Audit, Standards and Risk Committee

Wednesday, 13 December 2023

Local Authority Section 114 Notices: Key Issues and Lessons for SYMCA

Is the paper exempt from the press and public?	No
Reason why exempt:	Not applicable
Purpose of this report:	Governance
Is this a Key Decision?	No
Has it been included on the Forward Plan of Key Decisions?	Not a Key Decision

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Executive Summary

This report summarises the key issues and lessons learned in respect of those local authorities that have issued Section 114 Notices and it is also provides reassurance that there are robust controls in place at SYMCA to mitigate the risk of such extreme measures needing to be taken.

What does this mean for businesses, people and places in South Yorkshire?

Stakeholders of SYMCA should be reassured that the Authority is in good financial health and there are robust controls in place to minimise the likelihood of the Authority facing the same predicament as those councils which have issued Section 114 Notices.

Recommendations

Members of the Audit, Standards and Risk Committee are asked to note the contents of this report.

Consideration by any other Board, Committee, Assurance or Advisory Panel

N/A

1. Background

1.1 Contrary to recent media coverage of local authorities facing financial difficulty, a Section 114 Notice does not mean that a council has declared bankruptcy.

1.2 A Section 114 Notice, issued by the Chief Financial Officer of a local authority, usually means that he/she believes that the council's forecast income is insufficient to meet its forecast expenditure for the current financial year. This situation can arise for a number of reasons, which are examined in further detail later in this report. No new spending commitments on non-essential items can be entered into until a Full Council meeting has been held within 21 days to discuss next steps, which usually results in an amended budget being passed with reduced spending on discretionary services.

1.3 Section 114 Notices are enshrined in law. They originate from the Local Government Finance Act 1988. Since this legislation came into effect, ten councils have issued Section 114 Notices, sometimes on multiple occasions. This report sets out what those councils have in common, and what lessons can be learned.

2. Key Issues

2.1 At the time of writing, ten councils have issued Section 114 Notices:

- Hackney (twice: 1989 and 2000)
- Hillingdon (2000)
- Northamptonshire (twice in 2018)
- Croydon (three times: 2020, 2021 and 2022)
- Slough (2021)
- Nottingham (twice: 2021 and 2023)
- Northumberland (2022)
- Thurrock (2022)
- Woking (2023)
- Birmingham (2023)

Root causes

2.2 As noted above, the Chief Financial Officer is obliged to issue a Section 114 notice if:

- the Council is unable to meet its statutory requirement to deliver a balanced budget, or;
- the Council has incurred unlawful expenditure.

This report focuses on the root causes of the former scenario, although it should be noted that the latter scenario can lead to, and in the case of some of the councils listed above, has led to the former scenario.

2.3 Looking at the number of instances of Section 114 notices, 10 out of 15 have occurred since 2020, around the time of the Covid pandemic. This would suggest that the financial shock caused by the pandemic has exacerbated the plight of councils in financial distress. However, whilst it is true that the impact of Covid-19 has had a profound impact on the finances of local authorities, the situation is more complex.

2.4 In the ten years prior to Covid-19, the local government sector was subject to significant reductions in central government funding. According to SIGOMA, “councils are operating with a spending power that is 19% lower in real terms compared to 2010/11”.

2.5 In 2013/14, a new funding model for local government was introduced whereby councils retained 50% of business rates collected in their area. The intention of this model was to incentivise councils to boost economic growth. However, this funding model exposed councils to new financial risks which they were not always well equipped to deal with, for instance national revaluations and appeals, and dependence on a small number of large ratepayers.

2.6 It was critical that council finance officers sought out appropriate training and advice in preparation for business rates retention, and that they provided good quality professional advice to elected members when presenting budget proposals, for example ensuring that a prudent level of provisions and/or reserves should be set aside to mitigate such risks. Unfortunately, the Section 114 notice issued by Slough’s Section 151 officer in July 2021 highlights that “inadequate provision appears to have been made for NNDR, and the level of other provisions previously made also appears to have been insufficient”.

2.7 Whilst many councils took the responsible course of action to restructure their operating models, thereby cutting costs to maintain expenditure within the available funding envelope, some councils either failed to instigate transformation programmes, or they neglected to monitor progress thus allowing savings targets to slip. Non-delivery of transformation savings is cited in three of the ten Section 114 notices issued since 2020.

2.8 For other councils where there was limited means of generating sufficient additional income from local tax income, a high-risk commercial investment strategy was implemented which had the following consequences, especially in the case of Woking, Thurrock, and Slough:

- taking on unsustainable levels of debt out of kilter with the authority’s size
- not planning ahead for future interest rate increases
- setting aside insufficient resources for the repayment of debt (also known as Minimum Revenue Provision, or MRP)
- incorrectly charging revenue items to capital
- exposure to impairment of property values
- setting aside insufficient resources for repairs & maintenance of properties, often by over-estimating income streams

2.9 All councils, to a greater or less extent, are exposed to demand, inflationary and income pressures. In its most recent Section 114 notice, Nottingham City Council states that its financial challenges arise from the cost, volume, and complexity of need in adult social care, children’s social care, home to school transport and temporary accommodation, as well as pay and price inflation across the board.

2.10 Most councils with the same statutory functions would recognise this difficult situation, and where possible they would set aside adequate levels of reserves to provide a short-term solution whilst planning medium-term measures. However, the majority of councils which have had to issue Section 114 notices in recent years had not built-up prudent balances as a contingency, or they had failed to deliver recurrent savings to replenish those balances.

2.11 **Public Accounts Committee insights**

Some observers have raised concerns that the increasing backlog in external audits for local authorities is reducing both the effectiveness of external scrutiny and the ability to hold councils accountable. For instance, Meg Hillier, the Chair of the Commons Public Accounts Committee (PAC), said: “This lack of scrutiny of councils’ finances removes any early warning system for local authorities in financial difficulty. The implications for public services do not bear thinking about at both the local and national level, and for the lives of people who depend on them.”

A case in point is Slough. That council’s S114 notice was dated July 2021, in which it was stated that the accounts for the Council for 2018/19 were still to be signed off by external audit and 2019/20 and 2020/21 audits were not yet complete.

2.12 Having up to date audited accounts would allow external parties to place reliance on a council’s core financial statements and to scrutinise them for indicators of distress. Appendix 1 contains a link to an online news article which explores this issue in further detail.

Controls and safeguards place at SYMCA

2.13 The MCA has robust risk management processes in place which ensure that risks such as those identified in this report are assessed in a timely manner, with controls put in place to address them and further actions implemented where necessary. The three most relevant risks and associated controls are set out below.

2.14 <u>Financial health</u> (COR0012)

This risk arises due to a lack of quantum, breadth, and flexibility of funding to deliver on all activities. The following controls have been put in place:

- The MCA Group undertakes annual integrated business and budget planning to ensure resource is effectively aligned to priorities;
- The MCA Group undertakes cyclical budget monitoring to identify financial performance allowing for the reallocation of resource mid-year;
- The MCA has undertaken a significant reserve refresh re-deploying resource to known risks and holding a prudent amount of resource to mitigate financial shock;
- The MCA reports frequently to the Board and ensures partners remain apprised on financial matters through the Directors of Finance Group and Member budget engagement sessions;
- The MCA Group has developed a new medium term financial strategy forecasting the requirements for greater local financial contributions from partners;

- The MCA continues to lobby government for ongoing financial support to the public transport network and the continuation of capacity funding for core activity alongside other peer authorities;
- Exceptional treasury management performance has allowed for the creation of a new Capacity & Capability Reserve to sustain organisational resourcing and bridge inflationary pressures;
- New processes have been developed to support the management of Capacity and Feasibility Fund reserves. This allows greater focus on how reserves are deployed outside budget cycles.

2.15 <u>Borrowing leads to financial risk</u> (COR0013)

The following controls have been put in place to mitigate this risk:

- The MCA sets an Annual Treasury Management Strategy that is scrutinised by the Audit, Standards & Risk Committee and approved by Board. This governs its approach to borrowing and debt;
- The MCA ensures it has access to professional support via a contracted arrangement with Link Treasury Advisors, and internally through officers with appropriate qualifications;
- The MCA reports on its Treasury performance to Audit, Standards & Risk Committee and Board through a forward, backward, quarterly and mid-year review;
- The MCA has developed good working relationships with HM Treasury officers and negotiated a debt cap;
- The SY Directors of Finance Group has developed a number of principles around borrowing for the Investment Strategy activity.

2.16 <u>Constituent Authorities Experience Financial Pressures</u> (COR0025)

This risk could arise due to systemic cost pressures, funding challenges and financial shock, resulting in pressure on SYMCA to provide support, or loss of partner capacity to support SYMCA activity. The MCA mitigates this risk through controls such as monthly Place Liaison meetings, bi-monthly Director of Finance briefings, and close working relationships across programme management functions.

3. Options Considered and Recommended Proposal

3.1 Not applicable – this report is for information only.

4. Consultation on Proposal

4.1 Not applicable

5. Timetable and Accountability for Implementing this Decision

5.1 Not applicable.

6. Financial and Procurement Implications and Advice

6.1 The financial implications are set out in the main body of the report.

7. Legal Implications and Advice

7.1 The legal framework in relation to the issues set out in this report can be found in section 114 of the Local Government Finance Act 1988.

8. Human Resources Implications and Advice

8.1 Not applicable

9. Equality and Diversity Implications and Advice

9.1 Not applicable

10. Climate Change Implications and Advice

10.1 Not applicable

11. Information and Communication Technology Implications and Advice

11.1 Not applicable

12. Communications and Marketing Implications and Advice

12.1 Not applicable

List of Appendices Included:

None

Background Papers

None

Appendix 1

References

1. Article in Guardian on 6th November 2023; headline "Just 1% of English councils published audited accounts by deadline"

https://www.theguardian.com/society/2023/nov/06/just-1-of-english-councils-published-audited-accounts-by-deadline