

Committee: Scrutiny

Agenda Item

Date: 6 February 2014

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Title: Robustness of Estimates and Adequacy of Reserves

Author Stephen Joyce
Assistant Chief Executive – Finance

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 Cabinet on 18 February and Full Council on 27 February as part of the budget approval process.
3. There is an opportunity for the Scrutiny Committee to review the report and provide comments in support of the recommendations, or to propose alternatives. Examples of the questions Scrutiny may wish to consider are:
 - Are the risks clearly explained?
 - Is the advice about minimum safe contingency reserves proportionate to the risks involved?
 - Is the level of reserves held by the Council appropriate?

Recommendations

4. The Scrutiny Committee is requested to endorse the following recommendations to Cabinet, or suggest alternatives.
 - a) That the Cabinet recommends to Full Council that it takes account of the advice in the report when determining the 2014/15 General Fund budget and Council Tax.
 - b) That the Cabinet recommends to Full Council that it approves the risk assessment relating to the robustness of estimates as detailed in the report
 - c) That the Cabinet recommends to Full Council that it sets the minimum safe contingency level for 2014/15 at £1.2 million.
 - d) That the Cabinet recommends to Full Council that no transfers to or from the Working Balance should be built into the 2014/15 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 2014/15.
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 £1,200,000. 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 2014/15 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 2014/15 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) Waste & Recycling – This service continues to be the most complex financially and at greatest risk of volatility. Major risks are emerging in relation to the recyclables contract. Fuel costs are variable. Other budget risks have been identified regarding 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 risk.</p>	High	High (adverse or favourable)	High
<p>b) Localisation of Business Rates. The actual share retained by UDC will not be known until well after the end of the financial year and will depend on many variables including collection performance, value of new ratings, appeals, refunds, and reliefs granted. Because of known risks relating to potentially substantial appeals, the budget prudently assumes that the Council's share will be at the minimum safety net level. Accordingly there is no downside risk in terms of budgeted income. The downside risk relating to loss of unbudgeted income is considerable and the upside opportunity is potentially significant if growth and other outcomes exceed losses.</p>	High	High (favourable)	High
<p>c) 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. The Fritch Green community centre is unresolved and the Council may be required to incur further costs before the facility is transferred to the parish council.</p>	High	Medium (adverse)	Medium
<p>d) Efficiency Savings. Work continues to find ways of achieving the same or improved outcomes at lower cost. It is probable that some savings opportunities will be realized with unbudgeted savings arising in 2014/15. 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. Where budgets have already been reduced because of identified savings, the revised budget level is untested so there is an inherent risk of adverse variances. The Museum's budget has been reduced to its target minimum level which is likely to pose some challenges.</p>	Medium	Medium (adverse or favourable)	Medium

Risk item	Prob-ability	Impact	Overall Risk of budget variance
<p>e) 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, or if there is a repeat of Christmas/New Year free periods, income will reduce.</p>	Medium	Medium (adverse)	Medium
<p>f) Fees & Charges income. If economic conditions deteriorate or demand fluctuates there may be unbudgeted loss of income. Building Control, Planning, Land Charges, Licensing, Lifeline, Pest Control and Food Imports are all income streams where risk of volatility has been noted.</p>	Medium	Medium (adverse)	Medium
<p>g) Planning appeals. A risk of costs of defending appeals and the meeting costs awarded against the planning authority. The likelihood of both elements is raised by the large applications currently and soon to be determined.</p>	Medium	Medium (adverse)	Medium
<p>h) Treasury management. Investment risks are spread between public and private sector counterparties including UK banks systemically important to the UK economy. In the unlikely event of a banking failure, there could be a serious impact on the Council. Landsbanki related risks are expected to be resolved before the start of 2014/15.</p>	Low	High (adverse)	Medium
<p>i) 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. The Council has committed to subsidise the LCTS scheme to ensure cost neutrality for major precepting authorities. This is based on estimates and subject to variation. The LGRR reserve mitigates this risk.</p> <p>Housing Benefit reforms including the 'Spare Room Subsidy' and 'Benefit Cap' affect working age people living in rented accommodation. In some cases 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. Discretionary Housing Payments and Council Tax Hardship policies and budgets are available to assist those in genuine need. The budget includes an increase in the Homelessness service resources in order to meet anticipated increased demand.</p>	High	Low (adverse)	Medium

Risk item	Prob-ability	Impact	Overall Risk of budget variance
j) Local Plan – The possibility has been identified that additional consultancy spend or resources may be needed in order to ensure robustness of the Local Plan. The Planning Reserve exists to meet such costs so the risks to the budget bottom line are low.	Medium	Low	Low
k) Fritch Green Community Centre. Risks have been identified with the Fritch Green community center. This issue is unresolved and the Council may be required to incur further costs before the facility is transferred to the parish council.	Medium	Low (adverse)	Low
l) Office improvements. The Council is waiting for the results of a condition survey on the Saffron Walden offices and museum buildings. As a result it is not currently known whether the existing maintenance budgets will be sufficient, or too high. The possibility of additional capital expenditure being required could have an impact on capital financing costs within the revenue budget.	Medium	Low (adverse)	Low
m) 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	Low
n) 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
o) Capital Financing costs. These are influenced by variable factors such as cash flow, variations in the Capital Programme and availability of capital receipts. In some circumstances greater revenue financing of capital expenditure may make economical sense over the longer term.	Medium	Low (adverse or favourable)	Low
p) Pay award. The cost of living pay award for local authority staff is determined at a national level. At the time of writing, the 2014/15 award had not been determined. The budget assumes a 1% award, it is possible that the actual award will differ from this.	Medium	Low (adverse or favourable)	Low

Risk item	Prob-ability	Impact	Overall Risk of budget variance
q) Individual Electoral Registration. IER will be introduced from July 2014 and the full impact is presently unclear. It is practically certain that extra expenditure will arise but it is not presently possible to estimate the extent of the cost. A Cabinet Office grant has been allocated (£26,702) to be paid in April 2014. It is possible that the actual costs will exceed this amount.	Low	Low (adverse)	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. (£0.7m)
- An amount necessary to cover a 2% shortfall in expected gross income. (£0.5m)
- 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 **£1.2 million**.

20. The current forecasted level of the Working Balance as at 31 March 2013 is £1,214,000, which is £14,000 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 2014/15 budget.
21. This advice may change if significant changes in the identified risks occur before 27 February.
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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 pending the realisation of savings from strategic initiatives. The balance on the reserve is forecasted to be £1.84m as at 31 March 2014. The 2014/15 budget assumes that £0.75m will be used to fund the pension deficit payment, to be replenishment in the subsequent two years. The reserve is at level sufficient to ensure a balanced budget for the Medium Term Financial Strategy period.

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 2014 is £0.52m. There are no planned uses of the reserve in the 2014/15 budget, but as noted above, it is probably that schemes will be identified in-year. The reserve balance is considered sufficient to meet implementation costs arising from change projects. 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 2014/15 and 2015/16 there are no indications of what the funding position is to be from 2016/17 and there is material uncertainty about New Homes Bonus from 2017/18. The balance as at 31 March 2014 is £0.89m and the 2014/15 has a proposal to increase this to £0.96m. Along with other contingency reserves this is sufficient to ensure stability of the Council’s finances during the MTFs period.

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 £0.72m as at 31 March 2014. 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 £0.2m; the scale of possible adverse variances means that 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 2014. There are no commitments against this reserve. 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.

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 and pressures on the homelessness service, the reserve may need to be used in 2014/15 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.