CIPFA BRIEFING

December 2018

measured resilience in English authorities

In July 2018, CIPFA developed a proposal to publish an index of resilience of English councils, designed to support the local government sector as it faces continued financial challenge. The consultation document outlined a proposed methodology, and illustrated how the results might be displayed in practice. The Beta Version of CIPFA's Resilience Index, released to finance directors of English councils in December 2018, is a tool that enables authorities to view their positions, relative to others, on a range of measures linked to financial risk. This briefing note summarises key results from across the country, including a description of the measures chosen and their link to financial resilience.

The latest version of the Index follows a consultation which received over 180 responses. This tool is a test version and we will be running a series of development workshops with finance directors across the country in 2019 ahead of the release of a final version, when CIPFA also aims to publish a new Financial Management Code. Following official publication of local authority revenue and expenditure outturn data in November 2019, the Index will be made publicly available online. CIPFA believes that councils are best placed to make good judgements on their financial resilience through the provision of consistent indicators of resilience to be advised by their CFO in statutory statements that accompany the budget report. The boundaries used in this analysis should not be interpreted as a definitive judgement on a council's financial position.

The Chartered Institute of Public Finance & Accountancy

Context

In the aftermath of the 2008 financial crisis, public services knew they faced several years of efficiencies and cuts as the government tried to fulfil its commitment to eliminate the budget deficit. Nearly a decade later, it is now clear that public sector austerity is likely to continue until at least the middle of the next decade and, given the impact of Brexit, quite possibly beyond.

Effective financial management in the public sector has always been built on planning for the long–term, but the necessity now is to ensure organisations have the resilience to deliver annual savings and manage significant financial shocks while still pursuing ambitious goals for their local communities.

Achieving financial resilience is a challenge for all but some areas arguably have greater capacity to find alternative income and are less dependent historically on government funding. Clearly the reverse is true for others in less fortuitous situations where needs are high and potential for revenue growth limited.

Local government has faced unprecedented financial challenges in recent years that are likely to persist well into the next decade. English local government spends 25% less in real terms than eight years ago, and has lost nearly 50% of the grants received from central government, and yet continues to deliver core services.

However as we have seen in continuing coverage and announcements, we are approaching the point where a number of well–run councils will be in the position of being able to deliver little more than the core statutory provisions in order to meet their legal duty to balance the books.

The recent National Audit Office (NAO) report on financial sustainability in local authorities, published following the crisis at Northamptonshire County Council, indicates that there is a heightened risk of more councils over the next four years falling into special financial measures as a result of not reconciling the pressure on budgets. The initial aggregated findings from the CIPFA Resilience Index corroborate those of the NAO. Coincidentally in July 2018, the Public Accounts Committee called on the government to work with the local authorities and key stakeholder bodies over the next 12 months to agree and publish a shared definition of local authority financial sustainability and a methodology for assessing the extent to which local authorities are at risk.

CIPFA's intention in time is to make it a requirement to reference the Resilience Indicators in Section 25 statements and over time once the new CIPFA Financial Management Code is published in autumn 2019 we expect the indicators will help CFOs demonstrate improvements in financial management; and that we can further improve the range of data, particularly in relation to forward looking indicators linked to medium–term financial plans.

Summary overall position – aggregated Resilience Index outputs

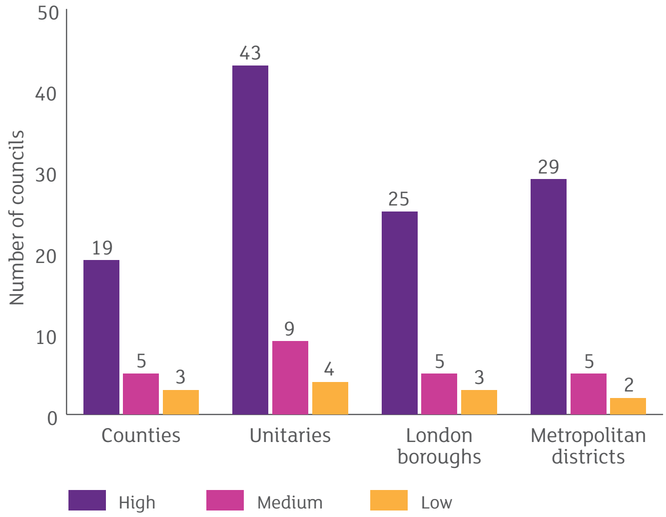
Aggregated results of the Resilience Index show the majority of councils are in a stable position and not showing significant signs of financial failure. However, there is a tail, of 10–15% of councils, where there are some signs of potential risk to their financial stability in the short term.

Reserves depletion time

The reserves[1] depletion time shows the number of years it will take for a council to deplete their reserves if they continue to use their reserves at the same rate as the last three years to March 2018. A low value implies that reserves will be fully exhausted in a short time if recent patterns persist. The chart shows the number of upper tier councils with more than 10 years of reserves, those with four to 10 and those with less than four years. Twelve councils record a very low score, but a further 24 fall in the medium range. The majority of councils have a longer depletion time including many councils which have added to their reserves over the past three years.

Only two district councils have a depletion rate below four years and a further four district councils have a depletion time between four and 10 years.

Reserves depletion time



Caution is needed with reserves data, as resources may be held for a specific event or programme at a future date.

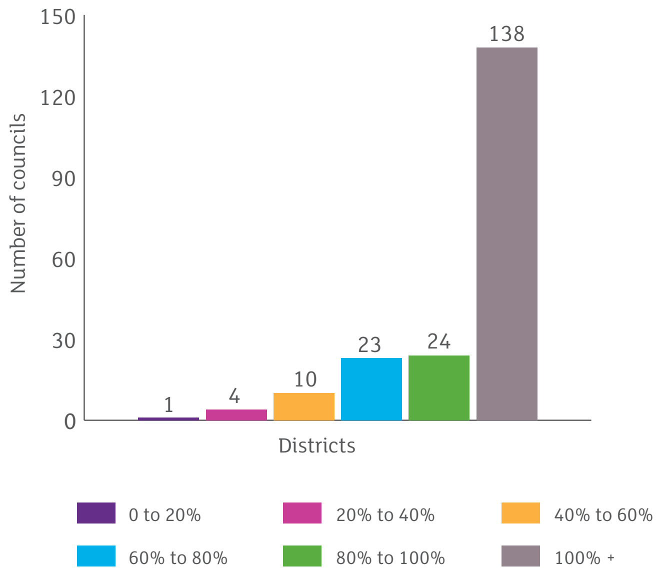
1 Reserves is the total of usable reserves from the general fund excluding the ring–fenced reserves for public health and schools.

Level of reserves

This measure shows the level of reserves as a proportion of net revenue expenditure. A low figure may suggest that a council will struggle financially if it experiences a financial shock or is unable to run a budget where income matches expenditure. The data shows a very wide range of values – from close to zero to over 200%. The majority of upper tier authorities – those with a social care responsibility – have reserves of between 10% and 50% of net revenue expenditure. County councils have a lower level of reserves than other types of council. District councils, which do not have a social care responsibility, typically have much higher levels with the majority holding reserves that exceed their net annual expenditure.

Level of reserves as proportion of net revenue expenditure

Level of reserves as proportion of net revenue expenditure in districts



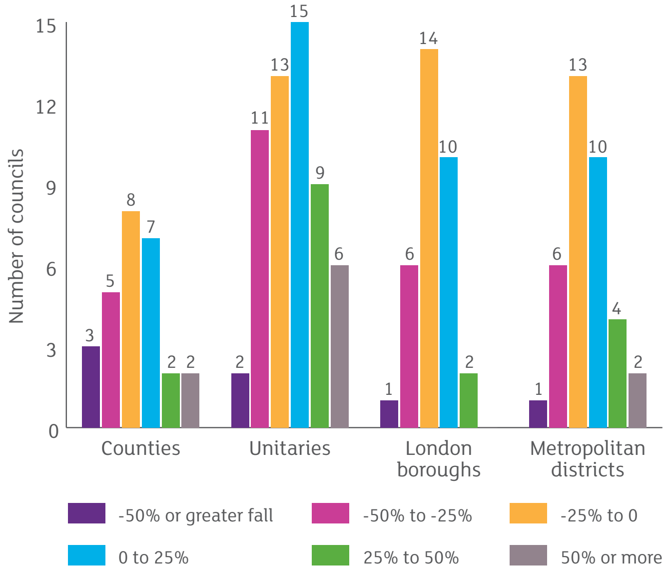
Change in reserves

This measure shows the average change in reserves over the past three years. There may be good reasons for depleting reserves – for example to meet a liability that has been planned for by setting aside an earmarked reserve. However, continued depletion of reserves may be a sign of financial stress and being unable to deliver a balanced budget.

Over the past three years, councils are evidencing a range of behaviours – with some seeing extensive reductions in their reserves whilst others have seen growth. Unsurprisingly, there is a very strong correlation between the rate of reserves depletion and the depletion time measure.

The chart shows the numbers of upper tier councils by the percentage change in reserves. There is a marked difference between district councils, the vast majority of which have added to their reserves, and other councils where there is a much more mixed picture.

Changes in reserves

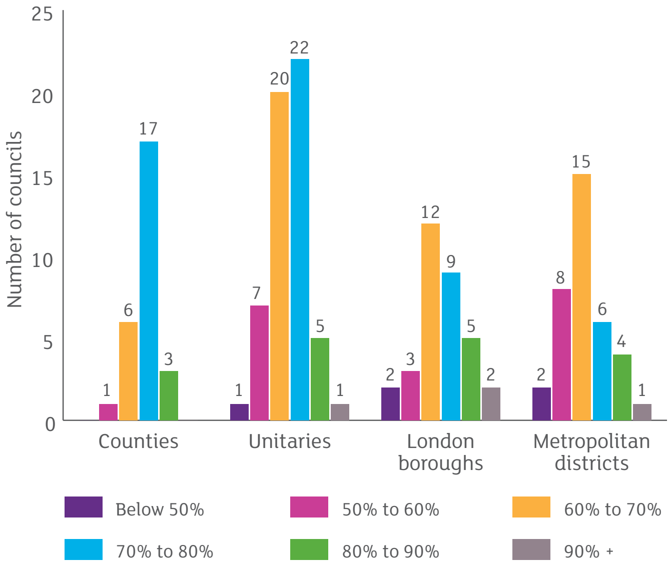


Council budget flexibility

The council budget flexibility measure is calculated as the proportion of net revenue expenditure accounted for by social care and interest payments. Social care is primarily demand driven and interest rates typically fixed. Therefore, councils find it harder to control or reduce these budgets than they do some other spending items. Thus, a high ratio may be indicative of potential difficulty in meeting future budget constraints. According to CIPFA and the Institute for Government's Performance Tracker report (autumn 2018), non–social care spending makes up only 46% of all local government spending.

About 30% of councils have a ratio above 75%. Counties typically have a higher level than other upper tier councils, reflecting the fact that they have a narrower range of services than other type of upper tier council.

Council budget flexibility



Council tax to net revenue expenditure ratio

This measure is calculated as the ratio of council tax requirement to net expenditure. In general, a high level may be associated with security of income. The ratio varies widely – from around 30% to 90%. The lower end is dominated by London boroughs, metropolitan districts and some unitary authorities where higher needs and lower council tax have been reflected in grant income.

This supports findings from the Public Accounts Committee July 2018 report, which showed that some metropolitan borough councils and London borough councils have had their spending power reduced by over 40%.

Making use of the indices

The presentation of the data provided by the CIPFA Resilience Index will, in due course, link with CIPFA's new Financial Management Code and support the Section 151 officer in their annual report to the council setting out the proposed budget for the coming year and the medium–term financial strategy. This is a key document for the authority, which needs to demonstrate all the features of a financially resilient organisation – openness, clarity, robust and constructive challenge, long–term planning, a clear analysis of risks, and realistic savings plans built on a sound strategy for implementation.

Under Section 25 of the Local Government Act 2003 the Section 151 officer is required to state in the budget report their view on the robustness of estimates for the coming year, the medium–term financial strategy, and the adequacy of proposed reserves and balances. The council is required to take this into account when making its budget and taxation decisions.

The Section 25 statements are important. They give the chief financial officer the opportunity to articulate their professional judgment of the authority's financial plans and direction and the risks it faces. In commenting on the sufficiency of reserves a realistic assessment of those available needs to be set out, projected over the medium term, with a historic profile of the last three years; and if they have dropped, the reasons why. For councils in, or facing, increasing difficulties this is the moment for the CFO to be absolutely clear of the position and what needs to happen to avoid a major failure, the Resilience Index will support the evidence base to enable that process.

Conclusion

This report sets out a baseline from which to analyse the direction of travel of councils financial resilience for future years.

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