

# **Report of the Director of Finance to the meeting of Executive to be held on 23 February 2016 and Council to be held on 25 February 2016**

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## **Subject:**

**S151 Officer's assessment of the robustness of the proposed budget estimates for 2016/17, and of the adequacy of forecast financial reserves**

## **Summary statement:**

**This report assesses the risks related to the proposed budget for the financial year 2016/17, and the adequacy of the available mitigations, in the context of the forecast reserves.**

**It concludes that the estimates are sufficiently robust for the Council to set the budget. It signals the need for reserves to be maintained in the range of £12-15m in future years in order to ensure financial resilience.**

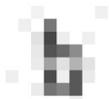
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**Portfolio: Leader of Council and Strategic  
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**Overview & Scrutiny Area: N/A**



## **1. SUMMARY**

This report assesses the risks associated with the proposed budget for 2016/17, and the adequacy of the available mitigations. The assessment is made in the context of the proposed use reserves and the outlook to 2018/19.

The Council is setting the budget for 2016/17, and making decisions about savings for 2017/18 which will require management action during 2016/17. The 2017/18 budget is not yet balanced.

The report concludes that the estimates are sufficiently robust for the Council to set the budget for 2016/7.

£6.1m of the Unallocated Corporate Reserves set aside to support the revenue budget are drawn down to provide a balanced budget in 2016/17, after which they reach £13.5m. In view of the growing challenge of identifying and implementing cuts, it is recommended that the Council maintains Unallocated Corporate Reserves in the range of £12-15m, so it is financially resilient to deal with residual risks in its environment and in recognition of the continued decline in external funding through to 2020.

For 2017/18, therefore, no further drawdown from reserves is planned, though a deficit remains of £7.9m. The deficit is £28.3m for 2018/19. Accordingly, continued reductions in the net cost of Council services will be required, which must be planned during 2016.

## **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 in the proposed budget. My assessment is informed by extensive personal involvement in the development of the proposed budget.

## **3. OPTIONS**

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

## **4. FINANCIAL & RESOURCE APPRAISAL**

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

My assessment is as follows:

- the financial outlook remains very challenging. The Government announced in its Spending Review its fiscal trajectories to 2020. It has also offered individual Councils a Four Year Settlement to 2019/20, to be taken up by October 2016, in return for an “efficiency plan”. This could reduce the degree of medium-term funding volatility but does not reduce the sheer scale of the cost reduction task
- Continued reforms in the education sphere (the evolving role of regional schools commissioners, national formula funding); potential developments in further integration of health and social care; and regional devolution – all these may bring consequences not factored into the medium term shape of the Council. For now, this assessment is based on the existing role and form of local authorities
- the principal financial imperative for the Council is to reduce its recurrent cost base, in order to remain a credible and viable organisation. The budget being proposed balances the 2016/17 budget, but in-year deficits remain at £7.9m for 2017/18, rising to 28.3m for 2018/19
- The scale of the changes required to deliver cost reductions means a complex programme of change with typically 6-9 month lead times. Recent experience has shown that even longer horizons are required fully to implement changes with many stakeholders. The programme will include changes agreed by Budget Council in 2015, with a wide range of individual changes of varying magnitude, risk and timescales. As a result, several layers of change need to be managed, with projects of varying maturity. This stretches the capacity of the organisation to deliver current operations and introduce change at the same time
- Although the Council is setting a budget for 2016/7 only, the decisions being recommended also set a firm direction for 2017/18, with a total of £24.4m cuts for 2017/18. The working assumption is that these decisions will hold good, which provides planning certainty, and mandates senior officers to take action during 2016/17 to ensure those savings are deliverable in 2017/18. However, with a deficit in 2017/18 of £7.9m still remaining, more cuts will need identifying. The Executive has signalled its intention to receive during 2016 quarterly updates on the development of further cost reduction proposals for 2017/18. This approach is not expected to lead to change in the 2016/17 estimates, but could lead to the early adoption of changes with a 2017/18 impact, subject to the normal consultation and approval processes
- The proposed budget has been developed with the Executive members, and reflects extensive engagement from Portfolio Holders, and management teams, which started in early summer 2015. As part of this work, every area of activity was tested against the extent to which it supported the Council’s New Deal outcomes. The proposed budget reflects a comprehensive stocktake of all expenditure and income
- Extensive public and internal consultation has allowed the new proposals to be tested, refined, and their impacts better understood. In some cases, the proposals will need further development to turn them into fully-worked up implementation plans in keeping with the Council’s adopted project management standards

- 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. However, the consultation on the proposals yielded a view amongst some stakeholders, that the multiple impact of discrete changes on individuals and single organisations, is not always apparent
- The implementation of proposed changes in Adult and Community Services and in Children's Services which affect individuals with sometimes high need for care, will need very close monitoring
- Proposed savings in Adult and Community Services which can have consequences for the District-wide health and social care economy require effective collaboration with the NHS and other partners. Through their responses to the budget consultations, it is clear that NHS partners recognise that need and welcome the opportunity to participate in shared planning
- The budget plans further £2.9m savings from changing entitlements to and methods of transporting individuals to and from services (as agreed by Budget Council in February 2015). Progress on these changes has been more difficult than planned, and there remains a low assurance that the savings will be realised. No specific contingency has been included in the base revenue budget
- The proposed allocation of the Dedicated Schools Grant (DSG) has been the subject of extensive and detailed development, scrutiny and ratification by the Schools Forum and its working groups. The distribution of the DSG will require continued change in the shape and deployment of Children's Services functions, though there is a high degree of confidence that this can be achieved in 2016/17
- Lessons from financial performance in 2015/16 have been reflected in the proposed budget, with specific provision of £1.5m being added to the budget for Looked After Children
- Adjustments to the base estimates to reflect changes in prices have been revised to reflect latest inflation data as it relates to the Council's cost base and supply chain. The budget is set on the basis that the additional 2% Council Tax increase for Adult Social Care is available for adult social care costs
- Past experience suggests there will 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 around £3m of non-recurrent revenue may carry forward. This is an acceptable financial risk except where delays means failure to deliver timely savings – these need to be managed on a case by case basis

- For 2016/17, all savings proposals are allocated to a responsible Director; there are no unallocated reductions. Some proposals with a 2017/18 impact will be dealt with as a group affecting more than one department, and will be led by a nominated lead Director
- 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 2015/16.

I confirm therefore that the estimates are sufficiently robust for the purpose of calculating the budgetary requirement.

## **Reserves**

The Council's financial strategy over the last 5 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 balance sheet includes reserves set aside for designated purposes and for specific liabilities and risks. In setting the proposed 2016/17 budget, a small number of these reserves totalling £2.2m have been allocated to support new non-recurrent requirements.

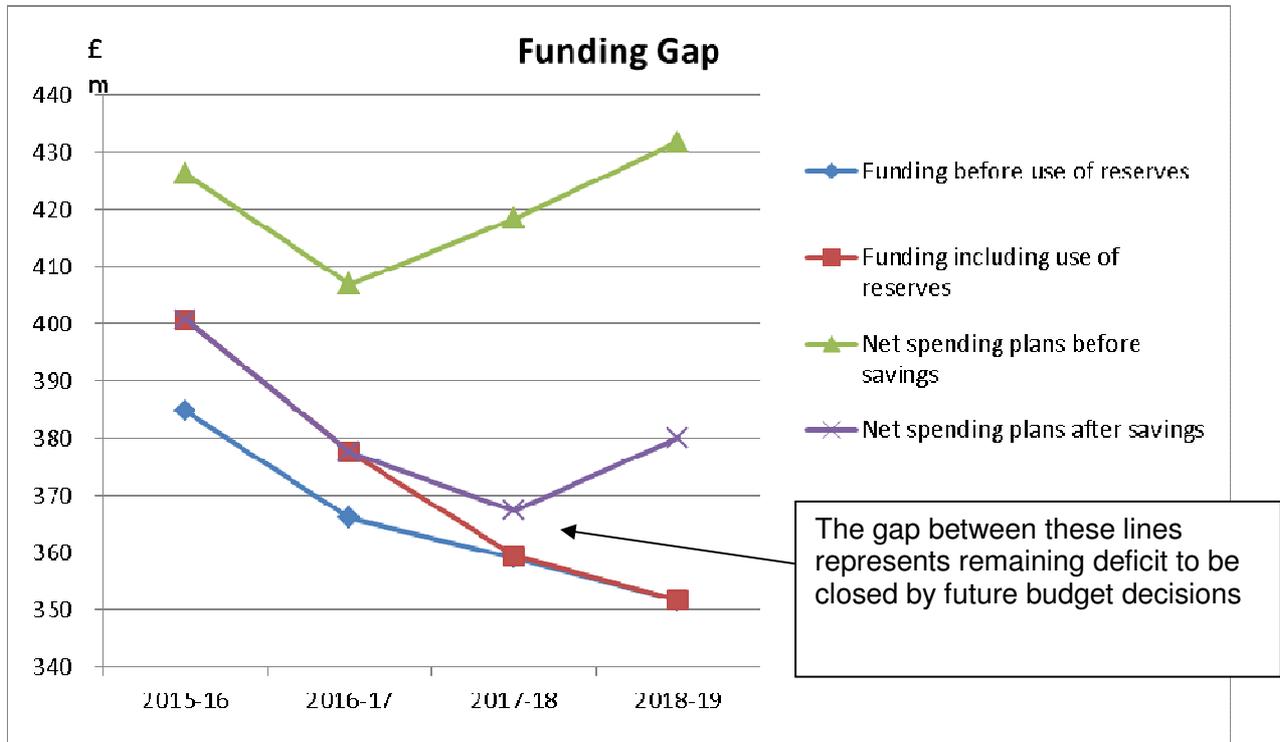
This assessment focuses on the level of Unallocated Corporate Reserves available to support revenue budgets.

The Council has been successful in reducing its recurrent cost base since 2010/11, and has been able to augment, then deploy, Unallocated Corporate Reserves. They will stand at a forecast £19.6m at April 1 2016.

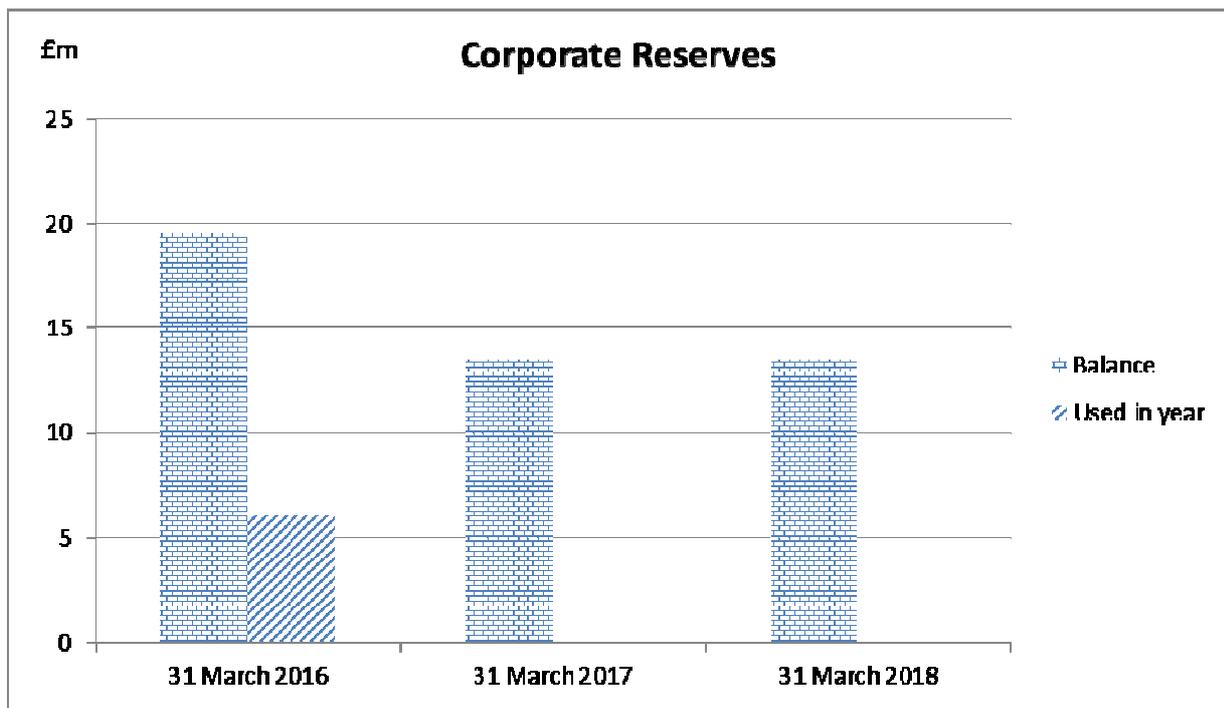
The outlook for the next three years is, on current proposals and *before* use of reserves, for a revenue deficit of £11.6m in 2016/17, £8.2m deficit in 2017/18, with a projected deficit of £28.3m in 2018/19. The proposed Budget assumes that £6.1m Unallocated Corporate reserves will be drawn down in 2016/17, and then stand at £13.5m at the beginning of 2017/18.

The graphs below show the gaps between funding and spending which remain before and after savings and use of reserves each year, and the remaining Unallocated Corporate Reserves.

### Graph Showing Gaps Between Funding and Spending



### Estimated Corporate Reserves



Appendix A of Document BA to this Executive contains details of the 3 year position, based on the proposed budget. Appendix F of that report quantifies what the resultant balance on corporate reserves would be given the current proposals.

I conclude that the reserves are adequate for the 2016/17 proposed budget.

On current plans, they will not be drawn on for 2017/18 (leaving an outstanding in-year deficit in that year of £7.9m).

The outlook for 2018/19 is tough. There remains in my view an unreconciled tension between resources, citizen expectations, and the statutory framework which may at least inhibit, if not prevent, the Council from curtailing or stopping entirely services. This applies particularly to services provided to individuals of all ages who, because of their personal circumstances, qualify for personal services.

There are many routes the Council can take to remain financially viable, but agreeing the cost reduction plan with stakeholders and citizens will be politically and managerially challenging, despite the engagement that began during 2015 under the banner of New Deal.

In this context, in my view the projected Unallocated Corporate Reserves for 2017/18 and beyond remain adequate **only if** further recurrent net cost reductions are targeted beyond 2016/17, for the following reasons:

- This class of reserves can cushion less and less the impact of the revenue budget deficit
- There are significant residual risks to the delivery of the proposed savings
- The amount of contingency in the annual base budget is set at a level which, learning from recent years' experience, reflects around 10% of the financial value of the savings being implemented
- Having very constrained reserves provides limited resource to finance non-recurrent invest-to-save or transformational activity
- As central government funding continues to decline to 2020, the Council will be increasingly reliant on local sources of taxation and other income. The last year has seen a high degree of volatility in the Business Rate base
- A residual general reserve of £13.5m represents 3.7% of the affordable projected net revenue spend of £367m in 2017/18 in what will remain a highly turbulent environment, given the continuing difficult outlook for public finances. Aiming for Unallocated Corporate Reserves in the range of £12-15m would, in my view, retain the resilience of the Council's position.

I therefore conclude that:

- while the proposed budget leaves an adequate level during 2016/17, the closing position for 2016/17 depends on continuous management of implementation risk
- for 2017/18 and beyond, 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 Executive has signalled its intention to receive quarterly updates on the

development of cost reduction proposals for 2017/18. Budget proposals for 2017/18 and beyond need to be well advanced by autumn 2016

- Elected Members, citizens and service users, and our partners should be prepared to accept further changes in the scale and cost of Council activity, over and above the proposed budget.

## **5. 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 £13m to avoid further calls on the Unallocated 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.

## **6. LEGAL APPRAISAL**

This assessment is made in accordance with the requirements of the Local Government Acts 1972 and 2003. The Council's Constitution provides that each year, before the budget is determined the Director of Finance will produce a report for the Executive showing ongoing commitments and a forecast of the total resources available to the Council to enable the Executive to determine any financial strategy guidelines.

## **7. OTHER IMPLICATIONS**

The Equality and Diversity issues arising from the new budget proposals are analysed in the reports accompanying the budget documentation presented to Executive on 9 February and 23 February 2016. The Interim Trade Union feedback on the budget proposals was detailed in a separate report and addendum presented to the meeting of Executive on 9 February 2016 and an addendum presented on 23 February. The Trade Union feedback and the feedback from the public engagement and consultation programme on the proposals previously approved by Budget Council in February 2015 was fully considered by Council at that time.

## **8. 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 2016/17 proposed budget, and will be drawn on in accordance with reserves policy, recognising that estimates will be subject to review as part of the rolling planning cycle

- the projected 2017/18 corporate reserves balance would, on current estimates, be adequate, only if further recurrent net cost reductions are agreed beyond 2016/17.

## **9. APPENDICES**

### **Appendix 1: Risk-Based Assessment of Potential Events**

## **10. BACKGROUND DOCUMENTS**

- 2016/17 and 2017/18 Budget and Financial Outlook to 2018/19 – Executive report 1 December 2015 (Document AH)
- 2016-17 and 2017/18 Budget Update and Financial Outlook to 2018/19 – Executive report 9 February 2016 (Document AU)
- Engagement and Consultation Programme in relation to the budget proposals for the 2016-17 and 17-18 Council budget – Executive report 9 February 2016 (Document AV)
- Interim Trade Union feedback on the Council's budget proposals for the 2016/17 and 2017/18 Council budget – Executive report 9 February 2016 (Document AW)
- Allocation of the Schools Budget 2016/2017 Financial Year – Executive Report 23 February 2016 (Document AZ)
- The Council's Revenue Estimates 2016/17 and 2017/2018 – Executive report 23 February 2016 (Document BA)
- The Council's Capital Investment Plan 2016/17 to 2019/20 – Executive report 23 February 2016 (Document BB)

**Risk-Based Assessment of Potential Events Affecting the Proposed 2016/17 Budget and Beyond**

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	Description and Mitigation in Place	Residual Risk Rating (Likelihood/Impact) and Contingency
		Likelihood: Low <20% <Medium < 50%< High<70% Impact: Low <£2m< Medium < £3m < High < £5m
Taxation streams are unstable	Collection rates and bad debt provision have been revised in the light of actual experience of the Council Tax Reduction scheme, Business Rates performance has been more volatile than Council Tax, with the outcome of appeals significantly reducing the tax yield. In year losses and gains can be handled through the Collection Fund, while variances can be dealt with in future years plans	Medium/Medium  Contingency provided through adjustment of plans for subsequent years.
Other income streams unstable	In the 2015/16 outturn, some income streams, both from grants and trading, have been volatile, and have been adjusted for in the proposed 2016/17 budget. Uncertainty about income from health partners exists in view of the national NHS financial position. On the upside, past performance suggests that unplanned income may materialise, offsetting generally the risks against the aggregate net revenue budget. Proposals to increase income for adults services and from green waste collection bring some risk.	Medium/Low  Contingency provided through in-year budget control.  Continuous dialogue with NHS partners over funding flows Close monitoring of trading
Member support for the budget diminishes	The Executive and individual Portfolio Holders, have been involved at a very detailed level in the development of the proposals. The budget is set for 2016/17 with a clear basis for the financial plan for 2017/18, with the Executive resolved to ensure that budgeting for 2017/18 is continuous.	Low/Low  Contingency provided through adjustment of plans for subsequent years
Plans for implementation of changes are not	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	Medium/Low  Mitigation provided through continuous

Risk Event	Description and Mitigation in Place	Residual Risk Rating (Likelihood/Impact) and Contingency
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robust	individual proposed change varies, and requires continuous project management. The proposals in Adult and Children's Services include a high degree of change, requiring dedicated project management resource (which has been funded in the budget). Lessons learned from the last two years suggest the risk of not having fully worked up plans at the beginning of the year must be addressed; and is not yet fully mitigated at the time of this assessment	improvement of plans.
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, or compromised by insufficient internal capacity	<p>From 2011/12 to 2015/16, the Council has managed to implement savings of £173m. Looking at performance in 2015/16, 86% of specific savings plans are forecast to convert into actual savings on time (compared with 93% in 2014/15). Given the cumulative impact of the savings since 2010, it will be increasingly hard to find mitigating savings. The degree of risk varies across Departments.</p> <p>To improve the conversion rate of specific savings, the standard programme and project management method, which has been adopted across Departments, will continue.</p> <p>There is a risk that the multiple impact of discrete changes on individuals or single organisations is not apparent until implementation, with unintended consequences that may need addressing.</p>	<p>Medium/Medium</p> <p>Compensating action to reduce net costs</p> <p>Contingency in base budget.</p>
Risks to timely implementation of changes to	The programme of change for Adult Services continues to be risk-laden in view of: the interconnectedness of the changes; the number and range of stakeholders to be consulted and managed; the	<p>High/High</p> <p>Use of dedicated programme management</p>

Risk Event	Description and Mitigation in Place	Residual Risk Rating (Likelihood/Impact) and Contingency
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packages of care in adults and children services	statutory framework; the close links between local decisions and nationally-sponsored policy and thinking on new models of health and social care; the financial challenges faced by businesses in the social sector; and recent actual experience of managing change. The package of proposals to reform entitlements to and methods of transporting individuals to and from services has taken longer than planned to implement, due to internal capacity and the need to engage widely with affected families. The proposals from Children's Services will require a significant project management effort, with a package of reforms that include a fundamental rethink about care arrangements for children with needs for specialist services; the rapid move to school-led improvement; and new ways of working with schools to deliver some special educational needs services. These risks will be monitored through project management.	resource  Continued collaboration with NHS and other partners  Learning from developments in other local authorities  Adoption of higher risk appetite in the assessment of individual cases
Uncertainties over the integration of health and social care, including delays in developing new models of care to support changes to service delivery	The future of adult social care is heavily influenced by national policy on integration. The Government has signalled an "improved" Better Care Fund, but details are scant. Work to develop "new models of care" could run slower than is necessary to inform/support local changes, with potential adverse financial and client impacts. Governance mechanisms including Health and Wellbeing Board and supporting bodies are in place, allowing shared planning with NHS partners, and joint participation in nationally led initiatives. Discussions are underway about the concept of a single "Accountable Care Organisation"	Medium/Low  The Council may have to make unilateral changes if the pace of change is too slow
Changes related to staff cannot be implemented to plan	Consultation with Trade Unions commenced on 23 November 2015, and has continued since. Implementation will focus on avoiding compulsory redundancy. The voluntary redundancy framework has proved to be effective, though there is a need to ensure that the skill base of the workforce is maintained. The total number of staff that	Low/Low  Compensating action to reduce net costs  Vacancy Management

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	could be at risk from this proposed budget is 335 FTE for 2016/17, and 139 for 2017/18 (in addition to 167 FTE for 2016/17 arising from decisions of 2015 Budget Council). Staff related changes account for £2.9m (17% of total new budget changes in 2016/17) (on top of £5.4m changes agreed at 2015 Budget Council)	Contingency provided in base budget
Changes related to external suppliers cannot be implemented to plan	The new budget proposals foresee a reduction to spending with external suppliers of £8.8m (50% of total new budget changes in 2016/17) (on top of £16.5m changes agreed at 2015 Budget Council). Past experience suggests that through individual contract negotiation budgets can be managed through a combination of volume and price; and increasingly through re-commissioning for revised levels of service. Suppliers of adult social care are indicating signs of financial stress, including from the anticipated impact of the National Living Wage. Additional funding for Adult Services will be available from the extra 2% increase in Council Tax	Low/Medium  Compensating action to reduce net costs  Additional 2% Council Tax rise to support adult social care costs  Contingency provided in base budget
Changes related to income generation cannot be implemented to plan	The proposed budget has rebased selected income lines, and does not require inflationary price rises on income budgets in 2016/17 (though an increase of 1% is anticipated for 2017/18. However, it still assumes total increases in income of £3.6m (21% of total new budget changes in 2016/17, with £1.1m accounted for by taxation changes. New charges for green waste management pose a potential risk.	Medium/Low  Compensating action to reduce net costs  Contingency provided in base budget
Customer/ citizen behaviour inconsistent with plan	Some budgets require significant degrees of change in behaviour and expectations on the part of service users and their representatives; and continuing consultation processes may pose risks to implementation. Experience to date says the most sensitive areas are in Adult Services; transport-related proposals, and in Children's specialist services.	Medium/Medium  Compensating action to reduce net costs  Contingency provided in base budget
Demographic changes place	The proposed budget has been increased to account for £1.5m of demographic growth in Adult Services. The Schools budgets	Low/Low

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unplanned burden on resources	(funded by the DSG) reflect the latest pupil census. Additional money is also provided for people with otherwise no recourse to public funds. It is expected that demographic growth and changes in the composition of the population will continue to lead to service pressures, which will need to be factored into future plans.	Contingency provided through adjustment of plans for subsequent years
Insufficient inflation allowance	Expenditure budgets have been selectively inflated at indices appropriate for the relevant commodities, ranging from 0.5% to 2.0%. Where appropriate, budget managers will need to absorb unfunded inflation through reducing consumption of goods and services. Pay budgets have been inflated to reflect nationally agreed pay awards.	Low/Low  Compensating action to reduce net costs
Capital investment is poorly controlled	The level of contingency in the capital plans is in line with historically consistent levels. Some individual 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. The sports facilities investment programme requires continued disciplined management and control; and the plans for the provision of social care facilities remain fluid. There are signs of inflationary pressures and skill shortages in construction, so project managers need contingency in their plans.	Low/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 (c £3m per year). 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
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 Schools 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.	Low/low

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	Changes in senior personnel mean the loss of continuity of knowledge, but bring the advantage of new perspectives. Programme managements are well established, and will be further strengthened in higher risk projects in Children's Services.	
Governance arrangements with external parties are not fit for purpose	Governance arrangements at District level have been re-tuned during 2015. Reforms continue in the education governance landscape. The Health and Wellbeing Board and supporting arrangements are in place, though the pace of development is often overtaken by national NHS developments. At regional level, Combined Authority governance is in place, though further changes may evolve in the wake of the devolution agenda. These factors do not increase financial risk as much as absorb leadership and management attention.	Low/Low