5.2 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.

Six authorities in Wales in 2014-15 had negative indicators due to low levels of current assets compared to current liabilities. Three authorities in Wales had an indicator greater than 20% in 2014-15. Cardiff's ratio was 4.9% for both years, slightly lower than the Welsh average for those years of 6.2% and 6.8% respectively.

Drawbacks of Measure
Position is at one point in time. Inclusion of assets held for sale (Property to be sold) 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. Note, this excludes those reserves which are restricted for use by the authorities i.e. HRA balances, schools' balances, capital grants unapplied and, where identified, the group entities and interests. 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.

The average % of reserves to gross revenue expenditure for Wales in 2014-15 was 17%. Nine authorities in 2014-15 had a % greater than 20%. Cardiff's ratio was low in comparison at 6% in 2014-15, the lowest in Wales.

Earmarked Reserves
The average % of earmarked reserves to gross revenue expenditure for Wales in 2014-15 was 12%. Seven authorities in 2014-15 had a percentage greater than 15%. Cardiff's ratio for 2014-15 was 4%, the second lowest in Wales.

Unallocated / General Reserves
The number of day's turnover covered by unallocated reserves for Wales in 2014-15 was 10. Three authorities had more than 15 days turnover cover. Figure for Cardiff was 6 days, with only one authority lower with 3.4 days.

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.

In 2014-15 one authority had long-term debt less than 16% of the value of their long-term assets and six authorities had long-term debt, which exceeded 30% of the value of their long-term assets. Cardiff's ratio in 2014-15 was in line with the Welsh average of 25%.

Drawbacks of Measure
The measure is aimed to suggest 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 revaluation cycles. Valuations and accounting practice has a big impact on this ratio e.g. Infrastructure assets change will have a massive impact. Some authorities may have a HRA, others not. Subsidy buy out borrowing will result in a significant change during 2015-16.
Treasury management strategies e.g. level of internal borrowing will impact on ratio, so a better choice for the numerator could have been the level of Capital Financing Requirement (CFR).

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 and 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
- Non-domestic rates income
- Non-specific grant income (included in the CI&E of the WGA return)

Two authorities had long-term debt less than 40%. Thirteen authorities had long-term debt exceeding 60% of their taxation and non-specific grant income. Cardiff's ratio in 2014-15 was the fourth highest at 75%.

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 we know 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. Subsidy buy out borrowing will result in a significant change during 2015-16.

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.

One Local Authority's council tax income accounted for more than 30%. Four authorities in Wales had council tax income, which accounted for less than 20% of their taxation and non-specific grant income. Cardiff's ratio was 26%, compared to the Welsh average of 23%.

<u>Drawbacks of Measure</u>
Does not take into account other income which may be a significant way for some Council's to lower Council Tax figures.