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 and performance boards).
- 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 partnership working, 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 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, 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 individual budget and accountability details issued to all budget managers, and financial targets being reflected in performance objectives and continues throughout the year within the performance appraisal process.

<u>Monitoring – a confirmation of the robustness of the budget</u>
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. Individual budget and accountability details are sent to budget 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.

<u>Current Financial Position</u>

<u>General Fund Revenue</u>
Current monitoring indicates that the forecast General Fund outturn for 2016/17 will show an overspend of **£1.003m (**before applying any trading surpluses) 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.**

<u>HRA Revenue</u>
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 2016/17 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. Current monitoring indicates that the HRA is forecast to be on budget for 2016/17.

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 **£538.627m** compared to resources of **£540.605m.** There is a projected surplus of resources in 2020/21 of **£1.978m.**

- Public Sector Housing
  The forecast spend to 2020/21 is **£261.599m** which is fully financed from available resources generated within the HRA.

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£0.492m 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.

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;
- all future schemes will need to address the consequences of cash flow shortfalls in the early years, and available funding must be identified and approved prior to the commencement of projects;
- 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 four year settlement confirms 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 increases the significance of Council reserve levels as these are 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 core cities. The data is based on 2015/16 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 2016 £m**	**Estimated Unallocated Reserves as % of NRE**
Birmingham	868.388	106.900	**12.3%**
Newcastle	239.398	14.134	**5.9%**
Bristol	348.297	20.000	**5.7%**
Liverpool	436.987	24.789	**5.7%**
Manchester	455.757	25.402	**5.6%**
Leeds	524.481	20.891	**4.0%**
Nottingham	**247.615**	**9.600**	**3.8%**
Sheffield	465.185	12.037	**2.6%**

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 ways of working, 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 Portfolio Holders.

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. The proposed General Fund balance for 2017/18 is **£11.600m**, which is **4.8%** of the net general fund budget, as at 1 April

2017. This represents an increase of **£2.000m** from 2016/17 and will be funded from a review of the existing earmarked reserves.

The increase to **£11.600m** exceeds the percentages within the current MTFS however an increase to the overall level of reserves is required due to the difficulties in meeting a reducing annual budget together with the significant funding implications from Health Integration and the wider commercial drive in 2017/18. This change to **4.8%** aligns the reserves level with other Core Cities and a refreshed MTFS will be presented in 2017/18 which will include updated guidance on the level of general reserves. **Appendix A** details individual risks and 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 **£1.800m** (i.e. **0.7%)** 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 2017/18 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 **£174.931m** in earmarked reserves at 31 March 2016 which includes schools budget balances of **£21.864m**. 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 main categories of earmarked reserves that the Council holds:

- Sums set aside for major schemes, including Private Finance Initiatives, capital developments, or to fund transition and transformation
- Potential Liabilities
- School Balances
- Insurance and risk management
- Traded surpluses

During the course of 2016/17 it is anticipated that there will be a net **£3.623m** increase in earmarked reserves and a net **£4.375m** will be utilised in 2017/18. 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 2016/17 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 2017/18 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 for budget managers;
- 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, new partnership arrangements, 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
Strategic Director of Finance
Chief Finance Officer
Nottingham City Council

February 2017

GENERAL FUND- RISK ASSESSMENT APPENDIX A			
DEPARTMENT/ POTENTIAL RISK	**WORST CASE £m**	**ASSESSEMENT OF RISK £m**	**ESTIMATED EXPOSURE £m**
CORPORATE RISK			
Cost overrun on Capital Schemes The Council has an ambitious investment strategy which may be subject to cost overrun. 5% cost overrun on Capital Programme is £8.229m	8.229	Low	2.057
Company Returns Risk that companies do not meet the planned trading position, require one-off investments.	1.546	High	1.391
Works Perks Impact of the Government's Finance Bill 2017 to remove the Income Tax and employer NICs advantages of salary sacrifice schemes.	0.250	Medium	0.125
TOTAL CORPORATE RISK	**10.025**		**3.573**

DEPARTMENT/ POTENTIAL RISK	WORST CASE £m	ASSESSMENT OF RISK £m	ESTIMATED EXPOSURE £m
CHILDREN AND ADULTS RISK			
Delivery of the savings included in the Sustainable Transformation Plan The delivery of the STP is predicated on a number of partnerships. This savings constitutes nearly 50% of the savings in 2017/18 and any shortfall could be significant for the MTFP.	8.680	Medium	4.340
Adults Demand Changes to the demand for Adults services are included in the budget process however a 1% change to those assumptions would equate to £0.906m. Demand changed by 3.35% in 2016/17 above budget.	3.035	Medium	1.518
Children's Demand Changes to the demand for Childrens services is included in the budget process on the assumption of 3.1% however a 1% change to those assumptions would equate to costs increasing by £0.894m.	0.894	Medium	0.447
Increased costs associated with Unaccompanied Asylum Seekers Budgeted levels for UACS are 8; in 2016/17 these numbers have risen to 22 and there is a possibility they could rise further 46. The costs associated with this cohort are not fully funded by government and are reflected as a risk.	0.747	High	0.672
TOTAL CHILDREN AND ADULTS RISK	**13.356**		**6.977**

DEPARTMENT/ POTENTIAL RISK	WORST CASE £m	ASSESSMENT OF RISK £m	ESTIMATED EXPOSURE £m
COMMERCIAL AND OPERATIONS RISK **Traded Activities** A range of trading activities have trading surplus target; a consequence of under achievement of the target could be an increase to the net charge to the general fund.	3.526	Low	0.882
TOTAL COMMERCIAL AND OPERATIONS RISK	**3.526**		**0.882**
DEVELOPMENT & GROWTH RISK **Economic conditions on the property trading account** Ability to achieve £12.415m surplus on property trading account due to the impact of the economy & regeneration of the city. Elements of this are at risk however mitigation plans will always be expected.	1.500	Medium	0.750
Increase in volume & cost of homelessness Nottingham City Council's Housing Aid Service had not used bed and breakfast for 7 years and there was no reliance on B+B as a form of emergency accommodation. National-level policy changes have led to increases in homelessness around the country, including Nottingham. In 2015/16 the service was forced to use B+B, but had reserves in place which could deal with the issue. This situation was not addressed at a national level and the issue has therefore arisen again in 2016/17 and could continue into 2017/18.	0.500	Medium	0.250
TOTAL DEVELOPMENT AND GROWTH RISKS	**2.000**		**1.000**
STRATEGY AND RESOURCES RISK **Insurance** Additional risk related to historical claims not yet assessed	1.500	Low	0.375
TOTAL STRATEGY AND RESOURCES RISK	**1.500**		**0.375**
TOTAL POTENTIAL RISK	**30.407**		**12.807**

HRA – RISK ASSESMENT			
POTENTIAL RISK	**WORST CASE** **£m**	**ASSESSMENT OF RISK** **£m**	**ESTIMATED EXPOSURE** **£m**
HRA RISK			
Universal Credit Increase in bad debt levels due to payment of rent direct to tenant	1.000	High	0.900
Fixed term tenancies Causing an increase in void properties	0.600	Low	0.150
Housing Benefit capped at LHA rate Certain properties harder to let resulting in increase to void properties	0.500	Low	0.125
Asset Levy greater than estimated An additional cost to be bourne by the Housing Revenue Account	1.500	High	1.350
Capital programme funding Shortfall in external funding or capital receipts creating pressure for additional funding from the HRA	0.600	Medium	0.300
Capital programme costs increase Costs of new build projects exceed budgets	1.500	Medium	0.750
More Right to Buy sales Reduced rental income to cover fixed costs of managing and maintaining the council's housing stock	1.000	Medium	0.500
TOTAL - HRA	**6.700**		**4.075**