

FINANCIAL RESILIENCE FRAMEWORK

1. Introduction

- 1.1 For Local Authorities generally, the measure of financial resilience has been to rely on in-year contingencies and its Reserves Policy.
- 1.2 The Council acknowledged, in the reports to the Urgent Business Committee and City Growth and Resources Committee in 2020, that financial resilience was a crucial aspect of financial management that became more important in times of crises, such as a global pandemic.
- 1.3 It was recognised that financial resilience was more than about its reserves and there was a need to be more comprehensive in the assessment of the measures of resilience. In the Medium Term Financial Strategy, approved on 28 October 2020 it was agreed that the Council's approach to financial resilience was to be developed further.
- 1.4 While the Covid-19 pandemic brought a specific focus to the subject, it was not the sole reason for further work. The ongoing national debate on the financial sustainability of the local government sector in Scotland, has followed on from the increasing number of local authorities in England in recent years that have found themselves in financial difficulty, resulting in Chief Financial Officers having to prepare formal s114 notices.¹
- 1.5 There has been greater emphasis from external auditors on the assurance and demonstration of the concept of 'going concern' for local authorities and this being a key area of audit activity now.
- 1.6 All of this adds up to the need for greater attention to be paid to the financial resilience of the Council and to consider what financial resilience is, how it is defined and measured and what it leads us to do.
- 1.7 The development of a financial resilience framework to shape the Council's understanding of key aspects of financial strength is the starting point and to define the areas that are most appropriate to consider. Further work will be done to develop this by looking at the comparators, where this applies, and also to consider in more detail the exposure the Council has from its Group entities.
- 1.8 The framework set out here is designed to be the first stage of addressing the instruction to the Chief Officer – Finance from the City Growth and Resources Committee to further develop the approach to financial resilience.

¹ Section 114 notices are the mechanism through which English local authorities report that they are unlikely to achieve a balanced budget for the financial year.

2. **Background**

- 2.1 The Council has always reviewed and paid attention to its usable reserves, those that it can draw on in a time of need. To this effect the Council has in place its Reserves Policy, which it reviews annually as part of the budget setting process. This is done in the context of assessing the level of reserves needed to meet estimated future expenditure when calculating the budget requirement. The Chief Officer - Finance is required, as part of the budget setting process each year, to provide a statement on the adequacy of reserves that is subject to an external audit review to assess value for money and a going concern opinion.
- 2.1 The Council keeps a level of reserves to protect against the risk of any uncertainties or unforeseen expenditure. This is considered best practice and demonstrates sound financial planning. Much like using savings to offset monthly household bills the use of financial reserves cannot solve a budget problem outright but allows for smoothing of impacts or allows the Council time to ride any short-term situations before returning to normal.
- 2.3 Therefore, reserves are mainly available to;
- ✓ Manage the impact of cuts over a longer period of time;
 - ✓ Invest in schemes that allow services to be delivered at lower cost;
 - ✓ Take “one-off hits” for the council as a whole without the need to further reduce service budgets;
 - ✓ Provide capacity to absorb any non-achievement of planned budget reductions in each year;
 - ✓ To temporarily roll over unused portions of grants that can legally be used at a later date;
 - ✓ To insure against major unexpected events (such as flooding);
 - ✓ To guard against general risk (such as changes in contingent liabilities);
 - ✓ To guard against emergent specific risks (such as a pandemic or financial crisis).
- 2.4 Financial resilience of the Council needs to be looked as a much wider subject as it is about our ability to anticipate, prepare for and respond to the changing financial environment, derived from internal decisions and external factors. To be financial resilient, is to know what would be available in the time of crisis, is to understand the exposure to loss of income, and commitment to expenditure, as well as understanding the flexibility the Council has in terms of accessing funds when they are needed.
- 2.5 In the Medium Term Financial Strategy financial resilience has been broken into the following four areas:
- Review of the Council’s Balance Sheet
 - Capital financing; investment, and borrowing
 - Build financial resilience and independence
 - Identify those that should pay by minimising fraud and avoidance

- 2.6 Maintaining a strong balance sheet provides the assurance that the Council is in a position to respond in the time of crisis, it can meet its obligations and provides confidence in the Council's ability to participate with our full range of stakeholders. They include our external auditors, our bond holders, credit rating agency, contractors and suppliers, and ALEOs.
- 2.7 Supporting our resilience in our balance sheet includes:
- In-year financial performance to manage the budget position, including cashflow;
 - An annual review of the balance sheet by our treasury advisors, with a focus on capital financing requirement, liquidity and long term borrowing;
 - Regular review of usable reserves and the appropriateness of sums earmarked; and
 - Regular review of provisions held.
- 2.8 Bringing all of this together to provide the information to the Council in a form that it can take account of in its decision making is an important next step. To inform that, further consideration has been given to the CIPFA Resilience Index that has been prepared with English Local Authorities, Moody's credit rating assessment reports and careful thought about what is important to the resilience of the Council, these areas will be refined to be more specific in due course.

3. **Proposal**

- 3.1 It is proposed to expand and redefine the components of financial resilience originally included in the MTFs. That expansion results in the following framework:
- Council reserves and liquidity (*the availability of resources*);
 - Reserves
 - Net Worth
 - Liquidity
 - In this section further work is anticipated regarding the Council exposure to its Group
 - Capital financing; investment, and borrowing (*the creation of resources and gearing*);
 - Capital Finance Requirement
 - Debt
 - Prudential indicators
 - Investment
 - Build financial resilience and independence (*the longevity and trends in resources*);
 - Top income streams
 - Top expenditure commitments
 - Operational Cashflow understanding
 - Exposure to areas of high demand (e.g. Adult and Children Social Care, Education)

- In this section further work is anticipated regarding the Council exposure to its Group
 - Identify those that should pay by minimising fraud and avoidance (*the security of resources*).
 - Counter fraud policy and procedure
 - Counter fraud resource
 - National Fraud Initiative
 - Internal and external audit assurance
- 3.2 The Council's financial resilience framework will sit within the Medium Term Financial Strategy and will be populated based on audited information up to 31 March 2021. The refreshed MTFS on 2 November 2021 will provide the first analysis of the framework.
- 3.3 The proposal is to obtain relevant information to measure the Council finances using the Financial Statements and additional information obtained from the audited Annual Accounts. This will provide the data to calculate a consistent set of relevant ratios that are important to measuring the strength and depth of the Council finances.
- 3.4 The intention is to go further and understand other aspects of the Council's financial position through the use of trend data to consider the impact of history and where possible to look forward based on Council approved plans and strategies.
- 3.5 The relevance and purpose of ratios needs to be carefully considered as they should all have a purpose. The proposal is to avoid simply listing lots of calculations just because they can be calculated, they will have a defined purpose. Examples of the type of ratio that are likely to be included are:

Financial Resilience Category	Potential Ratios/Measures
Availability of Resources	Usable Reserves / Net Revenue inc. HRA (%)
Availability of Resources	Net Worth / Net Direct & Indirect Debt (%)
Availability of Resources	Usable Reserves - GF / Net Revenue (%)
Availability of Resources	Usable Reserves - HRA / HRA Revenue (%)
Availability of Resources	Reserves Sustainability Measure
Availability of Resources	Level of Usable Reserves
Availability of Resources	Change in Usable Reserves
Availability of Resources	Council Tax Requirement / Net Revenue (%)
Availability of Resources	Unallocated Reserves
Availability of Resources	Earmarked Reserves
Availability of Resources	Change in Unallocated Reserves
Availability of Resources	Change in HRA Reserves
Availability of Resources	Current Ratio
Availability of Resources	Working Capital
Creation of Resources & Gearing	Net Direct & Indirect Debt / Net Revenue inc. HRA (%)

Creation of Resources & Gearing	Capital Financing Requirement / Net Revenue inc. HRA (%)
Creation of Resources & Gearing	Short-Term Direct Debt / Direct Debt (%)
Creation of Resources & Gearing	Capital Financing Requirement / Total Gross Income (%)
Creation of Resources & Gearing	Capital Financing Requirement - GF / Net Revenue (%)
Creation of Resources & Gearing	Capital Financing Requirement - HRA / HRA Revenue (%)
Creation of Resources & Gearing	Interest Payments - GF / Net Revenue (%)
Creation of Resources & Gearing	Interest Payments - HRA / HRA Revenue (%)
Creation of Resources & Gearing	Interest Payments / Net Revenue inc. HRA (%)
Creation of Resources & Gearing	Gross External Debt
Longevity and Trends in Resources	Adult Social Care Ratio
Longevity and Trends in Resources	Children Social Care Ratio
Longevity and Trends in Resources	Education Ratio

- 3.6 The data on income and expenditure trends will be taken from audited Annual Accounts, budgets, CIPFA and Scottish Government returns, the contracts register and Scottish Government finance circulars.
- 3.7 For the purposes of materiality and relevance, the proposal is to focus on the 'top 20' income streams and expenditure commitments that the Council has, based on value.
- 3.8 Security of resources will rely on the three lines of defence in the Risk Assurance Maps, including findings and the opinion of internal and external auditors.

4. **Using the Financial Resilience Framework**

- 4.1 Financial resilience ratios, trends and data collated to support a comprehensive view of the Council is not about there being one answer, nor is it about a statement of right or wrong. Instead, it is about providing context for decision making and planning. Through having the understanding of other aspects of Council finance I expect the Council to be able to consider more than simply balancing the budget. This might include decisions to grow reserves or address an adverse trend in expenditure commitments or reduce borrowing. This will assist the Council to be well informed and can make the choices it is entitled to make.

- 4.2 Councils have a very long history and decisions have been taken at different times for different reasons both at a local and national government level that leaves each Council today in the situation it is. Therefore, every Council is in a different position, no two Councils will have experienced the same history and it is inevitable the financial resilience of all will be different.
- 4.3 The financial resilience framework proposed should, in my view, be used as the basis for understanding the underlying financial position of the Council, from which decisions have to be taken, to provide the basis for highlighting where action is required or where it should be considered. The opportunity to get an insight into aspects of Council finance that may only emerge over time and that on an annual cycle could be overlooked or not given sufficient consideration.
- 4.4 I see some ratios having a direct impact on the short-term financial planning of the Council, while other being considered with aspiration and objectives stretching out over the medium to long term.
- 4.5 The data can act as triggers for action, with the final chosen ratios, where appropriate, to have in place some parameters to define or describe the urgency, scale and pace of action that is required. As the information accumulates then it can act as an early warning of emerging pressures.
- 4.6 As noted above the first set of Council figures will be incorporated into the Council's MTFs, being prepared for the City Growth and Resources Committee on 2 November 2021.

5. **Future development**

- 5.1 As referred to above, the Council has group entities that are incorporated into its accounts and therefore holds risk and reward from the relationships that it has. Given the impact of the pandemic on the group entities, I propose that over the next year, in conjunction with them, we do further work to understand the relevant exposure that the Council has to each and to document this in an appropriate way.
- 5.2 The ambition is that with further development and engagement with stakeholders in Scotland, and by using information from a common data set, prepared using the same accounting standards it gives the opportunity to compare the Council with its peers. I will update the Committee as this moves forward.