Risk control

Section 114 Notices

In partnership with

GALLAGHER BASSETT
GUIDE. GUARD. GO BEYOND.

Risk Management Partners
rmpartners.co.uk

Section 114 Notices

Introduction

On 5th September 2023 Birmingham City Council issued a Section 114 Notice. This decision was made as the local authority anticipated a disparity of approximately £87 million between its income and projected expenditure for the financial year[1].

They are by no means the first authority to issue a Section 114 Notice and are unlikely to be the last in the current financial climate, with one report suggesting that nearly one in ten local authorities in England fear becoming insolvent in the preceding twelve months period[2].

Although there may be a tendency amongst sections of the media to use words such as 'bankruptcy' during such events, local authorities cannot become bankrupt as commercial enterprises or individuals can. Instead, they utilise a Section 114 Notice, which is a report from the authority's Chief Finance Officer indicating that they anticipate engaging in expenditure that is deemed unlawful under the Local Government Finance Act 1988[3].

This unlawful expenditure can occur due to various reasons, but the main cause for issuing a Section 114 Notice is when authorities project that their expenses will surpass their income for a specific fiscal year, which is prohibited by the 1988 Act. In these circumstances, the Chief Finance Officer maintains a statutory duty to act.

Once the Chief Finance Officer (the Officer) issues a Section 114 Notice, the authority is prohibited from initiating new expenditures unless authorised by the Officer. Subsequently, the authority's leadership must convene a meeting within 21 days of the notice being issued to deliberate on strategies for aligning expenditure with available funding. Elected members, officers, and central government representatives will seek to explore various alternatives to balance the budget for the year.

In the case of Birmingham City Council, the local authority was forced to agree to a package of 'devastating' cuts to services and a 21% rise in Council Tax over two years to return to a balanced budget[4].

External Factors

Some specific external factors that can contribute to financial difficulties within local authorities including:

— **Reduced funding**: local authorities heavily depend on funding from central government to deliver essential services. However, in recent years, there have been substantial reductions in local government funding as part of austerity measures implemented to combat deteriorating national economic conditions. This decrease in funding places a strain on local authority budgets and creates challenges in sustaining services

— **Increasing demands**: local authorities have the responsibility of delivering a diverse range of statutory services, such as social care, education, housing, and waste management. The demand for these services has been on increasing due to factors such as the aging population and rising population numbers. Meeting these increasing demands within the confines of budget constraints can create financial strain

— **Rising costs**: local authorities have encountered significant cost increases over recent times, including employee salaries, pensions, energy, and infrastructure maintenance. These mounting expenses can surpass revenue growth, creating pressure on the local authority's finances

— **Local economic factors**: Economic factors unique to a specific region can influence the financial stability of a local authority. For example, if a local authority heavily depends on an industry in decline or witnesses a decrease in business activity, it can have repercussions on tax revenues and result in financial challenges

Governance Factors

After studying the financial failures that led to the issuance of Section 114 Notices at Northamptonshire Council, Croydon Council, and Slough Borough Council, CIPFA[5] identified some common governance factors that led to the financial difficulties:

— **Over-ambitious savings**: there were indications of excessively ambitious savings goals, which was particularly worrisome considering past records demonstrated a failure to achieve the targeted savings

— **Lack of a medium-term financial planning**: medium-term planning demonstrates a comprehension and commitment to ensuring financial sustainability

— **Leadership changes**: given the growing difficulty of achieving financial sustainability, it is crucial for leadership teams to collaborate effectively. It is worth noting that organisations that have undergone government interventions have often witnessed changes at the senior level

— **Inadequate governance**: the severity of the financial issues suggests a significant lack of oversight, with Audit and Governance Committees failing to fulfil their responsibilities and roles being poorly understood

- **Weak financial management**: the significance of strong financial management in terms of reporting and monitoring offers reassurance and substantiates the effectiveness of budgetary decision-making
- **Lack of reserves**: amidst the persistently challenging economic climate, organisations with minimal or no reserves encounter heightened risks

Costs to Society

When a local authority issues a Section 114 notice, it signifies that it is in a severe financial position and is unable to meet its financial obligations. The costs to society after such a notice can be significant and wide-ranging. Some potential costs include:

- **Service cuts**: As was the case with Birmingham City Council, to address a financial crisis the affected local authority may be forced to make substantial cuts to public services. Reduced services can have a direct negative impact on the quality of life for residents and the overall well-being of communities
- **Staff redundancies**: To reduce expenses, the local authority might have to consider reducing its workforce or implementing a hiring moratorium. Consequently, local authority employees could face job cuts, which could contribute to higher unemployment rates and potentially cause financial difficulties for those affected
- **Vulnerable populations**: Disproportionate impacts can be observed when service cuts primarily affect vulnerable populations, including the elderly, disabled, or low-income individuals who heavily depend on local authority services. When social care or support programs are reduced, these individuals may be left without crucial assistance, potentially worsening social inequalities and placing additional strain on other inter-related support systems
- **Delayed infrastructure project**s: The local authority may be compelled to delay or cancel scheduled infrastructure projects due to financial limitations. This can hinder economic progress, restrict job opportunities, and impede the enhancement of public amenities and services
- **Reputation and confidence**: The issuance of a Section 114 notice has the potential to harm the local authority's reputation and undermine investor confidence within the local area. Consequently, this can pose difficulties in attracting investment, obtaining funding for future projects, and impede long-term economic growth
- **Legal and financial**: The local authority could encounter legal obstacles, including lawsuits from creditors or compensation claims from individuals adversely impacted by service reductions. Moreover, the council's capacity to borrow funds or obtain credit may be curtailed, thereby further constraining its financial alternatives.

Overall, the consequences for society following the issuance of a Section 114 notice by a local authority can be significant. These repercussions affect various aspects, including the provision of public services, employment, vulnerable communities, economic progress, and the council's financial stability. This emphasises the crucial role of efficient financial management and planning to prevent such crises and safeguard the welfare of communities.

Preventative Actions

CIPFA[5] offers some practical advice to local authorities on how to improve financial resilience and the preventative actions to take. This includes:

- **Robust budgeting and forecasting**: local authorities should develop realistic budgets and regularly review and update their financial forecasts. This includes considering potential risks and uncertainties that may impact their financial position
- **Effective financial monitoring**: regular monitoring of financial performance is crucial to identifying any emerging issues or potential deficits. This involves closely tracking income and expenditure, as well as key financial indicators, to ensure that the authority remains on track
- **Contingency planning**: local authorities should have contingency plans in place to address potential financial shortfalls. This may involve identifying areas where expenditure can be reduced or exploring alternative sources of funding
- **Commercial risk management**: there should be a clear understanding of the risks associated with commercial activities, and effective supervision of council-owned companies
- **Savings strategies**: budget holders should actively participate in identifying and implementing effective savings strategies
- **Enhanced understanding**: elected members should undergo training on financial matters to enhance their comprehension of complex financial issues
- **Effective governance**: governance arrangements should be reinforced to include the capacity to express honest opinions and advice to those in positions of authority
- **Audit**: Internal Audit should assess the efficiency of financial rules and processes, as well as the understanding and adherence to financial regulations

— **Financial management**: an assessment should be made of the quality of financial management established within the local authority

— **Independent assurance**: gaining independent assurance on the annual governance statement can help to ensure it is effective

— **Financial resilience**: undertaking a financial resilience review can be an effective approach to gaining a comprehensive understanding of the broader financial position

Recovery Plan

Managing a financial crisis requires careful planning and strategic decision-making. Here are some steps that local authorities can consider to effectively manage a financial crisis:

— **Assess the situation**: conduct a comprehensive evaluation of the financial situation, encompassing the identification of underlying causes of the crisis, a thorough understanding of the extent of the financial deficit, and an assessment of the impact on services and stakeholders

— **Develop a financial recovery plan**: develop an all-encompassing recovery plan that delineates precise actions and measures to tackle the crisis. This plan should encompass strategies to curtail expenses, augment revenue, and enhance financial management practices

— **Prioritise essential services**: use a risk-based approach to determine and give priority to vital services that must be upheld despite any financial limitations. This guarantees the protection and uninterrupted provision of crucial services that cater to the community's needs

— **Engage stakeholders**: engage key stakeholders, including residents, employees, and community organisations, in the decision-making process. Encourage their input, ensure transparent communication regarding financial challenges, and foster collaboration to discover innovative solutions

— **Explore efficiency measures**: seek out possibilities to streamline operations and enhance efficiency. This could entail reviewing contracts, renegotiating agreements, or implementing technological solutions to automate processes

— **Seek external support**: establish connections with central government, other local authorities, and relevant agencies to seek support and guidance. They can potentially offer financial assistance, expertise, or access to resources that can aid navigation through the crisis

— **Communicate effectively**: sustain open and transparent communication with all stakeholders throughout the crisis. Regularly update stakeholders on the progress of the recovery plan, address any concerns, and effectively manage expectations

— **Monitor and review progress**: consistently monitor the execution of the recovery plan and periodically assess its effectiveness. Make necessary adjustments to ensure effective management of the financial crisis and steady progress towards achieving financial stability.

By adhering to these steps, local authorities can potentially navigate a financial crisis with greater effectiveness, mitigate the impact on services and stakeholders, and strive towards achieving long-term financial sustainability.

References

1. Statement regarding Section 114 notice. Birmingham City Council. Available here: https://www.birmingham.gov.uk/news/article/1381/statement_regarding_section_114_notice
2. The State of Local Government Finance in England 2024. the Local Government Information Unit (LGIU). Available here: https://lgiu.org/wp-content/uploads/2024/02/State-of-Local-Government-Finance-in-England-2024.pdf
3. The Local Government Finance Act 1988. Available at: https://www.legislation.gov.uk/ukpga/1988/41/contents
4. Birmingham City Council signs off 'devastating' cuts. BBC News. Available at: https://www.bbc.co.uk/news/uk-england-birmingham-68483264
5. Learning lessons: what Section 114 can teach us. CIPFA. Available here: https://www.cipfa.org/cipfa-thinks/insight/learning-lessons-what-section-114-can-teach-us

Further information

For access to further RMP Resources you may find helpful in reducing your organisation's cost of risk, please access the RMP Resources or RMP Articles pages on our website. To join the debate follow us on our LinkedIn page.

Get in touch

For more information, please contact your broker, RMP risk control consultant or account director.

contact@rmpartners.co.uk

Risk Management Partners

The Walbrook Building
25 Walbrook
London EC4N 8AW

020 7204 1800
rmpartners.co.uk

FP414-2025