

**Committee:** Cabinet

**Agenda Item**

**Date:** 16 February 2012

**13v**

**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 23 February as part of the budget approval process.
3. The Scrutiny Committee reviewed the report on 7 February and endorsed the recommendations. When discussing the report, the Scrutiny Committee Members noted in particular risks relating to Revenues and Benefits arising from Government reform of the benefits system.

## Recommendations

4. The Cabinet is requested to recommend that Full Council:
  - a) takes account of the advice in the report when determining the 2012/13 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 2012/13 at £1,214,000
  - d) agrees that the 2012/13 General Fund budget should include provision to increase the Working Balance up to the minimum safe level (an increase of £33,000).

## Background Papers

5. The following papers were referred to by the author in the preparation of this report and are available for inspection from the author of the report.

Local Government Act 2003  
Guidance Note on Local Authority Reserves and Balances – CIPFA 2003  
Medium Term Financial Strategy  
Budget reports and working papers

## Impact

Communication/Consultation	No specific implications
Community Safety	No specific implications
Equalities	No specific implications
Finance	Detailed in the report
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 2012/13.
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 £1,214,000. The current forecasted level of the Working Balance is £1,181,000. The ACE-F's advice therefore is that an increase in the Working Balance of £33,000 is required. The General Fund budget elsewhere on tonight's agenda includes provision to make the recommended increase.
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 2012/13 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 2012/13 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

Major risk item	Prob-ability	Impact	Overall Risk of budget variance
<p>a) <b>Refuse &amp; Recycling.</b> In 2012/13 a new waste service is to be implemented involving a new working week, new vehicles and new rounds, and a new garden waste service. The budget includes estimates of one off costs, expenditure and income under the new arrangements. There is a high level of estimation involved. It is assumed that there will be no slippage in the implementation plan.</p> <p>The budget has been prepared before key variables are resolved, and the outcome of a tender exercise involving vehicle provision and maintenance is subject of a separate report elsewhere on this agenda. Assumptions have been made that a new finance lease will be commenced and that maintenance will remain in-house. Further tender proposals are expected before the date of the Committee meeting for the supply of vehicles and design and build of a new workshop which will clarify capital costs. Other outcomes are possible but are unlikely to be selected if they involve significant additional cost. Long term depot provision is also unresolved.</p> <p>There is a specific risk item relating to the planned tender of the recyclables contract, which is expected to secure a significant income stream. Such markets are volatile so there is a risk that the expected income levels will not be secured.</p> <p>In addition there is an inherent volatility of costs and income in the waste service, with a high degree of variability experienced in recent years.</p> <p>The risks will be mitigated through use of the Waste Management Reserve and proactive management and budgetary control. Nevertheless the level of change surpasses that seen for many years and it is inevitable that budget variation will occur.</p>	High	High (adverse or favourable)	High
<p>b) <b>Revenues &amp; Benefits.</b> 2012/13 will be a challenging year for this service. There are plans to set up a partnership with Harlow and the Council is required to establish a new localised scheme of Council Tax Support by January 2013, for implementation in April 2013, to replace the existing Council Tax Benefit scheme.</p> <p>Both projects create potential for disruption to the service and will consume significant resource, potentially affecting performance. The service administers benefit claims totaling around £19.5 million and financial penalties for errors can be severe. The service collects around £50 million of council tax income and £35 million of business rates so small changes in collection performance can have a significant impact.</p> <p>The risks need to be mitigated through ensuring there is strong project management resource available and strong attention to performance management. Use of temporary staffing resources to overcome any short term performance issue will be imperative. Nevertheless even with mitigation the scale of challenges upon the service render this a high risk area in budget terms.</p>	High	High (adverse)	High

Major risk item	Prob-ability	Impact	Overall Risk of budget variance
<p>c) <b>Efficiency Savings.</b> The 2012/13 budget includes approximately £1m of efficiency savings and additional income generation (including car parks and recyclables as mentioned elsewhere in this report). These are set out in the budget and MTFS papers. There is reasonable confidence that the savings will be achieved as in most cases work to realise the saving has been completed. However there is inherent risk of outcomes being different to expectation. Work is actively underway on all workstreams which will result in further projects being approved and budget savings being made. It is likely, based on prior experience, that some savings opportunities will be realized earlier than expected with unbudgeted savings arising in 2012/13. 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 and/or external funding support. It is probable that unbudgeted costs will arise.</p>	High	Medium (adverse or favourable)	High
<p>d) <b>Supplies &amp; Services contracts.</b> Where contracts have indexation clauses, estimates have been made of the inflationary increase that will be applied. Inflation is falling however so the risk is not felt to be high at this stage. 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.</p>	Medium	Medium (adverse or favourable)	Medium
<p>e) <b>Fees &amp; Charges income</b> Attempts have been made to ensure that realistic estimates of income are included in the budget, but if economic conditions deteriorate there may be unbudgeted loss of income. Future charging arrangements for Licensing and Planning are under review by Government, adding uncertainty.</p>	Medium	Medium (adverse)	Medium
<p>f) <b>Capital Financing costs.</b> These are influenced by variable factors such as cash flow, variations in the Capital Programme and availability of capital receipts. Assumptions have been made about vehicle finance lease costs. Complex regulations exist which contribute to the difficulty in producing reliable estimates. There is a risk of favourable or adverse variances arising.</p>	Medium	Medium (adverse or favourable)	Medium
<p>g) <b>New Homes Bonus.</b> The Council has been allocated a provisional award of £1.248 million for 2012/13 (subject to confirmation). The budget includes proposals to make £708,000 available for one-off projects in 2012/13. Experience in 2011/12 would suggest that there is a possibility that progress in spending the money may be slower than anticipated.</p>	Medium	Medium (favourable)	Medium

Major risk item	Prob-ability	Impact	Overall Risk of budget variance
h) <b>Instability of banking industry.</b> 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) Up to £3m in a worse case scenario	Medium
i) <b>Car Parks Income.</b> A new tariff is due to come into effect on 16 April, and new payment methods are to be introduced. A forecast of the effect on income levels has been built into the budget. As with any revision in fees there is a risk that customer behaviour may temporarily change and outcomes may be different to those expected.	Medium	Low (adverse)	Low
j) <b>Landsbanki.</b> The situation is more positive than previously. Priority creditor status has been confirmed and the final step in the legal process was concluded on 19 January. Confirmation of the amounts and timing of distributions is awaited. 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. However, the adjustments posted to the accounts in previous years should be sufficient so remaining risk is felt to be low. If distributions are better than previous expectations, it is possible that an element of the write off adjustment already made will need to be reversed which will result in a credit being applied to the revenue account.	Low	Medium (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 MTFS sets out the basis for determining the minimum level of unearmarked reserves:
    - An amount necessary to cover a 2% overrun in gross expenditure. (2012/13 Gross Expenditure = £35.2m, 2% = £0.704m)
    - An amount necessary to cover a 2% shortfall in expected gross income (2011/12 Gross Income = £25.5m, 2% = £0.510m)
    - 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 **£1,214,000**.
  20. The current forecasted level of the Working Balance as at 31 March 2012 is £1,181,000, £33,000 below the minimum safe amount. The ACE-F's advice therefore is that an increase in the Working Balance is required. The General Fund budget elsewhere on tonight's agenda includes provision to increase the Working Balance by £33,000.
  21. This advice may change if significant changes in the identified risks occur before 23 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 £1.4m as at 31 March 2012. The 2012/13 budget assumes a withdrawal of £0.179m, leaving a balance of £1.221m. This is adequate to ensure a balanced budget until 2016/17, if the assumptions and savings targets described in the Medium Term Financial Strategy are realised. In the event of any slippage in the savings programme, the Council will need to identify opportunities to bolster this reserve.

**Landsbanki Contingency** – the Council has maintained a reserve in recent years while there was uncertainty about the recoverability of the Landsbanki deposit. As described above, the uncertainty has been greatly reduced such that it is no longer felt necessary to maintain a contingency reserve. The budget assumes that the unused balance on the reserve will be transferred to Change Management.

**Change Management** - to enable the Council to secure the capacity and expertise necessary to deliver strategic solutions. The forecast balance on the reserve as at 31 March 2012 is £1.255m. £250,000 is budgeted to be used in 2012/13 leaving an uncommitted balance of £1.005m. It is considered that this will be sufficient to cover implementation costs arising from the strategic solutions programme.

**Housing Benefits** – established as a contingency against adjustment to the Government grant claim that may be made in the event of errors found during the audit process. Adjustments can be significant bearing in mind the size of the claim (approx £19.5 million). In addition the reserve can be used to obtain temporary staffing resource to ensure that the service has the capacity needed to deliver the service. The balance on the reserve is estimated at 31 March 2012 to be £0.346m which is considered to be sufficient given current performance levels however there is a need to manage additional risk as described in the risk analysis above.

**Planning Development** – for costs associated with major planning issues such as Stansted airport. The reserve can also be used to bring about improvements in planning performance. The forecast balance on the reserve is £0.308m as at 31 March 2012. 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 is £0.220m. As described above there is a high degree of risk in this budget area. Consideration would need to be given to diverting favourable budget variances that may arise in this service to this reserve.

---

## 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.	3 (some risk that 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.