

Committee: Cabinet

Agenda Item

Date: 19 February 2013

11

Title: Robustness of Estimates and Adequacy of Reserves

Portfolio Holder: Councillor Robert Chambers

Item for decision

Summary

1. As part of the annual budget setting process, the Section 151 Officer is required to give the Council formal advice on the robustness of estimates and the adequacy of reserves. This is so Members can set a budget in full awareness of the risks and uncertainties, and ensure that adequate contingency reserves exist.
2. The advice, known as the "Section 25 report", is due to be considered by Full Council on 28 February as part of the budget approval process.
3. The Scrutiny Committee reviewed the report on 7 February and unanimously approved the recommendations. In so doing, the Committee noted the risks relating to Localisation of Business Rates, Benefits Reform and Section 106 agreements.

Recommendations

4. The Cabinet is requested to recommend that Full Council:
 - a) takes account of the advice in the report when determining the 2013/14 General Fund budget and Council Tax
 - b) approves the risk assessment relating to the robustness of estimates as detailed in the report
 - c) sets the minimum safe contingency level for 2013/14 at £1,189,000
 - d) agrees that no transfers to or from the Working Balance should be built into the 2013/14 budget.

Financial Implications

5. No direct implications arise from the recommendations.

Background Papers

None.

Impact

Communication/Consultation	The top priority emerging from public consultation is that the Council should continue to deploy strong financial management.
Community Safety	No specific implications
Equalities	No specific implications
Health and Safety	No specific implications
Human Rights	No specific implications
Legal implications	The report is prepared in order to comply with Section 25 Local Government Act 2003
Sustainability	No specific implications
Ward-specific impacts	No specific implications
Workforce/Workplace	No specific implications

Section 25 report

6. Section 25 of the Local Government Act 2003 requires each local authority, when setting its annual General Fund budget and level of Council Tax, to take account of a report from its Section 151 Officer on the robustness of estimates and adequacy of reserves. This document is the report made under Section 25 by the Assistant Chief Executive – Finance (ACE-F), as UDC's Section 151 Officer, applicable to the setting of the General Fund budget and Council Tax for 2013/14.
7. The purpose of this requirement is to ensure that when deciding on its budget for a financial year, a local authority is formally made aware of any issues of risk and uncertainty by the Section 151 Officer. The local authority is then expected to ensure that its budget provides for a prudent level of reserves to be maintained.
8. The ACE-F has assessed that the minimum safe contingency level is £1,189,000. The current forecasted level of the Working Balance is £1,214,000. The ACE-F's advice therefore is that the budget need not make any provision to increase the Working Balance, nor however should it be reduced, as there are sufficient Earmarked Reserves available to cover identified risks.
9. Section 26 of the Act empowers the Secretary of State to set a minimum level of reserves for which a local authority must provide in setting its budget. Section 26 would only be invoked as a fallback in circumstances in which a local authority does not act prudently, disregards the advice of its Section 151 Officer, and is heading for financial difficulty.

Basis of advice for the Section 25 report

10. In forming the advice for this report, the ACE-F has considered the following:

- The requirement established in the Council’s Medium Term Financial Strategy to ensure that a safe level of contingency is maintained.
- The degree to which the Council’s financial plans are aligned to the Council’s statutory obligations, local priorities and policy objectives.
- The adequacy of the information systems underpinning the Council’s financial management processes.
- Risks associated with the Council’s activities, as identified within the risk register.
- The level of earmarked and unearmarked reserves within the General Fund.
- The degree to which uncertainties exist within the draft 2013/14 budget.

Robustness of Estimates

11. There has been detailed scrutiny, review and challenge of budgets by managers, finance officers and CMT. The aim has been to ensure that the budget is based upon realistic estimates, for example, ensuring that contractual commitments are provided for, salary budgets reflect the approved establishment and current staff in post, and income budgets are based on an assessment of price and demand.

12. No budget can ever be completely free from risk. Necessarily, assumptions are made which means that the budget will always have an amount of uncertainty. The analysis below sets out the major risks applicable to 2013/14 and an indication of the possible impact.

13. It is not possible to give a precise estimate of the impact of each identified risk. As a general guide, the following broad definitions have been used:

Probability	Low	Possible, but unlikely
	Medium	Probable
	High	Almost certain
Impact	Low	Possible variance of up to £100,000
	Medium	Possible variance of £100,000 to £250,000
	High	Possible variance of over £250,000

Risk item	Prob-ability	Impact	Overall Risk of budget variance
<p>a) Localisation of Business Rates. The Government reforms of the method for distributing business rates are complex and final regulations governing some aspects are still awaited. The actual share retained by UDC will not be known until the end of the financial year and will depend on many variables including collection performance, value of new ratings, appeals, refunds, and reliefs granted. The Council maintains a Local Government Resource Review (LGRR) Earmarked Reserve in case of unforeseen adverse fluctuations. The downside risk is mitigated by the safety net mechanism, but the upside risk is considerable if growth and other outcomes exceed assumed levels.</p>	High	High (favourable) Medium (adverse)	High
<p>b) Waste & Recycling – This service continues to be the most complex financially and at greatest risk of volatility. The four day service and new vehicle fleet are still bedding in. Fuel costs are a variable factor here. A new workshop is due to come into operation. Other budget risks have been identified regarding recyclables, trade waste and green waste, all of which have income budgets that depend upon accuracy of forecasting activity levels. The Council maintains a Waste Management reserve to mitigate the downside risk and the draft budget includes a proposal to bolster this reserve.</p>	High	High (adverse or favourable)	High
<p>c) Reforms to Housing & Council Tax Benefit. The Council has approved a Local Council Tax Support Scheme that will require non-vulnerable working age people to pay more Council Tax than previously. Government funding is cash-limited so if costs exceed forecasts there is a risk of unbudgeted costs arising. The Council has committed to subsidise the LCTS scheme to ensure cost neutrality for County, Police, Fire and parish councils, in the case of the larger authorities this is based on estimates and subject to variation. Again the LGRR reserve mitigates these risks.</p> <p>Concurrently Housing Benefit reforms including the ‘Bedroom Tax’ and ‘Benefit Cap’ will affect working age people living in rented accommodation, often the same people affected by LCTS. Inevitably, hardship will be caused as people struggle to pay their rent, which means that the Council is at risk of incurring costs associated with preventing homelessness. The Hardship Fund reserve is available to mitigate this risk together with increased Discretionary Housing Payment funds from central Government.</p>	High	Medium (adverse)	High
<p>d) Section 106 agreements. Risks have been identified that in a number of cases the Council's obligations under certain S106 agreements may exceed the value of the available funds. These include the Woodland Park, Priors Green and Flitch Green developments, and it is possible that other unbudgeted issues may arise. Work is underway to quantify and mitigate the risks involved.</p>	High	Medium (adverse)	High

Risk item	Prob-ability	Impact	Overall Risk of budget variance
e) Efficiency Savings. Work continues to review council services to find ways of achieving the same or improved outcomes at lower cost. This is to help ensure that the Council is well placed to meet future challenges. It is probable that some savings opportunities will be realized with unbudgeted savings arising in 2013/14. In addition, the budget does not include the implementation costs that may arise, on the basis that these will be funded from the Change Management Reserve. Therefore it is probable that unbudgeted costs will arise.	Medium	Medium (adverse or favourable)	Medium
f) Car Parks Income. The budget is based on the existing tariff and charging periods as detailed in the fees and charges section of the budget report. If at some point during the year the Council decides to make changes, this will affect the income. For example if the charging period is shortened, income will reduce.	Medium	Medium (adverse)	Medium
g) Fees & Charges income. If economic conditions deteriorate or demand fluctuates there may be unbudgeted loss of income. Building Control, Planning, Land Charges, Licensing, Pest Control and Food Imports are all income streams where risk of volatility has been noted.	Medium	Medium (adverse)	Medium
h) Planning appeals. In 2012/13 the Council has lost planning appeals leading to substantial unbudgeted costs. It is therefore necessary to flag the risk of similar occurrences in 2013/14.	Medium	Medium (adverse)	Medium
i) Instability of banking industry. The Council has an investment strategy that minimizes the risk to funds on deposit. Reliance is placed on UK banks systemically important to the UK economy and the Government's deposit account facility. Nevertheless if a banking failure occurs, there could be a serious impact on the Council.	Low	High (adverse)	Medium
j) Local Development Framework – The possibility has been identified that additional consultancy spend or resources may need to be brought to bear in order to ensure robustness of the LDF.	Medium	Low (adverse)	Low
k) External funding. Due to inherent uncertainty about local authority budgets, there is a risk that funding for services such as A120 cleaning and the Highways Ranger could be reviewed or reduced.	Medium	Low (adverse)	Low
l) Supplies & Services contracts. Where contracts have indexation clauses, estimates have been made of the inflationary increase that will be applied. In addition some contracts are due to be re-tendered during the year which could affect the base price. Accordingly there is an inherent risk of price volatility.	Medium	Low (adverse or favourable)	Low

Risk item	Prob-ability	Impact	Overall Risk of budget variance
m) Capital Financing costs. These are influenced by variable factors such as cash flow, variations in the Capital Programme and availability of capital receipts. Complex regulations exist which contribute to the difficulty in producing reliable estimates.	Medium	Low (adverse or favourable)	Low
n) Pay award. The cost of living pay award for local authority staff is determined at a national level. There has been no award since 2009. At the time of writing, the 2013/14 award had not been determined. The budget assumes a 1% award, it is possible that the actual award will differ from this. A review of Members Allowances is also due to be completed.	Low	Low (adverse or favourable)	Low
o) Landsbanki. By February 2013, 50% of the deposit has been recovered, and it is expected that the full amount will be paid eventually, although there are no indications of when this might be, and it could take a few years. Residual risk remains because of exchange rate fluctuations and timings of payments which both have potential to affect the accounting value of the deposit. This in turn creates potential for write off adjustments to the revenue account. A contingency reserve has been established which is considered sufficient to absorb the adverse risk without requiring additional contributions from the General Fund.	Low	Low (adverse or favourable)	Low

14. Taking all of the above issues into consideration, the ACE-F is unable to provide a full assurance that there will be no unforeseen variances. This is an expected and acceptable situation for any organisation that has to deal with a large number of variables. Provided that the minimum safe level of balances is maintained (as detailed below), any variations arising as a result of any lack of robustness in the estimates should be manageable.

15. The risks identified will be proactively monitored and mitigating action taken as soon as reliable trends emerge. Budget monitoring reports to Members during the financial year will set out the latest position and action being taken, where applicable.

Adequacy of reserves

16. There is no available guidance on the minimum level of unearmarked reserves that should be maintained. In 2003 CIPFA stated that each authority should determine what is a prudent level of reserves based upon their own circumstances, risks and uncertainties.

17. The revised Medium Term Financial Strategy (MTFS) (elsewhere on the agenda) states that the Working Balance will be maintained at least at the minimum level necessary to provide a safe level of contingency.

18. The MTFFS sets out the basis for determining the minimum level of unearmarked reserves:

- An amount necessary to cover a 2% overrun in gross expenditure. (£0.692m)
- An amount necessary to cover a 2% shortfall in expected gross income. (£0.497m)
- Additional amounts necessary to cover specific risk items, if considered necessary. (other earmarked reserves, such as Waste Management and Change Management, are deemed sufficient)

19. Based on these criteria, the ACE-F assesses that the minimum level of unearmarked reserves necessary is **£1,189,000**.

20. The current forecasted level of the Working Balance as at 31 March 2013 is £1,214,000, which is £25,000 above the minimum level. It is not therefore necessary to recommend that the budget should provide to top up the Working Balance. Nor is it considered appropriate to transfer money to other reserves. Therefore it is recommended that no transfer to or from the Working Balance should be built into the 2013/14 budget.

21. This advice may change if significant changes in the identified risks occur before 28 February.

Earmarked Reserves

22. Earmarked reserves are established for items of future expenditure that the Council knows it will be incurring, but no formal commitment exists and the precise amount and timing is not known.

23. The principal earmarked reserves held by the Council relate to the following:

Budget Equalization – to be drawn upon as part of balancing the budget while savings from the strategic solutions programme start to materialise. The balance on the reserve is forecasted to be £1.25m as at 31 March 2013. The 2013/14 budget assumes a replenishment of £0.22m, bringing the balance to £1.47m. This is adequate to ensure a balanced budget until 2017/18, if the assumptions in the Medium Term Financial Strategy are realised.

Change Management – “Spend to save” money - to enable the Council to secure the capacity and expertise necessary to deliver strategic solutions and efficiency savings. The forecast balance on the reserve as at 31 March 2013 is £0.6m. The budget assumes that £0.1m will be used in 2013/14, leaving a balance of £0.5m. It is considered that this will be sufficient to cover implementation costs arising from the strategic solutions programme. However opportunities to bolster this reserve may need to be taken in the event of large scale change projects arising.

Local Government Resource Review (LGRR) – A reserve established to mitigate risk of adverse fluctuations arising from Government reform of local government finance which is ongoing. Although reasonably reliable figures exist for 2013/14 and 2014/15 there are no indications of what the funding position is to be from 2015/16. A Government Spending Review is due to take place during 2013 that should make the position clearer. In addition to further cuts in core funding there is a clearly identifiable risk arising from Localisation of Business Rates which this reserve helps to mitigate. The balance as at 31 March 2013 is

£0.87m of which £0.25m is committed in 2013/14 to subsidise the LCTS scheme. A review of the scheme will take place in 2013 in order to ensure ongoing sustainability from 2014/15.

Planning Development – for costs associated with major planning issues such as Stansted airport, and to help mitigate planning related risks e.g. appeals and S106 shortfalls. The reserve can also be used to bring about improvements in planning performance. The forecast balance on the reserve is £0.32m as at 31 March 2013. The budget provides for replenishment up to £0.57m. This is considered to be adequate for the intended purpose.

Waste Management – a reserve established to ensure adequate contingency in a service where costs and income are prone to fluctuation. The reserve can also be used to invest in service improvements. The balance on the reserve has reduced to only £66,000, of which £50,000 is committed to fund in-cab technology. Given the degree of volatility surrounding waste related budgets, additional contingency is required, and the budget provides to replenish this reserve to £200,000. Consideration would need to be given to diverting favourable budget variances that may arise in this service to this reserve.

New Homes Bonus – monies received in 2011/12 and 2012/13 but not allocated to specific projects have been placed in this reserve, with a balance of £0.8m at 31 March 2013, of which £40,000 is committed in 2013/14, leaving £0.76m. The intention is to keep the ongoing reforms of local government finance under review and if risk of adverse fluctuation is deemed manageable then to give consideration to making this reserve available to fund new projects.

Landsbanki Contingency – the Council has maintained a reserve in recent years while there was uncertainty about the recoverability of the Landsbanki deposit. Approximately £1.1m is still to be recovered, and is expected to be received in full in due course. As described above, there is residual risk arising from exchange rate fluctuations and the timing of repayments. The balance of £0.12m is considered sufficient to cover this.

Hardship Fund – this reserve, of £100,000, was established in 2011/12 in order to support the Council's homelessness services. In view of the housing benefit reforms referred to above, the reserve may need to be used in 2013/14 in order to prevent or minimise new homeless cases arising.

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
In general, actual events may differ from the assumptions and estimates used to produce the draft budget, which will lead to variances from the budget.	4 (variances will occur requiring action to be taken)	3 (potential impact which could adversely affect the council's financial position if not managed)	Budget monitoring and corrective action taken as necessary. Maintain sufficient reserves and Working Balance.