

Report to the Overview and Scrutiny Performance and Value for Money Select Committee

Local Government Financial Resilience

Portfolio Holder: Cllr Abdul Jabbar MBE, Deputy Leader and
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Reason for Decision

The purpose of this report is to:

- Summarise recent Local Authority financial failures and challenges as reported in the media;
- Present the findings of a National Audit Office (NAO) report from earlier in 2018 concerning the financial sustainability of Local Authorities; and
- Highlight the Chartered Institute of Public Finance and Accountancy's (CIPFA) efforts to ensure attention on financial sustainability remains in focus through the development of a financial resilience index.

Executive Summary

Recent media attention attracted by financial failure at Northamptonshire County Council alongside major financial challenges reported by other Local Authorities has placed the subject of financial resilience and sustainability firmly in the spotlight.

After almost a decade of year-on-year real terms reductions in Government funding for Local Authorities coupled with the emergence of major spending pressures within the realm of Adults and Children's Social Care, the risk of financial failure among Local Authorities is greater than it has been for many years. A Section 114 notice issued by the Chief Finance Officer at Northamptonshire in February this year was believed to be the first for over twenty years (the definition of a Section 114 notice is included at Appendix 1).

This notice imposed immediate spending controls on the organisation and meant that no new expenditure, other than on statutory services including safeguarding vulnerable people, was allowed. This was followed by a second Section 114 notice issued in July 2018 as the financial pressures had not adequately been addressed. This second notice stated there was still a budget shortfall of around £60-70m against a net revenue budget of £441m.

In addition to highlighting challenges at Northamptonshire and elsewhere, the report presents the findings of a NAO report from earlier this year regarding financial sustainability and also highlights CIPFA's efforts to focus attention on financial resilience.

Recommendations

The Committee is invited to consider and discuss the content of the report.

Local Government Financial Resilience

1. Background

- 1.1. After almost a decade of year-on-year real terms reductions in Government funding for Local Authorities coupled with the emergence of major spending pressures within the realm of Adults and Children's Social Care, the risk of financial failure among Local Authorities is greater than it has been for many years.
- 1.2. Financial failure and the imposition of statutory spending controls at Northamptonshire County Council has attracted significant media attention as has the existence of major financial challenges emerging in other Local Authority areas. The action having to be taken and the issues that have led to such action act as a warning to the rest of the sector.
- 1.3. Members will be aware of the specific financial challenges facing Oldham Council. It is therefore important to consider the issues in Oldham in the context of the challenges faced by Northamptonshire and other organisations as well as the wider Local Authority sector.
- 1.4. The remainder of the report therefore:
 - Summarises recent Local Authority financial failures and challenges as reported in the media;
 - Presents the findings of a National Audit Office (NAO) report, issued earlier in 2018, concerning the financial sustainability of Local Authorities; and
 - Highlights the efforts of the Chartered Institute of Public Finance and Accountancy (CIPFA), the UK professional accountancy body that specialises in the public sector, to ensure attention on this issue remains in the spotlight through the development of a financial resilience index.

2. Current Position

Northamptonshire County Council

- 2.1. In February 2018, Northamptonshire County Council's Director of Finance issued a notice under Section 114 of the Local Government Finance Act 1988 (see Appendix 1 for details) imposing immediate spending controls on the organisation. The notice meant that no new expenditure was allowed, other than on statutory services including those for safeguarding vulnerable people. As insufficient action had been taken to address the financial challenge, in July 2018, a second Section 114 notice was issued detailing a 2018/19 budget shortfall of around £60-70m against a net revenue budget of £441m. CIPFA has stated that it is unprecedented for any Council to issue two notices in such a short space of time. Councillors have voted to replace the Council and its seven districts with two new unitary authorities from 2020.
- 2.2. Four publically available documents highlight the financial failings at Northamptonshire as follows:
 - 1) Best Value Inspection Report (January to March 2018) – see section 2.3
 - 2) Section 114 Notice issued February 2018 – see section 2.4
 - 3) Section 114 Notice issued July 2018 – see section 2.5 - 2.6
 - 4) External Audit Report issue July 2018 – see section 2.7

A summary of the contents of each of these reports is set out in the following paragraphs.

Best Value Inspection Report (January to March 2018)

- 2.3. This report suggests effective budgetary control ceased several years earlier after a critical Ofsted inspection culminating in a report published in August 2013. Around the same period, the Council adopted the 'Next Generator' model to deliver financial savings but this approach was signed off with a poor business case. The subsequent failure to deliver savings meant the Council has since used one-off reserves to support the budget at a time of increasing spending pressures. Although the Council had the flexibility to use capital receipts to underpin the delivery of efficiencies, they were, in some cases, used instead to finance day to day expenditure. The report concluded that the Council had failed to comply with its Best Value Duty.

Section 114 Notice (February 2018)

- 2.4. The first Section 114 notice was issued in order to prompt action to avoid a negative General Fund balance for the 2017/18 financial year following a reported overspend of around £20m. Rigorous spending controls were immediately introduced and the Council's Minimum Revenue Provision policy was amended to mitigate the risk of running out of funds by the end of the financial year. After consideration of the notice, the Council issued an addendum to the 2018/19 budget which increased the savings requirement by £10m and reduced reliance on capital receipts to £30.9m for financing 'qualifying transformational expenditure'.

Section 114 Notice (July 2018)

- 2.5. A second notice was issued as the financial situation worsened following the setting of the 2018/19 budget. Budget monitoring reports indicated the Council faced a need to find in the region of £60-£70m of in-year savings in 2018/19. The forecast for 2019/20 was equally stark with a need for further savings over and above those in 2018/19 of £54m. Furthermore, the notice was blunt in describing historic approaches to financial decision making as "factually wrong, ill-informed, out of step with other public sector organisations, and inappropriate for informing the decisions made by a large public sector organisation with such serious responsibilities".

- 2.6. Practices adopted and described as 'inappropriate' include:

- Using reserves for use on day-to-day expenditure rather than for unexpected events or for the planned purposes for which they had been earmarked (i.e. earmarked reserves);
- Maximising use of the HM Government Policy of Flexible Use of Capital Receipts in the expectation of only light-touch inspection;
- Knowingly adopting unachievable savings as part of the budget (this was definitely the case for the 2017/18 budget);
- Accepting the costs of demand-led services could not be controlled in any meaningful way; and
- Assuming a future review of local government finance would result in "fairer funding" and that difficult decisions could be put off in this expectation, with the gap between income and expenditure met through "one-off interventions".

These are clearly activities which should be avoided by all Councils so that financial resilience can be maintained.

External Audit Report (July 2018)

- 2.7. This report, addressed to the Council's Audit Committee, indicated further financial management failings. A proposed sale and leaseback of the Council's HQ at One Angel Square (essential to balance the 2017/18 budget) did not materialise until 2018/19. In

addition, information in the budget was not supported by an appropriate valuation. It advised that the use of Public Health Grant and Section 106 funds to underpin the Council's Revenue Budget could lead to challenges regarding whether this is legally appropriate. In the case of Public Health, the Council has subsequently offered to refund £7.9m of additional expenditure in excess of the grant from a period beginning in 2018/19. In the case of Section 106 funds, the application of the funding appears to contradict Counsel Opinion. Furthermore, there are insufficient funds in their Insurance Reserve to meet known liabilities.

Financial Sustainability Issues Reported Elsewhere

- 2.8. Northamptonshire is not the only authority to have attracted media attention in relation to financial resilience and financial sustainability. Other Councils are reportedly facing challenges which, if unresolved, could lead to similar financial failure. The following table summarises some of the media reports in this regard:

Local Authority Area	Summary of Issue(s)
Birmingham City Council	<p>£177m of reserves were used in 2016/17 and 2017/18 to balance the revenue budget. The Council is not in immediate danger of running out of funds but may miss its £100m savings target by 2021/22.</p> <p>In providing an opinion on the 2017/18 accounts, the External Auditor issued a statutory recommendation under S24 of the Local Audit and Accountability Act 2014 advising that improvement in a range of financial management related activities was required.</p>
Glasgow City Council	A potential £0.5bn equal pay bill plus a £130m deficit.
East Sussex County Council	Planning for service provision that will only cover the legal minimum. Forecast savings required by 2021/22 are £46m.
Hartlepool	The 2019/20 budget is the "most challenging the Council has ever faced" seeking to address a deficit of almost £6m.
Highland Council	A forecast overspend of £5.1m. Council reserves are below the minimum level recommended by Audit Scotland.
Lancashire County Council	<p>An over reliance on reserves in recent years means the Council's financial position is "at a tipping point" according to auditors.</p> <p>The Council is endeavouring to save £135m by 2022.</p>

Local Authority Area	Summary of Issue(s)
Oxfordshire County Council	Up to 890 jobs could be lost as the Council considers a revamp to increase digital investment and make use of new technology. The proposal could save up to £58m. The Council insists it has good levels of reserves and no cash flow problems.
Shropshire County Council	A recruitment freeze has been introduced.
Somerset County Council	Warning of possible Section 114 notice and severe spending restrictions. £13m of additional spending reductions proposed to tackle an £11.4m overspend largely from Children's Services.
Suffolk County Council	The Council was forecasting an over spend in 2018/19 of £8.6m; £5m of which relates to Children's Services. This is in addition to a £5.2m overspend in 2017/18.
Surrey County Council	Warning of possible Section 114 notice. Savings of £250m required over the next three financial years. Surrey has repeatedly used one-off measures over recent years to balance the budget - something its latest accounts warn is "not repeatable".
West Sussex County Council	The Council Leader has said West Sussex faces 'going the way of Northamptonshire if it doesn't balance its budget next year'. The Council is considering cutting its £6m housing support budget.
Torbay District Council	An immediate freeze on non-urgent expenditure has been introduced.

NAO Report - Financial Sustainability of Local Authorities

2.9. In March 2018, the NAO published its most recent report examining the financial sustainability of Local Authorities. Key messages from the report are as follows:

- In real terms, Government funding for Local Authorities has reduced by 49.1% between 2010/11 and 2017/18. The reduction by 2019/20 is expected to reach 56.3%;
- Spending power reduced by 28.5% between 2010/11 and 2016/17. Metropolitan Districts have experienced the largest average reduction at 33.9%. County areas haven't been as hard hit with an average reduction of 22.1%;
- Service demands are increasing. Between 2010/11 and 2016/17:
 - Numbers of looked after children have increased by 10.9%;
 - There has been a 14.3% increase in the population 'in need' aged 65 and over;
 - Households accepted as unintentionally homeless and in priority need have increased by 33.9%.

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- In the three years to 2016/17, service reductions accounted for less than half of funding reductions. Use of reserves and reductions in other spend have become more important in terms of balancing budgets;
 - In relative terms, Social Care spending has been protected at the expense of other services;
 - Across the sector as a whole social care has grown from 45.3% to 54.4% of service spend;
 - The sector as a whole had a service overspend of £901m in 2016/17. Single tier and county councils have switched from a period of service underspends to growing overspends - £1bn in 2016/17;
 - In Councils that provide Social Care services, reserves have grown since 2010/11 but started to fall back in 2016/17;
 - Reserves - based on their rate of use in that year (10.6%), single tier and County areas had the equivalent of less than three years' worth of reserves left.

2.10. The report concludes that:

- The sector has done well to manage substantial funding reductions since 2010/11, but financial pressure has increased markedly since the NAO's last study;
- The current pattern of growing overspends on services and dwindling reserves exhibited by an increasing number of Authorities is not sustainable over the medium term. The financial uncertainty created by delayed reform to the Local Government financial system risks longer-term value for money;
- The performance of the Ministry for Housing, Communities and Local Government (MHCLG) has improved since the NAO's last study however, conditions in the sector have worsened and MHCLG must continue to strengthen its oversight and assurance mechanisms;
- The capacity of the MHCLG to secure the sector's financial sustainability in the context of limited resources is shaped by the priorities and agendas of other departments. Each department has its own narrow view of performance within its own service responsibilities. There is no single central understanding of service delivery as a whole or of the interactions between service areas;
- To date, the current spending review period has been characterised by one-off and short-term funding fixes. Where these fixes come with restrictions and conditions, this poses a risk of slowly centralising decision-making. This increasingly crisis-driven approach to managing local authority finances also risks value for money; and
- The current trajectory for Local Government is towards a narrow core offer increasingly centred on social care. This is the default outcome of sustained increases in demand for social care and of tightening resources. The implications for value for money to government from the resulting re-shaping of local government need to be considered alongside purely departmental interests.

2.11. As a result, the NAO recommends that the:

- MHCLG should work with the sector to develop a long-term plan that is genuinely able to address the current financial and demand pressures in the sector and to secure its financial sustainability;
- MHCLG should continue to strengthen its processes for assessing Local Authority funding requirements at future spending reviews especially in children's social care;
- MHCLG should continue to build on its improved oversight of the sector's financial sustainability;
- Government, led by MHCLG, should develop a clear understanding of the role and significance of Local Authorities as a whole in the context of the current funding climate; and
- Government should improve outcome data.

The CIPFA Proposal for a Local Authority Financial Resilience Index

- 2.12. CIPFA has consulted on the proposed publication of an index of resilience for English Councils. The decision to develop an index is driven by CIPFA's desire to support the Local Government sector as it faces a continued financial challenge. The Chief Executive of CIPFA is leading the debate on the key issues.
- 2.13. The index, was based on publically available information, and sought to provide an assessment of the relative financial health of each English council. The proposed index is based on six indicators including the:
- 1) Level of reserves;
 - 2) Percentage change in reserves;
 - 3) Ratio of government grants to net revenue expenditure;
 - 4) Proportion of net revenue expenditure accounted for by children's social care, adult social care and debt interest payments;
 - 5) Ofsted overall rating for children's social care; and
 - 6) Auditor's Value for Money judgement.
- 2.14. The Council responded to the consultation which closed on 24 August 2018. The response welcomed the work done by CIPFA to draw attention to the significant financial pressures Local Authorities are faced with. However, the Council believed the index relied too much on the reserves position of Authorities and was too backward looking. The Council also believed the index needed further overall development work and suggested CIPFA should engage organisations such as the Local Government Association (LGA) and the NAO more closely to assist in this process.
- 2.15. The CIPFA proposal and consultation is attached at **Appendix 2** and Oldham's response to the consultation is attached for reference at **Appendix 3**.
- 2.16. A total of 189 responses were received by CIPFA ranging from individual authority responses, such as those from Oldham Council, to those from representative groups, such as the Society of Local Authority Chief Executives and Senior Managers (Solace), the LGA and the Special Interest Group of Municipal Authorities (SIGOMA). CIPFA has welcomed the responses but, given the volume and extent of the comments received, only recently issued a response to these comments on 4 December 2018 (see **Appendix 4**). The key issues in CIPFA's response include:
- The removal of the composite index that combined a number of factors into a single weighted measure;
 - Providing the report initially to Local Authorities and their auditors via their S151 officer themselves rather than publishing openly; and
 - Adaptations to some of the indicators – and these will remain under review and subject to feedback from users in the coming months.
- 2.17. CIPFA remains committed to the project and sees it as supporting Chief Finance Officers (CFOs) who may on occasions wish to consider the data from an independent body and thereby add further weight to the expert advice that they already provide.
3. **Options/Alternatives**
- 3.1. Options are not presented as the report is intended to prompt discussion and debate among Committee colleagues.

4. **Preferred Option**

- 4.1. Options are not presented as the report is intended to prompt discussion and debate among Committee colleagues.

5. **Consultation**

- 5.1 Cabinet Members and Chief Officers have been consulted on the content of the report.

6. **Financial Implications**

- 6.1. There are no direct financial implications arising from the report, however, the content does emphasise the requirement for good financial management and the importance of the role of the S151 Officer in ensuring that the Council remains financially resilient.

7. **Legal Services Comments**

- 7.1. There are no legal implications arising directly from the report.

8. **Co-operative Agenda**

- 8.1. The pressure on Local Authority finances shows no sign of relenting. Developing a co-operative future where everybody can do their bit and with everybody benefitting is as important as ever. Taking a co-operative approach provides the opportunity to do things differently, provide a sustainable solution to the unprecedented challenges Oldham faces as well as making the most of the assets/strengths that lie in our communities.

9. **Human Resources Comments**

- 9.1. There are no Human Resources implications arising directly from the report.

10. **Risk Assessments**

- 10.1. The issue of financial resilience and sustainability across the Local Authority sector is highly relevant to the ongoing development of the Council's Medium Term Financial Strategy and associated budget options for 2019/20 and beyond.
- 10.2. There would be a risk to the financial resilience of the Council and its future stability should there be a departure from established good practice and procedures that operate within the Council. It is however, important that the Council ensures that it has regard to the failings at Northamptonshire County Council when considering its approach to budget setting and its future financial management arrangements.

11. **IT Implications**

- 11.1. There are no IT implications arising directly from the report.

12. **Property Implications**

- 12.1. There are no property implications arising directly from the report.

13. **Procurement Implications**

- 13.1. There are no procurement implications arising directly from the report.

14. **Environmental and Health & Safety Implications**

14.1. There are no Environmental and Health & Safety implications arising directly from the report.

15. **Equality, community cohesion and crime implications**

15.1. There are no equality, community cohesion and crime implications arising directly from the report.

16. **Equality Impact Assessment Completed?**

16.1. N/A.

17. **Key Decision**

17.1. No

18. **Key Decision Reference**

18.1. N/A.

19. **Background Papers**

19.1. The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref:	Background papers are included in Appendices 1 to 4
Officer Name:	Anne Ryans
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20. **Appendices**

20.1. The following appendices are included in the report:

Appendix 1	Definition of a Section 114 Notice
Appendix 2	CIPFA Consultation - Local Authority Financial Resilience Index
Appendix 3	CIPFA Consultation – Oldham Council Response
Appendix 4	CIPFA Consultation Response – Local Authority Financial Resilience Index