

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 Cabinet Member for
Finance and Corporate Services

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Reason for Decision

The purpose of this report is to:

- Provide an update on the ability of Local Authorities to withstand future budget pressures by summarising recent Local Authority financial failures and challenges as reported in the media;
- Present the findings of a recent Public Accounts Committee report concerning the financial sustainability of Local Authorities; and
- Highlight the Chartered Institute of Public Finance and Accountancy's (CIPFA's) efforts to ensure attention on this issue remains in the spotlight through the development of a Financial Management Code which will support CIPFA's financial resilience index.

Executive Summary

Following on from the report presented to this Committee in December 2018 and in light of further recent media attention with regards to the financial sustainability of Local Authorities following the financial failure of Northamptonshire County Council in February 2018, this paper provides an update on the issues that are facing Local Government. There have also been a number of papers issued by a variety of organisations on the issue of Local Government Financial Sustainability and a summary of these are provided for Members.

Recommendations

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

Local Government Financial Resilience

1. Background

- 1.1. Members of this Committee will recall that a report was presented to its meeting of 13 December 2018 discussing the issues around Financial Resilience within Local Government. This was in light of the continuation of real terms reductions in Government funding for Local Authorities coupled with the emergence of major national spending pressures within the realm of Adults and Children's Social Care.
- 1.2. The report also followed the financial failure resulting in the issuing of two notices under Section 114 of the Local Government Finance Act 1988 (see **Appendix 1** for information) which resulted in the imposition of immediate spending controls at Northamptonshire County Council. This failure attracted significant media attention and has highlighted the existence of major financial challenges emerging in other Local Authority areas. This report will provide further details on the Local Authorities most recently considered to be facing the increased risk of financial failure.
- 1.3. Members will be aware of the specific financial challenges facing Oldham Council. It is therefore important to continue to consider the issues in Oldham in the context of the challenges being dealt with by Northamptonshire, other Local Authorities, and the continuing uncertainty in relation to the future funding of Local Government finance.
- 1.4. The following sections in this report therefore will:
 - Provide an update on the ability of Local Authorities to withstand future budget pressures by summarising recent Local Authority financial failures and challenges as reported in the media;
 - Present the findings of a recent Public Accounts Committee report concerning the financial sustainability of Local Authorities; and
 - Highlight CIPFA's efforts to ensure attention on this issue remains in the spotlight through the development of a Financial Management Code which will support CIPFA's financial resilience index.

The report also includes a commentary on the current financial resilience of Oldham Council.

2. Current Position

Northamptonshire County Council

- 2.1. Members will recall that Northamptonshire County Council issued its first Section 114 notice in February 2018, imposing immediate spending controls on the organisation followed by a second notice in July 2018.
- 2.2. Since the last report was presented to this Committee, Northamptonshire County Council has reported a revenue underspend of £4.460m for 2018/19 due to the successful delivery of £24m of savings and in year management actions being delivered via the stabilisation plan of £8.2m.

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- 2.3. Despite this revenue underspend, work is still ongoing to address legacy financial issues using a variety of different means such as Capital dispensation (agreed by Government), and the formation of a transformation strategy. It is also important to note, that from 2021 (previously April 2020) the County Council is to be abolished and replaced by two new unitary authorities.

Financial Sustainability Issues Reported Elsewhere

- 2.4. As detailed within the last report, there are a number of other Local Authorities which have attracted media attention in relation to financial resilience and financial sustainability. Below are details of the most recent announcements.

Dorset Council

- 2.5. In April 2019, Dorset's nine Council's merged into two which aimed to save £108m over six years. However, a report presented to the new Authority's Cabinet detailed that there is a projected overspend of £12.6m for 2019/20, £7.1m for the general fund and £5.5m for the Dedicated Schools Grant (DSG). This forecast is due to a large increase in the demand for social care across both Adults and Children's Social Care service areas whilst there is also an increased pressure on the High Needs Block of the DSG.
- 2.6. The Authority plans to use the general fund reserve which was increased to £29m at the end of 2018/19 to balance the budget within 2019/20. There is also a review of all earmarked reserves underway to ensure that those held are still required for the purpose on which they were created.
- 2.7. Although the use of reserves has been identified to balance the in year budget, work is still required to address the issues causing financial stress for the Council as the continued use of reserves is unsustainable.

East Sussex County Council

- 2.8. At the beginning of July 2019, East Sussex County Council announced that it was facing a £15m budget gap for the financial year 2020/21, rising to £27m in 2022/23. Members will recall that East Sussex County Council has already implemented a core offer approach to keep within its current financial envelope and the budget pressures identified are after implementation of this management action.
- 2.9. Similar to Dorset Council and in line with the national trend, the pressure is due to an increase in demand for social care services. Work is ongoing at the Council to revisit estimates. However, uncertainty around Central Government funding intentions is making it difficult for the Council to plan effectively.

Redcar and Cleveland Borough Council

- 2.10. On 30 July 2019, the Statement of Accounts for Redcar and Cleveland Borough Council was presented to its Governance Committee. Within the Value for Money opinion given by Mazars LLP, the auditors for Redcar and Cleveland Borough Council, concerns were highlighted with regard to the financial sustainability of the Council. The auditors concluded that the Authority does not have enough reserves in the medium term to cover the estimated budget gap.
- 2.11. The Authority has used £8.9m of reserves to balance its budget for 2019/20 however doing so, has meant that the level of reserves remaining will not meet the budget gap in full for 2020/21 leaving £1.6m still to be found. With no reserves available, there would be a

requirement for the Authority to also find savings of £10.8m in 2021/22 and another £11.8m in 2022/23.

- 2.12. Although this is the current position, once again uncertainty around Government intentions is preventing effective financial planning but in the context of Redcar and Cleveland, the Council considers future Government announcements on Local Government funding could have a positive impact on this forecast.

Section 24 Notices

- 2.13. Under the Local Audit and Accountability Act 2014, External Auditors can issue Councils with a Section 24 Notice. This is a statutory recommendation and is a strong warning to a Council of the Auditor's concerns but stops short of a public interest report. A Section 24 Notice requires Full Council to agree its response to the points included within the recommendations within 1 month of issue and to publish how it proposes to address the issues raised. Whilst such a notice may relate to a range of financial issues, it can act as a warning in relation to financial resilience. Although rare, there have been two recent instances of Local Authorities receiving such notices.
- 2.14. In March 2019, Birmingham City Council was issued with a third Section 24 notice in three years. The External Auditor, Grant Thornton UK LLP concluded that the Authority faced a "unique level of one-off risks", including funding for the 2022 Commonwealth Games but required the Council to take action on a number of areas relating to governance and finance. In a letter, the Auditor warned the Council over its use of non-earmarked reserves, even though these currently stand at a healthy £152m.
- 2.15. In July 2019, Auditors issued an adverse audit report for Redditch Borough Council, telling the Council it needs to save £1.5m over the next three years and is at risk of breaching its statutory duty to set a balanced budget. The report by Grant Thornton UK LLP advised that it had issued a Section 24 Notice, recommending urgent action to prevent both the General Fund and Housing Revenue Account balances being exhausted by the end of 2020/21. The report, considered by the Council's Audit Committee, advised that the Auditors were not satisfied that the Council had made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The Auditors pointed out that they had previously identified financial issues in 2017/18 saying then that Redditch was "not in a financially sustainable long-term position and did not have sufficiently developed plans to address this". The escalation to a formal Section 24 Notice suggested that these previous concerns had not been addressed.

Reports on the Financial Sustainability of Local Authorities

- 2.16. Due to the number of media announcements, there have been several recent reports issued on the subject of Financial Sustainability in Local Authorities. Details of these reports can be found below:

Public Accounts Committee – Local Authority Financial Resilience

- 2.17. On 12 March 2019, the Public Accounts Committee released a paper on the subject of Local Authority Financial Resilience. The report included the following:
- Local Financial accountability; the legal framework
 - Local Authority budgeting
 - Financial Resilience concerns in England
 - Financial Stress; effects on individual authorities
 - Monitoring financial resilience

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- 2.18. The briefing paper was issued due to the concerns around Local Authority Financial Resilience since 2010, the uncertainty around future funding of Authorities and the debates that are being held on whether Local Authorities in England have enough access to sufficient funding to discharge their functions. It also had regard to the media reports of financial difficulties of Local Authorities since the financial crisis of Northamptonshire County Council.
- 2.19. Highlighted within the briefing paper are the results from the Local Government Information Unit and the Municipal Journal's Annual Statement of Local Government Finance Survey which showed that in February 2019, 80% of the 158 respondents (key decision makers in Local Authorities) were "not confident in the sustainability of local government finance". Of the respondents, 53% expected to use reserves in 2019/20. As expected, it also highlighted that the services under most pressure included Children's Services, Adult Social Care and Homelessness.
- 2.20. A key theme throughout the paper is the level of reserves and the unplanned use of these resources by Local Authorities particularly in recent years and the report makes reference to the work completed by CIPFA on its Local Authority Financial Resilience Index.
- 2.21. What is clear from the briefing paper is that funding of Local Authorities is of key concern across the sector and that the outcome of the Comprehensive Spending Review and Fair Funding Review (which were due to inform the 2020/21 Local Government Finance Settlement) will be fundamental in ensuring that Authorities are sustainable in the long term. However, due to the recent change in Prime Minister and the delays in taking forward Brexit, the timing of these reviews is unclear.

CIPFA's Local Authority Financial Resilience Index

- 2.22. Members of this Committee will recall that CIPFA consulted on the proposed publication of an index of resilience for English Councils. The decision to develop an index was driven by CIPFA's desire to support the Local Government sector as it faces continued financial challenges.
- 2.23. The index, based on publicly available information, was initially focused around six indicators. However, taking into consideration feedback received from the consultation, CIPFA then proposed an increase to fifteen indicators. The indicators have yet to be finalised. CIPFA plans to deliver a series of development workshops with Finance Directors before the release of the final version which is expected to be after the official publication of Local Authority revenue and expenditure outturn data in November 2019.
- 2.24. The tool will sit alongside CIPFA's planned Financial Management Code which aims to support good practice in the planning and execution of sustainable finances. Further details of the new Financial Management code can be found at Sections 2.25 to 2.31 and **Appendix 2**.

CIPFA's Proposed Financial Management Code

- 2.25. On 15 March 2019, CIPFA published a consultation on its proposed Financial Management Code that would support its Financial Resilience Index. This consultation concluded on 30 April 2019. The objectives of this code are "to support good practice in financial management and to assist Local Authorities in demonstrating their financial sustainability".
- 2.26. The code is based upon a series of principles which will be supported by specific standards of practice which CIPFA consider necessary for a strong foundation. The foundation being the ability to:

- Financially manage the short, medium and long-term finances of a Local Authority
- Manage financial resilience to meet foreseen demands on services
- Financially manage unexpected shocks in their financial circumstances

2.27. The proposed Financial Management code builds on the success of the CIPFA Prudential Code which requires Local Authorities to demonstrate the long term financial sustainability of their capital expenditure. The Code is also consistent in that it is based upon principles rather than prescriptions and each Local Authority must demonstrate that they meet the requirements of this code. It is expected that this Code will be in place for April 2020.

2.28. The underlying principles of this code are as follows:

- Organisational **Leadership** – the demonstration of a clear strategic direction based on a vision in which financial management is embedded into organisational culture
- **Accountability** – based on medium term financial planning which drives the annual budget process supported by effective risk management, quality supporting data and whole life costs
- Financial Management is undertaken with **transparency** at its core using consistent, meaningful and understandable data, reported frequently with evidence of periodic officer action and elected member decision making
- Adherence to professional **standards** which are promoted by the leadership team and evidenced
- Sources of **assurance** are recognised as an effective tool mainstreamed into financial management and includes political scrutiny and the results of both external audit and internal audit inspection
- The long-term **sustainability** of local services is at the heart of all financial management process and is evidenced by prudent use of resources

2.29. Underpinning each of these principles are Financial Management Standards. These standards can be found at **Appendix 2**.

2.30. An expectation of the Code is that Local Authorities comply with the CIPFA Statement on the Role of the Chief Financial Officer (CFO) in Local Government. The aim of this Statement is to set out the fundamental principles that support a successful CFO which is considered to be critically important for good governance in public sector organisations. This Statement also provides assurance that the CFO will focus on dealing with the current issues around financial sustainability of organisations.

2.31. Members of this Committee can be assured that when the final version of the Financial Management Code is published, there will be an exercise to ensure that the Finance Service, and where possible, the wider organisation, is compliant with its requirements in advance of its implementation in April 2020.

Additional CIPFA Documentation

2.32. On 31 July 2019, CIPFA published a new document entitled 'Talking About Tomorrow' / Shaping Successful Local Services. Whilst this contained no new information over and above the proposed Financial Management Code detailed above, it did reference back to that document and again highlighted the importance of Local Authorities demonstrating financial sustainability and resilience.

BBC Analysis of Government Data

2.33. The BBC has conducted an analysis based on Government data building on CIPFA's draft Financial Resilience Index. This analysis was recently reported and identified that 11

Authorities were expected to have fully exhausted all reserves in the next four years unless they are topped up.

2.34. The 11 Authorities mentioned in the article represent a mix of Authority types and also varied geographical locations and were identified as follows:

- Northamptonshire County Council
- Somerset County Council
- Rotherham Council
- Thurrock Council
- Croydon Council
- Stoke-on-Trent City Council
- Sutton Council
- Isles of Scilly
- Knowsley Council
- Greenwich Council
- Medway Council

2.35. The article identifies that “systematic underfunding” of Local Government is responsible for the continued use of reserves by Local Authorities. Councillor Richard Watts of the Local Government Association stated "This is unsustainable and does nothing to address the systemic underfunding that they face. Ongoing funding gaps are simply too big to be plugged by reserves."

2.36. It should be noted however that the Authorities identified as having used a lot of their reserves insisted that they were not running out of cash and so this difference of view also helps to highlight the limitations of simply using financial information at a fixed point without the wider Authority context.

Oldham Council Financial Resilience

2.37. The Statement of Accounts for 2018/19 which were approved at the Audit Committee on 25 June 2019, showed that Oldham Council increased its general fund balances by £0.849m to a value of £14.840m. This provides increased financial resilience for the Council and enables balances to be held at a value sufficient to support 2020/21 budget setting in line with the calculated risk assessment presented to Budget Council in February 2019.

2.38. The Revenue Account earmarked reserves balance slightly reduced from £82.731m to £80.623m whilst other earmarked reserves have increased by £3.661m to £12.935m. These include movements in the Schools Balances and the Revenue Grant Reserve (which are not available for general use). It is important to note that total earmarked reserves showed a small overall increase to £93.558m, but that £8.818m of these earmarked reserves have been used to support the 2019/20 budget and others have been set aside to provide financing for future Council initiatives.

2.39. In accordance with good practice, the Council does have a Reserves Policy which is reviewed annually by the Audit Committee (most recently at the meeting of 25 June 2019).

2.40. As detailed within the Council's Audit Completion Report, presented alongside the Statement of Accounts, the External Auditors concluded that for 2018/19 the Council had made proper arrangements to deliver financial sustainability in the medium term. However, it was also pointed out that “the use of reserves to support revenue budgets in the longer term is not sustainable, and the Council will need to ensure that its longer term financial sustainability does not deplete its reserves to unsustainably low levels”.

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- 2.41. Whilst the Council does continue to face significant financial challenges, its financial position is still strong, as demonstrated with an increase in both balances and earmarked reserves at the end of 2018/19. There is a robust 2019/20 budget together with a Medium Term Financial Strategy covering the period to 2023/24 supported by a Capital Strategy and Capital Programme also covering 2019/20 to 2023/24. Together with a suite of other financial reports approved at the Budget Council, these provide a firm base from which to move into the budget process for 2020/21. There are also robust in-year financial monitoring arrangements in place with regular reports to Cabinet. However, whilst the Council remains financially resilient, it must be mindful of the Auditor's comments about the depletion of reserves.

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. Financial implications are included in full within the report.

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. Sustained 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 means the risk of fiscal failure among Local Authorities is greater than it has been for many years.
- 10.2. Fiscal failure and the imposition of spending controls at Northamptonshire County Council has attracted significant media attention as has the existence of major fiscal 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.

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- 10.3. The issue of financial resilience and fiscal 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 2020/21 and beyond.
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 and 2 and in the report 'Local Government Financial Resilience' presented to the Overview and Scrutiny Performance and Value for Money Select Committee on 13 December 2018 |
| Officer Name: | Anne Ryans |
| Contact No: | 0161 770 4902 |
20. **Appendices**
- 20.1. The following appendices are included in the report:
- Appendix 1 Definition of a Section 114 Notice
Appendix 2 CIPFA's Proposed Financial Management Standards

Definition of a Section 114 Notice

What is a S114 Notice?

Within the Local Government Finance Act 1988, Section 114 (3) dictates that:

“The chief finance officer of a relevant authority shall make a report under this section if it appears to him that the expenditure of the authority incurred (including expenditure it proposes to incur) in a financial year is likely to exceed the resources (including sums borrowed) available to it to meet that expenditure”.

In general terms this means that for Local Government, it is the Chief Finance Officer or Section 151 officer who has the role under law of being the most senior financial advisor to the wider Council's leadership on its financial plans. Uniquely across the public sector however, the CFO also has the power and responsibility to legally suspend spending for a period of time if they judge the Council does not have a balanced budget or the imminent prospect of one.

What Happens when a S114 Notice is Issued?

It means that no new expenditure is permitted, with the exception of that funding statutory services, including safeguarding vulnerable people, however existing commitments and contracts will continue to be honoured.

Council officers must therefore carry out their duties in line with contractual obligations and to acceptable standards, while being aware of the financial situation. Any spending that is not essential or which can be postponed should not take place and essential spend will be monitored.

The only allowable expenditure permitted under an emergency protocol would include the following categories:

- existing staff payroll and pension costs
- expenditure on goods and services which have already been received
- expenditure required to deliver the council's provision of statutory services at a minimum possible level
- urgent expenditure required to safeguard vulnerable citizens
- expenditure required through existing legal agreements and contracts
- expenditure funded through ring-fenced grants
- expenditure necessary to achieve value for money and / or mitigate additional in year costs

Councillors have 21 days from the issue of a Section 114 notice to discuss the implications at a Full Council meeting.

Mapping of CIPFA summarised Financial Management Standards onto CIPFA Principles of Good Financial Management (DRAFT)

