

Committee: Finance & Administration Committee
Date: 8 February 2011
Title: Robustness of Estimates and Adequacy of Reserves
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Agenda Item

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Item for decision

Summary

1. 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 2011/12.
2. 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.
3. The ACE-F has assessed that the minimum safe contingency level is £1,130,000. The current forecasted level of the Working Balance is £1,181,000. The ACE-F's advice therefore is that no additional increase in the Working Balance is required. The ACE-F is not recommending that the balance be reduced. The General Fund budget elsewhere on tonight's agenda includes no transfers in or out of the Working Balance.
4. 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.

Recommendations

5. Members are requested to recommend that Full Council on 24 February:
 - a) takes account of the advice in the report when determining the 2011/12 General Fund budget and Council Tax
 - b) sets the minimum safe contingency level for 2011/12 at £1,130,000
 - c) agrees that no transfers to or from the Working Balance are required in the 2011/12 General Fund budget
 - d) approves the risk assessment relating to the robustness of estimates as detailed in the report.

Background Papers

6. 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

Basis of advice for the Section 25 report

7. 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 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 2011/12 budget.

Robustness of Estimates

8. There has been detailed scrutiny, review and challenge of budgets by managers, finance officers and SMB. 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 current staffing levels, and income budgets are based on an assessment of price and demand. Each budget has received pre-scrutiny by the responsible Committee prior to consideration by Finance & Administration Committee and Full Council.
9. 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 2011/12 and an indication of the possible impact. Attached at the end of the report are the detailed risk assessments received by each Committee as part of the budget review process in January.
10. 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	Probability	Impact	Overall Risk of budget variance
a) Landsbanki. The amount at risk is £2.3m. The Council is required to write off an estimate of the irrecoverable sum in the 2010/11 accounts. Legal proceedings are ongoing in Iceland to determine whether UK local authorities are to be treated as priority creditors. The estimated recovery for priority claims is 93%. Non-priority claims may realise up to around 30%. The Council has established a Contingency Fund of £1.2m which is expected to be sufficient, which means it is unlikely that any additional contribution in 2011/12 shall be required. Accordingly there is nothing in the budget for Landsbanki losses in 2011/12. In the event of a worse case outcome it is possible that additional write off will be necessary and this remains a major risk item. Conversely, an improved position could result in Contingency monies to be freed up for other purposes.	Medium	High (Adverse) Up to £1.1m in a worse case scenario	High

Major risk item	Probability	Impact	Overall Risk of budget variance
<p>b) New Homes Bonus. As reported to Full Council in December, the Government has proposed a new funding stream for councils to reward increases in housing supply. It is possible that the Council will earn substantial sums from this scheme. Nothing is included in the budget because (a) the scheme is subject to confirmation (b) the Government has indicated that the scheme may be funded by reductions to other grants to local government (c) over-budgeting for specific grant schemes contributed to the Council's problems in the past. The Development Control Committee decided that it would be imprudent to include a budget for this item.</p>	Medium	<p>High (favourable) Up to £0.87m if proposals are confirmed in full with no adjustments elsewhere</p>	High
<p>c) Strategic Solutions. Work is actively underway on all workstreams which will result in projects being approved and budget savings being made. The 2011/12 budget includes savings for projects that have been completed and where savings are confirmed. No adjustments are included for projects that are in progress and the savings are not yet confirmed. 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 almost certain that unbudgeted costs will arise and probable that additional savings will be made.</p>	High	<p>Medium (adverse) Unbudgeted costs to be met from Change Management reserve Medium (favourable) Additional savings to be realised</p>	High
<p>d) Revenues & Benefits. This item is flagged as high risk in the detailed risk assessment attached at the end of this report. Implementing the partnership in 2011/12 could result in unbudgeted costs and/or fluctuations in performance that have financial consequences. Conversely, a smooth and successful implementation could result in a net saving being realised before the end of the financial year. Some support service budget savings are predicated on the assumption that the partnership will go ahead in October.</p>	High	<p>Medium (adverse or favourable)</p>	High

Major risk item	Probability	Impact	Overall Risk of budget variance
<p>e) Local Amenities. This item is flagged as high risk in the detailed risk assessment attached at the end of this report. There is a risk that Section 106 funds will not be sufficient to finance ongoing commitments. Following an unsuccessful tendering exercise grounds maintenance contract is currently being brought in house. This is likely to entail unbudgeted implementation costs. It is expected that day to day costs can be managed within existing budgets but as with any significant change budget variations can occur.</p>	Medium	Medium (adverse)	Medium
<p>f) Refuse & recycling. These budgets have significantly underspent in recent years. A Zero Based Budget exercise has been carried out for 2011/12 which means that there is no contingency for unforeseen events or adverse circumstances. Costs and income relating to waste are variable and there is always an inherent possibility of budget variances arising. There are specific uncertainties relating to disposal costs and the level of trade waste income. A Waste Management Reserve of £282,000 has been established, with a proposal in the 2011/12 budget to increase this to £400,000.</p>	Medium	Medium (adverse or favourable)	Medium
<p>g) Housing & Council Tax Benefits.</p> <p>For 2011/12 total benefits expenditure is estimated at around £18.2m with an average grant subsidy of 97.8% i.e. grant income of £17.8m. This is subject to many variable factors including accuracy of processing, and the actual subsidy received may be lower or higher. With large sums involved, relatively small fluctuations can have a large impact.</p> <p>As at the time of preparing this report, the 2009/10 grant claim had not been settled by DWP. The External Auditor reported that errors had been made so it is possible that some grant will be clawed back. During 2011/12, the external audit of the 2010/11 grant claim will be carried out. If errors are identified that affect entitlement to grant, these will need to be adjusted for. A Benefits reserve of £120,000 has been established.</p>	Medium	Medium (Adverse) Possible six figure sum if DWP take a hard line.	Medium

Major risk item	Probability	Impact	Overall Risk of budget variance
h) Fees & Charges Income. 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. Some fees have been increased this year in line with the Pricing & Concessions Policy, which could have unforeseen effects. New statutory charging requirements for Building Control and Planning will have an effect in 2011/12. The position regarding land charges has clarified but there is a risk of further Government guidance in this area.	Medium	Medium	Medium
i) 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. There is a risk of favourable or adverse variances arising.	Medium	Medium (adverse or favourable)	Medium
j) 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) Up to £3m in a worse case scenario	Medium

11. Taking all of the above issues into consideration, together with the detailed risk assessments attached, the ACE-F's opinion is that the Council's estimates are not absolutely robust so he is unable to provide a full assurance that there will be no unforeseen adverse 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.

12. 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

13. 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.
 14. 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.
 15. 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. (2011/12 Gross Expenditure = £33.5m, 2% = £0.67m)
 - An amount necessary to cover a 2% shortfall in expected gross income (2011/12 Gross Income = £23.0m, 2% = £0.46m)
 - Additional amounts necessary to cover specific risk items, if considered necessary. (other earmarked reserves, such as Waste Management and Change Management, are deemed sufficient)
 16. Based on these criteria, the ACE-F assesses that the minimum level of unearmarked reserves necessary is **£1,130,000**.
 17. The current forecasted level of the Working Balance as at 31 March 2011 is £1,181,000, £51,000 above the minimum safe amount. The ACE-F's advice therefore is that no increase in the Working Balance is required. The ACE-F is not recommending that the Working Balance be reduced. The General Fund budget elsewhere on tonight's agenda includes no transfers to or from the Working Balance.
 18. This advice may change if significant changes in the identified risks occur before 24 February.
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Earmarked Reserves

19. 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.
20. The principal earmarked reserves held by the Council relate to the following:

Landsbanki Contingency – to absorb the reduction in the value of the deposit placed in the failed Icelandic bank, Landsbanki. At time of preparing this MTFS it is estimated that the amount to be written off in 2010/11 is £1.162m. The forecast balance on the reserve as at 31 March 2011 is £1.162m so is deemed to be adequate based on the current information available. If the situation in Iceland deteriorates during 2011, additional contingency provision may be required.

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 £0.268m as at 31 March 2011. This is considered to be adequate for the intended purpose.

Change Management - to enable the Council to secure the capacity and expertise necessary to deliver strategic solutions. Implementation costs of the strategic solutions have not been quantified. The forecast balance on the reserve as at 31 March 2011 is £0.131m, to which will be added the underspend arising in 2010/11, currently forecasted to be £0.584m giving an estimated total of £0.715m. £76,000 is budgeted to be used in 2011/12 leaving an uncommitted balance of £0.639m. Together with external funding support it is considered that this will be sufficient to cover implementation costs arising from the strategic solutions programme.

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 £1.215m as at 31 March 2011. The 2011/12 budget assumes a withdrawal of £0.118m, leaving a balance of £1.097m. This is adequate to ensure a balanced budget until 2015/16, if the 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.

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 £0.282m. The 2011/12 budget includes provision to increase this balance to £0.4m.

Risk Analysis

21. The risk analysis is provided above. The mitigating action is proactive budgetary control as referred to in paragraph 13.

RISK ASSESSMENT – IN GENERAL

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.	2 (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.

Detailed risk assessments accompanying budgets approved by Committees in January are attached.

COMMUNITY & HOUSING COMMITTEE BUDGETS RISK ANALYSIS

Risk	Likelihood	Impact	Mitigating actions
Day Centres – in November the Committee endorsed Scrutiny Committee recommendations decided that alternative models for service provision be explored. Subject to the completion and implementation of any review, this could affect the 2011/12 budget	3 (likely that changes will be made)	2 (sums involved are not material)	Ensure financial implications of any changes are identified before decisions taken
Homelessness – B&B budgets reduced due to new facility being available, however with any new arrangement risks of variable costs exist. Service depends on £85,000 of Government grant, which appears to be safe for the time being.	2 (inherent risk in all new ways of working)	2 (sums unlikely to be significant)	Budget monitoring
Leisure PFI – service depends on £450,000 of Government grant, which appears to be safe for the time being. Inherent risks associated with a complex and major contract. Indexation estimate is based on RPI forecast.	2 (inherent risk in contracts of this type)	3 (if a serious problem arises, sums involved could be significant)	Contract management
Pest Control – seasonal variations affect demand for services such as wasp control. Private sector alternatives exist so there is a risk of loss of income due to competition.	3 (variability of some sort is common)	2 (amounts involved are not material)	Budget monitoring
Public Health – airport related income is variable due to commercial changes and economic downturn	2 (some risk)	2 (variances unlikely to be material)	Budget monitoring
Sports Development – risks to income from customers and partners due to economic downturn	2 (some risk)	2 (variances unlikely to be material)	If income reduces, activities will be curtailed.

DEVELOPMENT CONTROL COMMITTEE BUDGETS RISK ANALYSIS

Risk	Likelihood	Impact	Mitigating actions
<p>Development Control - There are risks to the level of planning fee income. It is assumed that planning applications will continue to come in at the current rate. There is a risk that activity will slow down due to the recession. The Government is consulting on a new system of setting fees to recover costs. A separate costing exercise will need to be done to ensure costs are recovered.</p>	<p>2 (some risk that variances will occur requiring action to be taken)</p>	<p>3 (potential impact which could adversely affect the council's financial position if not managed)</p>	<p>Budget monitoring and corrective action taken as necessary.</p> <p>Costing exercise and new scale of fees to be implemented from October 2011.</p>
<p>Development Control - There is a risk of appeals costs falling upon the Council.</p>	<p>2 (raised likelihood due to the large applications currently and soon to be determined)</p>	<p>3 (amounts involved potentially significant)</p>	<p>Take care to ensure due process followed. Maintain reserves at a safe contingency level.</p>

ENVIRONMENT COMMITTEE BUDGETS RISK ANALYSIS

Risk	Likelihood	Impact	Mitigating actions
Building Surveying: There are risks to the level of building control fee income. It is assumed that applications will continue to come in at the current rate. There is a risk that activity will slow down due to the recession.	2 (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. Monitor impact of new scale of fees and adjust as necessary.
Local Amenities: there is a risk that Section 106 funds will not be sufficient to finance ongoing commitments. A new grounds maintenance contract is currently being tendered and cost increases are considered probable. Either the increased costs will have to be met or specifications reduced.	3 (strong likelihood that adjustments to the level of activity will be required and/or additional funding needed to meet commitments)	3 (potential impact which could adversely affect the council's financial position if not managed)	Audit of Section 106 commitments. A review of grounds maintenance activity.
On Street Parking – subject to development of the arrangements between the County Council and Colchester Parking Partnership, there is a risk that UDC will have to fund a share of any trading deficit that is incurred.	2 (any new arrangements give rise to financial risk and uncertainty)	2 (Uttlesford represents a relatively small proportion of the volume of activity)	Influence decision making by being a member of the Parking Partnership Board
Street Cleansing – inherent risk of fluctuation on commodity items like fuel and grit. ECC funding position for A120 uncertain.	2 (inherent risk)	2 (amounts involved unlikely to be material)	Monitor and take corrective action if necessary.
Waste Management – zero based budget review means that there is no contingency for unforeseen events or adverse circumstances.	3 (refuse & recycling costs and income are inherently volatile)	2 (underspends no longer likely but possibility of unbudgeted costs exists)	Maintain Waste Management contingency reserve

FINANCE AND ADMIN. COMMITTEE BUDGETS RISK ASSESSMENT

Risk	Likelihood	Impact	Mitigating actions
<p>Revenues & Benefits – implementing the partnership in 2011/12 could result in unbudgeted costs and/or fluctuations in performance that have financial consequences. Conversely, a smooth and successful implementation could result in a net saving being realised before the end of the financial year. Some support service budgets are predicated on the assumption that the partnership will go ahead in October.</p>	<p>3 (probable that some variances will arise)</p>	<p>3 (sums involved potentially significant due to the complexity of the project)</p>	<p>Project management and oversight by Joint Committee</p>
<p>Corporate Management – if the national local government pay award differs from the assumed level, there will be a budget variance.</p>	<p>3 (a strong chance that the pay award will differ, or there will be no award at all)</p>	<p>2 (in view of current climate unlikely to be significant unbudgeted costs)</p>	<p>Tolerate the risk but keep abreast of status of pay negotiations</p>
<p>Corporate Management – external audit fees – the budget assumes a 5% saving in line with the Audit Commission's proposed scale of fees. However the actual fee payable is subject to locally determined factors.</p>	<p>2 (possible that the local auditor will determine that a different level of fee is applicable based upon their risk assessment)</p>	<p>2 (existing budgeted fee already above average so unlikely to see significant increases beyond that)</p>	<p>Oversight by Performance Select Committee</p>
<p>Democratic Representation – in 2011 a Cabinet style of governance is to be implemented. A new system of Members allowances will be adopted. The frequency and volume of committee meetings will change.</p>	<p>2 (possible changes in the total level of allowances & expenses payable)</p>	<p>1 (the objective of cost neutrality or better has been identified)</p>	<p>Independent Remuneration Panel</p>
<p>Financial Services – Insurance - It is assumed that the 2011/12 renewal (w.e.f. 1 October) will achieve a cost neutral outcome i.e. any inflationary uplift will be offset by negotiated reductions and/or risk transfer to the Council.</p>	<p>2 (a cost neutral outcome may not be possible)</p>	<p>2 (there may be a modest cost increase although the nature of the long term agreement should keep this to a minimum)</p>	<p>Liaison with Zurich</p>

Risk	Likelihood	Impact	Mitigating actions
Financial Services. There is a dependency on external support in some areas e.g. systems support, asset management. The arrangements may come to an end if there are problems within partner organisations	2 (inherent risk in partnership working)	2 (alternatives would need to be sought that have additional cost and/or some activity would have to be scaled down)	Relationship management
Information Technology – IT contractual indexation assumed at 3%. Actual increases will vary depending on RPI and contract terms.	3 (Inflation levels fluctuate)	2 (extra indexation over 3% should not be significant)	Supplier management
Land Searches - It is assumed that search fees will continue to be received at the same rate. The government has promised further guidance on what can and cannot be charged for which may reduce income and the assumption also depends heavily upon the strength of the housing market.	3 (further Government guidance expected)	2 (following substantial clarification in 2010 further changes unlikely to have a material impact)	Tolerate the risk and keep abreast of developments

LICENSING COMMITTEE BUDGETS RISK ASSESSMENT

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.	2 (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. Licensing Reserve will be used to even out surpluses and deficits arising.