The Chartered Institute of Public Finance & Accountancy

local authority financial resilience index

Consultation Response

Introduction

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 Financial Resilience Index Consultation ran from the 6 July 2018 until the 24 August 2018; respondents were able to respond either by email or online. In total 189 responses were received from a wide range of stakeholders across all tiers of local government itself, auditors and national audit bodies, as well as umbrella organisations and representative organisations in the sector.

Background

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 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.

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.

There are a number of tools already available to assist councils in recognising and dealing with an impending and serious financial situation. These include the Section 114 statement. CIPFA believes that timely use of these statements *can* be effective in stabilising councils before they go over the cliff edge. Such use would hopefully avoid the type of failure we have seen in Northamptonshire County Council, where it is clear from the independent inspector's best value inspection that too little action was taken too late. The provenance of CIPFA's proposed suite of indicators is therefore to support chief finance officers (CFOs), many of whom are regrettably not appointed at director level reporting to chief executives, and who may on occasions wish to reflect the concerns of an independent body and thereby add weight to their advice.

It is against this background that CIPFA has taken a leadership role in the public interest and devoted resources to the development of indices of financial resilience. Our intention was that financial data for each local authority would be collected and published in the public domain. This summary report provides an overview of the responses to initial proposals and how they are shaping development of the tool.

Responses

Over a seven week period in July and August there was an unprecedented level of interest in the consultation with 189 submissions from individuals, local authorities themselves, representative groups, and statutory bodies and auditors. At the same time a lively and occasionally heated debate played out in the pages of the trade and some national media.

CIPFA welcomed in particular the response of the National Audit Office which opened its constructive and helpful feedback by saying that:

"there is value in bringing together publicly available information based on an agreed 'industry standard' definition of financial resilience to provide an early warning system on local financial challenges and to support effective local governance. We also support the principles of a transparent methodology and CIPFA's intention to make the output of the index freely available."

Conversely there were representations, reflected in the public debate, which expressed concern that a publicly available index of resilience could be a largely reductive exercise likely to stigmatise less resilient authorities and generally put too much emphasis on financial considerations at the expense of local context and broader governance considerations.

Nearly all responses CIPFA received included detailed feedback on the relative merits of the measures proposed. The majority of feedback fell into the following broad themes:

- **Choice of indicators, dashboard presentation and weighting**
  - There was doubt about the combination of indicators to generate a composite index with respondents expressing concern that the inevitably creation of league tables based on a single composite index figure would be unhelpful. Few respondents actually agreed with the initial choice of indicators and their weighting.
  - The chosen indicators should if possible include forward looking considerations and assurance, particularly around delivery of anticipated savings and authorities' medium-term financial plans (MTFP).
  - There was a general acceptance of the proposed approach to presentation of using a dashboard.
- **Retrospective and forward views**
  - The proposals presented a largely static and retrospective point of view, whereas the trajectory of an authority's financial position over time ought to underpin the profile. Although there was a recognition of the benefit of including forward-looking indicators, beyond assessment of all MTFPs, there were few suggestions for forward-looking metrics.
  - The weightings could be inappropriately subjective. Equally they did not apply to all authority types.
- **Transparency**
  - While a wide variety of views were submitted there was no overall unanimity but there was little dissent over the fact that CIPFA is doing the right thing in drawing attention to a matter of high national concern.
  - Most respondents agreed to the need for transparency – but a sizeable number had concerns over the possibly negative impacts of adverse indicators and many councils wanted to see their results prior to publication.
  - The initial proposal for the dashboard of financial resilience indicators to use a public 'traffic-light' grading system is a concept that some did find challenging, and there is accompanying concern that it could thereby become an exercise in 'naming and shaming'. Naming and shaming is not CIPFA's intention at all. It is, however, our intention to provide an early warning system for local authorities with deteriorating financial positions and thereby to prompt action where it is needed.

We have worked hard to respond to the comments made in the consultation and in other discussions. The new developed and dynamic set of indicators (Appendix 1) will remain under review and subject to feedback from users in the coming months. Going forward specific efforts will be made to consider forward looking indicators related to the resilience of medium term financial plans, for which there is currently no consistent available data, as well as debt ratios and servicing requirements.

The most significant change that has been made to date is the removal of the composite index that combined a number of features into a single measure. This measure was criticised for the inevitable degree of subjectivity underpinning the weighting and the general hostility to the ranking that was implied.

In liaison with stakeholders, we have added a new indicator currently called the "reserves depletion period" that shows the length of time a council's reserves will last if they deplete their reserves at the same rate as over the past three years. Presenting this indicator shows that generally most councils have either not depleted their reserves or their depletion has been low.

We have made some minor adjustments to other indicators including changing names and reordering to put the reserves and flexibility ratio first as some respondents, including the NAO, suggested that these measures were key.

We have also made a range of functional and cosmetic changes. The tool includes a guidance section to enable users to make the best use of the tool and information on the indicators is available by a simple click. A choice can be made between upper and lower tier authorities, defined as those with or without a social care responsibility, which changes the view to exclude inappropriate indicators. As well as comparing with their tier, councils can now compare themselves with their statistical nearest neighbours. Also users can now export data. The tools also now incorporate the latest RO data published on 15 November 2018.

Further minor tweaks are planned ahead of the release to councils as we subject the tool to rigorous quality assurance.

Role of the section 151 officer

With regard to the role of the section 151 officer, CIPFA is growing increasingly concerned that the position and consequent authority of the CFO is slipping further away from the top table. An argument put forward that specialised financial skills at director level are, in and of themselves, too narrow should be challenged as out of kilter with all other major organisations in the public and private sector where it is recognised that good governance is served by the skills of a finance professional at director level.

There was broad consensus and clear agreement that local leadership needs to know the proximity of their authority to its financial limits. The corollary to this needs to be an understanding that Section 114 notices are not a notice of last resort but need to be recognised for what they are: a sensible control mechanism and early warning system in a broader assurance framework.

To strengthen the position of the section 151 officer in carrying out their statutory duties, it is therefore CIPFA's ambition in time to make it a requirement to reference the indicators in Section 25 statements.

Next steps

Following the feedback CIPFA remains committed to the provision in time of transparent, publicly available information.

We have however listened to the objective commentary and consequently, we have been modifying our proposals accordingly.

Financial Resilience Index – Beta Version

CIPFA now aims to provide a tool with a group of indicators able to illustrate the trajectory of an authority's financial position within the context of each authority's own comparator tier or nearest neighbours group.

The tool will not now provide, as originally envisaged, a composite weighted index but within the suite of indicators it will include a RAG alert of specific proximity to insufficient reserves given recent trajectories.

Distribution of the beta version, confidentially for the first year, with the most up to date local authority revenue data will enable section 151 officers and leadership teams to manipulate the data themselves, make peer group comparisons and assess the implications of the selected metrics for their authority's business planning and medium-term financial planning.

CIPFA's Policy and Research and Analytics teams will run workshops with local authority CFOs, representatives of treasurers' societies and others in the first quarter of 2019 to build on their experience of using the beta version in situ.

How will the indicators be distributed?

The Financial Resilience Indicators tool will be provided in the first instance, in year one, direct to individual authorities and their auditors via their CFO as a profile for their own use.

In subsequent years it will be made publicly available.

CIPFA's ambition in time will be to make it a requirement to reference the indicators in Section 25 statements.

CIPFA will not initially be publishing the tool openly as we continue to work with treasurers' societies, local authorities themselves, Ministry of Housing, Communities and Local Government, National Audit Office, Local Government Association and others to achieve a joint sector approach. All those CIPFA has consulted with agree there is the potential to explore further collaboration on the best mechanism to meet the sector's needs and, as expressed by the Public Accounts Committee, find a 'shared definition of local authority financial sustainability and a methodology for assessing the extent to which local authorities are at risk'.

Over time once the new CIPFA Financial Management Code is published we expect the indicators will be able to 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.

When the revised suite of indicators is distributed CIPFA will publish a summary report of its aggregated findings and analysis.

Appendix

Indicator	Description	Relationship to risk and interpretation
Reserves depletion time	This indicator is the ratio between the current level of reserves and the average change in reserves in each of the past three years. A negative value (which implies reserves have increased) or one greater than 100 is recoded to 100.	The indicator provides a measure of how long (in years) it will take for a council to completely denude its reserves, if they continue to use reserves at the same rate as in the previous three years. A low value suggests that there is a risk that the authority will run out of reserves. A high value says, that, on current trends, they are unlikely to deplete their reserves.
Level of Reserves	This indicator is the ratio of the current level of reserves (total useable excluding public health and schools) to the council's net revenue expenditure. For a small number of authorities, we have set the figure at 100% to remove the impact of some extreme outliers.	A low level of reserves may indicate that a council has low capacity to cope with financial shocks. It will also face a risk should expenditure exceed income.
Change in Reserves	This indicator shows the average percentage change in reserves (total useable excluding public health and schools) over the past three years.	A council that is using up its reserves may be at risk if they do not move to a more balanced budget.
Unallocated Reserves	This indicator is calculated as the ratio of unallocated reserves to net revenue expenditure.	This indicator provides some further information on the reserves indicator. A low level of unallocated reserves may be a sign that a council will struggle with financial shocks.
Earmarked Reserves	This indicator is calculated as the ratio of earmarked reserves (excluding public health and schools) to net revenue expenditure.	This indicator provides some further information on the reserves indicator. A low level of earmarked reserves could mean that a council will struggle with financial shocks or that they have not planned effectively for their use of reserves.
Change in Unallocated Reserves	This indicator is the average percentage change in unallocated reserves over the past three years.	This indicator provides some further information on the reserves indicator. A council that is using up its reserves may be at risk if they do not move to a more balanced budget.
Change in Earmarked Reserves	This indicator is the average percentage change in unallocated reserves over the past three years.	This indicator provides some further information on the reserves indicator. A council that is using up its reserves may be at risk if they do not move to a balanced budget.
Flexibility ratio	This indicator is the ratio of total spending on adults' social care, children's social care and debt interest to net revenue expenditure.	This indicator provides a measure of the degree of flexibility within a council's budget. Spending on these items is less likely to be reduced compared to other categories. A high ratio suggests that the council has little flexibility to make further savings, potentially leading to risk.
Children's Social Care Ratio	This indicator is the ratio of spending on children's social care to net revenue expenditure.	This indicator provides a breakdown of the total ratio to allow councils to understand their relative position for this component.
Adult Social Care Ratio	This indicator is the ratio of spending on adult social care to net revenue expenditure.	This indicator provides a breakdown of the total ratio to allow councils to understand their relative position for this component.
Grants to Expenditure Ratio	This indicator shows the proportion of net revenue expenditure funded by central government grants.	Grants are a diminishing source of funding. However, a relatively high level of grants may suggest that a council may experience financial difficulties in the future as grants continue to be a declining source of income.
Council Tax Requirement / NRE	This indicator shows the ratio of council tax to NRE.	This indicator provides a measure of the importance of council tax. A low ratio suggest higher dependency on grants which may suggest that a council may experience financial difficulties as grants diminish further.
Retained Income from business Rates/ Net Expenditure	This indicator shows the ratio of retained income from business rates as a proportion of net expenditure.	As locally raised business rates become more important, a lower ratio may be associated with difficulties in raising the income necessary to support spending.
Children's Social Care Judgement	This indicator shows the latest OFSTED judgement on the quality of children's social care.	A rating of inadequate or requires improvement may be associated with future higher spending on children's social care adding to council funding pressures.
Auditors VfM Assessment	This indicator shows whether auditors have produce a non-standard conclusion on a council's accounts.	A non-standard judgement may indicate some concern over the financial management and decisions within a council.

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