Chartered Institute of Public Finance and Accountancy (CIPFA)
77 Mansell Street, London E1 8AN
resilienceindex@cipfa.org

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Local Authority Financial Resilience Index Consultation

We are writing on behalf of the Association of County Chief Executives (ACCE) in response to the Chartered Institute of Public Finance and Accountancy (CIPFA) consultation on proposals for an ***index of resilience for English councils***. We welcome the opportunity to respond to this consultation.

ACCE brings together the Chief Executives of over 30 large English upper tier and unitary authorities. Members of ACCE work to identify common challenges, commission research and share solutions, and discuss key issues with senior Whitehall civil servants.

As chief officers in England's largest councils, we know that financial resilience is the biggest risk faced by most upper-tier local authorities. Opportunities to improve longer term financial planning and transparency for the sector - and importantly to raise the profile of this issue with central government - are vital.

We therefore support CIPFA's efforts to promote better financial management and planning, and to share the endeavour of reducing the financial risk for local authorities. The current focus on resilience is understandable given developments at Northamptonshire. The financial challenges facing the authority could clearly have been better managed, and there is extensive evidence of poor financial management.

Despite events in Northamptonshire triggering the proposals by CIPFA, financial stability has been a growing concern for all councils, and in particular for county authorities, for some time.

Recent analysis by the Society of County Treasurers (SCT) and County Councils Network (CCN) showed that county and county unitary authorities face funding pressures amounting to £3.2bn over the next two years alone. The budget analysis showed that 58% (1.861bn) of this is caused by demand-led pressures. Some of the financial pressures facing counties are particularly acute; such as demographic pressures. Moreover, the approaches to delivering necessary savings and transformation are constrained by the lower funding received by county authorities and the context of operating within a two-tier system of local government.

The seriousness of the financial challenges facing our councils is recognised at the most senior of political and officer levels. ACCE recently surveyed chief executives on their confidence in delivering balanced budgets over the coming period, with the initial results showing that by 2020/21 only 19% of chief executives are confident they can deliver a balanced budget without additional resources.

ACCE Policy Support: James Maker
CCN | 18 Smith Square | Westminster | London | SW1P 3HZ | Tel: 020 7664 3002 | Email: james.maker2@local.gov.uk |

These mirrored the findings of the same surveyed carried out by CCN with council leaders, with just one third (33%) confident they will be able to deliver a balanced budget in 2020/21 without an extra cash injection.

The aforementioned research by CCN and the SCT showed that county authorities will have to deliver an estimated £1.39bn of savings between 2018 and 2020, increase council tax and use reserves (in some cases) to deliver balanced budgets. CCN has been clear that the 'Core Offer', recently outlined by East Sussex County Council as part of a prudent financial strategy, could become the norm across our membership.

While difficult decisions, accompanied by excellent financial management and stewardship, will therefore be essential to meet our statutory requirements and deliver balanced budgets, they cannot on their own solve the funding crisis we face. The failings at Northamptonshire brought a lot of attention to local government and there were clearly systemic issues of its own making; but these issues do not apply to the whole sector. A fair quantum of funding and a fair distribution of resources is required for local authorities to continue to provide the services that communities and people rely on.

It is within this context that ACCE responds to the proposals put forward by CIPFA. County chief executives discussed the framework at length during a recent meeting of the association. While some individuals may have differing views on the index, there has been a clear collective view during these discussions on the need to raise concerns over the proposals.

We welcome CIPFA's desire to support the sector in these tough times, improve transparency and financial resilience. However, overall, we believe that the proposed Resilience Index is a blunt instrument with which to measure financial resilience and also look at the overall funding challenges facing the local government sector.

We are concerned that the limitations of publicly available data means that inevitably the approach produces an overly simplistic view and is on a number of fronts technically weak, and in some cases, flawed. Below, building on an analysis by the SCT, we set out a number specific issues with the proposed framework.

More widely, we are concerned that condensing financial resilience into these few measures will not provide a true picture of a local authority's financial health and sustainability, and could result in poor decision making. By setting out a series of indicators we risk distilling the complex into the overly-simplistic; which does not take into account the individual circumstances and environments of local councils, their culture, or their future transformation. On top of this, the index could be out of date by the time it is published – rendering it moot. An authority's position at a moment in time is one thing, the quality of their plans for the future are another.

Most fundamentally, it is important that an index does not simply provide central government and critics with undue 'evidence' of perceived wider financial management shortcomings that detract from the funding challenges local authorities face.

County authorities are faced with an increasingly precarious financial situation that is not of their own making, but is the result of aforementioned rising demand, unfunded cost pressures and reductions in local government funding. Any system proposed by CIPFA must support us in raising awareness of this issue and securing the necessary action by Government in the upcoming Spending Review.

If the proposals for a Financial Resilience Framework are taken forward, we hope the analysis provided here and the expertise of the SCT are used to ensure that the technical concerns raised are addressed and the presentation of any index considers the wider views outlined above.

We hope that regardless of the outcome of the consultation, CIPFA will work with ACCE to create an approach that supports learning and innovation across the sector, rather than defensiveness judgments the proposed model could inevitably create. This could involve improving existing systems, such as the LGA's peer reviews, which could genuinely offer help to struggling local authorities and ensuring we collectively highlight the continuing funding pressures facing local authorities.

<u>Technical Analysis & Response to Consultation Questions</u>

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

- *Indicator 1 - The level of total reserves excluding schools and public health as a proportion of net revenue expenditure.*

We agree a low level of reserves means there is little scope to draw on reserves should the budget not be met. However, looking at reserves opens up a number of questions that will not be answered by the analytic proposed by the consultation and we would urge CIPFA to consider how the information is presented in light of the following points:

- has the authority identified the risks within its budget, are those risks understood and assessed, and are there measures in place to mitigate?
- if the authority has earmarked reserves is it clear why and are these reserves appropriate given local circumstances and their strategic corporate objectives?
- are there robust plans in place for their use?
- if the authority has no earmarked reserves – why is this, how are they managing future spending issues/pressures?

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If CIPFA is intent on using this metric, we would make the following further observations on how this could be improved. It is not clear from the documentation if CIPFA are proposing to measure all reserves, or to exclude earmarked reserves. In a period of financial difficulty, an authority may well turn to all reserves, not just non-earmarked reserves. Instead we would suggest that this measure should only relate to non-earmarked reserves.

- *Indicator 2 - The percentage change in reserves, excluding schools and public health, over the past three years.*

We note the statement in the commentary that 'If a council is reducing its reserves, it may not be achieving necessary savings to balance its budget.' Whilst this may be correct, it could also be the case that authorities are withdrawing reserves to use them for the purpose for which they are intended. It is therefore important that the local context is considered.

We therefore believe that the change in reserves in itself is not sufficient to form a judgement about future resilience – the reasons for reserves and their drawdown need to be understood – sums may be being set aside to save for future expenditure or to fund future commitments which may be intended to produce revenue savings for the long term or mitigate longer term risk within the budget. Drawdowns may be planned in accordance with longer term spending and funding strategies.

We do however recognise that it may be worth exploring the unintended use of reserves – this could be investigated by reference to reserves being used when the budget is set, compared to reserves being used at outturn. This would be worth looking at as it may be that savings incorporated as part of the budget were not being delivered.

- *Indicator 3 - The ratio of government grants to net revenue expenditure.*

We don't believe that including this would add value to a resilience index. On-going uncertainty over the system for local government finance has been and continues to be a major factor as the amount of income retained is ultimately controlled by Central Government. Local government has dealt with ten years of reductions in funding, and future uncertainty over funding levels makes long term financial planning extremely difficult and can drive perverse behaviours.

Indeed, this indicator seems almost irrelevant, given that both the public health grant and revenue support grant will be ending. We would also suggest that any indicator which measures individual funding streams (council tax, business rates etc.) will not prove to be useful – it is the composite amount compared to expenditure which is important.

Given this, we suggest the application of a measure of gross expenditure to the sum of council tax, business rates, specific grants and fees and charges would be better. Differences

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would show the extent to which reserves are used to set the budget. If this is used in the context of a trend analysis, it would be possible to see a reliance on reserves to balance the budget.

- *Indicator 4 - Proportion of net revenue expenditure accounted for by children's social care, adult social care and debt interest payments.*

This suggested indicator measures the proportion of adults and children's social care to net expenditure. This has a fundamental flaw - if net expenditure is greater than sustainable funding streams (i.e. the budget has been balanced by use of reserves), then measuring the proportion of social care and debt spend to expenditure could be understating a structural problem in the budget. Whilst it could identify where there is disproportionate spend in these high risk areas it would not be able to predict future challenges.

As an alternative we would suggest that this is compared to recurrent funding streams. In addition, we also suggest the inclusion of home to school transport, given its volatility.

- *Indicator 5 - Ofsted overall rating for children's social care.*

Past experience has shown that any authority that has an 'inadequate' or 'requires improvement' rating is likely to have to invest substantial sums in improvement programmes.

However, the extent of additional investment required and the period for that investment can vary significantly due to the actual rating and the action required, there is therefore a question on whether there should be a differential in scoring depending on the detail of the rating across all the classes. Adding in this necessary judgement may make this measure too complex and cumbersome.

- *Indicator 6 - Auditor's VFM judgement.*

We believe this could be a key measure of a local authority's financial resilience derived from a broad assessment both backward and forward looking. However, the VFM opinion can be qualified for a range of reasons, of varying degrees of severity, so the index needs to take this into account.

For it to be meaningful there should be a greater definition of the assessment and guidance to ensure consistency in the assessment, which we do not believe this is the case at present. The amount of time the external auditor spends on this measure is low and given that this is given 10% of the overall weighting, it is important that there is confidence in a consistent application across local authorities.

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

The index assumes that resilience is merely a matter of performance and that therefore the best performing councils will be resilient, but given that the pressures on the local authority finances we do not believe this to be the case. We are therefore concerned that there is a danger that the compilation and publication of a comparative index would be a measure of degrees of failures rather than the performance of the local government sector.

This therefore makes it critical that the methodology underpinning any index is as strong as it could be. Given this:

- we note that reserves (levels and changes) carry a combined weighting of 0.5 – half of the overall score. For the reasons set out above we are concerned that this is overplaying the role of reserves.

- we note the intention to weight the Auditor's VFM judgement at 0.10 but believe this has the potential to provide a more holistic and forward looking view of financial resilience and therefore would wish to see this have a much higher weighting although note concerns below.

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

We have concerns about the phrasing of the dashboard, which states that there is a "worst performing" and "best performing" council for each indicator. This is inappropriate as, for instance, spending a high proportion of its budget on social care does not make a council badly performing.

See below response to d.

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?

In general, we welcome and encourage transparency and believe that by sharing data and insight we can work towards raising standards across the sector. However we are concerned that without context and meaning the proposed summary and dashboard will do little to support individual councils face the expected financial pressures of the next couple of years.

Using a RAG system and a combined weighting system is overly simplistic and could potentially distract from the message the sector is trying to press home to residents and decision makers about the scale of the financial challenges faced by local authorities.

If the intention is to support S151 officers and leaders, then we would suggest that each measure be given an individual score and it is this detail that is published. Sitting alongside others such as the CFO insights, the index would help inform and guide financial management and planning in the local authority in a targeted way.

We would therefore support a “balanced scorecard” type approach that would be more appropriate and enable more relevant comparisons to be made. This would allow each authority to focus its actions where they are most needed.

We are also concerned that the system assigns *relative* scores. An authority’s score or scores can therefore only be measured in relation to others in the same group (e.g. all County Councils). If the financial situation of the whole group is serious (as is the case at present given the state of local authority funding), then a ‘green’ rating for an authority merely means that it is more resilient than others in the same group, not that is its resilient per se.

e. 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?

A forward view of financial performance is absolutely crucial in order to make a judgement about financial resilience. We believe that the complexity of the issues does require informed judgement taking into account an authority’s financial position (immediate and looking forward) but also its corporate context and future plans. The proposed resilience index measures can only be a snapshot in time and can only reflect past decisions.

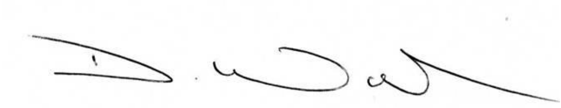
Hard measures of future financial performance could be derived from Local Authorities’ medium to long term financial strategies but this data is not uniform and not available centrally. Furthermore this data will be based on a range of assumptions which cannot be predicted with accuracy into the future and therefore relies on assumptions, risk assessment and clear financial strategy with supporting and deliverable actions, which are all key factors in making a judgement about financial resilience.

We believe that the Local Government Association has an important role to play - the sector led corporate peer challenge has proved to be a successful way of assessing local authorities. A dedicated financial resilience assessment (there is already a financial peer challenge offer which could be further developed) would enable a more in-depth view of each authority’s local circumstances and its ability to foresee and cope with future financial challenges.

We also believe that the external auditor’s opinion on a local authority’s ability to secure financial resilience provides an opportunity to take a more holistic and forward looking view. However we note that since the abolition of the Audit Commission the reduction in audit fees means the time available for this important work is continually squeezed.

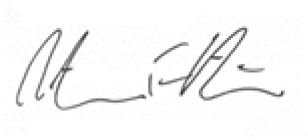
We look forward to further opportunities to engage with CIPFA on this work in the coming months.

Yours Sincerely



Debbie Ward
Chair, ACCE
Chief Executive Dorset County Council

Anthony May
Vice Chair, ACCE
Chief Executive Nottinghamshire County Council



Richard Flinton
Secretary, ACCE
Chief Executive North Yorkshire County Council

ACCE Policy Support: James Maker
CCN | 18 Smith Square | Westminster | London | SW1P 3HZ | Tel: 020 7664 3002 | Email: james.maker2@local.gov.uk |