ANNEX 5

ROBUSTNESS OF THE BUDGET

CONTENTS

APPENDICES

Robustness of the Budget and Adequacy of Reserves

1. Introduction

The Local Government Act (Part II) 2003 requires a council's Chief Finance Officer (CFO) to report to councillors on the robustness of budget estimates and the adequacy of that council's financial reserves. The City Council's CFO (also known as the Section 151 officer) holds the post of Acting Director of Strategic Finance. A summary of this evaluation is set out below.

2. Overall Robustness of the Budget

The City Council's annual budget is constructed in order to deliver the Council Plan. The Medium Term Financial Strategy (MTFS) is the overarching framework within which the Council's financial planning and management activity takes place. The annual budget is an integral part of the rolling 3-year Medium Term Financial Plan (MTFP). This approach enables it to support delivery of the Council's priorities, services and improvements. It provides the means by which planned spending may be controlled within available resources. Therefore, this assessment of the robustness of the budget focuses on the likelihood that actual spending will vary from the budget and the consequent impact on the financial health of the organisation.

The Council is a going concern and the budget process is part of a continuous service planning and financial cycle. Therefore, a wealth of knowledge and understanding of the previous and current local and national financial and economic environments is used to make informed assumptions and judgements about the future. This activity seeks to establish a robust budget which is appropriate, realistic and constructed having taken a practical and appropriate assessment of risk.

Many of the details used to inform this assessment are set out in the other Annexes of this report and are therefore not replicated here.

Assumptions

Underlying assumptions have been examined and found to be satisfactory as follows:

- The funding for inflationary pressures is considered to be appropriate, being consistent with known trends and reasonable forecasts.
- The income aspects of the overall budget are calculated based on previous and current trends, known influences and identified risks.
- There are appropriate bad debt provisions in place.
- Other known trends and known and potential pressures (e.g.: demographic changes, new legislation, changes of use etc.) have been evaluated, subjected to various peer reviews and professional challenge and adequately provided for.
- The organisational and financial frameworks and processes required in order to operate within the proposed budget are practical and adequately planned.
- Capital receipts used in the funding of the capital programme have been based on professional estimates both of timing and value with a specific risk assessment applied to determine likelihood of receipt.

Other mechanisms have been used in order to confirm the robustness of the budget estimates, which sit within an overarching planning and governance framework. These include:

- The strength and use of current performance and financial management procedures and reporting and forecasting arrangements (including for example: the Annual Governance Statement, internal and external audit reports, monitoring and forecasting reports, the performance appraisal system, performance boards and the accountability letters).
- The extent, value and complexity of the individual and collective proposed savings in the context of the overall MTFP.
- The track record of services in relation to the implementation of previous and current budget proposals.
- The track record of services in being able to deliver services within budget and deal with emerging pressures within budget.
- The degree and quality of engagement by colleagues and councillors in the process to develop and construct the budget.
- The qualifications, experience and contribution of professional colleagues (ie: finance and HR) engaged throughout the process.
- Proposed rent levels and collection rate trends.
- The introduction and use of various gateways in relation to recruitment to permanent posts, of agency staff and the use of consultants.
- The proportion and profile of savings that is permanent, ongoing and sustainable. For example service transformation, workforce reduction, divestment, increased income etc.
- The level of expenditure and income that is one-off in nature.
- The process for the identification and evaluation of current contingent liabilities as set out in the most recently published Statement of Accounts.
- A review of the movements in and availability of contingency, provisions and earmarked reserves to meet unforeseen and emerging future cost pressures.
- The use of professional experience and best professional judgment, supported by appropriate professional and technical guidance.

<u>Linking Service Delivery to the Budget</u>
In addition to reviewing the framework for the construction of the budget, the CFO has also considered the adequacy of the processes through which it is then delivered, taking account of the fact that:

- Local government continues to see significant reductions in national funding and major changes to national policy.
- The Government's welfare reform programme has brought significant costs for local authorities, such as the localisation of Council Tax Support to replace the national council tax benefit scheme, as well as the other costs associated with helping citizens prepare for significant changes to Housing Benefit etc.
- The Council has a three-year financial plan, providing a clear framework for both financial and non-financial plans and ensuring an alignment of financial resources with organisational priorities.

- Budgets have been constructed following detailed guidelines, based upon a baseline of the current policy framework and previously agreed levels of service, and that all service investments and reductions are identified separately.
- There has been widespread and practical engagement throughout the budget development and construction process with all senior colleagues and Executive Councillors.
- There have been extensive briefings of colleagues and Executive Councillors in relation to the financial position and the reasons for it. There has also been a wide range of communications with stakeholders. All this has built a good degree of understanding of the issues and how this has impacted on the budget.
- Budgets have been subject to review by senior finance colleagues throughout the process in terms of reasonableness and accuracy.
- Elements of the budget have been subjected to peer review and challenge.
- The City Council's budget process provides all stakeholders with an opportunity to analyse and review the financial plans being proposed. Feedback has been sought on the detailed proposals from a number of sources, including councillors, trades unions, colleagues, the business representatives and community groups.
- The Corporate Leadership Team (CLT) has reviewed detailed information on the budget and associated issues and has been fully engaged in working up, analysing and recommending options.
- There is a clear performance management regime in place, with clear accountability of individuals and teams for the delivery of services within budget and including the delivery of all budget proposals. This starts with the individual Accountability Letters issued to all managers and financial targets being reflected in performance objectives and continues throughout the year within the performance appraisal process.

Monitoring – a confirmation of the robustness of the budget

The Council's financial controls are set out within financial regulations, allowing significant assurance of the strength of financial management and control throughout the Council. Formal accountability letters are sent to senior managers setting out their personal financial responsibilities, including implementation of savings and investments.

These arrangements provide a framework for financial monitoring and regular reports setting out spending to date and a projection to the year-end are provided to the CFO, Departmental Leadership Teams and CLT. In parallel, section plans are formulated and delivered to manage and minimise any significant variations to approved budgets.

These are supported by the current arrangements for reporting to councillors, through which reports are reviewed approximately quarterly by the Executive Board.

Current Financial Position

General Fund Revenue

Current monitoring indicates that the forecast General Fund outturn for 2014/15 will show an under spend of c **£1.011m.** Un-earmarked reserves levels have been informed by the detailed risk assessment undertaken as part of the budget process. These are shown in **Appendix A** and **B.**

HRA Revenue

The City Council is required to periodically review the HRA to ensure that it does not move into deficit. In order to allow for unforeseen expenditure or loss of income, a working balance is needed. The 2014/15 budget allowed for a working balance of **£4.000m** and given the potential financial impact of welfare reforms on the HRA, it is recommended that the level of working balance be maintained at this level.

3. Capital Programme Risk Management & Governance

Capital programme schemes often span a number of years, so it is essential that a longer term view is taken on programming and resourcing.

<u>Capital Programme – Current Position</u>

- <u>General Fund</u>
  The forecast spend over the capital programme, including schemes in development, is **£714.080m** compared to resources of **£714.160m.** There is a projected surplus of resources in 2019/20 of **£0.080m** this includes unsecured projected capital receipts of **£17.557m.**

- <u>Public Sector Housing</u>
  The forecast spend in the 5 year period is **£324.610m** which is fully financed from available resources generated within the HRA. The MTFP is estimated to generate an additional £17.553m of resources to fund future commitments to maintaining decent homes.

<u>Capital Programme Risk</u>
The proposed five-year programme is ambitious and will require the Council to use a high proportion of available resources. Substantial investment of this nature will result in the Council being exposed to additional risks as follows:

- a 52% increase in the authority's borrowing over the next five years;
- exposure to interest rate changes; a 0.5% increase in interest rates will increase the cost of borrowing by c£0.700m per annum;
- major schemes have a long pay-back period, which will require the use of reserves in the early years to fund short term deficits in business plans;
- the cost of feasibility studies are all undertaken at risk;
- schemes may not cover their costs or make the desired return.

<u>Capital Programme Governance</u>
In order to manage these risks the following key principles will be adopted in managing the capital programme:

- where new projects are added to the programme that will not cover their costs, an existing project will be removed or amended;
- all projects must have a robust and viable business case, which considers and includes whole life costing and revenue implications (including rate of return);
- all schemes will be subject to robust and deliverable business plans and models which demonstrate the necessary return on investment required;
- the decision to progress schemes will be dependent on securing the stated level of external funding or grant as appropriate;
- new projects will be considered where the Council can make a return on investment;
- where new sources of external funding/grants become available, the programme will be revisited;
- all schemes will be subject to an independent internal 'Gateway Review Process'.

The Medium Term Financial Strategy includes the following requirements for consideration of the funding of the capital programme:

- The Council will endeavour to maximise grant funding for schemes which will assist in the delivery of the corporate priorities, part/full grant funded bids will be subject to the same prioritisation process
- Prudential or Unsupported Borrowing can be used where it can be demonstrated that it is affordable and sustainable in the medium term. Borrowing must be within approved limits and in accordance with the prevailing guidance in the Treasury Management Strategy
- Capital Receipts generated from the sale of land, buildings and other assets will be a non-earmarked, council–wide resource, to be allocated according to Council priorities only after a thorough and objective options appraisal and consideration of opportunity costs, and not earmarked to a particular project, scheme, service, directorate and/or geographical area.

The City Council recognises the importance of individual and collective accountability and requires managers to formally acknowledge their responsibilities. Financial management is an integral aspect of effective leadership and good management, relevant councillors and managers are required to participate fully in all aspects of capital investment plans.

Corporate Directors will be accountable for the success and deliverability of all capital projects within their remit; including:

- Ownership of business cases and any subsequent changes to them.
- Ensuring that capital projects are delivered in line with agreed targets and resources.
- The successful outcome and benefits realisation of capital projects.

4. Adequacy of Reserves and Risk Assessment

National decisions regarding public funding and expenditure have been taken by central Government to support their stated intention to reduce the national deficit. This has again resulted in a significant reduction in the level of funding available to the City Council. Although this has been met with a robust and detailed approach to the identification and delivery of the savings required as a consequence, this level of cost reduction attracts a heightened degree of risk associated with its delivery. Whilst the current proposed budget fairly represents sufficient resourcing for current planned activity, this risk cannot be ignored and the levels of contingency included within the budget reflect these risks.

The assessment of reserves is even more important in the context of the sustained cuts in funding. It is important to acknowledge that reserves are ‘one off’ funds and are therefore more suitable for funding ‘one off’ or unexpected costs. The use of reserves to fund ongoing expenditure is generally not advised, except in emergencies and/or to enable transition to new ways of working.

Taken together, reserves, contingencies and the processes within the financial framework provide capacity to deal with the changes arising form external forces. This will include, for example: increased demand for services from citizens, changes in legislation and guidance from central government, economic changes, interest rate changes and employee relations. This list is indicative rather than exhaustive. The localisation of both Business Rates and Council Tax Support (formerly benefits) increases the significance of Council reserve levels as these are new significant variables on both income and expenditure.

In recommending an adequate level of reserves, the CFO considers and monitors the opportunity costs of maintaining particular levels of reserves. This opportunity cost may be the lost opportunity of investing those funds in service improvement and/or spending on alternative activities. There is a balance to be struck between setting prudent levels of contingencies and reserves considered to be an adequate ‘safety net’ to ensure the Council can operate successfully in a very challenging environment and ensuring sufficient funds are in place for service provision and other Council activities. The levels recommended here are considered to have achieved that balance.

Table 1 shows the estimated Net Revenue Expenditure (NRE) and Unallocated Reserves for Nottingham compared with those of other councils. The data is based on 2014/15 CIPFA Finance and General Estimates, demonstrating Nottingham’s reserve position is lower relative to similar councils.

TABLE 1 : COMPARISION OF RESERVES WITH OTHER AUTHORITIES			
Authority	**Net Revenue Expenditure * £m**	**Estimated Unallocated Reserves as at 1 April 2014 £m**	**Estimated Unallocated Reserves as % of NRE**
Birmingham	1016.177	23.700	2.33%
Sheffield	447.197	10.816	2.42%
Nottingham	**268.523**	**9.500**	**3.54%**
Derby	188.177	7.143	3.80%
Leeds	575.234	27.200	4.73%
Manchester	504.372	24.079	4.77%
Liverpool	483.237	24.789	5.13%
Newcastle	261.757	14.134	5.40%
Leicester	293.474	25.800	8.79%

This decision is supported by a comprehensive risk assessment to ensure that the level of reserves represents an appropriately robust financial safety net for the organisation. In assessing these risks the CFO has consulted with relevant colleagues and stakeholders to ensure all risks have been identified. The importance of this work, its depth and accuracy, is further enhanced as a number of the proposals included within the budget plans involve significant changes to current structures, systems and processes, they involve higher levels of risk than those which broadly maintain current arrangements. At the most practical level those risks begin with the possibility of slippage and disruption in the transition from old to new arrangements. The CFO has sought to ensure that issues of this type and their potential budgetary implications are appreciated by relevant colleagues and councilors.

Given the level of savings included in this MTFP the CFO has undertaken an assessment of their deliverability and set out clearly the implications and contingency plans which apply where savings are not delivered as planned. Robust and timely monitoring of savings delivery plans with ongoing contingency planning will be critically important throughout the year.

General Fund

The MTFS requires the opening balance on the General Fund Reserve to be between 2% and 4% of the total net general fund revenue budget. For 2015/16 this range is **£5.5m to £11m**. This level of reserve has been informed by the risk assessment as detailed in **Appendix A** of this Annex. The proposed General Fund balance for 2015/16 is **£9.5m**, which is **3.54%** of the net general fund budget, as at 1 April 2015. This level is expected to be sufficient in all but the most unusual and serious combination of possible events and provides an optimum balance between risk management and opportunity cost.

The MTFS provides for a central contingency value of between 0.4% and 0.9% of the previous years net revenue budget (NRB). The proposed level is **£2m** (i.e. **0.75%**) and takes account of the significant savings package and challenging future financial outlook

Housing Revenue Account (HRA)

The MTFS requires the City Council to establish opening HRA reserves of between 2% and 3% of the gross HRA spend (capital and revenue) the precise level within this range being informed by the risk assessment with no opening working balance ever being set below the 2% threshold in an individual year. **Appendix B** details the risks and the working balance required in 2015/16 is **£4.000m,** which is **2.3%** of the gross spend.

Earmarked Reserves

Earmarked Reserves are funds set aside to provide for specific future expenditure plans. The Council held balances of **£148m** in earmarked reserves at 31 March 2014 which includes schools budget balances of **£22m**. A review of these earmarked balances has been performed to establish the purpose of the reserves and the likely timescale that these reserves will be utilised.

There are 6 main categories of earmarked reserves that the Council holds:

- Sums set aside for major schemes, such as capital developments, or to fund
- Transition and transformation
- Insurance and risk management
- Potential Liabilities
- School Balances
- Other specific

During the course of 2014/15 it is anticipated that a net **£7.485m** will be released from earmarked reserves to fund known commitments and a further net **£7.167m** will be utilised in 2015/16. In addition a number of movements have been made within the overall reserve balances to realign to commitments against the capital programme and to reflect the level of risk and uncertainty associated with major capital schemes.

A further review of reserves will be undertaken as part of the 2014/15 closedown process.

Conclusions

In conclusion, with contingencies and reserves at the level set out here and in the overall budget report, the CFO considers that the proposed budget for 2015/16 is robust and that the level of reserves is adequate because:

- The overall budget process is established good practice and fit for purpose, there is an annual review of the process and continuous improvement is embedded;

- The process is supported by appropriately qualified and experienced professional colleagues;
- There has been good and extensive engagement in the budget development and construction process by senior colleagues and Executive Councillors;
- There have been thorough arrangements in place to challenge proposals and make revisions as a result;
- Known cost pressures (including inflation) have been identified and resourced at realistic levels;
- Risks have been identified (and where appropriate costed) and will be subject to control and management using established risk management procedures;
- There is clear accountability of both individuals and teams effected through the continued use of accountability letters, individual performance objectives, reporting, peer review and individual performance appraisals;
- There is a wider organisational understanding of the financial position, the reasons for it and the need for good financial management;
- Budget monitoring and scrutiny arrangements are in place, including arrangements for the identification of remedial action;
- There is an overall satisfactory track record within the Council for the implementation of the majority of strategic choices and for delivering services within budget;
- The principles for the control of the capital programme and management of resources are required to manage the ambitious capital programme set out by the Council;
- The levels of contingencies and reserves are considered to be, based on currently known information and professional judgment, adequate to deal with the inherent higher levels of risk within the budget arising from: a continued significant reduction in funding, high value cost reductions, increased demand from citizens, the complex nature of some of those changes requiring major service redesign and organisational change, the prevailing challenging economic situation, the impact of extensive policy changes from central Government; all in the context of the City's demographics;
- It is recognised that contingencies and reserves will continue to need to be constantly reviewed to determine adequacy and there are processes in place to increase such provisions should this be required.

This statement has been prepared in good faith and having made best endeavours to take into account all known prevailing relevant issues.

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Chief Finance Officer
Nottingham City Council

4 February 2015

GENERAL FUND- RISK ASSESSMENT APPENDIX A			
DEPARTMENT/ POTENTIAL RISK	**WORST CASE £m**	**ASSESSEMENT OF RISK £m**	**ESTIMATED EXPOSURE £m**
CORPORATE RISK			
NNDR appeals risk The income risk on Business rates is shared with Government. A 1% increase in the level of successful appeals could cost £0.600m.	0.600	Medium	0.300
Council Tax Support Potential for increase in Council Tax Support of 2%. A 1% increase in demand for CTS will reduce Council Tax collection by approximately £0.300m.	0.600	Low	0.060
Major Incidents Any major incident or emergency may result in significant costs to the Authority. Depending on the incident concerned, the Council may be able to recover such costs through the Bellwin Scheme or from specific reserves earmarked for the purpose eg Insurance Reserve. The balance recognises the potential losses not covered by these circumstances.	15.000	Low	1.500
Adverse variation in inflation A 1% increase in inflation on supplies and services would lead to additional pressure of £2.5m.	1.250	Medium	0.625
Adverse variation in grant funding Potential for Government to revise the funding mechanisms to squeeze local authority funding even harder in future years (eg by increasing the proportion of business rates centrally or amendments to fund the business rates safety net payments by top-slicing grants) A 1% variation in grant funding equates to £1.600m	1.600	Low	0.160
Restriction on charging for services Potential for Government to restrict the level of local charges levied for some services	0.900	Low	0.090
TOTAL CORPORATE RISK	**19.950**		**2.735**

DEPARTMENT/ POTENTIAL RISK	WORST CASE £m	ASSESSMENT OF RISK £m	ESTIMATED EXPOSURE £m
Slippage in delivering Big Ticket Strategic Choices Failure to deliver savings within planned timescales.	2.357	Medium	1.179
Safeguarding -Children in Care Children in Care numbers are higher than predicted for the budget and actions to mitigate demand are not as effective as planned.	2.818	Medium	1.409
Impact of Children & Families Bill The financial implications of the transformation of the delivery of services to children with SEN.	1.255	Medium	0.628
Performance element of the Better Care Fund An element of the Better Care Fund is dependent on meeting specified performance criteria defined by DoH. This is based upon the achievement of a 3.5% reduction in non-elective emergency admissions to acute care. The Health and Wellbeing Board and Executive Board Commissioning Sub-Committee agreed a 50/50 split between Nottingham City Council and NHS Nottingham City CCG of the total value of £1.556m.	0.788	Low	0.079
Realisation of Adult Social Care Mental Health demand Cost and demand for mental health services is greater than provided for in the MTFP.	1.305	Medium	0.653
Adults Safeguarding and Assessment Increased demand for services and action to manage demand not having the assumed impact.	1.614	Low	0.161
Educational Services Grant Reduction Failure to reduce costs of services funded by ESG in line with the reduction in grant.	1.563	Low	0.156
Legal Costs Increased demand for legal services as a result of increased activity related to Children In Care	0.250	Medium	0.125
TOTAL CHILDREN AND FAMILIES RISK	**11.950**		**4.390**

DEPARTMENT/ POTENTIAL RISK	WORST CASE £m	ASSESSMENT OF RISK £m	ESTIMATED EXPOSURE £m
COMMUNITIES RISK			
Trading activities There is a range of trading activities in the communities department each with its own trading surplus target. The consequence of under achievement of the target could be an increase to the net charge to the general fund although there are mitigations in the MTFS that could be instigated to offset some of the risk.	2.311	Low	0.231
Robin Hood Energy Costs are being incurred to set up the company. There is a risk that the company will not be as successful as anticipated and will be unable to repay.	1.000	Low	0.100
TOTAL COMMUNITIES RISK	**3.311**		**0.331**
DEVELOPMENT RISK			
Cost overrun on Capital Schemes The Council has an ambitious investment strategy which may be subject to cost overrun. 5% cost overrun on GF programme is £10.368m	10.368	Low	1.037
Business rates uplift insufficient to fund City Deal TIF2 scheme in the creative quarter In order to generate additional activity in the City Deal area capital works are required to unlock the potential of the area. These capital works will be financed from prudential borrowing which will be repaid from increase business rate collection in the area. There is a risk that the additional business activity will not generate sufficient additional income to support the development and alternative capital resources will be required to mitigate any shortfall in resources.	2.000	Low	0.200
Slippage in achieving Strategic Choice savings and Big Ticket Initiatives A range of challenging savings and Big Ticket initiatives has been included in the budget. There are risks in relation to the timescales for deliverability of these initiatives and their scale of impact.	0.900	Medium	0.450
TOTAL DEVELOPMENT RISKS	**13.268**		**1.687**

DEPARTMENT/ POTENTIAL RISK	WORST CASE	ASSESSMENT OF RISK	ESTIMATED EXPOSURE
	£m	£m	£m
RESOURCES RISK			
Reduction of external budgeted income from the sale of services to schools			
Services to schools sold include HR, Legal, IT and Internal Audit. Expenditure could be reduced, but redundancies may be incurred and not all costs may be mitigated.	0.199	Medium	0.100
Partners withdraw from services provided under SLA for Finance, HR, Legal and IT (SLA's are reviewed annually)			
Viability of the business case is compromised. Investment in IT does not happen and savings are prevented.	0.230	Low	0.023
Finance			
Demand for support for the commercialism agenda increases	0.150	Medium	0.075
TOTAL RESOURCES RISK	**0.579**		**0.198**
TOTAL POTENTIAL RISK	**49.058**		**9.341**

HRA – RISK ASSESMENT			
POTENTIAL RISK	**WORST CASE** **£m**	**ASSESSMENT OF RISK** **£m**	**ESTIMATE OF EXPOSURE** **£m**
Development - Housing Revenue			
Welfare reform impact on the level of rent collected	0.500	High	0.450
Welfare reform impact on other rents & service charges	0.100	Medium	0.050
Welfare reform increase in void properties	0.600	Medium	0.300
Impact of introduction of Universal Credit	0.500	High	0.450
Increase in bad debt provision due to reduced Discretionary Housing Payments	0.900	High	0.810
Impact of interest rates on debt	0.285	Low	0.071
Increased demand for unplanned housing repairs	1.500	High	1.350
Expected Capital Receipts not realised	0.600	Medium	0.300
Unforeseen costs of new build programme	2.000	Low	0.200
Increase in right to buy properties	0.300	Medium	0.150
TOTAL - HRA	**7.285**		**4.131**