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LONDON BOROUGH OF CROYDON BUDGET SETTING AND FINANCIAL MANAGEMENT

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1. Introduction and Summary

In July 2022, Worth Technical Accounting Solutions Limited were engaged by the London Borough of Croydon to support the Council's "Opening the Books" initiative. This work included a high-level review of the Council's budget setting and financial management arrangements. In summary, we identified that:

- budget setting spreadsheets were over-complicated and difficult to understand,
- 2023/24 budget reports should provide clearer and consistently presented information to decision-makers,
- savings plans should be rationalised and consolidated. All savings plans over £0.5m should have detailed business cases which are subject to robust scrutiny before being included in the budget, and
- there should be clearer links between items classified as transformation costs, savings plans and approved transformation initiatives.

We also recommended that:

- in the short term, all proposals for avoidable revenue growth should be re-considered,
- financial modelling should, as soon as possible, firm up estimates for spending pressures already identified but not yet quantified,
- financial modelling should also incorporate the correction of historical accounting issues as well as new financial risks,
- section 25 reports should be expanded to report specifically on the adequacy of General Fund balances and any proposed transfers to and from reserves,
- levels of reserves and balances must be accurately reported to members and kept under regular review,
- if a significant shortfall in General Fund balances is identified, the Council should as a priority either develop plans for bridging the gap or consider the need to request additional Government support

Looking forward, the Council should develop more ambitious improvement plans which deliver financial savings by reducing some elements of service provision and rationalising the current asset base. Whilst we have seen some good examples of transformation work in specific areas, there is scope for this approach to be developed and extended.

Since our initial review was completed, the Council has moved forward in a number of areas, which is to be welcomed. These include the following:

- the Mayor's business plan now includes specific objectives to "do less and do it better", and to tackle current financial challenges as a priority
- members have also approved more ambitious asset disposal plans,
- Treasury Management and capital investment plans are being reviewed with a view to minimising new borrowing
- the Council now reports monthly on levels of reserves and balances
- new financial models for budget-setting have now been developed and introduced.

We understand that the Council is now forecasting a balanced budget for 2022/23. In view of expected financial pressures identified for 2023/24, however, a Section 114 Notice was issued in November 2022, which (it is anticipated) will be followed by a further request for CD support.

2. Budget setting and medium-term financial plans

At Croydon, the Corporate Finance Team use a spreadsheet-based system to record and model the key financial assumptions which underpin annual budgets and medium-term financial plans. In our view this spreadsheet is over-complicated and difficult to understand, with 64 columns, over 470 rows and (currently) 24 separate iterations to monitor changes over time. We have provided the Council with examples of budget setting spreadsheets which are simpler and easier to use, and can be more readily summarised in financial reports to senior management and elected members.

The Council's current approach to budget setting and financial management is to focus on cost growth, funding changes and savings delivery, as set out in Appendix 1. We agree with this approach in principle, but the spreadsheet used to generate and model key financial information does not record these three different types of budget pressure consistently, and this lack of transparency is reflected in reports to members. For example:

- some items included in cost growth are in fact undelivered savings, but the 2022/23 budget report does not clearly set this out
- some funding increases e.g. New Homes Bonus, are included as savings, even where they are matched (or even exceeded by) expected spending
- changes to the Local Council Tax Reduction Scheme Support, which generated an additional £4.4m of income, was included as a saving, not as additional funding
- use of reserves and contingency budgets are recorded as either savings or growth
- some savings are matched by growth which makes both items seem larger than they really are and makes the spreadsheet harder to follow e.g. in Children's Services, re-focussing £0.3m of Public Health Grant funding is included as both a saving and as budget growth, as is £0.9m grant funding for Fair Cost of Care

In our experience, local authorities find it most helpful to clearly differentiate between cost growth, funding changes and savings delivery. These three categories of budget pressure can then be separately and consistently identified in financial modelling, annual budgets and in-year monitoring reports, which improves transparency.

Although we found the 2022/23 budget report to be comprehensive in scope, some of the detailed information was not clear. For example:

- we were unable to reconcile appendix B, which sets out the growth and savings proposals at Directorate level, with the summary of growth and savings included in the budget report itself
- we identified some instances of appendices including incorrect or out of date information, which raises concerns about version control and the quality of the consistency checks being carried out before key financial reports are being presented to members.

Going forward, 2023/24 budget reports should provide accurate and consistently presented information to decision-makers, with:

- key messages for members highlighted in the summary report and clearly spelled out in non-technical language

- savings and growth figures for each Directorate set out in separate appendices so that savings can be tracked more easily during the year

- assumptions about funding changes also dealt with in separate appendices, and

- control totals, consistency checks and version control techniques used to ensure that all of the appendices are consistent with the summary budget report.

By utilising a £145m Capitalisation Direction (CD) from the Government, the Council has been able to cover 2020/21 overspends, reinstate General Fund balances (see section 3), and to set balanced budgets for 2021/22 and 2022/23. Looking forward, work is currently under way to review key financial assumptions and to update the Council's medium-term financial plans.

As a minimum, financial plans should be extended to 2025/26 with the assumptions underpinning these plans updated and included in 2023/24 budget reports. Preparatory work for 2023/24 also needs to ensure that base budgets are correct for all key service areas. For example:

- some budgets, for example Housing Benefits, are clearly under-funded with no chance of delivery and have longstanding issues which need to be properly addressed

- some service areas which delivered under budget in previous years do not seem to have experienced corresponding reductions to funding in 2022/23.

Financial modelling completed to August 2022 had identified budget gaps currently estimated at £52m, although some cost pressures are still being quantified. For example:

- little work had been done on 2024/25 growth and savings
- financial modelling had been undertaken in response to proposed Government changes on funding for adult social care, in line with neighbouring local authorities. However this is a developing area and current estimates will need to be updated and refined as further information becomes available
- some accounting issues relating to Brick by Brick and Croydon Affordable Homes had not yet been addressed, and
- Minimum Revenue Provision (MRP) calculations were being reviewed.

In addition:

- interest rate charges are likely to increase significantly above the assumptions set out in the Council's Treasury Management Strategy for 2022/23
- some revenue costs have been incorrectly capitalised as Transformation expenditure, and
- budget reports have identified that some savings plans are unlikely to be achieved.

Any assessment of budget pressures will inevitably change over time as circumstances develop, but as a first step all financial modelling, and reports to members, need to include a comprehensive and realistic assessment of all spending pressures currently identified. Reports to senior officers and members also need to be clear about:

- spending growth which is beyond the Council's control, such as interest rate increases and changes to pension fund contribution rates. Budget reports should include a realistic assessment of the potential impact that unavoidable cost increases will have on future spending plans

- current cost pressures which have resulted from accounting errors, or incorrect decision-making, in previous years,

- demand-led growth in social care services and increases in items such as utility costs, which cannot be avoided altogether but can be managed and, to some extent, controlled. For example, in the light of recent fuel cost increases, many authorities are putting in place detailed energy management plans. The Council does have a number of energy management initiatives, including a12-month street lighting pilot, but could be developing more comprehensive plans for managing utility costs down to minimum levels.

- council-led increases such as IT projects and regeneration initiatives. Until the Council's financial position improves, council-led growth should be kept to a minimum.

Adopting this approach should help the Council to make a more accurate assessment of potential reductions in General Fund balances and the possible requirement for further CD support.

Recommendations

R1 Budget setting spreadsheets and financial modelling tools should be understandable by staff outside the corporate finance team, easy to use and maintain, and link back readily to Council reports.

R2 Financial modelling and budget reports should be clearer about anticipated growth, funding changes and expected savings and should ensure that this information is accurately and consistently presented to decision-makers.

R3 2023/24 budget reports could be made easier to understand by:

- **highlighting key messages for members in the summary report**
- **setting out savings and growth figures separately**
- **setting out assumptions about funding changes in appendices, and**
- **ensuring that all appendices are consistent with the summary report.**

R4 Financial modelling already underway to quantify budget gaps for 2023/24 and future years should, as a minimum, be extended to 2025/26 and the updated assumptions underpinning these plans should be included in budget reports.

R5 Financial modelling should take account of account of all cost pressures identified, including historical accounting issues and new and emerging financial risks.

R6 2023/24 budget reports need to be clear about unavoidable spending growth and the plans in place to manage demand-led items e.g., social care and utilities budgets, down to unavoidable levels.

R7 Until the Council's overall financial position has stabilised, any other proposals for revenue growth should be reconsidered, unless there is a clear expectation that these can generate additional savings.

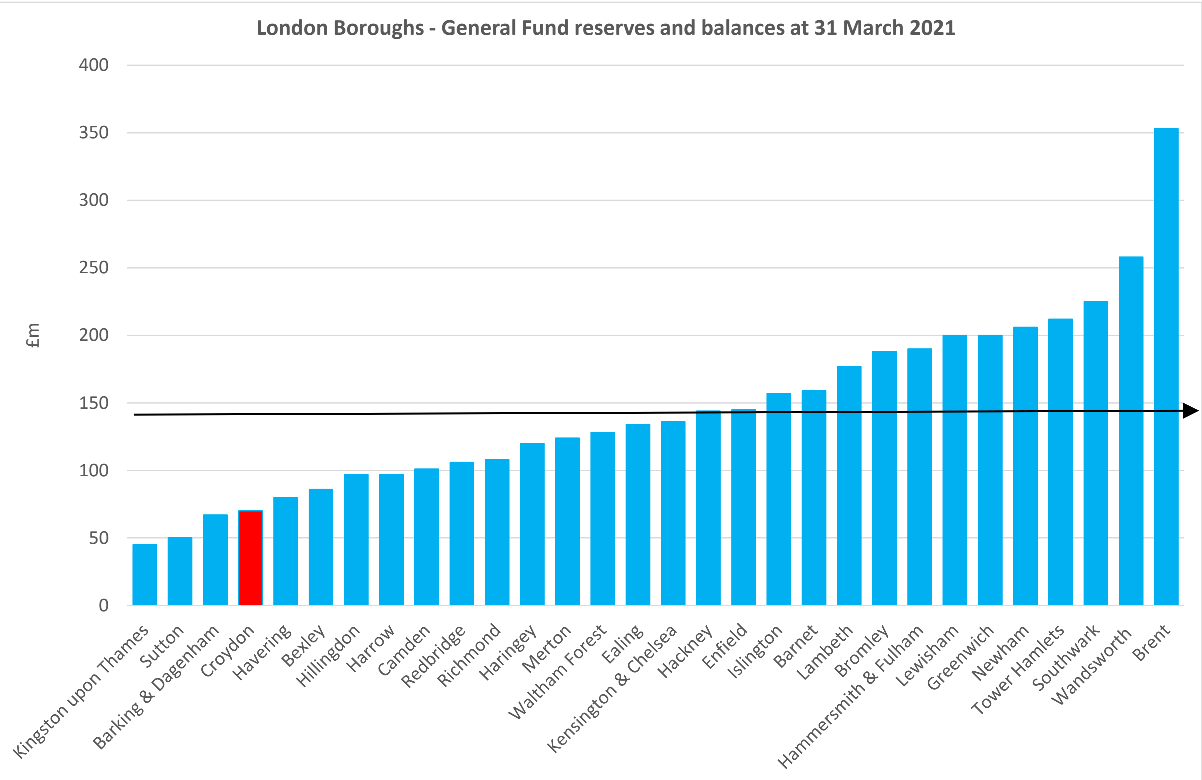
3. General Fund reserves and balances

Obtaining a CD has enabled the Council to reinstate General Fund reserves and working balances. The Statement of Accounts reported General Fund balances of £70m in total at 31 March 2021, comprising:

- £27m working balances, and
- £43m earmarked reserves.

The Council's 2021/22 outturn report to Cabinet (14 September 2022) confirmed that the in-year underspend of £2.4m would be added to General Fund working balances, creating a total of £30m at 31 March 2022.

This represents a significant improvement on the position at 31 March 2020 when the Council only held £5m in General Fund reserves in total, but £72m is still well below the average of £140m for London authorities at 31 March 2021, as shown below:



Source: published financial statements for 2020/21. Excludes Westminster and City of London councils whose reserves are so large they distort the analysis. Croydon is highlighted in red, and the black line represents the Council average.

There is no set formula for calculating appropriate levels of General Fund working balances but the s151 officer must be satisfied that they remain sufficient to cover budget overspends and other contingencies. [CIPFA research on reserves] indicates that at 31 March 2021 local authorities were holding between 5% and 10% of their net revenue expenditure as General Fund working balances. With a net cost of services of c£325m in 2020/21, equivalent figures for Croydon would be between £16m and £32m.

The reported General Fund balance of £30m at 31 March 2022 sits comfortably within this range, but we have seen no evidence of the Council's rationale for setting working balances at this level.

The Council's 22/23 budget specifically included a commitment to increase, if possible, General Fund working balances and reserves but as the position may change considerably during the current financial year, it is imperative that the expected level of General Fund balances at the year-end is accurately reported to members and kept under regular review.

Under section 25 of the Local Government Act 2003 there is a requirement for the Council's section 151 Officer to report specifically on the adequacy of the proposed level of reserves. Croydon's section 25 report for 2022/23 was included in the budget setting papers and refers to:

- a number of financial risks currently facing the Council, although some new and emerging risks were not referred to, and
- the possibility of a further CD request, additional asset sales, or the use of reserves balances, potentially being necessary to secure financial resilience going forward.

The section 25 report also included reference to the Council using capital receipts to fund the CD and to reduce borrowing levels. Given that CDs to date total £145m, expected asset sales are only £135m, and the Council also seems to be assuming that Transformation costs will be funded from capital receipts, the necessity of embarking on a much more ambitious disposal programme may be more immediate than this report suggests.

To meet current legal requirements, future section 25 reports should include clear statements about the following:

- expected levels of General Fund reserves at 31 March each year,
- how much of this total amount is to be retained as working balances,
- confirmation that this expected level of working balance is adequate,
- confirmation that working balances will be cash backed,
- whether or not any new earmarked reserves are to be established, and
- expected transfers to and from earmarked reserves.

Given its importance to the Council, having a stand-alone section 25 report might also be beneficial and we have provided officers with examples of such reports for information.

Monthly Monitoring Reports should also set out movements in General Fund reserves and balances during the year so that members are made aware of any changes as soon as they are identified and not just at the year end. These forecasts should be comprehensive and realistic and should reflect all of the spending pressures identified in section 3 above where these impact on General Fund balances and reserves.

More regular and more transparent reporting on forecast levels of General Fund balances would highlight any significant shortfalls at an earlier stage. This would enable the Council, as a priority, to either develop plans for bridging the gap, or consider the requirement for further Section 114 Notices and requests for additional Government support.

Recommendation

R1 Section 25 report should present a realistic assessment of the Council's current and expected financial position, and should be expanded to comply with the Local Government Act 2003 by reporting specifically on:

- **expected levels of General Fund balances and reserves,**
- **all identified spending pressures (which should be quantified),**
- **the s151 officer's opinion on the adequacy of those balances,**
- **the split between earmarked reserves and working balances,**
- **confirmation that working balances will be cash-backed,**
- **any new earmarked reserves which need to be established, and**
- **any proposed transfers to and from earmarked reserves.**

R2 To provide additional context for decision-makers, the section 25 report could also include information on levels of General Fund balances at neighbouring authorities, and CIPFA guidance on setting levels of balances and reserves.

R3 Monthly budget monitoring reports should clearly set out the Council's target level of General Fund working balances and compare this to expected balances at the year end. If a significant shortfall is identified, the Council should as a priority either:

- **develop plans for bridging the gap, or**
- **consider the requirement for additional Government support.**

4. Savings delivery

The Council currently has over 200 separate savings plans ranging from just £1,000 to c£10m. Each identified saving has a supporting document to explain what the saving relates to, but only a limited number have detailed business cases or identify the costs involved in achieving the savings anticipated. Savings delivery is key to the Council's financial recovery, so as a priority, savings plans need to be clear, comprehensive, realistic and up-to-date.

The savings schedule is large, confusing, and difficult to manage, which inhibits wider understanding and ownership of savings plans. We also found examples of duplication in the savings schedule, e.g., there are 10 separate savings targets for reducing homelessness and for reducing the costs of temporary accommodation. Current savings plans should be consolidated, with any duplication removed,

The approach to savings in the main is target driven, which means that in some areas it is difficult to determine how the saving is going to be delivered. Not all savings plans are clear about which individual member of staff is responsible for delivering them, which significantly reduces the likelihood of any real savings being achieved.

As a starting point a target-based approach is reasonable, but care must be taken to ensure that all savings included in the budget are deliverable and realistic. Recent budget reports have identified that a significant number of savings plans included in the 2022/23 budget are unlikely to be achieved because they represented either:

- top-down targets agreed by individuals who have now left the Council
- cross-cutting savings not allocated to specific individuals or departments
- adjustments that simply net down identified growth, and
- technical adjustments used as mechanism to balance the budget rather than make real efficiency savings or reductions in services.

Some specific examples are listed below:

- a 100% forecast increase in parking enforcement income (over £3m) is not supported by detailed implementation plans,
- 10 separate savings plans are aimed at reducing the cost of temporary accommodation but mostly appear to be duplication of the same or similar initiatives, and
- increasing digital service capacity is presented as a £3.0m reduction in ICT costs. In fact, these represent saving from reducing staffing across the Council which have not been quantified or agreed by Directorates where the reductions need to occur and therefore do not currently seem to be achievable.

Other examples are provided in section 2.

We recommend that all savings plans have nominated "owners" who are responsible for delivering the savings identified within specified timescales. Larger savings plans, say over £0.5m, should be supported by detailed business cases which are subject to robust scrutiny before being included in the budget and which include a realistic assessment of any additional cost requirements.

We have found at other local authorities that overview and scrutiny committees have a useful role to play in this regard by:

- challenging the realism of potential savings plans
- assessing the impact that identified savings will have on service delivery and Council functions, and
- monitoring delivery of agreed savings plans.

Given the Council's current financial position, its approach to identifying and delivering savings may well need to be more radical in the future. Financial information taken from the Council's 2022/23 budget report and set out in Appendix 1 suggested that in both 2023/24 and 2024/25 there was an expected net growth position of £10m and almost £14m respectively. To successfully address its financial challenges, the Council should be aiming to reduce net growth in revenue services.

This re-balancing cannot be achieved through efficiency savings alone, therefore the Council needs to embark on a more fundamental review of the services it is providing and what these cost. We have seen some good examples of transformation work in specific service areas, for example SEN provision, youth services and adults social care. However, this approach is not yet widespread across all Council services and needs to be developed and extended, for example by:

- challenging any provision of non-essential services, or services to non-priority groups
- identifying more cost-effective delivery models for essential services
- reducing the size of the capital programme so that it just provides for schemes covered by grant income or emergency health and safety works, and
- reducing the Council's existing asset base, which would not only generate capital receipts to reduce borrowing but could also significantly reduce maintenance, repairs, and utility costs.

Recommendations

R1 Current savings plans should be rationalised and consolidated, with any duplicated items removed. All savings plans should have nominated "owners" who are responsible for delivering the savings identified within specified timescales set out in budget reports.

R2 Larger savings plans, say over £0.5m, should have detailed business cases which clearly identify the cost of delivering these anticipated savings, and are subject to robust scrutiny before being included in the budget.

R3 Progress on the delivery of major savings initiatives should be regularly reported to members in addition to progress in delivering target savings overall.

R4. The Council has successfully implemented transformational change in a number of areas but may need to extend this approach in order to develop more ambitious savings plans.

5. Transformation costs

Directions and statutory guidance from the Government, first published in 2016, permit local authorities to use capital receipts to fund the revenue costs of projects that will:

- reduce costs,
- generate additional income, or
- support a more efficient provision of services.

Guidance on what does (and does not) qualify as eligible expenditure is provided on:

Guidance on flexible use of capital receipts - GOV.UK (www.gov.uk)

Over £30m of staff costs and IT-related expenditure has been assumed by the Council to be transformational and therefore included in capital rather than revenue budgets between 2022/23 and 2024/25. Some of these items of expenditure clearly represent activities which are not transformational. For example, the Croydon Digital Service Team are providing an ongoing service that does not fit the definition of transformation but the costs of this team (£0.5m per annum) are being accounted for as capital expenditure.

The Council's external auditor (Grant Thornton) has also commented that the link between some items of Transformation expenditure, and the financial savings or service improvements generated, is not clear.

The approach to using transformation funding appears in some cases to be tactical rather than strategic, aimed primarily at transferring revenue costs into capital budgets rather than improving the financial position of the Council overall. Officers have explained that these were largely historical decisions and work is now under way to remove these items from capital budgets.

Looking forward, the Council needs to put in place a much clearer process for identifying and accounting for transformation costs, which:

- demonstrates a clear link between the items of expenditure capitalised, schedules of identified savings and transformation initiatives which are actually taking place
- only accounts for transformation costs as capital expenditure where they meet Government guidance criteria in full.

Any ICT costs which meet the definition of intangible assets should be capitalised and financed from borrowing in line with Section 4.5 of the CIPFA Code of Accounting Practice. Other costs should be charged to revenue budgets as appropriate.

It should also be borne in mind that:

- Government Guidance updated in August 2022 clarifies that the capital receipts used to finance Transformation costs must *be "derived from asset disposals by the local authority outside the "group" structure".* The wording of the Guidance suggests that this interpretation should have been placed on all Transformation funding capitalised since 2016. As we understand that the Council may have used intra-group capital receipts (from Croydon Affordable Homes) to finance Transformation costs in previous years. This accounting treatment will need to be revisited.

- any Transformation costs which are capitalised must be met from capital receipts and not from borrowing. The Council has recently approved more ambitious asset disposal plans, with a view to ensuring that sufficient capital receipts are generated to finance not only capitalised Transformation costs but also current (and any future) CD support.

Recommendation

R1. The Council needs to put in place a much clearer process for identifying and accounting for Transformation costs, which only treats such costs as capital expenditure where they meet Government guidance criteria in full.

R2. To meet current Government guidelines, the Council should also ensure that any Transformation costs which are capitalised are financed from capital receipts and not borrowing.

Appendix 1 – Approved Budget 2022/23 and current financial plans

Approved Budget 2022/23 and current plans 2023/24 - 2024/25				
Savings Proposals	**2022/23**	**2023/24**	**2024/25**	**Total 22/23-24/25**
	£m	**£m**	**£m**	**£m**
Children, Young People & Education	(9.5)	(3.1)	(1.6)	(14.2)
Adult Social Care & Health	(16.4)	(9.7)	0.0	(26.0)
Housing	(2.9)	(1.9)	0.0	(4.7)
Sustainable Communities, Regeneration & Economic Recovery	(12.4)	(4.4)	0.0	(16.8)
Assistant Chief Executive	(8.3)	3.3	(2.3)	(7.3)
Resources	(2.9)	(2.0)	(1.6)	(6.5)
Corporate	(27.8)	3.8	1.0	(23.0)
Total	**(80.1)**	**(14.0)**	**(4.5)**	**(98.6)**
Growth Proposals	**2022/23**	**2023/24**	**2024/25**	**Total 22/23-24/25**
	£m	**£m**	**£m**	**£m**
Children, Young People & Education	0.0	0.0	0.0	0.0
Adult Social Care & Health	8.5	6.9	0.7	16.2
Housing	2.1	0.0	0.0	2.1
Sustainable Communities, Regeneration & Economic Recovery	7.4	0.9	0.0	8.2
Assistant Chief Executive	1.5	(0.3)	0.0	1.2
Resources	0.3	0.0	0.4	0.7
Corporate	55.8	29.2	20.4	105.3
Total	**75.5**	**36.7**	**21.5**	**133.7**
Net Directorate Savings/Growth	**(4.6)**	**22.7**	**17.1**	**35.1**
Funding	(12.7)	(5.8)	(3.2)	(21.7)
Net Position	**(17.4)**	**16.9**	**13.9**	**13.4**
Reserves Movement	(7.6)	(6.9)	0.0	(14.5)
Approved Budget 2022/23 and current plans 2023/24 - 2024/25	**(25.0)**	**10.0**	**13.9**	**(1.1)**