

## **ROBUSTNESS OF BUDGET ESTIMATES AND ADEQUACY OF RESERVES: STATEMENT OF THE CHIEF FINANCIAL OFFICER**

### **BACKGROUND**

Section 25 of the Local Government Act 2003 requires the authority's Chief Financial Officer to comment on the robustness of the estimates and the adequacy of reserves allowed for in the budget proposals in the budget report, so Members have advice available to them when they make their budget decisions. The Chief Financial Officer also has a responsibility under section 114 of the Local Government Act 1988, to report if it appears to him that members are likely to set an unbalanced budget for the year. It is therefore imperative that the Chief Financial Officer is able to agree the soundness of the Council's financial strategy.

In addition the CIPFA guidance on Local Authority Reserves and Balances requires that a statement reporting on the annual review of earmarked reserves should be made to Council, at the same time as the budget. The statement should list the various earmarked reserves, the purpose for which they are held and provide advice on the appropriate levels. It should also show the estimated opening balances for the year, planned additions/withdrawals and the estimated closing balance.

### **ROBUSTNESS OF ESTIMATES**

#### **Overview**

Given the anticipated cutback in Government funding for Local Authorities to deal with the Government's funding deficit, the Council has been running a comprehensive review of all its services and staffing structures for some time now. However it was only on 13<sup>th</sup> December that the extent and timing of those cuts was finally announced and while the probable overall level of grant cuts over the next 4 years is as severe as projected, the cuts are much more front end loaded than expected: around 50% of the 4 year cuts hit this Council next year. This leaves all authorities in a difficult position in putting together a sustainable strategy in time for consultation then decisions by members. The position is exacerbated by the inadequate allowance nationally for Councils to capitalise redundancy costs, a point reflected in our response to the grant consultation and made strongly to the Secretary of State by most Councils, the LGA. and other local government commentators

To allow for the Council's planned approach to service and staffing reviews to proceed as planned it is thus necessary to utilise a greater level of one off savings and balances than usual-a total of £9.2m for next year. This is a position most councils are finding themselves in and one advocated by the Secretary of State when lobbied extensively to reduce the level of front end loading of the cuts. This obviously introduces a higher level of risk into the financial strategy than usual and can only be supported by the presence of an existing planned programme of reviews which are already generating savings to replace this extensive reliance on one offs for 2011/12. As long as this

programme of reviews delivers on time and target then the projected residual deficit in 2012/13 can be covered with a mix of council tax increase and a more routine use of one off sums. It is important that the progress of these reviews is closely monitored and a separate officer board is in place to do this with reports through to the Directors' management team and then Cabinet via financial monitoring if there are any issues starting to arise. It is imperative that we keep to timetable on the reviews and their implementation to ensure we can set a sustainable budget for 2012/13 in a year's time.

Given the scale of grant cuts and savings already made over recent years, it is inevitable that this funding shortfall can not be met by efficiency savings alone and as the process moves on will increasingly impact on front line services. The rolling programme of reviews means that as each service review comes to fruition we will need to ensure proper consultation and appraisal of the implications of the impacts of proposals during the year rather than just the usual once a year process around the budget. We anticipated this a year ago and have been carrying out consultation during the last year on local peoples' views of services to protect or cut and this dialogue will need to continue.

Overall therefore, given the planned programme of service reviews and accompanying organisational and staff restructures which have been under way for some time now, it is considered that the Council is pursuing a sound financial strategy in the context of the most difficult financial position it has faced due to the heavily front loaded Government grant cuts.

**The 2011/12 budget and medium term financial plan has been informed by:**

**1. Council Wide Risk Management**

We are pursuing a planned approach of service reviews but as flagged above the high level of grant cuts will increasingly have front line service impacts.

It therefore seems inevitable that the level of risk will increase both to individual services and the operation of the council as a whole and this will be common to local authorities across the country. The current review of key risks is thus important to ensure we put in place a level of mitigation wherever possible. We have set aside an additional contingency of over £1m next year and carried out a risk based review of all reserves and balances to inform the budget strategy. There has also been an assessment of key service risk exposure resulting in investment into both Children's and Adults' social care services.

Risk management awareness sessions have been held during 2010 to ensure that all service areas clearly identify the key risks to the achievement of their objectives. This has included sessions for both Members and employees.

## 2. The Monitoring Process

Financial monitoring is carried out on a monthly basis and highlights any significant variances, and therefore areas of risk, both for current and future years, with regular reports being presented to Corporate Management Team and Cabinet during the year. Progress on the programme of service and staffing reviews will be monitored through this route flagging both 'in year' and 12/13 financial strategy impacts. Performance and risk monitoring are also carried out to complement the financial monitoring and are reported on an exception basis to Corporate Management Team and Cabinet. This provides further indications of any potential risk areas for the council and action is taken to review any issues identified.

## 3. The Budget Setting Process

The overall medium term financial planning position of the Council is controlled through a model which is updated during the year as new information becomes available- including current year trends identified through monitoring. At a more detailed level Finance officers meet with budget holders and review all budgets on an annual basis on top of the usual monitoring work. Budgets are cash limited. Areas of unavoidable growth, pressures and developments have been identified and scrutinised as part of the budget process along with the deliverability of the savings package which forms an integral part of the overall strategy. These link to both the budget monitoring process, performance monitoring and risk management, discussed above, together with other issues such as meeting new legislative requirements and statutory obligations.

### 2011/12 Budget Assumptions:

Given the difficult financial position the Council faces, a tight line has been taken on planning assumptions for next year but this is mitigated by the inclusion of the additional £1m contingency and risk assessed review of reserves and balances.

<u>Inflation</u>	
Pay Award	0% for all years. Any actual pay awards will have to be found from within cash limited budgets. As part of a three-year pay deal for teachers a pay increase of 2.3% took effect from 1 <sup>st</sup> September 2010. No further increases are planned.
Employer's Pension Contribution	The Council has agreed with pension fund officers and the fund's actuaries the maintenance of its current contribution rate of 16.3% for the next 3 years. An independent review of public services pension provision is

	<p>being undertaken by John Hutton which is likely to fundamentally change the current system. The final report will feed into the Government's budget on 23<sup>rd</sup> March 2011.</p>
Employer's National Insurance Contribution	An increase of 1% has been included for the NI contribution in line with announcements made in the March 2010 Budget.
Social Care Purchasing Budgets	The procurement strategy for social care purchasing is currently under review with a view to delivering efficiency savings.
Electricity, Gas, Water	There is a working assumption of meeting cost increases from efficiency savings. There is also a central contingency provision as flagged below
Inflation/Income provision	A provision of £1m was earmarked and included in the January report for contractual inflation pressures. Tight control will be exercised to ensure that this is only allocated where a very real need can be proven in priority areas. This arrangement has also operated for 2010/11.
Service Pressures	<p>Two key service pressures have been identified:</p> <ul style="list-style-type: none"> <li>- Adult Social Care – where £1.6m is being re-invested to address demographic pressures and costs previously met by the PCT</li> <li>- Children's Social Care – where £1.4m additional funding has been provided to meet an increasing cost of vulnerable children.</li> </ul>
Interest Rates	Base rates began the year at 0.5% and have remained there all year. The Bank of England extended its Quantitative Easing programme during last year to £200bn. There has not been any extension to this or any unwinding during the current year. The next move in the base rate is expected to be upwards, but the timing of this is subject to considerable speculation as the Monetary Policy Committee seeks to balance the impact on a still fragile economy

	<p>with the need to respond to continuing high inflation rates. Our investment and borrowing strategies for 2011/12 are set within this context.</p> <p>The assumptions for new borrowing are 2.4%, 4.4% and 5.4% in 11/12, 12/13 and 13/14 respectively and the average return on investments is 3.7%, 4.7% and 5.4% respectively. One of the primary objectives is to reduce the Council's exposure to risk while at the same time maximising returns. The Treasury Management Strategy for 2011/12 is presented to Council alongside the budget reports.</p>
Treasury Management	<p>The Treasury Strategy for 2011/12 follows the requirements of the Revised CIPFA Treasury Management Code of Practice and clearly identifies the various exposures to risk and strategies in place to minimise this. The Audit Committee has a role to review and monitor the Council's treasury management arrangements which includes policies, procedures and the management of risk. The 2011/12 Treasury Strategy was presented to Audit Committee on the 1 February for their consideration and comments.</p>
Dedicated Schools Grant (DSG)	<p>The figure assumed for Dedicated Schools Grant is £113.684m. The final DSG allocation to the Council will not be known until June 2011 when all adjustments for academies and pupil numbers are finalised. In 2011/12 a number of specific grants have been transferred into DSG to mainstream them. DSG is based on a guaranteed unit of funding (GUF) per pupil. The proposed allocation for 11/12 is based on the same GUF as 10/11 plus an amount per pupil for the mainstreamed grant.</p> <p>The settlement received is much tighter than previous years and schools will face difficult decisions to balance their budgets – discussions have already begun with the Schools Forum to assess the full implications of the mainstreaming of grants. A number of other “non front line schools grants” have also been deleted and services will have to be withdrawn unless schools elect to buy into the services previously funded by those grants. An</p>

	<p>assumption has been made in the budget strategy that £1.2m income will be generated from schools, or through service reductions if schools do not buy back in, which will partly offset this reduction.</p>
<p>Estimates on the level and timing of capital receipts</p>	<p>The revenue budget and capital programme assume around £80m anticipated future capital receipts over the medium term planning period. Any delays in generating expected receipts or in the amounts generated will need to be taken into account in future service and financial strategies. This could require scaling the capital programme back, re-phasing schemes or entering in to additional prudential borrowing. Delivery of projected receipts is monitored on a monthly basis as part of overall financial monitoring and reported to Cabinet quarterly. There should be no decisions taken which significantly increase this medium to long term exposure until there is a clear pattern of receipts being delivered as planned and satisfactory progress with the programme of service and staffing reviews</p>
<p>Prudential Borrowing / Prudential Indicators</p>	<p>The use of prudential borrowing is in line with previously approved investment programmes. Given the overall financial position faced by the Council it is important that no further significant prudential borrowing commitments are entered into (unless matched by additional savings/income flows) until delivery of the savings from the service and staffing review programmes is substantially secured. Prudential Indicators are approved as part of the budget strategy (see separate report on this agenda) and are monitored and reviewed on a regular basis.</p> <p>The rules around the calculation of the cost of borrowing that must be charged to the revenue account – the minimum revenue provision (MRP) - have been prudently applied in setting the 2011/12 budget strategy. The policy in relation to MRP is set out in the Treasury Management Strategy Report.</p>
<p>Single Status</p>	<p>The Single Status process is underway with an implementation date of April 2014. There is currently an annual budgeted provision in place</p>

	<p>since April 2007 equal to 4% of the relevant pay bill to cover additional net costs for non schools based staff. This has been set aside in the accounts for the 3 years 2007/08 to 2009/10. The 2010/11 accounts will be closed on the same basis. Schools have been advised to make a similar provision. As the implementation date is now definitely falling after 2011/12 the contribution for 2011/12 will be suspended, but is still built into the ongoing budget projections after that year. The benefit of this one year suspension of provision has been utilised to support the overall financial strategy and thus avoid accelerating the service reviews and staff restructure programmes to deal with the unexpectedly severe front loading of government grant cuts announced on 13<sup>th</sup> December.</p> <p>There is possible exposure to liabilities from back pay and equal pay claims and the authority will seek to identify the possible range of liability at similarly structured authorities though this is very difficult. Possible application for a capitalisation direction can be made for meeting backdated one off costs when there is any information available to support a claim, but the success of this is likely to be limited under the regulations.</p>
Savings	<p>There is a planned programme of service reviews and restructures which will deliver savings over the medium term planning strategy. Gross employee savings of £5.4m and non-staff savings of £10.4m have been identified for the 2011/12 budget process of which £4.1m is one off. Additional gross savings of £11.3m and £10.7m respectively are budgeted for 2012/13. A reserve of £4m has been set aside to fund redundancy costs and further funding will be identified as the restructure process proceeds and actual costs and their phasing are clarified (this report also recommends a further switch of £0.8m to supplement this fund.) Application will also be made for capitalisation permission from the government</p>

<p>Financial Risks inherent in any new funding partnerships, major outsourcing deals or major capital developments</p>	<p>There are a number of major capital projects that have been identified which require careful project management and monitoring during 2011/12 and beyond to ensure commitments are matched by funding actually achieved, particularly the reliance on capital receipts and future government funding levels for the council and its public sector partners. These include the Town Centre Redevelopment and Borough Towns Initiative, BTI - Sports &amp; Learning Communities, the Local Housing Investment Programme and New Civic Offices.</p>
<p>The availability of other funds to deal with major calls on contingencies</p>	<p>General reserves or other funds may have to be used temporarily and restored if revenue contingencies, management and policy action is insufficient to deal with a major issue. The Council has evaluated the risks it faces against available balances as outlined earlier in this appendix and concluded that around £4.2m is available to use in the overall budget strategy. This position will be kept under review.</p>
<p>The overall financial standing of the authority (level of borrowing, debt outstanding, collection of council tax etc.</p>	<p>The Council's approach to sustaining its overall sound financial position is covered in a number of sections of this Appendix already. The overall projected net indebtedness position at 1 April 2011 is £86.4m; net additional prudential borrowing anticipated in the medium term strategy is £56.3m which relies on delivery of capital receipts totalling £80.1m in line with profiled disposals or borrowing costs will rise further.(additional information is provided in both the Capital Programme and Treasury Management Strategy Reports). The Council budgets prudently for its level of borrowing, avoiding external borrowing where cash flow permits and running down investment exposure while new placement rates are low. The assumed council tax collection rate for 2011/12 onwards is high at over 99%, but being achieved already for past years. This adjustment also allows for additional 'in year' losses such as increased take up of Single Person Discount and other reliefs. For each 1% not collected the cost is approximately £0.55m in lost income to the Council. Legislation requires that any collection fund deficit is corrected through Council Tax in the next year. Collection has outperformed</p>

	<p>projections allowing use of a council tax surplus as part of next year's strategy .</p> <p>Cumulative collection rates to date for recent years are</p> <table data-bbox="667 376 954 562"> <tr> <td>2005/06</td> <td>99.52%</td> </tr> <tr> <td>2006/07</td> <td>99.57%</td> </tr> <tr> <td>2007/08</td> <td>99.43%</td> </tr> <tr> <td>2008/09</td> <td>99.28%</td> </tr> <tr> <td>2009/10</td> <td>98.90%</td> </tr> </table> <p>Recovery for all years is projected to be well over 99% finally.</p>	2005/06	99.52%	2006/07	99.57%	2007/08	99.43%	2008/09	99.28%	2009/10	98.90%
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<p>The authority's track record in budget and financial management</p>	<p>The Council continues to demonstrate strong financial management with outturn being within +/- 1% of the net budget set:</p> <ul data-bbox="671 824 1353 969" style="list-style-type: none"> <li>• 2006/07 – underspent by £0.479m (0.47% of budget)</li> <li>• 2007/08 – underspent by £0.300m (0.27% of budget)</li> <li>• 2008/09 - underspent by £0.366m (0.31% of budget)</li> <li>• 2009/10 – underspent by £0.332m (0.27% of budget)</li> </ul> <p>This demonstrates continued strong financial management, despite considerable pressure on service budgets, notably children's social services.</p>										
<p>Virement and Contingencies</p>	<p>Virement is an important feature of budgetary control. It provides flexibility to adapt expenditure patterns to meet changing needs and objectives, consistent with Council policy.</p> <p>No Head of Service or Service Delivery Manger should plan to overspend. All expenditure should be consistent with approved service priorities and the overall approved budget.</p> <p>During 2010/11 a review of all service balances held was undertaken and £1.1m was clawed back to create an additional one-off contingency for 11/12, which when added to the ongoing contingency of £1.6m gives a total contingency of £2.7m for the year ahead.</p>										
<p>The adequacy of the authority's insurance arrangements to cover major unforeseen risks</p>	<p>The Council's insurance arrangements are a balance between external insurance premiums and internal funds to "self insure". The Council use the services of an external insurance advisor to provide additional expertise in managing insurance arrangements.</p>										

	The insurance section work closely with the Audit & Assurance Manager to identify insurance related risk areas and recommend ways of mitigating future risk.
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These assumptions are reviewed on an annual basis.

## **Reserves & Balances Policy**

### **Introduction**

Guidance on local authority reserves and balances is available from the Chartered Institute of Public Finance & Accountancy (CIPFA). This represents good financial management and underpins the framework followed by Telford and Wrekin Council in this policy.

### **Types of Reserves and Balances**

As part of the Service & Financial Planning process, the Council will consider the establishment and maintenance of reserves and balances.

Reserves and balances can be held for a number of purposes. Some reserves and balances are essential for the prudent management of the Council's financial affairs. These will provide a working balance to cushion the impact of uneven cash flows; a contingency for the impact of unexpected events or emergencies and allow the creation of earmarked reserves to meet known liabilities. The consequences of not keeping a minimum level of reserves can be serious and is therefore one of the considerations taken into account when setting the medium term financial plan.

When establishing reserves, the Council will ensure compliance with the Code of Practice on Local Authority Accounting in the United Kingdom.

Some of the most commonly established earmarked reserves are:

- Sums set aside for major schemes, such as capital developments
- Insurance reserves – to provide for an element of self-insurance
- Service Balances – to permit year end under spends to be carried forward for future commitments
- School Balances – unspent balances of budgets delegated to individual schools

### **Level of Reserves and Balances**

The minimum prudent level of reserves that the Council should maintain is a matter of judgement. It is the Council's safety net for unforeseen circumstances and must last the lifetime of the Council unless contributions are made from future year's revenue budgets. CIPFA guidance does not set a statutory minimum level so it is up to the Council itself, taking into account all the relevant local circumstances, to make a professional judgement on what the appropriate level of reserves and balances should be. Telford & Wrekin Council adopts a risk based approach to determine the appropriate level of reserves and balances to sustain and that which can be released to support the medium term financial plans.

Reserves and balances are only maintained in accordance with the risk assessment undertaken and are used in a planned way. Therefore the opportunity cost of maintaining the determined levels is kept to a minimum while interest is earned on the retained amount.

### **Process**

Each reserve and balance will have a clear purpose showing how and when it can be used together with a process for review to ensure continuing relevance and adequacy.

An annual review of reserves and balances will be undertaken as part of the budget process each year and a schedule presenting the estimated opening balances for the forthcoming year, planned additions to/withdrawals from and the estimated closing balances will be presented in the budget report. The schedule will also show the purpose of each reserve and a comment on the appropriateness of the value held.

The key financial risks will also be identified and an assessment of estimated exposure and possible mitigation will be made. This will link to the Council's key strategic risk register. The conclusion of this risk evaluation process will determine the resources available over the medium term to support the Council's budget.

This process will be repeated each year to ensure the ongoing adequacy of the Council's reserves and balances.

### **Responsibilities and Reporting Mechanism**

The Chief Financial Officer has a duty to local tax payers, and must be satisfied that the decisions taken on balances and reserves represent proper stewardship of public funds.

The level and usage of reserves will be formally approved by Council, as part of the budget strategy, informed by the Chief Financial Officer's judgement and expertise.

The budget report to Council will include a statement showing the estimated opening balances for the year ahead (including general fund and earmarked funds), any projected additions to/withdrawals and an estimated end of year balance. This will be accompanied by a statement from the Chief Financial Officer on the adequacy of the general reserves and provisions for the forthcoming year and the authority's medium term financial strategy. A statement reporting on the annual review of reserves and balances will also be made to Council at the same time.

## **Legal Framework**

This policy is in accordance with the following legislation:

Local Government Finance Act 1992 - The balanced budget requirement  
Local Government Act 2003 – The Chief Finance Officer’s duty to report on the robustness and adequacy of reserves when the authority is considering its budget requirement

Local Government Act 1972 – the requirement for each authority to make arrangements for the proper administration of their financial affairs and that the Chief Finance Officer has responsibility for the administration of those affairs