

CIPFA BRIEFING

March 2016

balancing local authority budgets

and section 114 notices

Due in large part to the impact of the spending reviews and funding cuts, chief finance officers (CFO) have found it increasingly difficult to balance the budget. CIPFA's local authority CFO confidence monitor for 2016-17 showed more than 56% of finance leaders are less confident that they will reach a balanced budget and be able to continue to deliver services for the next financial year.

Concern about the rising cost of social care in upper tier councils and uncertainty over future funding streams are challenging robust financial planning. Many types of council are finding that the amounts generated through business rates, the New Homes Bonus and fees and charges can fluctuate dramatically and sometimes be difficult to estimate. This puts the council's budget at greater risk. This is in addition to the unexpected changes in funding linked to Central Government policy announcements.

This briefing looks at what it means to have a balanced budget and who is responsible for achieving this equilibrium. It also considers what factors have a negative impact on the budget and result in a local authority facing a spending crisis. To avoid a financial crisis the council will implement a spending freeze and so the briefing covers the implementation of this approach. However, the briefing also considers what will happen if the spending freeze fails and the CFO must implement the gravest financial sanction – the Section 114 notice.

Balancing a budget

Local authorities are required by law to have a balanced budget. However what is meant by 'balanced' is not defined in law and this has meant CFOs using their professional judgement to ensure that the local authority's budget is robust and sustainable.

A prudent definition of a sustainable balanced budget for local government would be a financial plan based on sound assumptions which shows how income will equal spend over the short- and medium-term. Plans would take into account deliverable cost savings and/or local income growth strategies as well as useable reserves.

Legislation provides a description to illustrate when a budget is considered not to balance, which is:

- where the increased uncertainty leads to budget overspends of a level which reduces reserves to unacceptably low levels, or
- where an authority demonstrates the characteristics of an insolvent organisation, such as an inability to pay creditors.

CFOs must interpret this based on the circumstances of their own organisation and should continually monitor income and expenditure throughout the year to make sure that the finances are on target. Any significant alteration in either expenditure or income may result in an unbalanced budget. Factors affecting a budget could include:

- natural disaster
- sudden policy change
- demographic pressures
- unexpected funding pressures
- failure to realise planned savings.

In this case it would be necessary for the authority to find an alternative way to balance its budget. This would usually be through the introduction of an emergency savings programme.

Avoiding an unbalanced budget

To avoid an unbalanced budget local authorities have to be financially resilient. Good financial management is fundamental in establishing confidence in the budget and ensuring that the finances can withstand unexpected pressures. Setting a clear medium-term financial plan will help clarify expected income and expenditure and regular monitoring will ensure that any financial issues are identified early and measures can be brought in to realign the budget. These plans must incorporate any financial, operational and strategic risks faced by the authority.

Medium-term financial planning

Across the public sector the spending review process has led to a focus on medium-term planning covering periods of three to five years. Authorities which have based their plans on forecasts of funding levels tend to update their plans on an annual basis so as to reflect the latest funding predictions. Accurate awareness of the funding available in the forthcoming years means a council stands a better chance of balancing the budget.

Use of reserves

CIPFA recognises that reserves are very useful options for balancing the budget in the short-term. Reserves can be called upon to manage fluctuations between financial years to ensure that an overall balanced budget is maintained. CIPFA's advice has always been clear that reserves should not be used to pay for day-to-day expenditure and that it is important that they are replaced when the short-term need has passed. CIPFA has sent a consistent message to local authorities that the use of reserves must be very measured and the advice provided in the CIPFA Briefing on Local Authority Reserves (June 2015) supports this view.

Allocated reserves can be used for:

- planned investment
- capital projects
- change programmes
- unexpected events such as natural disasters.

Responsibility for balancing the budget

The responsibility of the budget rests with the CFO who will work with the leadership team to set the medium-term financial plan. This plan will allow the organisation to deliver its long-term goals by ensuring that a suitable budget is in place. The CFO is also responsible for ensuring that the finance team constantly monitor the financial health of the authority. CIPFA would argue that in order for the CFO to be fully effective, they need to be at the centre of the organisation's strategic vision as well as having the technical ability to manage the organisation's finances.

However the CFO cannot work in isolation and should be supported by the chief executive so that the vision and strategies of the organisation are sustained through a strong financial plan. The chief executive is ultimately responsible for the success of the organisation and it is their task to bring the leadership team together. This role is particularly important during a time of financial crisis when spending restrictions may be imposed.

Spending restrictions will be more challenging for services which are demand-led and include a statutory duty such as adult social care and children's services.

At this time the chief executive's role will be to support the CFO in identifying solutions and working with the leadership team to produce a measured response. The chief executive must maintain communication and collaboration throughout the organisation. Any approach will only be successful if there is a consistent and clear message from the leadership team. The chief executive will be responsible for ensuring that this message is also communicated to external stakeholders and delivery partners.

Implementing a spending freeze

A spending freeze is an approach to help balance the books in-year. It sits alongside all the planned approaches and strategies set out in the budget when it was first approved. The need for a spending freeze in year may be because of an unplanned event or unexpected set of circumstances which mean the council is heading for an unmanageable overspend at year end or in future years.

Implementing the freeze is a sign of good financial management. It shows that although the finances are not on target good monitoring has identified the problems at an early stage and the leadership are working collaboratively across the organisation to realign income and expenditure.

How it is done in practice will vary between authorities but it will invariably mean having to navigate a path between the requirements of statutory service delivery and meeting the terms of current service contracts. The most common approach is where expenditure is limited or stopped altogether. A series of spending gateways will certainly need to be introduced with authorised signatories required where spending over a certain figure occurs. In 2015, for example, Buckinghamshire County Council introduced a spending freeze in which the CFO was required to sign any commitment above £100k.

However, it must be recognised that temporary suspension of spending can still accommodate an emergency release of funding if specified in advance. Some services such as adult social care and children's services will still have to spend during the freeze. It is necessary therefore that the CFO, supported by the chief executive, works collaboratively with the directors of these services to identify an approach to minimise spend or exclude certain areas from the spending freeze. Whilst this adds additional pressures to the local authority as a whole, services that are exempt from a spending freeze will be able to ensure certain customers are safeguarded.

Examples of short-term measures incorporated into a spending freeze include non-essential job vacancies, renewing computer equipment, routine repairs, staff training and highways and pavement maintenance. Budget holders would be asked to consider if the expenditure is absolutely necessary, if it can be deferred or if an alternative is available.

Statutory and non-statutory services

Statutory services are those an authority is required to provide by law – i.e. the public has a right to receive the service and the council a duty, and not just the power to provide it. Local authorities have over 1,000 statutory services to deliver and the implementation of a spending freeze must also explore the provision of these services. Few services are prescribed in law and over the past five years local authorities have been innovative in their approach to their delivery. As opportunities for savings from other areas have reduced the need to review statutory provision has become more urgent to help balance the budget.

The dividing line between statutory and non-statutory is not as simple as one might think and the decision about what costs are allocated to which service is critical to managing a budget, particularly during a freeze. Councils face Judicial Review if they misinterpret a service where there is a duty to provide.

Implementing a Section 114 notice

The authority that gives the CFO power to issue a Section 114 notice comes from Section 151 of the Local Government Act 1972. According to the Act the CFO can also be the Section 151 Officer. If the CFO judges that the council is unable to set or maintain a balanced budget they must consider the possibility of a Section 114 notice. Such a notice is only given in the gravest of circumstances. The process is governed under legislation and once issued the council has 21 days to consider a response. However, during that time spending and other financial activity is suspended.

To reach this point would suggest that:

- the authority has failed to heed previous warnings from the CFO about the financial risks to the authority
- the council has failed to appreciate the seriousness of the budgetary position
- the CFO has failed to warn of the risks.

It may also suggest that there may be a breakdown in the relationship between the chief executive and the CFO as warnings and conversations should have been taking place at the very highest level of the organisation.

While issuing a Section 114 notice should not be seen as a failure, it will result in the loss of financial control by the leadership team and the process should be seen as the action of last resort.

External audit will become involved during the process. From past experience CIPFA understands that the Department for Communities and Local Government (DCLG) would also be made aware of the financial crisis being experienced by the local authority and become involved.

New ways of working

Combined authorities, partnerships, and shared service arrangements now dominate the agenda and it is clear that the legal framework surrounding the Section 114 has not been tested in these circumstances. The Act was written for a very different type of local government structure and the ways councils now operate present quite different risks and challenges.

Conclusion

To balance a budget is a complex and continuous activity. Local authorities must ensure they have good financial planning in place supported by monitoring and review. However, unexpected budgetary pressures may occur that result in an unbalanced budget. Realigning the budget requires good communication and financial control. It is the responsibility of the CFO to ensure that the budget is balanced but they cannot work in isolation. The CFO must be supported by the chief executive and the leadership team.

CIPFA position:

- The CFO must be on the leadership team to ensure the financial plans are aligned with the strategic goals.
- The CFO must explore all avenues before issuing a Section 114 notice but should issue a notice where necessary.
- Good communication between the CFO and chief executive and across all stakeholders is essential for a spending freeze to be successfully implemented.
- Maintaining a robust approach to medium-term financial planning will ensure financial resilience.
- An authority should have a programme of monitoring and review covering strategies, risks and governance structures in order to mitigate against unforeseen events.
- Reserves are a vital part of prudential financial management in local authorities, including their ongoing ability to meet the balanced budget requirement and should not be used on an on-going basis to cover shortfall in day-to-day expenditure.
- An authority should prioritise how to deal with statutory service delivery on implementing a spending freeze in order to safeguard vulnerable groups and avoid the risk of Judicial Review.



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