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Report of the Director of Finance to the meeting of Council to be held on February 20 2014

Document M

Subject: **S151 Officer's assessment of the robustness of the proposed budget estimates for 2014/15 to 2015/6, and of the adequacy of forecast financial reserves**

Summary statement:

This report assesses the risks arising from the budget proposed by Executive to Council, and the adequacy of the available mitigations, in the context of the forecast reserves. It concludes that the estimates are sufficiently robust to allow the Council to set the budget, but raises concerns about the adequacy of reserves by 2016/17 unless further action is taken during the 2014 planning round.

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Portfolio: Leader of the Council

Overview & Scrutiny Area: N/A

1. SUMMARY

This report assesses the risks arising from the budget proposed by Executive to Council for 2014/15 and 2015/16, and the adequacy of the available mitigations, in the context of the proposed reserves and the outlook for 2016/17.

It concludes that the estimates as proposed are sufficiently robust to allow the Council to set the budget, but raises concerns about the adequacy of reserves by 2016/17 unless further action is taken during the 2014 planning round.

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2. BACKGROUND

I am the Council's S151 Officer under the Local Government Act 1972. Under Section 25 of the Local Government Act 2003, when the Council sets the budget, I am required to report on:

- the robustness of the estimates made for the purposes of the calculations, and
- the adequacy of the proposed financial reserves.

This report comments on the revenue and capital estimates proposed by Executive to Council.

My assessment is informed by extensive personal involvement in the development of the proposed budget, work which started in late 2012.

3. OTHER CONSIDERATIONS

None.

4. OPTIONS

This report does not set out alternative options. Legislation requires Council to have regard to my assessment when setting the budget.

5. FINANCIAL & RESOURCE APPRAISAL

The financial appraisal underpinning my assessment is set out in the separate budget estimates papers to this Executive.

My assessment is as follows:

- the financial outlook remains very challenging, with national public finance policy for the foreseeable future likely to place the local authority sector under continued funding squeezes
- the principal financial imperative for the Council is to reduce its recurrent cost base, in order to remain a credible and viable organisation. In November 2013, the reduction required was estimated at £115m by 2016/17, starting from the 2013/14

base. While the profile of the funding gap has changed, Council budget decisions are still required of £37m for 2014/15, rising by a further £52m for 2015/16. The gap for 2016/17 is estimated at in excess of £115m

- The scale of the changes required to deliver cost reductions mean a complex programme of change with typically 6-9 month lead times. The Executive is proposing a two year budget, in the context of a three year outlook, as part of a rolling planning cycle: this is the right approach. By adopting a continuous planning approach, the Council will be able to refresh plans for 2015/16-2016/17 during 2014

- The proposed budget has been developed with the Executive, and reflects extensive engagement from Portfolio Holders, other members and management teams, which started in late calendar year 2012, and has continued since

- Extensive consultation has allowed proposals to be tested and refined

- The range of proposals to reduce net costs is wide, and distributed across the Council, which in itself diversifies the risk. In many cases the proposed changes are independent and mutually exclusive at an operational level; though the programme of change for Adult and Community services is more interdependent

- Experience in 2013/14 has confirmed that risks to the implementation of changes in Adult Services, will need very close monitoring, backed by appropriate contingency

- The proposed allocation of the Dedicated Schools Grant has been the subject of extensive and detailed development, scrutiny and ratification by the Schools Forum and its working groups. However it should be noted that the proposed use of £4m of DSG is subject to ratification by the Secretary of State for Education

- Lessons from financial performance in 2013/14 have been reflected in the proposed budget, through the adjustment of selected expenditure and income budgets totalling £7.2m

- The largest single risk to 2015/16 (and beyond) derives from the need to agree with stakeholders in the District how to integrate health and social care, and the net impact of spending financed through the Better Care Fund (which, it is assumed, will be used to finance social care activity which supports integration and the policy intent of the Fund)

- In a turbulent and changing environment, there will always be a residual risk that activity will not be delivered to planned timescales. Where this occurs, mechanisms are available to carry forward funds between years. Based on previous years experience, there is a risk that £3m-£5m (0.2% -0.5%) of gross expenditure) of non-recurrent revenue may carry forward. This is an acceptable risk except where delays means failure to deliver timely savings – these need to be managed on a case by case basis

- All savings proposals are allocated to a responsible Director; there are no unallocated reductions

- Slippage of the Capital Investment Plan can be managed without risk to affordability

- Contingencies in the base revenue budget have been set at a level consistent with experience in 2013/14, being pegged at a total of £3.6m

- The capital plan has been reduced to be affordable within the proposed revenue plan over 3 years.

I confirm that the estimates presented to Council by the Executive in its papers are sufficiently robust for the purpose of calculating the budgetary requirement.

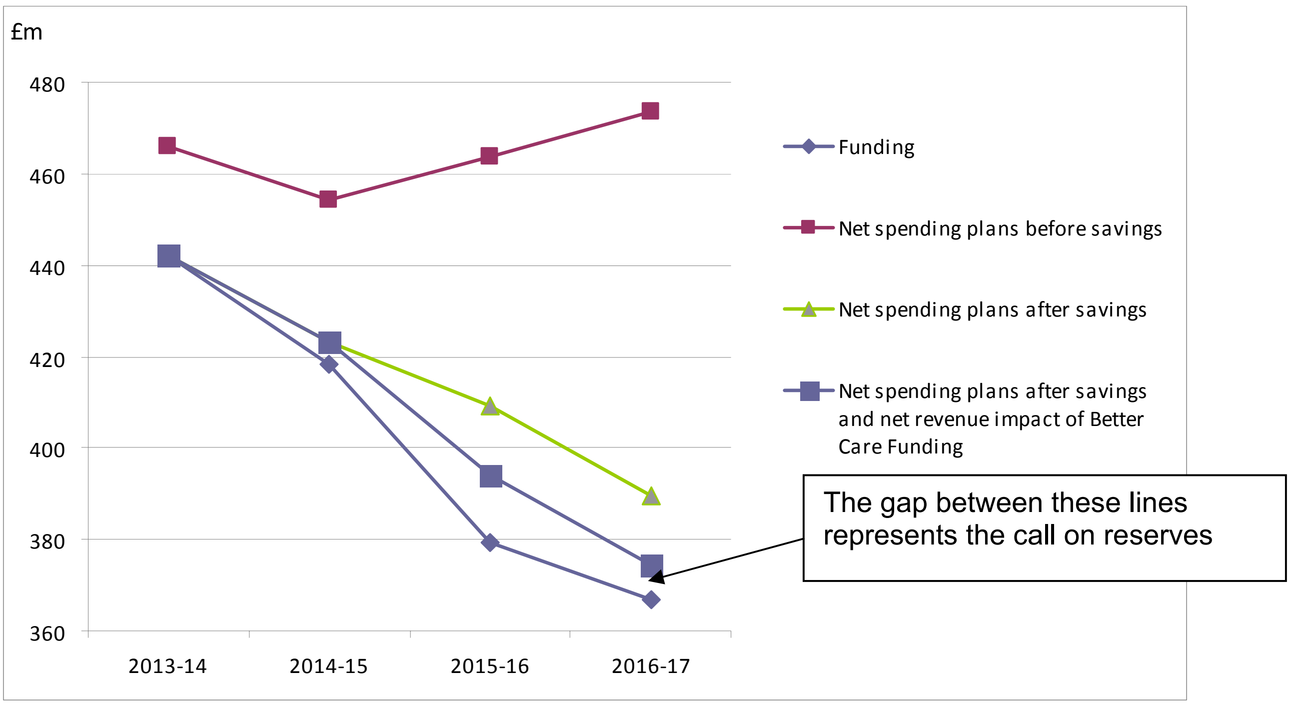
Turning now to the adequacy of reserves, the Council's financial strategy over the last 3 years has been to maintain the strength of the balance sheet to provide resilience in a turbulent environment, whilst reducing the recurrent net cost base. The Council adopted and has adhered to a policy on the use of reserves which has served it well.

The Council has been successful in reducing its recurrent cost base over the last 3 years, and has been able to augment, then deploy, corporate reserves.

The outlook for the next three years is, on current proposals, for a revenue deficit of £0.6m in 2014/15, £15m deficit in 2015/16, with a projected deficit of £7.6m in 2016/17 all of which require funding from reserves. The relatively large gap in 2015/16 is to some extent non-recurrent and could be bridged through the use of reserves, to smooth the cost reduction path to 2016/17, in line with the reserves policy.

The graph below shows the extent to which the gap between funding and spending each year is reduced by the proposals. Any remaining in-year deficit represents a draw on reserves.

Graph Showing Closure of Gap Between Funding and Spending



Appendix A of Document L to this Council contains details of the 3 year position, based on the proposed budget. Appendix F of that paper projects what the resultant balance on corporate reserves would be given the current proposals. The projection assumes a redesignation of c £9m of earmarked reserves in 2014/15 to support the revenue budget.

I conclude that the reserves are adequate for the 2014/15 proposed draft budget, and will be drawn on for the proposed 2015/16 budget in accordance with reserves policy, recognising that estimates will be subject to review as part of the rolling planning cycle.

However, I conclude that the projected 2016/17 corporate reserves balance would, on current estimates, be *inadequate*, for the following reasons:

- There remain significant risks to the delivery of the proposed service savings
- The assumption about the net impact of the Better Care Fund (£15m) likewise carries significant risk, with the quantum, purpose, and degree of service delivery changes to be managed, all uncertain
- The amount of contingency in the base budget has already been stripped back
- Having very constrained reserves provides limited resource to finance non-recurrent invest-to-save or transformational activity
- A residual general reserve of c £7m represents just 1.9% of the projected net revenue spend of £372m in what will remain a highly turbulent environment, given the continuing difficult outlook for public finances. A corporate reserve in the range of £12m-£15m would retain the resilience of the Council's position.

I therefore conclude that, while the proposed budget leaves an adequate level of reserves for 2014/15, the 2015/16 closing position depends on adequately managing the exposure related to the integration of health and social care.

For 2016/17 it is imperative that the Council agrees further reductions to net revenue expenditure, aiming for a balanced in-year revenue budget in that year. The planning and consultation for this will need to start during 2014, given the lead times for change. Elected Members, citizens and service users, and our partners should therefore be prepared for the need to accept further changes in the scale and cost of Council activity, at the latest during 2016/17, over and above the proposed budget.

6. RISK MANAGEMENT AND GOVERNANCE ISSUES

In reaching this conclusion I have modelled the potential financial impact of the risks identified in Appendix 1 to this paper. Using a quantitative method combining the likelihood and impact of adverse events occurring, I estimate that the level of risk that needs to be managed is in the order of £4m to £6m each year to avoid further calls on the corporate reserves. This risk analysis will be used to inform management action during the year.

The existing and proposed governance mechanisms to manage the budget are examined as part of my risk assessment.

7. LEGAL APPRAISAL

This assessment is made in accordance with the requirements of the Local Government Acts 1972 and 2003.

8. OTHER IMPLICATIONS

8.1 EQUALITY & DIVERSITY

The Equality and Diversity issues arising are analysed in the reports accompanying the budget documentation presented to Council.

8.2 SUSTAINABILITY IMPLICATIONS

None

8.3 GREENHOUSE GAS EMISSIONS IMPACTS

None

8.4 COMMUNITY SAFETY IMPLICATIONS

None

8.5 HUMAN RIGHTS ACT

None.

8.6 TRADE UNION

None

8.7 WARD IMPLICATIONS

None

8.8 AREA COMMITTEE ACTION PLAN IMPLICATIONS (for reports to Area Committees only)

None

9. NOT FOR PUBLICATION DOCUMENTS

None

10. RECOMMENDATIONS

That Members have regard to this report in setting the budget, and in particular note my conclusions that:

- the estimates presented to Council are sufficiently robust for the purpose of calculating the budgetary requirement

- the reserves are adequate for the 2014/15 proposed budget, and will be drawn on for the proposed 2015/16 budget in accordance with reserves policy, recognising that estimates will be subject to review as part of the rolling planning cycle

- the projected 2016/17 corporate reserves balance would, on current estimates, be inadequate, unless further cost reductions are targeted during the 2014 planning round, aiming for a balanced in-year revenue budget for 2016/17.

11. APPENDICES

Appendix 1: Risk-Based Assessment of Potential Events

12. BACKGROUND DOCUMENTS

- Two year budget 2014-15 and 2015-16 and financial outlook to 2016-17 Executive Report 5th November 2013 (Document AE)
- 2014-15 and 2015-16 Budget Update – Executive Report 4th February 2014 (Document BA)
- Engagement and Consultation Programme Feedback on the Council's Initial Draft Budget Proposals for 2013-14 - Executive Report 4 February 2014 (Doc BB)

- Interim Trade Union Feedback on the Council's Initial Draft Budget Proposals for 2014-15 - Executive Report 4 February 2014 (Doc BC)
- The Council's Revenue Estimates for 2014-15 and 2015-16 – Council 20th February 2014 (Document L)
- The Council's Capital Investment Plan for 2014/15 onwards –Executive 18th February 2014 (Document BJ)
- Allocation of the Schools Budget 2014/15 Financial Year – Executive 18th February 2014 (Document BH)

APPENDIX 1

Risk-Based Assessment of Potential Events

The table outlines: the risk event that could occur and cause the plan to vary; the mitigations that are in place; and an assessment of the potential quantified impact of the individual risk materialising, together with the additional mitigating factors.

Risk Event	**Mitigation in Place**	**Residual Risk Rating (Likelihood/Impact)**
		Likelihood: Low <30% <Medium < 70%< High Impact: Low <£2m< Medium < 5m < High
Government funding reduces further than forecast	Stability now expected for 2014/15. Monitoring in place of key fiscal cycle events for 2015/16. Public finance in next Parliament likely to mean continued austerity, but specific impacts on Bradford not certain. However, the planning arrangements in place allow lead time for future budget plans to be flexed for future years	High/low Contingency provided through balance sheet reserves for 2015/16 Contingency provided through adjustment of plans for subsequent years
Taxation streams are unstable	The Council Tax regime is more stable now, following implementation of reform in 2013/14. Collection rates and bad debt provision have been revised in the light of actual experience of the Council Tax Reduction scheme. Business Rates regime and performance are more volatile. Estimates for collection and appeals rates have been revised in the light of actual experience. In year losses and gains can be handled through the Collection Fund, with variances from plan can be dealt with by planning ahead for future years	Medium/Low Contingency provided through adjustment of plans for subsequent years
Other income streams unstable	Actual under-performance in 2013/14 against income targets has been reflected in the proposed budget through reduction to income targets totalling c £2m. On the upside, past performance suggests that unplanned income may materialise, offsetting generally the risks against the aggregate net revenue budget. Unbudgeted income ranged between £1m-£2m in the last two years, but the sources are insufficiently certain to include in the estimates.	Medium/Low Contingency provided through in-year budget control

Risk Event	Mitigation in Place	Residual Risk Rating (Likelihood/Impact)
		Likelihood: Low <30% <Medium < 70%< High Impact: Low <£2m< Medium < 5m < High
Member support for the budget diminishes	The Executive, individual Portfolio Holders, and other Members have been involved at a very detailed level in the development of the proposals.	Low/Medium Contingency provided through adjustment of plans for subsequent years
Plans for implementation of changes are not robust	Senior managers have spent significant time developing budget options. Each savings proposal is required to be accompanied by a project plan setting out the implementation path. The impact of the plans has been tested in consultation. The degree of risk in each individual proposed change varies, and requires continuous project management.	Low/Medium Contingency provided through continuous improvement of plans, through base budget risk action contingency
Planning is insufficiently flexible to respond to unexpected events	Governance arrangements allow Directors, under delegated authorities, and in consultation with Portfolio Holders, to flex plans during the year. If necessary, recourse can be had to the Executive to approve changes within the overall agreed budget envelope	Low/Low
Implementation of change is poorly controlled	From 2011/12 to 2013/14, the Council has managed to implement savings of £100m. Looking at performance in 2013/14, 75% of specific savings plans were converted into actual savings (compared with 85% in 2012/13). However, compensating savings were delivered. To improve the conversion rate on specific savings, a standard programme and project management method is being adopted across Departments. A separate related risk is the management capacity to deliver change. The degree of risk varies across Departments: the programme of change for Adult Changes is the most risk-laden in view of: the interconnectedness of the changes; the number and range of stakeholders to be consulted and managed; and recent actual experience of managing change.	Medium/Low Mitigations will include: Programme management activity to control plans Compensating action to reduce net costs Risk action contingency in base, representing 7%/8% of the total specific changes in each year.

Risk Event	Mitigation in Place	Residual Risk Rating (Likelihood/Impact)
		Likelihood: Low <30% <Medium < 70%< High Impact: Low <£2m< Medium < 5m < High
Integration of health and social care is uncertain and leads to high degrees of instability	The medium term financial outlook includes an assumption that £15m of the Better Care Fund flows through to the Council to support Adult Services activity that support the integration of health and social care. There is no firm consensus yet between the partner in the health and social care economy about that number, nor about what the Fund will be used for. The plan to use the Better Care Fund will be agreed by the Health and Wellbeing Board. Until firm consensus is reached, plans, and their implications, cannot be firmed up.	High/High Mitigation through: Governance mechanisms including Health and Wellbeing Board and supporting bodies Flexing of plans as appropriate Use of balance sheet to offset financial uncertainty
Changes related to staff cannot be implemented to plan	Consultation with Trade Unions has been extensive, and implementation will focus on avoiding compulsory redundancy. The voluntary redundancy framework has proved to be effective. The number of full time equivalent posts expected to be affected by the proposed budget is c 660, and staff related changes account for £6.6m (23%) of total budget changes in 2014/15, rising to £12.9m (50%) of the additional changes in 2015/16	Low/Medium Compensating action to reduce net costs Contingency provided in base budget
Changes related to external suppliers cannot be implemented to plan	The budget proposals foresee a reduction to spending with external suppliers of £10.7m (38%) of total budget changes in 2014/15, and £8.9m (35%) in 2015/16. Past experience suggests that through individual contract negotiation budgets can be managed through a combination of volume and price. However, Adult Services have found their supply chain less amenable, hence the minor rebasing of the Purchased Care budget.	Low/Medium Compensating action to reduce net costs Contingency provided in base budget
Changes related to income generation cannot be implemented to plan	Over the past two years, general economic conditions, and changes in the schools sector, have contributed to pressure on income budgets. Property disposals have reduced the rental income base. The proposed budget has rebased selected income lines, and does not require inflationary price rises on selected income budgets. However, it still assumes total real increases in income of £5.6m (20%) of total budget changes in 2014/15, and £1.2m (5%) in 2015/16	Medium/Low Compensating action to reduce net costs Contingency provided in base budget

Risk Event	Mitigation in Place	Residual Risk Rating (Likelihood/Impact)
		Likelihood: Low <30% <Medium < 70%< High Impact: Low <£2m< Medium < 5m < High
Customer/ citizen behaviour inconsistent with plan	Some changes require higher degrees of change in behaviour from service users; and continuing consultation processes may pose risks to implementation. The consultation to date suggests the most sensitive areas are in Adult Services (changes affecting care packages); Children Centres; and Youth Services	Medium/Medium Compensating action to reduce net costs Contingency provided in base budget
Demographic changes place unplanned burden on resources	The proposed budget has been increased to account for c £4m of demographic growth in Adult Services. The Schools budgets (funded by the DSG) reflect the latest pupil census. As a fast-growing city, it is expected that demographic growth will continue to lead to service pressures, which will need to be factored into future plans.	Low/Low Contingency provided through adjustment of plans for subsequent years
Insufficient inflation allowance	CPI inflation is running at 2% (December 2013). Expenditure budgets have been selectively inflated at indices appropriate for the relevant commodities, ranging from 2% to 6%. Where appropriate, budget managers will need to absorb unfunded inflation through reducing consumption of goods and services.	Low/Low Compensating action to reduce net costs
Capital investment is poorly controlled	The capital plan has been reduced to make it affordable for the revenue budget. A adequate level of contingency is included in the plan. However, some individual major projects have yet to reach full business case stage, so their cost will need to be monitored. Recent experience suggests that capital projects take longer to implement than implied by the financial plan; but the revenue budget implications tend to be favourable.	Medium/Low Contingency provided through adjustment of plans for subsequent years
Sources of funds for capital investment do not materialise	The capital investment plan is partly funded from capital receipts. If they do not materialise, the plan (or individual projects within in which are dependent on receipts) will need to be reviewed.	Low/Low Contingency provided through adjustment of plans for subsequent years

Risk Event	Mitigation in Place	Residual Risk Rating (Likelihood/Impact)
		Likelihood: Low <30% <Medium < 70%< High Impact: Low <£2m< Medium < 5m < High
Internal governance arrangements are not fit for purpose	Constitutional arrangements, internal delegations, and the financial control environment are in place and, from audit testing, are effective. The School Forum and the supporting mechanisms are likewise effective at enabling a mature discussion about the use of local authority and DSG funds to support schools and pupils. Changes in senior personnel mean the loss of continuity of knowledge, but bring the advantage of new perspectives.	Low/low
Governance arrangements with external parties are not fit for purpose	The Health and Wellbeing Board, and supporting governance structures, are still bedding in, which poses a potential risk in view of the extensive health and social care reforms in train. The emergence of the Combined Authority to oversee significant capital investment schemes (particularly transport) will change the way in which spending decisions are made, though this is unlikely to increase financial risk.	Medium/Medium