Aberdeenshire COUNCIL

Business Services

REPORT TO AUDIT COMMITTEE – 24 MAY, 2018

AUDIT SCOTLAND 'LOCAL GOVERNMENT IN SCOTLAND FINANCIAL OVERVIEW 2016/17'

1. Recommendations

The Committee is recommended to:

1.1 Consider key messages and Audit Scotland's recommendations.

1.2 Consider using the scrutiny tool supplied by Audit Scotland to enhance understanding of the council's financial position.

2. Discussion

2.1 On 28 November, 2017, Audit Scotland published its annual report "Local Government in Scotland: Financial Overview 2016/17" (available online www.audit-scotland.gov.uk/report/local-government-in-scotland-financial-overview-201617). The report indicates that Councils are showing signs of increasing financial stress. Funding has reduced while costs and demands on services have increased. In response, more councils developed savings plans and are using reserves to fund services.

Budgetary pressures

2.2 The Scottish Government's general revenue grant (GRG), which represents around two-thirds of council budgets, fell in real terms by 5.2% in 2016/17 to £9.7 billion, even while considering the funding support given for health and social care integration. Aberdeenshire Council's income (from GRG, Non-Domestic Rates and Council Tax) was the fourth lowest in 2016/17, falling just within the low end of the average received by councils (£2,000-£2,400 per head of population).

2.3 Councils faced, and will continue to face, additional pressures which Audit Scotland are highlighting as impacting on many council budgets as follows:

2016/17
- continuation of the council tax freeze (ending 2017/18)
- the move to a single UK-wide state pension
- annual increases in staff costs
- teacher-related costs (staff numbers, inductions and increased pension contributions)

2017/18
- costs of meeting Scottish living wage and minimum wage guidelines
- the new apprenticeship levy
- the Non-domestic rates revaluation

<u>2018/19 and beyond</u>

- an ageing and growing population
    - Aberdeenshire is projected to experience the 3rd highest population increase in Scotland between 2014 and 2039. Older age groups (70+) will see the greatest proportional increases. (Aberdeenshire Council, *Strategic Assessment*, 2017).
- general inflation
    - In November, 2017, the Office for National Statistics (ONS) reported that the Consumer Prices Index (CPI rose to a six-year high of 3.1%. The Bank of England's forecasts published in November, 2017, expect CPI inflation to remain above 2% until 2020.
- interest rate rises
    - Long-term borrowing interest rates are largely dependent on the strength of the UK and global economy. Rates were volatile in 2016, ending the year at lower levels. There continues to be uncertainty as to the European Union exit terms as well as the impact the change of administration in the United States will have. However, there is a risk that long term borrowing rates will rise during 2018. The latest forecast provided by our Treasury advisors are that interest rates may rise from current rate of 0.5% to 0.75% in June, 2018, and potentially to 1.0% by the end of 2018.
- increased staffing costs, potential end to the public sector pay cap
    - The Scottish Government's Draft Budget 2018/19 proposed lifting the cap on public sector pay (1%) and increasing pay by 2% or 3% (depending on salaries). However, these proposals are under scrutiny until 20 January, 2018, and the final settlement on local government pay increases are also subject to negotiation. There may be support from some parties to raise pay in line with inflation.
- difficulty in income collection due to increased charges and Universal Credit roll-out
    - The In-Year collection rate for Council Tax sits at approx. 96%. Every attempt is being made to increase this but as Universal Credit is rolled out, there is a reliance on customers applying for Council Tax Reduction as this is not awarded automatically through the DWP. The downturn within the Oil & Gas Industry, cost of living and the number of double charges being levied due to properties remaining empty long term, which may be down to properties not selling or owners having insufficient funds to bring properties back into use, has had a detrimental effect on Aberdeenshire collection rates.
- potential changes to Non-domestic rates (removing relief for new ALEOs)
    - Aberdeenshire Council's plan to generate savings by creating a new ALEO (Sport and Culture Trust) is now being reconsidered, since the Scottish Government accepted the Barclay Review's recommendation that new ALEOs should not be exempt from paying Non-domestic rates.
- potential impacts of Brexit

- The impacts of Brexit for Aberdeenshire Council relate to the overall regional economic impacts (trade, labour, skills, and costs) and to specific impacts on the organisation (European funding, legislation and standards). In addition to analysis undertaken by the council's own Brexit team, there is more relevant research available from organisations like the Local Government Association (LGA) and the National Council of Rural Advisers (NCRA).

Measures taken by councils

2.4 Councils have faced these challenges by increasing income and/or by reducing revenue spending via savings. Appendix 1 shows a flowchart of measures taken.

Income raising

2.4.1 In 2016/17, twenty-four councils chose to raise council tax (the freeze ended in 2017/18), while fourteen councils removed the 10% discount on second homes. Page 35 of the report shows Aberdeenshire as one of the councils expecting the highest percentage increases in council tax income in 2017/18 (almost 10%). However, this could be due to the Scottish Government's reforms to the council tax banding multipliers for 2017/18, which added £110m to the council tax due to all councils. Within Aberdeenshire, Band E has the highest number of properties, in addition to this, the total percentage of properties within Bands E – H equates to 42% of the total chargeable properties. Although service charges only represent 8% of councils' total income, some have also tried to maximise their income by increasing fees or introducing new charges (e.g. garden waste collection). Audit Scotland suggests that councils review their charging policy to ensure consistency with corporate objectives.

Savings

2.4.2 For 2016/17, councils approved £524m of savings. Plans focused on the main spending areas, like reducing staff numbers, rationalising surplus property and improving procurement of goods and services. There's an indication that councils will find it increasingly difficult to identify and deliver savings - for 2017/18, council-approved savings were about £317m. The report suggests that some councils' budget-setting reports could do more to evidence how savings align with council plans and what impact they may have on service delivery.

2.4.3 Aberdeenshire Council's Annual Audit Report for 2016/17 indicated an overspend of £1.7m for the year, due to increased staff costs and reduced income. A funding gap of £20m has been identified for 2018/19.

Reserves

2.4.4 More councils are drawing on reserves than previously. Councils budgeted to use about £79m of reserves in 2016/17 and proposed to use £105m of reserves in their budgets for 2017/18. However, the actual use of reserves was often different from that originally planned - the report presents various reasons but notes that they were not always clear from management commentaries. Thus, in 2016/17, 20 councils drew on their usable revenue and capital reserves, compared to eight in 2015/16.

2.4.5 The levels of usable reserves vary widely across councils, as do their reserves policies. Audit Scotland highlights that some councils will need to take remedial action, or they will risk running out of General Fund reserves within two to three years if they continue to use them at the levels planned for 2017/18.

2.4.6 Aberdeenshire Council is not counted among these councils. However, compared to other councils, Aberdeenshire holds a relatively low level of usable reserves. Audit Scotland's annual audit report 2016/17 for Aberdeenshire Council noted that the Council's level of usable reserves has fallen by 36% since 2012/13. The level of uncommitted general reserves at 31 March, 2017, was sitting at £8.5m, which is below the revised limit of £9m approved in February, 2017. Compared to other councils, Aberdeenshire Council has low levels of reserves. The AAR indicates that there is a growing risk that the Council may not have sufficient reserves available to address an unforeseen event. The report adds that using non-recurring income, such as reserves, is not a viable long-term strategy and stresses that the underlying reasons for overspending should be addressed.

Debt

2.4.7 Council Debt increased by £836 million in 2016/17 as councils took advantage of low interest rates to borrow more to invest in larger capital projects. The report states that councils' debt levels are not currently problematic, but some may experience concern about debt-associated costs in the long term. Audit Scotland suggests that the affordability of capital programmes should be kept under review, and new capital expenditure should be supported by robust business cases that explain how they will support corporate objectives.

Housing Revenue Account

2.5 The report is accompanied by Supplement 3, on the Housing Revenue Account. In 2016/17, the Housing Revenue Account represented 8% of all councils' revenue income. Councils are required by legislation to ensure rent levels at least cover the costs of their social housing provision. The level of HRA reserves varies across councils, but the total level has seen an upward trend over the last five years, reaching £125m. An appropriate level of reserves is important, allowing councils to respond to unforeseen events and meet commitments.

2.6 However, total HRA debt has also risen to £3.6 billion as councils borrow money for new builds and improving stock.

2.7 Across HRAs in Scotland, total income has increased by 11% in the last 5 years to just over £1.15 billion, while total expenditure has increased by 10% to just over £927 million. Expenditure can be related to loan charges and bad debt provision, but also maintenance. In 2016/17, councils spent an average of

£1,199 per house in repairs and maintenance to maintain quality and safety standards.

2.8 Due to increased expenditure on repairs and maintenance, Aberdeenshire's total HRA income for 2016/17 was down from budget by £3.1m. The Council's policy is to use net income as Capital Funded from Current Revenue (CFCR). Despite the drop in CFCR, total capital expenditure was £1.6m greater than budgeted. This was funded through borrowing and increased levels of grant received in relation to new build properties. Overall, the Council maintained its uncommitted HRA working balance of £2m.

Local Government Pension Schemes

2.9 The report also contains Supplement 2, on the Local Government Pension Scheme. Across the 11 pension funds administered by councils, assets increased from £34.5 billion to £42 billion. However, the estimated value of liabilities also increased from £42 billion to almost £55 billion.

2.10 There have been several changes following the introduction of the LGPS scheme in 2015, and while funds responded well to the more complex governance arrangements, the report notes there are still challenges ahead. Overall, investments performed well despite political and economic uncertainty, but the average return will be influenced by the larger funds such as Strathclyde's.

2.11 The report provides a list of pressures that pension funds will face, arising from council severances, the complexities of the new career average scheme, the guaranteed minimum pension reconciliations, pensions auto-enrolment, new regulatory arrangements starting on 1 January,2018 (MIFID 2), and cost-reduction needs.

2.12 In 2016/17, Aberdeenshire Council's net pension liability increased by £159.3m (62.7%) to £413.2m, attributable to a decrease in the discount rate used by the scheme's actuary. Significant increases were also experienced throughout Scotland.

Recommendations on financial management

2.13 Audit Scotland's report provides a Scrutiny Tool, which proposes questions that can help councillors to understand and scrutinise the council's financial position (Appendix 2). Considering these questions might support the Council in conducting financial self-assessment exercises.

2.14 According to the report, leadership is the main determinant of a council's financial position, in addition to pressures and constraints. Amid a challenging financial outlook, it is of increasing importance to have proactive self-evaluation, robust medium-term financial strategies, and effective leadership to deliver them.

2.15 Councils' budget-setting processes for 2016/17 were impacted by external factors, like unexpected delays in the Scottish Government's funding announcements and the integration of health and social care. As a result, some councils' expenditure and use of reserves differed noticeably from their original plans. Audit Scotland suggests that councils may benefit from analysing how to make budget-setting more resilient to these risks. They could also evaluate their financial management processes and commentaries, to ensure that accounts explain performance clearly and can support better scrutiny over the whole year.

2.16 The Head of Finance and Monitoring Officer within Business Services have been consulted in the preparation of this report, their comments are incorporated within the report and they are satisfied that the report complies with the Scheme of Governance and relevant legislation.

3 Scheme of Governance

3.1 The Committee is able to consider and take a decision on this item in terms of Section G.1.3 of the List of Committee Powers in Part 2A of the Scheme of Governance as it relates to the review financial statements, management letters or reports and compliance with relevant codes of practice.

4 Implications and Risk

4.1 An equality impact assessment is not required because the report is to advise Committee of performance and does not have a differential impact on any of the protected characteristics.

4.2 There are no staffing, financial or Town Centre First Principle implications arising from this report.

4.3 The following Risks have been identified as relevant to this matter on a Strategic Level:
BSSR001 Balancing the Books – the report provides information that can inform the implementation of the Medium Term Financial Strategy.

Ritchie Johnson
Director of Business Services

Report prepared by Irina Bonavino Policy Officer
2 May 2018

Appendix 1

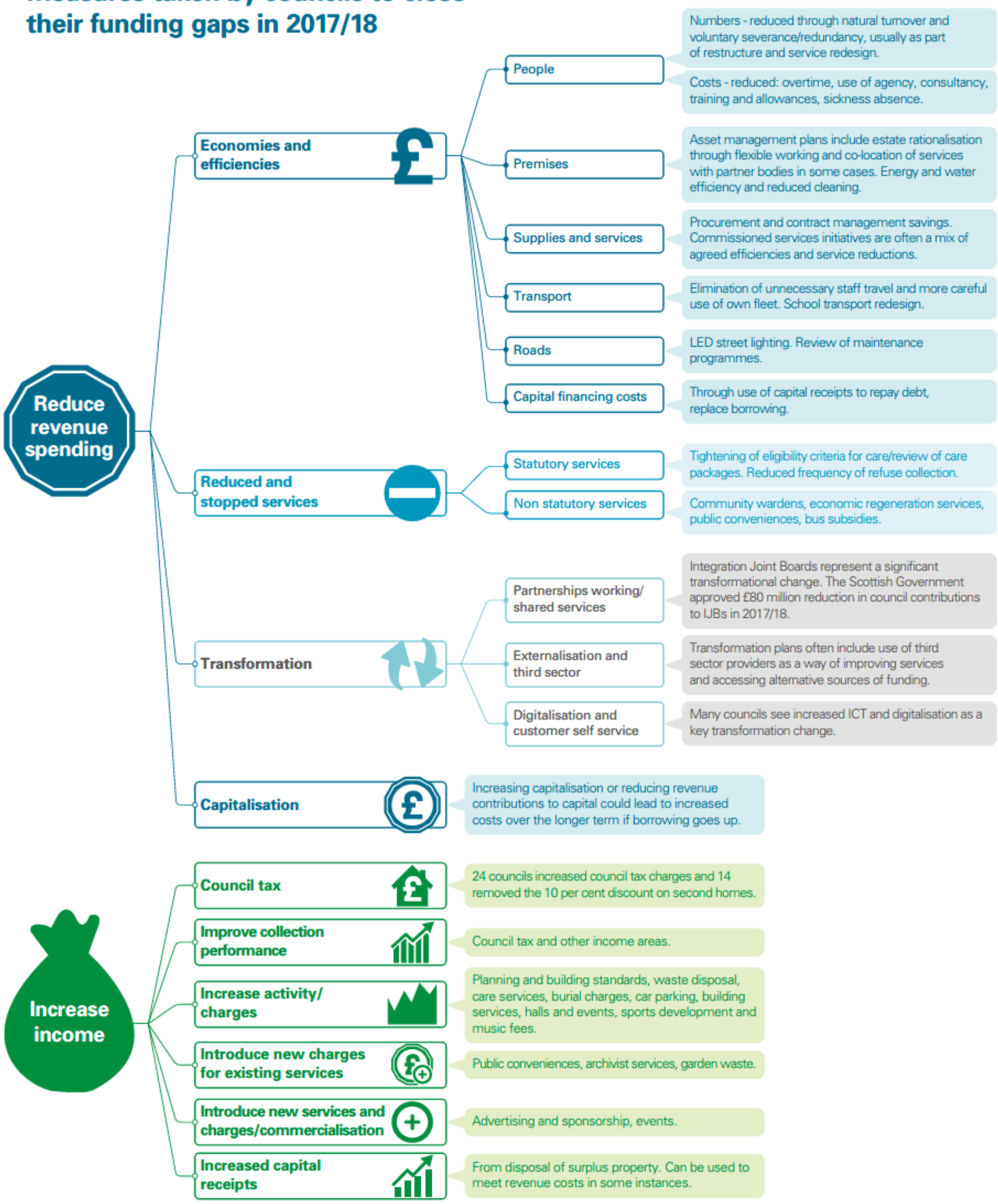
SUPPLEMENT 4

Prepared by Audit Scotland | November 2017

Local government financial overview 2017

ACCOUNTS COMMISSION

Measures taken by councils to close their funding gaps in 2017/18



Appendix 2

Supplement 1: Local government financial overview 2016/17

Scrutiny tool for councillors

This scrutiny tool captures several potential questions for councillors and relates to our report ***Local government in Scotland Financial overview 2016/17***.

It is designed to provide councillors with examples of questions they may wish to consider helping them better understand their council's financial position and to scrutinise financial performance.

How well informed am I?		
Questions for councillors to consider	**What do I know?**	**Do I need to ask further questions?**
Budget setting (paragraphs 65–68 and 76–80)		
1. Does your council have a medium term financial strategy aligned with corporate objectives?		
2. How does annual budget setting link to medium term financial planning?		
3. How is your council preparing for any further real terms reduction in Scottish Government funding?		
4. If your council plans to raise council tax do you know how much it will raise? How will you communicate and explain the reasons for the rise to constituents?		
5. What impact will savings have on the delivery of services? What are the potential risks?		
Financial and savings plans (paragraph 69–80 and 86)		
6. What is your council's financial position? What challenges does the council face?		
7. Does your council have a savings plan? What are the options to close future funding gaps?		
8. What measures in the council's corporate and transformational plans are aimed at addressing the underlying demand for some services?		
Reserves (paragraphs 36-48)		
9. What is the council’s reserves policy?		
10. What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services?		

11. What are the different types of reserves your council holds? Do you know what these can be spent on?		
12. What is the likely use of reserves for 2017/18? How does this compare to forecast funding gaps?		
13. What are the levels of reserves held by your council's IJB? Are these in line with the IJB's reserve policy?		
Levels of debt and affordability (paragraphs 49–54)		
14. What share of your council's budget is taken up with interest payments and debt repayment?		
15. What proportion of the council's debt is linked to inflation (i.e., subject to indexation)? What does that mean for longer term affordability?		
Budget outturn reports and management commentaries		
16. Do budget monitoring reports clearly explain performance against plans and any changes to plans?		
17. Do management commentaries clearly explain council performance and any changes to plans?		
Financial scrutiny (paragraph 84)		
18. What additional training would you like to receive to develop your knowledge and skills in financial scrutiny?		
Charging for services (paragraphs 23–26)		
19. Does your council have a charging policy? Is this in line with corporate plans and objectives? When was this last reviewed?		
20. What information do you need to be able to explain increases in fees and charges to your constituents?		
Exit packages (paragraph 40–42)		
21. Are staff severances in line with the council's workforce plan?		
22. How does the council ensure that councils have the capacity to delivery transformational change?		
23. Do you know the implications of your council's pension liabilities of staff retiring early?		
Capital programmes (paragraphs 31–33 and 65–66)		
24. How clearly does the council's capital programme link with the asset management plan		

	and corporate objectives?		
25.	Has non-delivery of the capital programme (i.e., slippage) been significant at your council in recent years? Why?		