

ABERDEEN CITY COUNCIL

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| COMMITTEE | City Growth and Resources |
| DATE | 7 February 2019 |
| REPORT TITLE | Council Financial Performance – Quarter 3, 2018/19 |
| REPORT NUMBER | RES/19/002 |
| DIRECTOR | Steven Whyte |
| CHIEF OFFICER | Jonathan Belford |
| REPORT AUTHOR | Lesley Fullerton |
| TERMS OF REFERENCE | 1.3 |

1. PURPOSE OF REPORT

1.1 To provide the financial position of the Council, as at Quarter 3 (December 2018) and the full year forecast position for the financial year 2018/19, including:

- General Fund and Housing Revenue Account (HRA) revenue and capital accounts and the associated Balance Sheet; and
- Common Good Revenue Account and Balance Sheet.

2. RECOMMENDATION(S)

2.1 It is recommended that the Committee note the: -

- a) Progress made to date to achieve budgeted savings;
- b) General Fund and HRA financial performance to the end of Quarter 3 as detailed in Appendix 1;
- c) Common Good financial performance to the end of Quarter 3 as detailed in Appendix 3;
- d) General Fund forecast revenue and capital positions as detailed in Appendix 2;
- e) HRA forecast revenue and capital positions as detailed in Appendix 2;
- f) Common Good forecast position as detailed in Appendix 2; and
- g) Group Entities forecast revenue position as detailed in Appendix 4.

2.2 To note the information provided by the Chief Officer – Finance in the report that the Council has continued to reduce expenditure in line with the Committee instruction however new and continuing pressures in key areas (such as the increased pay award offered in December 2018; and needs associated with looked after children) are not likely to be fully offset by the year end. This means that there is a forecast deficit on the General Fund for the year;

- 2.3 To agree that the Council continue to minimise expenditure in the remaining weeks of the year to offset the cost pressures in the system; and
- 2.4 To note that if the final outturn exceeds budget for the year that this is met from the Council's uncommitted balances.

3. BACKGROUND

- 3.1 This report focuses on both the financial performance for the year to 31 December 2018 and the forecast financial position for the full year for the Council's General Fund, Housing Revenue Account and Common Good.
- 3.2 The performance for the year to date has so far been a positive one with net expenditure largely in line with budget for this stage of the year.
- 3.3 Savings realisation and tracking at the nine month point indicates that progress has continued, but has become more difficult due to the various changes to spending patterns that have taken place in the quarter, the reduction particularly in goods and services has not specifically been applied to the original target reductions.

| Description | Target Reduction | Achieved Reduction at end of Quarter 3 |
|-------------------------------|------------------------------------|----------------------------------------|
| Posts reduction | 370 fte; with a value of £10.4m | 330 fte*; with a value of £10.0m |
| Assets | £0.7m | £0.6m |
| Commissioning and procurement | £6.8m | £3.3m* |
| Income | £0.2m | £0.0m |
| Total | £18.1m | £13.9m |

*figure to be updated

- 3.4 A significant proportion of the posts reduction savings have been achieved through the voluntary severance / early retirement scheme. The costs associated with the scheme continue to be a pressure against the Council Balance Sheet, legitimately using one-off funding for recurring revenue benefit. The one-off nature of Balance Sheet resources makes the continuation of posts reduction through this means unsustainable and this should be reviewed. Other means of managing and planning the workforce size and shape have therefore been required and it has been a feature of the management of staff that turnover and vacancies are fundamental to that approach.
- 3.5 Notwithstanding this positive start to the year, there were cost and demand pressure areas highlighted in Quarters 1 and 2 reporting that at the end of Quarter 3 continue to be challenging to manage in-year, and therefore there is a similarity in many of the notes provided on variances in the appendices to those reported at the last quarter. These are described in more detail in Appendix 2.

- 3.6 The forecasts are built upon a range of assumptions, estimates and judgements. Unprecedented in recent years has been the failure for the national pay bargaining to reach agreement and the consequence of this is that the Council remain unclear what the final pay bill for the year is going to be.
- 3.7 The budget was set for this financial year was based on lifting the pay cap as described by the Cabinet Secretary for Finance and the Constitution in December 2017. Since then offers made by the Employer side has increased the exposure of the Council to a new level, most recently at the end of Quarter 3 when a revised offer was made of, in general terms, lifting salaries by 3.5% with effect from 1 April 2018; with a multi-year component being added that offered a further 3% from 1 April 2019 and a further 3% from 1 April 2020. While there are caps on the offer for 2018/19 and a revised offer to teachers that attracts some Scottish Government Funding, there is no agreement yet and unions are divided in the advice being offered to members, some recommending acceptance, other rejection. Ballots and consultation with members of the various Trade Unions will continue until the end of February so agreement would appear to be unlikely until March 2019 at the earliest.
- 3.8 The estimated cost impact, above the Council approved budget is now approximately £2.1m for 2018/19.
- 3.9 An increasingly protracted period to resolve this part of the budget leaves the Council trying to manage one of the largest annual cost pressures it faces towards the end of the financial year, uncertain of what the outcome will be.
- 3.10 The full year impact of an additional 1% increase in any pay award settlement would cost the Council approximately £3.2m and with EIS expectations of a 10% increase for teachers this would represent a 6% increase on current forecasts. If based on equity this was applied to all staff categories, then the impact on the Council would be c.£18m of additional cost.
- 3.11 The fact is that the Council is no clearer on the outcome than it was when reporting the quarter one position in early summer. As part of national pay bargaining, the Council will honour the terms of the final agreement reached and will ensure staff are remunerated accordingly. However, the question remains in terms of how, within the remaining couple of months of the financial year, can the Council finance an unknown liability without turning to reserves.
- 3.12 There are also unquantified and hugely uncertain liabilities that may yet arise for which the Council will have to account. These are referred in the appendices as contingent liabilities. Examples include emerging issues such as the Scottish Child Abuse Inquiry, which has a number of strands that could impact on the Council. The recommendations that the financial redress scheme for Survivors of Child Abuse in Care being put in place by the Scottish Government will be funded by those responsible. The implication being that Councils will have to fund a proportion of this scheme, while no details exist of how this will be applied it provides further reason to be taking

action to prepare and also to recognise that the use of reserves is a highly likely position at the year end.

- 3.13 If the above actions are agreed then there is scope to further reduce expenditure, the extent is difficult to quantify accurately as expenditure in these areas has already been reduced, is expected to reduce and therefore the underlying costs that could be saved may be lower than. There is also limited time to change and have an impact on 2018/19.
- 3.14 The result, of the combined effect of positive progress around agreed savings, the identified cost pressure areas and underlying uncertainties and risks, is that the overall operational conditions are pressuring the Council and while action has been taken and continues to be actively managed, there is a very high likelihood that the Council will spend more than it had budgeted to.
- 3.15 The Council must continue to do everything it can to reduce General Fund expenditure or raise General Fund income to place the Council in the best position it can; and to expect that the Council uncommitted balances will be required to meet a shortfall in funding in 2018/19.
- 3.16 The Council has taken a prudent view of the financial position that is forecast across all functions and also taken advantage of a number of mechanisms available to arrive at the outturn position, including a review of the profile of capital financing costs, ongoing support to debt repayment through the Capital Fund and an optimistic view that the Council will not have to draw any further funding from the Corporate Contingency.
- 3.17 Following the COSLA Leaders meeting on Friday 25 January 2019 a revised offer to teachers was made (with additional funding committed by the Scottish Government). It had been expected to be supported by the teaching unions, however the recommendation to the membership is to reject the revised offer. This makes the level of uncertainty and timing of resolution particularly challenging to be certain of where the actual outturn will land. A range has therefore been provided in section 3.23 below. The impact of drawing from uncommitted balances of the Council has to be considered in the context of setting the 2019/20 budget, as depending on the value there may be a need to replenish them during that year.
- 3.18 Therefore the unintended consequence of this further delay and level of uncertainty is that it has a material impact on the budget planning for next year. While the Council has been working on a range of scenarios for next year, the position described in the Budget Report from March 2018 is expected to be out of date. That report described a £31m gap to be addressed.
- 3.19 Taking account of savings and the likely cost pressures described in the appendices to this report and the current understanding of Finance Circular 8/2018, issued by the Scottish Government in December 2018, this will increase the gap. It remains unclear how much by, but it is again forecast to be within a range.

- 3.20 Based on information known, but not yet confirmed there are additional costs around pay – knock on effect of a much higher offer for 2018/19 and an increased offer in comparison to the assumption used for 2019/20. There is lower Scottish Government funding for core services, according to the Finance Circular Health and Social Care Funding must be handed to the Integration Joint Board, limiting how much is available for other General Fund services. These assumptions move the budget gap to be in the range of between £40m and £50m for 2019/20, which the Council will have to address.
- 3.21 The budget papers for 2019/20 will be prepared and published later in February, ahead of the special budget meeting on 5 March 2019.
- 3.22 The recommendation excludes capital investment in the capital programme and expenditure on the Housing Revenue Account, which is expected to continue in line with its business plan. Clearly, the decision to stop spending needs to take cognisance of impact on our vulnerable communities as well as policy and legislative obligations.
- 3.23 The forecast, contained in Appendix 2, is for reasons of presentation quantified as a specific value, an over spend of £2.7m, and does not reflect the range of scenarios that could be achieved if the individual elements that make up the current forecast prove to be different. I have taken a prudent view of what may be possible overall to address the pressure areas described in the budget, resulting in what I believe is an extremely challenging sum to be addressed before the end of the year, without some fundamental changes in the organisation and its service standards. With the action being taken to reduce expenditure, it is reasonable to estimate that the current forecast sits within a range:

| Assumption | Impact |
|------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------|
| Improve income and collection levels and expenditure levels lower than currently forecast. | Potential surplus achieved at year end. |
| Actual spending and income in line with forecasts, estimates and judgements at Quarter 3. (Appendix 2) | Forecast of £2.7m over budget. |
| Additional cost pressures from, for example a severe winter, a higher pay award and additional demand pressures. | 10% pay award for teachers would lead to a potential deficit of £9m at year end. |

3.24 Summary of Appendices

- a) The financial statements contained within Appendix 1 reflect the income and expenditure for the period to December 2018 and reflect some of the statutory accounting adjustments required to ensure compliance with International Financial Reporting Standards (IFRS). These adjustments are described in the Appendix.

- b) The Balance Sheet figures at 31 December 2018 reflect the actual position at the balance sheet date where appropriate. The figures shown include statutory adjustments where these have been made, and where this is not possible the figure as at 31 March 2018 has been used. Reserves have been updated to reflect the impact of the performance to date such that Usable Reserves have increased during the period. Due to the timing of the receipt of income from the Scottish Government and Non-Domestic Rates payers there is currently a significant net income position shown at 31 December 2018.
- c) Appendix 2 provides an overview of the forecast outturns for revenue and capital across the General Fund, Housing Revenue Account and Common Good. The uncertainty in relation to the General Fund is identified in the preceding paragraphs of the report and the Appendix presents the forecast based on a set of assumptions, estimates and judgements, which would result in an over spend, recognising that the overspend may sit within a range. The forecasts for Capital, the Housing Revenue Account and Common Good are all within budget.
- d) Appendix 3 presents the Common Good position as at 31 December 2018 and provides an overview that shows income exceeding expenditure for the period and therefore an increase in the value of the Common Good.
- e) Appendix 4 presents the Group Entities forecast for the year and indicates that there are no material areas of concern in relation to these entities for 2018/19.

4. FINANCIAL IMPLICATIONS

- 4.1 The financial performance of the Council's main accounts, General Fund, Housing Revenue Account and Common Good are presented in the Appendices.
- 4.2 Appendix 1 also includes a Management Commentary providing:
- Further information on the Performance in Quarter 3; and
 - Information on the 2018/19 Forecast Financial Position, and this is expanded on in Appendix 2.
- 4.3 The audited accounts for 2017/18 demonstrated the Council's ability to effectively and actively manage its financial position. The Balance Sheet as at 31 March 2018 reflected substantial net worth in the organisation and a strong financial platform from which to operate in 2018/19 and to plan for the future.
- 4.4 The budget set for 2018/19 recognised that this would be another financially challenging year and that strong fiscal management coupled with financial restraint would be required to ensure that the budget was achieved, and that this would continue to underpin the Balance Sheet for future financial years.

- 4.5 The financial constraint described in the report is necessary based on the continuing value of forecasts at Quarter 3 and due to the level of uncertainty in significant cost areas, described in section 3 and Appendix 2.
- 4.6 The Council continues to tackle increased demand and active management of elements of the budget that remain uncertain, and this requires continuous close fiscal management. Close monitoring, changes to working arrangements – moving to capital instead of revenue activities, limiting external recruitment, limiting and changing the arrangements for ordering and authorising goods and services purchased are continuing to be in place for 2018/19, commencing after the instruction from the Committee on 31 October 2018.
- 4.7 The impact of expenditure exceeding budget on the General Fund at the year-end would be a draw from the General Fund balance that the Council keeps as part of its risk-based Reserves Policy. Depending on the value if this arose then the Council will have to consider replenishing monies used in the budget for 2019/20.
- 4.8 The Housing Revenue Account and Common Good are forecast to end the year on or within budget therefore will maintain or increase the current value of their Balance Sheet resources.

5. LEGAL IMPLICATIONS

- 5.1 While there are no direct legal implications arising from the recommendations of this report, there are additional reporting requirements due to the London Stock Exchange listing, for example the requirement to notify them ahead of publication of the report.

6. MANAGEMENT OF RISK

| | Risk | Low (L), Medium (M), High (H) | Mitigation |
|------------------|----------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------|
| Financial | The main financial risk the Council is managing is the increased demand on services. | M | Reviewing all areas of expenditure with a view to only incurring essential expenditure. |
| | The risk around the final cost of the pay award is significant for the Council given the proportion of the budget that is pay related. | H | Current forecasts are based on the pay offer by Employers, increased in December 2018. Continuing fiscal restraint is being exercised |
| | In relation to capital projects there is a risk that following the procurement process, | M | Quantification and review of indicative project costs by suitably qualified staff |

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|---------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------|---|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| | tendered costs will vary from that assumed at the time of project approval. | | or external body where appropriate. |
| Legal | Where actions that impact on the statutory duties of the Council are chosen then there is a risk that the Council will not meet its statutory obligations. | L | Prior to action being taken there would require to be an assessment of the legal implications. |
| Employee | There is a risk that changes to budgeted expenditure levels and fiscal restraint will impact on the number of employees working in the Council. | M | Impact assessments can be carried out to identify impact of fewer staff and active management of tasks, including prioritisation and a focus on productivity. |
| Customer | There is a risk that changes to budgeted expenditure levels and fiscal restraint will impact on the customer experience. | M | Prioritisation, a focus on productivity and active management of services using the TOM principles to minimise effects. |
| Environment | None identified | | |
| Technology | None identified | | |
| Reputational | There is a risk that through the reduction of expenditure the Council may be criticised that spending isn't in line with budgets. | H | The Council has continued to address priority spending areas, and to protect people. It is equally accountable for the use of public funds and to ensure that they are managed robustly. There are a wide range of unknown external factors that require to be balanced to deal with the current operating environment. |

7. OUTCOMES

| Local Outcome Improvement Plan Themes | |
|----------------------------------------------|---------------------------------------------------------------------------------------------|
| | Impact of Report |
| Prosperous Economy | The Council continues to plan for spending hundreds of millions of pounds in 2018/19 and to |

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| | invest in front-line services across its statutory responsibilities as well as capital infrastructure. Investment in the city will have a positive impact on the economy. |
| Prosperous People | Robust and effective management of the Council's finances will ensure that services can continue to be provided. |
| Prosperous Place | Investment will enhance the place by creating a better and more vibrant city in which to live. |

This report does not impact on the design principles of the Target Operating Model.

8. IMPACT ASSESSMENTS

| Assessment | Outcome |
|------------------------------------------------------|----------------|
| Equality & Human Rights Impact Assessment | Not required |
| Privacy Impact Assessment | Not required |
| Duty of Due Regard / Fairer Scotland Duty | Not applicable |

9. BACKGROUND PAPERS

None.

10. APPENDICES

Appendix 1 – Financial Statement for the period ending 31 December 2018

Appendix 2 – Forecast Financial Position for the year 2018/19

Appendix 3 – Common Good Financial Statement for the period ending 31 December 2018

Appendix 4 – Group Entities Forecast Financial Position for the year 2018/19

11. REPORT AUTHOR CONTACT DETAILS

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