The Special Interest Group of Municipal Authorities (Outside London)

# SIGOMA Response to the Consultation on the Local Authority Financial Resilience Index

## 1. SIGOMA

1.1. This submission is made on behalf of SIGOMA, the Special Interest Group of Municipal Authorities.

1.2. SIGOMA is a special interest group (within the LGA) of 46 local authorities in the northern, midland and south-coastal regions of England, comprising 32 metropolitan districts and 14 unitary authorities, covering key urban areas.

1.3. Our membership includes authorities in the North East, Yorkshire and the Humberside, the North West, the East and West Midlands and the Southern Ports.

1.4. SIGOMA authorities face among the most serious financial challenges of any authority group. They have faced average cash term cuts to core spending power of 27% this decade, compared to the English average of 18% and are able to raise around 20% less in council tax and business rates due to their low tax bases.

1.5 The cost pressures faced by our members are also much greater than most. 96% of SIGOMA authorities are more deprived than the English average, making both demand for vital services and the cost of meeting local needs higher than average.

1.6 We welcome the opportunity to respond to this consultation and to put forward proposals to help ensure the index is made as meaningful as possible.

1.7 It is probably fair to say that the views of our members are polarised on this issue. We cannot state that we are representing the views of all members in our response and we hope we make clear where there are dissenting views.

## 2. General comments

### Principles

2.1 Though SIGOMA members are broadly supportive of the principle of CIPFA's financial resilience index there are a number of our membership who have strenuous objections to the proposal both in principle and in practice and view the objective of defining indicators that would identify risk of failure as an impossible objective and a distraction. They also take the view that it would be impossible for the data to be made available in any way that would not turn it into a league table with all the accompanying uninformed reaction.

2.2 Those who are supportive in principle welcome its stated aim to provide "an early warning system to senior officers and members" and the important clarification that "the index is not a performance table". They also welcome the underlying motivation behind the exercise, to prompt further investigation rather than attempting to present the index as a categorical predictor of financial weakness/resilience. They have strong reservations, however, about the index in its proposed form.

2.3 We present our response to the questions below, therefore, reflecting the views of members who support the principles but feel that the current proposals fail to meet the objectives the index aims to achieve. It must be recognised however that a significant minority of our members oppose the introduction of the index in principle, however carefully constructed

2.4 We believe the index should provide an overview of all of the factors that can lead to financial stress, be resistant to manipulation and be constructed so as to ensure planned spending is not misconstrued as a sign of financial weakness.

2.5 With the objective in mind of an early warning system, the indicators should be more forward looking and make more use of revenue estimate and prudentential borrowing data. Much of the information proposed would be retrospective and not available until some three or four months after the financial year end of an authority.

2.6 We are conscious too that attempts have previously been made to arrive at a similar indicator by the LGA and others, and that similar exercises are currently being undertaken by a number of organisations, including the National Audit Office. It is important therefore that this index builds on the strengths of previous work and takes on board lessons learned. It is also important that the efforts of like-minded organisations are not unnecessarily duplicated. It may therefore be useful for CIPFA to communicate and coordinate with other such groups in order to make the index as meaningful as possible.

2.7 We note the comments in the foreword that the index is not intended as a comment on quality of leadership. However the consultation refers to the use of tools such as the s114 statement to identify approaching financial crisis and "avoid the type of failure that arose at Northamptonshire", presenting the resilience index as an aid to financial evaluation. It appears to be the case however that finance staff at Northamptonshire alerted leadership to impending financial crisis well before the inspector's report; also many of our members have pointed out that most authorities will already be using data of the sort suggested in the consultation to evaluate their financial status. This highlights that some of the issues that can determine whether authorities end in financial crisis <u>will</u> depend on governance and leadership, not just the comparing financial data. Some members are concerned that the index will become a tool to evaluate the s151 officer , not the organisation as a whole.

2.8 Some members have asked whether the index has been tested against the specific examples of Northamptonshire and other councils who have experienced financial difficulty i.e. would the indicators if measured in earlier years have warned that these authorities were approaching financial difficulty. Others have suggested that the relative index proposed would be of less use than an index based on indices of those authorities that have actually failed or come close to failure.

2.9 In addition we have often commented, and it must be plain, that not all failures will present as financial failures though they may have a strong underlying link to inadequate financial resource. Failure can more often present as a failure of service provision, especially in the high risk areas of welfare services. Again, such failures may include an element of poor management but we question whether an authority that provides a sub-standard service but stays within financial constraints is less of a failure than an authority which maintains minimum standards at the risk of a weakened balance sheet . In other words the resilience indices are only one half of the story, with performance being the other half. This is briefly referred to in the foreword but needs to be explicit in the final documentation

2.10 The methodology set out on p4 appears reasonable, it would be welcome if further explanations of the rationale behind the selected indicators and sub indicators could be made for example why so much emphasis is place on reserves and why earmarked and un earmarked reserves have equal weighting.

2.10 Comparatively low reserves for one authority may not present the same risks as they do for another and this information will only be truly meaningful if accompanied by assurance from Section 151 officers that the level of reserves is sufficient (or insufficient) and explaining why this is the case.

2.11 The reasons why only a limited range of indicators feed into the index and why they are so narrowly weighted are unclear. This is not explained in the consultation. We are of the view that this focus is likely misplaced and may work against CIPFA's stated objective to create "an authoritative measure of councils' financial resilience".

2.12 We would add that the timing and closure date of this consultation is less than ideal, covering as it does a period when many local authority Finance Directors and Finance Officers are on annual leave making it difficult to ensure a consensus opinion is obtained. In short further work and a longer consultation period is needed.

## *a. Are the proposed indicators the right ones – are there other measures that should be included or ones omitted?*

3.1 The measures presented are predominantly reasonable in their own right, but do not appear to represent a comprehensive picture of the potential points of resilience or weakness within local government finance which could be displayed.

3.2 There is, as the consultation acknowledges, very little in measures that are forward looking .In this sense, the index does not strictly meet the stated objective of supporting the local government sector in acting as an early warning system. We address this later in our response.

**Only a Relative Measure**

3.3 The consultation notes that: "The decision to develop an index is driven by CIPFA's desire <u>to support the local government sector</u> as it faces a continued financial challenge. The index… <u>will provide an assessment of the relative financial health of each English council</u>."

3.4 The index proposed will therefore give an indication of how councils are performing relative to each other, but no indication of the absolute health of an individual authority.

3.5 This could lead either to complacency or unwarranted adverse reaction. It would be possible, for example, for all authorities to perform poorly while half of authorities would appear to be performing well. Or that all authorities are within reasonable boundaries of risk yet the lowest scores presented as failing. Again this undermines the stated objectives. It may be more meaningful to construct a baseline indicator constructed from the indicators of those authorities who have actually failed or been forced to issue notices.

3.6 It may be possible to overcome this limitation through collaboration with other groups such as the LGA or NAO, and through reference to their work on the sustainability of local services and the wider sector. This would help to put the index in context and illustrate the point that sustainability will inevitably become more challenging as austerity continues to amplify the pressures councils are facing.

**Overemphasis on Reserves**

3.7 The index considers levels of both earmarked and unallocated reserves as well as a percentage change in these reserves. Public health and schools reserves are also considered. The treatment of reserves as part of the index is problematic for a number of reasons.

3.8 The inclusion of Earmarked reserve ratios (those set aside for a specific purposes) and Public Health Reserves is questioned by some members. An increased earmarked reserve may contribute little to supporting an authority's revenue position, as they are created against the possibility or probability of specific expenditure. This measure is therefore of questionable value as a measure of financial resilience and may be misleading, particularly when considered over a short period.

3.9 Factors considered to be more significant indicators are:

- Repeated and unplanned use of general reserves to balance annual revenue
- Budgeted use of general reserves to balance ongoing costs (possible failure to plan efficiency?)

3.10 This highlights the weakness of over reliance on using reserves as a measure of financial resilience and the risks associated with weighting them so heavily.

**No standalone indicator of service quality**

3.11 All of the proposed indicators are presented as a proportion of net expenditure. This means they will rightly highlight authorities that may be balancing annual budgets by running down reserves etc.

3.12 However, it does not appear to include any indicators that would highlight those authorities that are taking tough decisions and being forced to drastically cut service expenditure instead of running down their reserves.

3.13 These authorities may not show the same outward signs of financial stress as others, according to the Index as currently proposed, but this may be because their cuts to services have been much higher (their net expenditure – the denominator – may have reduced in proportion to the various numerators considered). The main problem here is that these authorities are possibly much closer to the point where there are no cuts left to make, and therefore, if they do start to experience problems, will have fewer options left to explore.

3.14 While Adults and Children's social care as a proportion of net expenditure will give some indication of this, variation in these indicators over time may be a useful addition, since a snapshot of social care expenditure gives less indication of how circumstances may have worsened.

3.15 It may therefore be useful to examine current service level expenditure as a proportion of a set datum, for example 2010 service expenditure. The lower the figure the greater the possible risk of service or financial failure in unforeseen circumstances.

**No standalone indicator of Debt Financing and MRP**

3.16 No standalone indicators appear to be included to highlight levels of debt financing and council's Minimum Revenue Provision. Although it is acknowledged that cost of debt is reflected along with social care as an "unavoidable" cost.

3.17 High levels of debt and longer loan periods may be signs of financial risk and, if income levels fall, may result in cost of debt plus expenditure on statutory services exhausting income from council tax and business rates. Authorities with higher borrowing or borrowing over longer periods have fewer options to reschedule debt or re-evaluate MRP in difficult times.

3.18 CIPFA might consider including measures such as debt as a proportion of Capital Financing Requirement, as measured under prudential borrowing, as a measure of extent to which borrowing is being maintained at planned levels. Some authorities have suggested absolute borrowing or debt to assets measures as an indicator.

3.19 Managing the cost of servicing debt, like reserve use, is likely a key indicator of councils' financial health and should be afforded similar prominence both as a standalone indicator and as a component of councils' final index score.

3.20 At the least, debt servicing should include Minimum Revenue Provision. Whilst authorities have had some latitude to vary MRP policy, that latitude is diminishing and once set the Policy will determine an MRP charge that is unavoidable in the short term.

**External Audit**

3.21 External audit reports highlighting areas of ongoing concern and value for money issues should form part of the assessment since these will help to contextualise the overall index score and provide an indication of the strength of financial management in the face of challenging circumstances.

3.22 It may also add value to give chief finance officers the opportunity to provide a brief comment on the auditor's judgement and their authority's position in the index should the full analysis be made publically available. This could perhaps be put into practice through reference to authorities' section 25 reports, wherein chief finance officers are required, under the Local Government Act, to:

"…report on…

(a)the robustness of the estimates made….

(b)the adequacy of the proposed financial reserves.".[1]

**3.23 Recommendation: CIPFA should consider limiting the overall index to reduce the impact of all reserves-based metrics on authorities' scores since, while important, these can be misleading and only represent one part of the overall picture of financial resilience. Standalone indicators for spend on vital services and debt financing as a proportion of net expenditure could also be considered.**

### *b. Is the method for combining the indicators to produce a composite indicator appropriate? Are the weights, particularly the greater weighting on reserves reasonable?*

**Method of Combining Indicators**

4.1 The method of combining the indicators by assigning each an indexed value between 0 and 1 appears to be reasonable for identifying relative risk of authorities. It must be recognised however that this relative weighting will be of little help in predicting the actual likelihood of an individual failure where the sector as a whole is facing severe financial stress.

4.2 The current methodology implies that all of the base metrics listed at the top of p9 are of equal value to the others that feed into the same indicator. While we have no firm view on the relative value of these base metrics, it will be important for CIPFA to justify its reasoning for considering metrics within each of the six indicators to be of equal value and to ensure this is explained transparently in the final version.

4.3 For an indicator such as "level of reserves", for example, should schools and public health reserves, earmarked or unallocated reserves have equal relative significance? Some members suggest that un-earmarked reserves only, should be included in this section.

[1] https://www.legislation.gov.uk/ukpga/2003/26/section/25

**Weighting of Main Indicators**

4.4 The weightings proposed are not explained. The consultation simply states that: "the proposed… weights… reflect [CIPFA's] view on the relative importance of each indicator." For the index to be subject to informed scrutiny and thereby win the backing of the local government sector, however, we feel it is important that the reasoning behind this is made transparent.

4.5 We have already made clear above that we feel the weighting of reserve factors in the overall measure is excessive The Index should consider all of the factors that may contribute to financial weakness/ resilience rather than placing the majority of its focus on a single indicator

4.6 The index could benefit greatly from placing greater emphasis on warning signs that emerge earlier and could lead councils to resort to rapid depletion of reserves later on. This approach may help to better meet the important and rightly stated aim of providing an "early warning mechanism".

4.7 We feel that authorities' social care and debt financing ratios are of at least equal importance and it is not made clear in the consultation why these are considered under a single indicator, which will have the effect of diluting their impact on the overall score. We have suggested some other measures that may be included.

4.8 It is also unclear why the weighing of the grants to expenditure ratio is so low, despite evidence from the IFS and others that the most grant dependent authorities in the country have seen the greatest cuts to core spending power and been forced to make among the deepest cuts to vital services.[2]

4.9 Members also query what will happen whilst those authorities who are rate retention pilots have no RSG whilst those who are not retain some RSG and also what will happen when we move to 75% rate retention and RSG disappears? Perhaps a better measure would be the counter measure of an authority's ability to raise income locally? A sort of "gearing" measure of Council Tax +Business Rates divided by gross expenditure where a low score suggests lack of ability to increase local income.

**4.10 Recommendation: weightings and indicators should be reconsidered with a view to making the index representative all elements of council finance that may indicate weakness or resilience – all avenues authorities may pursue in order to deal with austerity. Councils have sought to cope with austerity in different ways and the index should be calibrated so as to highlight all those experiencing difficulties, not just those whose relative financial weakness manifests itself principally through depletion of reserves.**

**Such a shift in focus would help to meet CIPFA's objective of providing an early warning system. It may even be feasible to consider rapid depletion of reserves separately, since this may prove more valuable as a late warning system.**

[2] https://www.ifs.org.uk/publications/8780

**c. Is the proposed presentation, including both the summary and the individual council dashboard, the right way to present the data?**

5.1 We do not wish to appear overly critical of what is clearly an early draft however the details presentation of the tables and graphs on page 9 could be made clearer.

5.2 The leftmost column of the first table should contain descriptors of what indicator is showing. The calculations could be included in a separate column or note. Those involved in local government finance may be able to infer what the calculations are showing with relative ease, but this will not necessarily be the case for the general populous or some Members, should the index be made public. This could be done by a referenced addendum to the table which should also explain the implications of a negative indicator for each line and whether a high indicator would be favourable or unfavourable.

5.3 There is no main category score and no overall score in the top most table though (we assume) the Trend analysis is of the overall score

5.4 The trend analysis has no y axis description or value and the colour scheme between this and the group performance table does not align ('Barchester' is red on the trend analysis and yellow on the group performance).

5.5 The group performance presumably compares authorities of the same type, and the colour scheme suggests that the red and green coding roughly accounts for the upper and lower quartiles of that group.

5.6 This indicator might be more valuable, however, if the colour coding was based on the upper and lower levels of all authorities or if there was coding both nationally and within authority groupings. This might give each authority a colour coding nationally, within its authority type (Mets, Counties, Unitaries and London Boroughs), and perhaps regionally too. A met authority may, for example, be performing well against other Mets, but badly nationally, and providing this detail may be useful for authority benchmarking and zeroing in on why certain authorities may be more or less resilient than others.

5.7 The graph at the bottom of the table is presumably of local authorities, representing the national picture, but has no title , x axis or y axis labels, so this remains unclear. It would be useful if this graph was colour coded by authority type. Also the score for the illustrated authority on the graph (500?) seems much higher than the "Barchester" score in the overall performance table of 84, again making the graph purpose unclear.

5.8 The Index example also contains no guidance notes. This means the intended audiences may be unclear as to what the charts show and, more importantly, what they mean. What, for example, does an 'unqualified' auditors' judgement mean to a non-local authority finance audience? See points in 5.1 above.

5.9 CIPFA may therefore wish to consider providing an annual commentary on the index, for example, to aid interpretation and identify outside factors that may help account for any common trends. This will be especially important if the index is to be made public since it would provide an official stance to temper the potential speculation of non-specialists.

**5.10 Recommendation: the presentation needs to be clearer and considered with a non-local government finance audience in mind, if the index is to be published. All elements should be explained so as to avert the possibility of ill-informed speculation on what the results might mean.**

## d. Do you have any comments on CIPFA's view that to aid transparency the full analysis should be freely available on CIPFA's website?

6.1 The stated aims of the resilience index are to: "to promote better financial management and provide an early warning system to senior officers and members [and] support good practice in the planning of sustainable finances." However, the proposal to publish the full index may serve to undermine these aims.

6.2 All SIGOMA are therefore of the view that the full analysis should not be made publically available, at least in a non-anonymised form. Though the tables might be presented in a "member only" section of the website.

6.3 Despite CIPFA's best intentions, the index would have the appearance of a league table. Though the aim is clearly to provide an early warning system – an indicator of authorities that may be experiencing financial difficulty – in the hands of the press it is not difficult to see the index being sensationalised and misinterpreted as an index of authorities that are experiencing financial difficulty.

6.4 Another issue is the potential for the index to cause unnecessary alarm within local authority leadership, again via the unintended but, nevertheless, entirely possible misinterpretation that an authority may be experiencing financial difficulty when the data is susceptible to reasonable explanation. It may be reasonably anticipated that this could have the potential to result in rash decisions and potentially bring the performance of finance officers into question (whether the underlying explanation for a poor score happens to be reasonable or not).

6.5 This could foreseeably hinder rather than help the planning of sustainable finances, at best heightening the risk of unintended consequences and, at worst, become a self-fulfilling prophecy whereby authorities singled out feel pressured into making snap financial decisions they may not otherwise have made, and which may not be beneficial to their overall resilience.

6.6 Here, again, the relative nature of the index means that however well local authorities may be doing collectively, there will always be those at the bottom that appear to be in trouble. And, however badly all authorities may be doing collectively, there will always be those at the top that appear to be doing well.

6.7 Therefore, it may be more prudent and in better keeping with the objectives of the index to make an anonymised overview of the data publically available, in order to give the media an idea of how many local authorities are facing financial difficulty and to help draw attention to the risks associated with ongoing austerity.

6.8 Individual authority profiles, like the one set out on p9 of the consultation, however, could still be communicated privately individual local authorities. This would give officers the opportunity to explain why their 'score' might be as it is, placing it in a fully informed context. Local authority leaders could then be permitted to publish their local profile in the press should they wish to draw attention to their authority's position, but this decision could be left at their discretion.

6.9 This approach should bring all of the benefits of a publically available index, drawing attention to the challenges faced by the local government sector as a whole, as well as identifying instances where CIPFA and MHCLG may wish to conduct further investigations to establish whether a poor index score is actually representative of poor financial resilience.

**6.10 Recommendation: an anonymised overview could be made publically available, but indicators for individual authorities should be kept private and only accessible to CIPFA, MHCLG and the local authorities they pertain to.**

**Available data tends by its nature to be retrospective, what forward looking indicators would you also see as useful to include to support the index?**

7.1 The Index analysis presented on p9 appears to pertain predominantly to a single year, with some trend analysis provided for the previous three years for the 'trend analysis' section only.

7.2 Since the index is relative, to present any trends of value in order to indicate the overall sustainability of the sector, and thereby support the sector as a whole, it should span a longer period.

7.3 The indicator could be backdated to 2010, for example, the beginning of the austerity programme.

7.4 We would recommend that the indicator could incorporate or make use of:

- Revenue estimate data showing planned v Outturn service expenditure and income
- Revenue estimate data showing planned use of general reserves to balance revenues
- Revenue estimate v Outturn to show unplanned use of general reserves
- Treasury policy statements showing under or over borrowing as % of CFR (or net assets)
- Treasury policy statements showing proportion of variable and fixed interest borrowing (or interest rate risk).
- Treasury policy statements showing debt maturity profiles
- ONS population demographic details showing projections for increasing/decreasing proportions of vulnerable residents

7.5 This approach, however, must be tempered by the understanding that some indicators may not display consistent, predictable trends. Earmarked reserves being a case in point already highlighted. Such considerations must therefore be properly accounted for in the weighting of the index.

**7.6 Recommendation: in order to meet the Index' stated aim of supporting local government, it should be backdated in order to provide more perspective and context regarding the adverse circumstances local authorities currently face. As an 'early warning mechanism', it will be difficult**

**for the index not to be perceived as a predictive indicator. CIPFA should address this by providing clear explanations of what the data shows as well as what it does not, emphasising its limitations and its purpose as a diagnostic tool designed to highlight authorities that may be rather than those that are experiencing financial difficulties. Better use should be made of forecasts and projections to consider an authority's exposure to and preparedness for future risks.**