. The cut-off figure is designed to bring larger town and parish councils within the Best Value framework, and thus recognises that they play a role in their communities of similar importance to district councils. Should the Government draw a similar distinction in relation to the financial regime for bigger parish councils? If so, where and how should the line be drawn? If some local councils are subject to the same controls as principal authorities and given the same freedoms and responsibilities, should they also have access either to Government grant or to the business rate? And, if so, how would that be managed in practice?
- J32. Finally, if the ideas in the Audit Commission's 'think piece' are taken forward, should the dividing line for audit purposes be the same as the one used to determine which financial regime local councils are subject to?

Questions

- J33. In this annex, we have posed the following specific questions about reform of the financial regime for town and parish councils:
- Should the s137 limit on expenditure by parishes be increased or otherwise amended?
 - Should parish precepts be subject to the same reserve powers that protect principal authorities taxpayers from excessive council tax increases?
 - How should CTBSL deal with parish precepts?
 - What would be the implications of making counties billing authorities? And what can be done to clarify council tax bills?
 - Should more be done to prevent 'double taxation'?
 - What are the implications for town and parish councils of the reforms proposed in the green paper for fees and charges?

- Is there a case for reforming parishes' capital finance regime? And how can the interests of those who use and pay for their services be protected?
 - In addressing these questions, it would be helpful if respondents could also consider whether different answers might be appropriate for different types of town and parish council.
- J34. The future role of parish councils in contributing to effective local governance in rural communities will be considered further in the forthcoming rural white paper. Respondents may also wish to consider the proposals in that paper alongside this one.