Appendix 2 - Financial Ratios - Definitions and Drawbacks

Working Capital as % of Gross Revenue Expenditure

Working capital is defined as current assets less current liabilities. This indicator measures the authority's ability to cover existing expenditure from working capital. Authorities with strongly positive indicators would have little difficulty liquidating sufficient assets to continue to operate in the event of a cash flow crisis; authorities with negative indicators may have to borrow to carry on, incurring additional costs.

This is unlikely to be a risk for Local Authorities given their ability to obtain short-term borrowing but it does act as an indicator of how an authority manages its short-term finances.

Drawbacks of Measure
Position is at one point in time. Inclusion of assets held for sale (Property to be sold in the following year) in the measure could distort comparison between years and with other authorities.

Reserves as % of Gross Revenue Expenditure

This measure indicates the level of funds authorities are retaining for future plans and unforeseen expenditure. Reserves have been split into three distinct indicators as follows.

Useable Reserves - for purposes of this indicator, usable reserves include earmarked reserves, unallocated/general reserves and capital receipts. They include both Housing Revenue Account (HRA) and Schools Balances which have restrictions on use.

Earmarked Reserves - amounts set aside to be used to meet specific, known or predicted future expenditure. The indicators exclude HRA and schools balances.

Unallocated / General Reserves - amounts held to cushion the impact of unexpected events or emergencies. The indicator excludes the HRA Balance

Drawbacks of Measure
Comparison between years is difficult due to transfers in / out of settlement. Different reserves may have been set aside to meet different exposures / levels of risk. Capital receipts are included in the measure but not usable for revenue purposes.

Long-term Borrowing to Long-term Assets

This ratio measures the relationship between a Council's long-term borrowing and long-term assets.

Drawbacks of Measure
This measure looks at whether assets could be disposed of to pay off borrowing. This is in most cases not possible. In addition, authorities may have or be in different phases of their fixed asset revaluation cycles. Valuations and accounting practice has a big impact on this ratio. Some authorities may have a Housing Revenue Account (HRA), others not. A subsidy buy out took place in 2015/16 which resulted in significant change and levels of borrowing for those authorities with a housing stock.

Treasury management strategies e.g. level of internal borrowing will impact on the ratio, so a better choice for the numerator could be the level of Capital Financing Requirement (CFR), which is a measure of capital expenditure incurred but not yet paid for.

Long-term Borrowing to Taxation and Non-Specific Grant Income

This ratio measures the relationship between an authority's long-term borrowing (as defined in the previous section) and its income from taxation and non-specific grants. It provides an indication of the potential for debt repayments to impact on future spending plans. In this analysis, income includes:

- Council tax income
- Revenue Support Grant from Government
- Distributed Non-domestic rates income
- Non-specific grant income

Drawbacks of Measure
Impacted on by Treasury Strategies and timing of borrowing decisions, so again use of CFR may have been better. Ratio likely to be significantly influenced by movements in / out of the settlement. Considers the level of borrowing rather than the cost of servicing that borrowing, which is one of the required prudential indicators, which itself has some limitations. Protected services and other impacts mean that some income cannot be utilised for other purposes such as capital financing costs. i.e. the ratio does not distinguish between controllable and non controllable income. A subsidy buy out took place in 2015/16 which resulted in significant change to levels of borrowing.
The WG calculation of income includes capital grants and other external contributions in year towards capital expenditure. These may vary significantly between years, however the calculation of income excludes rent income, whilst HRA borrowing is included in long term borrowing.

Council Tax as % of Taxation and Non-Specific Grant Income

This ratio measures how much council tax contributes to taxation and non-specific grant income.

Drawbacks of Measure
This does not take into account other income which may be a significant way for some Council's to lower Council Tax figures. The WG calculation of income includes capital grants and other external contributions in year towards capital expenditure. These may vary significantly between years