READING BOROUGH COUNCIL

REPORT BY EXECUTIVE DIRECTOR OF RESOURCES

TO:	**Council**		
DATE:	**25th February 2020**		
TITLE:	**CHIEF FINANCE OFFICER'S REPORT ON THE ROBUSTNESS OF THE COUNCIL'S 2020/21 BUDGET**		
LEAD COUNCILLOR:		**PORTFOLIO:**	
SERVICE:	**Directorate of Resources**	**LEAD OFFICER:**	**Jacqueline Yates**
JOB TITLE:	**Executive Director of Resources & Section 151 Officer**	**E-MAIL:**	**Jackie.Yates@reading.gov.uk**

1. PURPOSE OF THE REPORT AND EXECUTIVE SUMMARY

1.1 Under Section 25 of the Local Government Act 2003 there is a requirement for the Council's Chief Financial Officer (Executive Director of Resources) to report to Council on:

a. The robustness of the estimates made for the purposes of the calculations of the budget; and

b. The adequacy of the proposed level of financial reserves.

Council in considering its Budget should have regard to this advice

2. RECOMMENDED ACTION

2.1 That Council notes this report in setting its budget for 2020/21 and indicative budgets for the subsequent two financial years 2021/22 and 2022/23:

APPENDICIES: Appendix 1 Statement of Reserves and Balances

3. POLICY CONTEXT

3.1 As outlined in the Medium Term Financial Strategy and budget report which appears elsewhere on the Agenda, the Council faces a number of significant uncertainties going forward in relation to the outcomes of the Fair Funding Review, Business Rates retention post 2020/2021, any replacement for New Homes Bonus and Brexit. Their impact on income streams and service costs could be significant.

3.2 As a Unitary authority the Council provides the broadest possible range of services and has an inherently higher level of risk than many other authorities simply due to the complexity and nature of the services it provides. Additionally,

the Council has taken policy decisions to establish several alternate delivery models including wholly owned companies and PFI arrangements which whilst having advantages also have the potential to increase the Council's risk profile.

3.3 In October 2019 the Chartered Institute of Public and Finance and Accountancy (CIPFA) launched a new Financial Management (FM) Code in response to the fact that the well documented financial difficulties faced by some authorities had revealed concerns about fundamental weaknesses in financial management, jeopardising their ability to maintain services into the future. The FM Code is designed to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability. The first full year of compliance with the Code will be 2021/22, with 2020/21 being a shadow year. It is not yet clear what the required reporting requirements will be, but they will be advised once they are known. A self- assessment against the Code will be reported at the end of Q1 2020/21 to the Audit and Governance Committee.

3.4 The Council's 2016/17 accounts were signed off by the Council's External Auditors in July 2019 and the audit of the 2017/18 accounts is in progress. The 2018/19 accounts have also been prepared and are expected to be handed over to the auditors before the end of February 2019. The issues experienced with closing the 2016/17 accounts had a direct impact on the Council's ability to prepare its 2017/18 and 2018/19 accounts in a timely way and have increased the Council's risk profile from an audit perspective. However, it is not anticipated that the delay in signing off the Council's 2017/18 and 2018/19 accounts will impact on either the 2020/21 budget or MTFS.

4. ROBUSTNESS OF THE ESTIMATES

Approach to and Assumptions within the 2020/21 Budget and Medium Term Financial Strategy

4.1 The Council has taken a prudent approach to developing its Medium Term Financial Strategy (MTFS). All savings and pressures previously identified within the February 2019 MTFS have been reviewed and amendments made where appropriate.

4.2 All aspects of the Council's budget, efficiency savings, additional income, service reductions and pressures have been subject to review, with Assistant Directors being required to review the plans they put forward in previous years and confirm delivery of the proposals or, put forward business cases for change where necessary. Budget proposals have subsequently been reviewed by:

- The Finance Team
- Corporate Management Team
- Lead Councillors

4.3 The Council's Housing Revenue Account and Capital Programme have been through similar review processes.

4.4 The assumptions on which the MTFS is based are contained within the main budget report, however, key assumptions include:

- **Council Tax increase**- 3.99% per annum for 2020/21 with 1.99% thereafter. This is below the 2020/21 referendum level of 2% and includes an additional 2% for a social care precept (assumed to be applied in the Governments core spending power calculation).
- **Finance Settlement** – The figures are as per the Government's Final Settlement announcement
- **Pay Assumptions** – 2% per annum
- **Inflation** – Non pay budgets have been increased where necessary in order to maintain service levels by either CPI (assumed at 2% over the period) or as contractually specified
- **Provisions** - There are adequate provisions for bad debts and appeals against business rates valuations

4.5 To deliver the Council's policy priorities and a balanced budget in each year of its MTFS 2020/21 - 2022/23 savings of £32.9m are required over the period (£8.2m to be delivered in partnership with Brighter Futures for Children and £24.7m from retained Council services). To facilitate the delivery of service efficiencies and ongoing revenue savings transformation funding of £4.5m has been provided for within the General Fund Capital Programme funded from the 'flexible use of capital receipts. In addition, Brighter Futures for Children are in discussions with the Department for Education about the potential for them to fund further transformation.

4.6 The continued need to deliver a high level of savings poses an inherent risk to the delivery of a balanced budget position as over time they become more complex and difficult to deliver. Consequently, it is important there is continued focus on savings delivery to ensure they are delivered as planned. Contingency sums of £3.5m, £4.9m and £5.2m have been allowed for across the period of the Plan to mitigate any potential shortfall or slippage in the delivery of higher risk savings.

4.7 The Council has an ambitious Capital Programme over the next three years totalling £358.3m (£296.4m General Fund and £61.9m Housing Revenue Account). The net cost of which (after the application of specific grants and contributions) is predominantly funded from borrowing. The Council's external borrowing is projected to increase to £631.3 million over the period. The associated capital financing costs together with the revenue implications of the specific schemes are provided for within the relevant revenue accounts.

4.8 It is imperative that close monitoring of the Capital Programme takes place to ensure projects are delivered to time and budget so that borrowing costs do not increase beyond what is provided for within revenue budgets.

Financial Management

4.9 All reports to members have the associated financial implications identified within the report. Monitoring of the budget throughout the year is undertaken by Financial Services in conjunction with Assistant Directors and Budget/Project Managers. When budget pressures do emerge, it is the responsibility of the service area to contain them in the first instance, failing that they should be managed within the Directorate and ultimately at a corporate level. If pressures

remain at year end in excess of the contingency sum, reserves will reduce and subsequently need to be replenished.

4.10 Comprehensive budget monitoring reports are considered by the Council's Corporate Management Team on a monthly basis and quarterly performance reports are presented to the Council's Policy Committee.

4.11 Recognising the significant level of transformation and savings required to deliver a balanced budget and MTFS a series of Programme Boards; (each chaired by a member of the Corporate Management Team) was set up in 2018/19 to manage and track transformation delivery. A review of the Board Structure, their terms of reference and membership is currently underway to ensure they remain fit for purpose.

4.12 In recent years the Council has experienced significant overspends in demand led budgets. In 2017/18 these overspends reduced significantly with Adult Social Care (ASC) delivering to budget and Children's services reducing its overspend by half. In the current year the latest outturn forecast (as at the end of quarter 3) is similar, with ASC projecting a small underspend at year end and Children's services a similar level of overspend to 2018/19 (£1.6m).

4.13 As a result of containing pressures and the delivery of savings which enabled the release of contingency budgets the Council underspent against budget in both 2017/18 and 2018/19. This meant the Council only had to draw down £1.2m from reserves rather than the £4.3m budgeted for in 2017/18. In 2018/19, the overall outturn position was a £3.2m underspend, £0.5m was transferred to general reserves and £2.7m to earmarked reserves bringing them back to more sustainable levels. As at the end of quarter 3 2019/20 the Council is projecting an underspend of £3.1m.

Insurance and Risk Management

4.14 The Council's Insurance arrangements are a mix of external premiums and internal self insurance funds. An external review of the Council's Insurance Reserve was undertaken in 2018/19 and concluded the reserve was sufficient.

4.15 The Council has an internal risk manager and strategic risk management is being embedded across the Council.

5. ADEQUACY OF RESERVES AND BALANCES

5.1 The prudent level of reserves a Council should maintain is a matter of judgement. The consequence of not having adequate reserves can be significant. In the event of a serious problem or a series of events, the Council could run the risk of a deficit or be forced to cut expenditure in a damaging or arbitrary way should reserves not be available.

5.2 The Council drew heavily on its reserves in 2016/17 (£12.5m). However, due to the delivery of £25.1m savings over the two years 2017/18 and 2018/19 and the consequent release of contingency sums, as well as the benefit of having been part of the Berkshire Business Rates Pilot in both the current and prior two years,

the Council has not had to draw on reserves to the levels previously anticipated and reserves have been resourced back to more sustainable levels.

Going forward the Council faces significant financial uncertainty in terms of Business Rates Retention, the Fair Funding Review and Brexit. There is also an ongoing need to manage the considerable demand pressures on Children's services and Adult Social Care and realise service transformation. Additionally, the unions have recently rejected the employers pay offer and are claiming 8% more than has been budgeted for. Consequently, for this authority the Section 151 Officer recommends that the level of working balance for the General Fund should be in the region of £7.5 million or 5% of net revenue expenditure.

5.3 In addition to the working balance the Council holds earmarked reserves, these include:

- Ring fenced accounts funded by third parties which must be repaid if not used for the purposes specified, e.g. grants
- Reserves which have a statutory limitation as to their use, such as Schools Balances, Dedicated Schools Grant and Housing Revenue Account reserves
- Accounts it is considered prudent to set aside for specific purposes, e.g. the Insurance Fund, Schools Deficits which will crystalize on academisation
- Committed but unspent budgeted amounts carried forward at the end of the financial year to deliver specific projects

In total the Council's General Fund earmarked reserves and working balance are forecast to be in the region of £45.5 million at 31st March 2020. A full schedule of reserves and balances including those which are ring fenced to the Housing Revenue Account and Schools is attached at Appendix 1 together with an explanation as to their intended use. It should be noted that the earmarked reserves figures are indicative and will change depending on how quickly associated expenditure is incurred.

5.4 CIPFA have stated that there should be no imposed limit on the level or nature of balances required to be held by an individual Council. However, in light of recent high profile failures and funding concerns being raised by authorities they have launched a financial resilience index which uses a basket of indicators to measure individual authorities financial resilience compared to their comparators. Key indicators include:

- The current level of reserves held compared to the average change over the last three years
- The level of reserves held (excluding Public Health and School reserves) as a percentage of net revenue expenditure
- The average change in reserves over the last three years excluding Public Health and School reserves
- The total cost of Adult & Children's social care as a percentage of the Council's net revenue expenditure
- The level of external interest payable by the Council compared to net revenue expenditure
- The level of external debt held by the Council
- Council Tax requirement compared to net revenue expenditure

- The level of fees and charges income as a proportion of total service expenditure
- Growth above baseline
- OFSTED rating
- Auditors value for money conclusion

5.5 Based on the latest data available, the Council's reserves position is now around the average compared to all unitary authorities, which is a significant improvement from the 2017/18 position. Whilst the risk ratings allocated by CIPFA are relative to other Unitary authorities, it does not necessarily follow that the Council is at a higher risk. Areas where the index highlights there is comparatively more risk include:

- **The level of external interest payable by the Council compared to net revenue expenditure and the level of external debt held by the Council** - These 2 index scores highlight that the Council has higher levels of external debt to fund its Capital Programme, and therefore also has higher levels of external interest payable than the average unitary authority as a proportion of its net revenue budget. However, the revenue costs of this external interest have been modelled and budgeted for in the 2020-2023 Medium Term Financial Strategy. The levels of external debt are also assessed as part of the Council's Capital Financing Requirement set out within The Treasury Management Strategy (included elsewhere on the agenda) and the Council continues to maintain an "under borrowed" position. Therefore, the potential risk suggested by these index scores is not considered to be of particular concern.
- **The total cost of Adult & Children's social care as a percentage of the Council's net revenue expenditure -** This index score is consistent with the position of other upper tier councils nationally due to ongoing pressures in respect of social care. Central Government has recognised social care as a significant cost pressure and has attempted to address this for 2020/21 by allocating new one-off social care grant funding to councils, as well as offering the facility to increase Council Tax via the Adult Social Care Precept, which have both been included in the 2020-2023 Medium Term Financial Strategy. It is hoped that the pending Fair Funding Review will attempt to address these cost pressures on a recurring and longer term basis.
- **Growth above baseline** - This index compares the total baseline funding level of the Council with retained business rates income. This index is showing as higher risk due to the Council having been part of the Berkshire business rates pilot pooling arrangement which generates a high amount of business rates income compared to other unitary authorities suggesting a high reliance on this funding source. However, the level of business rates included in the 2020-2023 Medium Term Financial Strategy makes no assumption that the pool will continue, and a prudent approach has been taken in respect of future year growth; whilst recognising that Reading is in a relatively buoyant area for continued business rates growth.

6. CONCLUSIONS

6.1 Considering all of the above, the Council has taken a prudent approach to setting its budget and I would conclude that:

- The process for the formulation of General Fund, HRA and Capital budgets provides for a reasonable assurance of their robustness;
- The level of contingencies provided for slippage in, or non-delivery of higher risk savings is prudent;
- The provision of a transformation fund funded from the 'flexible use of capital receipts' facilitates the ongoing delivery of required savings; and
- The level of the Council's total reserves have moved back to more sustainable levels and are sufficient to provide for:
    - A working balance to cushion the impact of unexpected events or uneven cash flows; and
    - The setting aside of funds to meet known or anticipated liabilities (earmarked reserves).
    - A base budget at the end of the three year MTFS period that does not expose the Council to an underlying use of reserves.

7. LEGAL IMPLICATIONS

7.1 The Council has a legal requirement to set a balanced budget. In agreeing its' budget Council is required to consider the report of its S151 Officer as set out in paragraph 1.1 above.

8. FINANCIAL IMPLICATIONS

8.1 These are set out in the body of the report.

9. EQUALITIES IMPLICATIONS

9.1 There are no Equalities Implications arising directly from this report.

10. ENVIRONMENTAL IMPLICATIONS

There are no environmental implications arising directly from this report.

11. BACKGROUND PAPERS:

Budget Papers
Q3 Performance Report
CIPFA's Financial Management Code
CIPFA's Financial Resilience Index

Summary of Estimated Reserve Movements 31.03.20 - 31.03.23

Appendix 1

		Balance 31.03.20 £ '000	Movement in year £ '000	Balance 31.03.21 £ '000	Movement in year £ '000	Balance 31.03.22 £ '000	Movement in year £ '000	Balance 31.03.23 £ '000
General Fund Balance	Minimum level of unallocated reserves, 5% of net revenue budget	**(7,500)**	**0**	**(7,500)**	**0**	**(7,500)**	**0**	**(7,500)**
Earmarked Reserves-General Fund								
Emergency Planning/Brexit Reserve	To cover for unforseen emergencies not budgeted for and costs arising from Brexit	(715)	0	(715)	0	(715)	0	(715)
Other Reserves	A variety of small reserves held to cover future unforseen expenditure	(108)	0	(108)	0	(108)	0	(108)
Communications Reserve	To allow for investment in communications strategies and engaging with the public	(175)	50	(125)	50	(75)	0	(75)
Housing Benefit Subsidy Loss Reserve	To provide for any potential clawback from central government of housing benefit subsidy following audit of the annual housing subsidy claim.	(300)	(150)	(450)	(150)	(600)	0	(600)
Public Health	The Public Health Grant is ring-fenced so any underspend is carried forward and spent in future years	(420)	0	(420)	0	(420)	0	(420)
Schools Deficit Liability	To fund potential deficits of schools that may become academies in the future	(850)	0	(850)	0	(850)	0	(850)
Climate Change	To allow for investment to address the climate emergency	(250)	250	0	0	0	0	0
Legal and Taxation Reserve	To meet potential one-off legal or tax liabilities	(300)	0	(300)	0	(300)	0	(300)
Organisational Change	To help meet the cost of the Council's change programmes that cannot be charged to capital	(3,095)	(392)	(3,487)	(623)	(4,110)	(623)	(4,733)
Pension Liabilities	To cover potential future Pension Fund liabilities arising from employer pension contribution rate fluctuations	(1,100)	0	(1,100)	0	(1,100)	0	(1,100)
Commercial Property Liabilities	To manage urgent liabilities associated with the Council's property	(1,700)	0	(1,700)	0	(1,700)	0	(1,700)
Revenue Grant Unapplied Reserve	To hold Revenue Grant balances where the conditions for use have been met but relevant expenditure has not yet been incurred	(3,214)	0	(3,214)	0	(3,214)	0	(3,214)
Self insurance	To meet estimated liabilities in connection with internally-held risks related to the Council's Insurance programme	(5,541)	0	(5,541)	0	(5,541)	0	(5,541)

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Capital Financing Smoothing Reserve	To smooth funding across the period of the Medium Term Financial Strategy	(4,582)	170	(4,412)	1,821	(2,591)	546	(2,045)
IT and Digital Reserve	To replace IT and digital equipment that has passed its useful life to improve operational efficiency	(2,000)	300	(1,700)	1,000	(700)	500	(200)
Flexible Capital Receipts Reserve	To allow for potential slippage in the delivery of capital receipts to fund transformation as well as funding beyond the end of the flexible capital receipts directive in 2021/22	(8,105)	2,000	(6,105)	3,000	(3,105)	0	(3,105)
Direct Revenue Financing of Capital Reserve	To support the capital programme to bring down the associated revenue costs of capital financing such as external interest and Minimum Revenue Provision (MRP	0	(10,537)	(10,537)	0	(10,537)	0	(10,537)
Redundancy Reserve	To fund costs of redundancy	(1,000)	0	(1,000)	0	(1,000)	0	(1,000)
Demographic & Cost-Led Pressures	To provide for potential cost pressures arising from demographic or other demand led services	(2,000)	0	(2,000)	0	(2,000)	0	(2,000)
Abortive Capital Cost Reserve	To provide for the cost of feasibilty studies that do not progress into capital schemes	(500)	0	(500)	0	(500)	0	(500)
Business Rates Smoothing	To provide for the potential downturn in the economy that would reduce the level of Business Rates	(2,000)	0	(2,000)	0	(2,000)	0	(2,000)
Total Earmarked Reserves		**(37,954)**	**(8,309)**	**(46,263)**	**5,098**	**(41,165)**	**423**	**(40,742)**
Total Revenue Reserves		**(45,454)**	**(8,309)**	**(53,763)**	**5,098**	**(48,665)**	**423**	**(48,242)**

Other Ringfenced Reserves

Schools Reserves

School Balances	Schools are able to carry forward any underspends on their budgets	(2,208)	0	(2,208)	0	(2,208)	0	(2,208)
Dedicated Schools Grant	This is in deficit due to overspends in high needs block. This is planned to be repaid by 31st March 2023	3,008	(142)	2,866	(1,142)	1,724	-2142	(418)
		800	**(142)**	**658**	**(1,142)**	**(484)**	**(2,142)**	**(2,626)**

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		Balance 31.03.20 £ '000	Movement in year £ '000	Balance 31.03.21 £ '000	Movement in year £ '000	Balance 31.03.22 £ '000	Movement in year £ '000	Balance 31.03.23 £ '000
Housing Revenue Account Reserves								
HRA/Major Repairs Account Balance	Represents the balance carried forward on these accounts	(32,055)	(168)	(32,223)	(261)	(32,484)	-749	(33,233)
North Whitley PFI	To provide a smoothing reserve for PFI payments	(9,748)	0	(9,748)	0	(9,748)	0	(9,748)
		(41,803)	**(168)**	**(41,971)**	**(261)**	**(42,232)**	**(749)**	**(42,981)**
Total Revenue Reserves (including Other Ringfenced Reserves)		**(86,457)**	**(8,619)**	**(95,076)**	**3,695**	**(91,381)**	**(2,468)**	**(93,849)**