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 Strategic Director of 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 multi-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 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 the introduction of Universal Credit.
- 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 budget 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 2015/16 will show an under spend of **£1.625m.** 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.**

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 2015/16 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.

Capital Programme – Current Position

- General Fund
  The forecast spend over the capital programme, including schemes in development, is **£660.126m** compared to resources of **£664.453m.** There is a projected surplus of resources in 2020/21 of **£4.327m** this includes unsecured projected capital receipts of **£20.634m.**

- Public Sector Housing
  The forecast spend to 2020/21 is **£281.603m** which is fully financed from available resources generated within the HRA. The MTFP is estimated to generate an additional **£3.140m** of resources to fund future commitments to maintaining decent homes.

Capital Programme Risk
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 significant 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£0.750m 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 required return.

Capital Programme Governance
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. The offer of a four year settlement demonstrates continued reduction in funding in the medium term. 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 CORE CITIES			
Authority	**Net Revenue Expenditure * £m**	**Estimated Unallocated Reserves as at 1 April 2015 £m**	**Estimated Unallocated Reserves as % of NRE**
Birmingham	959.115	136.700	14.25%
Manchester	473.081	27.037	5.72%
Bristol	354.978	20.000	5.63%
Newcastle	251.399	14.134	5.62%
Liverpool	448.867	24.789	5.52%
Leeds	542.335	21.690	4.00%
Nottingham	**254.248**	**9.500**	**3.74%**
Sheffield	401.521	10.616	2.64%

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 reserves to be between 2% and 4% of the total net general fund revenue budget. For 2016/17 this range is **£4.878m to £9.755m**. 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 2016/17 is **£9.5m**, which is **3.9%** of the net general fund budget, as at 1 April 2016. 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 **£2.000m** (i.e. **0.78%**) 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 2016/17 is **£4.000m,** which is **2.2%** of the gross spend.

Earmarked Reserves
Earmarked Reserves are funds set aside to provide for specific future expenditure plans. The Council held balances of **£160.105m** in earmarked reserves at 31 March 2015 which includes schools budget balances of **£24.120m**. 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
- Potential Liabilities
- School Balances
- Other specific
- Insurance and risk management
- Traded surpluses

During the course of 2015/16 it is anticipated that a net **£6.839m** will be released from earmarked reserves to fund known commitments and a further net **£5.234m** will be utilised in 2016/17. 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 2015/16 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 2016/17 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.

Geoff Walker
Director of Strategic Finance
Chief Finance Officer
Nottingham City Council

18 February 2016

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 with increased exposure to appeals risk given the large influx of appeals in 2015.	0.870	Medium	0.435
Council Tax Support Potential for increase in Council Tax Support of 2%, this would reduce Council Tax collection by approximately £0.486m	0.486	Low	0.122
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, this use of reserves or specific Insurance policies. The balance recognises the potential losses not covered by these circumstances.	15.000	Low	3.750
Companies Risk that new companies do not meet the planned trading position, resulting in lower returns to the Council.	1.200	Low	0.300
TOTAL CORPORATE RISK	**17.556**		**4.607**

DEPARTMENT/ POTENTIAL RISK	WORST CASE £m	ASSESSMENT OF RISK £m	ESTIMATED EXPOSURE £m
CHILDREN AND ADULTS RISK			
Slippage in delivering Big Ticket Strategic Choices Slippage in the Big Ticket implementation.	3.400	Low	0.850
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.	1.500	Low	0.375
Adults Safeguarding and Assessment The assessment and safeguarding service continue to experience increased demand over and above current levels budgeted for in the MTFP	1.500	Medium	0.750
Public Health Grant Failure to deliver savings in line with grant reductions	2.500	Low	0.625
TOTAL CHILDREN AND ADULTS RISK	**8.900**		**2.600**

DEPARTMENT/ POTENTIAL RISK	WORST CASE £m	ASSESSMENT OF RISK £m	ESTIMATED EXPOSURE £m
COMMERCIAL AND OPERATIONS 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.	2.220	Very Low	0.222
Harvey Hadden Business plan not achieved due to increased costs not planned for and any mitigations not successful. The new Rateable Value for Harvey Hadden Sports Venue has been classed as £0.675m, an appeal against the new value is being lodged. Once the multiplier has been taken into account, the annual rate value is £0.331m per annum. Budget provision has been made for £0.150m, leaving a shortfall of £0.181m	0.181	Medium	0.091
Markets INTU (Victoria Centre) have significantly increased the service charge of the indoor market within the Victoria Centre. To increase this directly to the traders, would cause an immediate loss of business, and a large drop in occupancy that would adversely affect the market traders account. Therefore a phased rental increase has been agreed with Leadership, which will see increases in rental passed to traders, but over a 3 year period. This results in a budget pressure to the markets budget, but not passing the cost through also causes a pressure. A case is currently being considered for the best process.	0.200	High	0.180
Energy - PV Panels Within the manefesto we are committed to installation of 3000 PV panels onto social housing within the City. As of Feb 2016, the tariff generated by these panels has greatly reduced. This gives a risk to the acheivement of the Energy and Waste Big Ticket and the delivery of the Manefesto pledge, without causing a cost	0.097	Medium	0.049
TOTAL COMMERCIAL AND OPERATIONS RISK	**2.698**		**0.542**

DEPARTMENT/ POTENTIAL RISK	WORST CASE	ASSESSMENT OF RISK	ESTIMATED EXPOSURE
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 £9.675m	9.675	Very Low	0.968
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.	1.066	Low	0.266
TOTAL DEVELOPMENT RISKS	**10.741**		**1.234**

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	0.220	Medium	0.110
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 is not prioritised and savings are prevented	0.250	Low	0.063
Finance			
Demand for support for the commercialism agenda increases	0.150	Medium	0.075
Finance			
Contract claims arising from partnership arrangement for key service delivery	0.250	Medium	0.125
IT			
Further investment required to meet performance needed from shared services	0.300	Medium	0.150
Insurance			
Additional risk related to historical claims not yet assessed	1.500	Low	0.375
TOTAL RESOURCES RISK	**2.670**		**0.898**
TOTAL POTENTIAL RISK	**42.565**		**9.881**

HRA – RISK ASSESMENT			
POTENTIAL RISK	**WORST CASE £m**	**ASSESSMENT OF RISK £m**	**ESTIMATED EXPOSURE £m**
HRA RISK			
Impact of Welfare reform			
Potential increase in void properties and impact of the implementation of Universal Credit	0.700	Medium	0.350
Housing repairs			
Demand for reactive repairs increases	1.200	High	1.080
Capital programme costs increase			
Increased costs in new build projects not managed	2.400	Low	0.600
Rental income below target			
Increase in right to buys continues at levels above budget	1.000	High	0.900
Discretionary Housing Payments			
Demand for support from the fund is greater, requiring additional resources from the HRA	0.900	High	0.810
Capital Programme Funding			
Shortfall in external funding of the programme creating pressure for additional funding from the HRA	0.600	Medium	0.300
TOTAL - HRA	**6.800**		**4.040**