



<b>REPORT OF:</b>	<b>DIRECTOR OF FINANCE AND IT</b>
<b>TO:</b>	<b>FINANCE COUNCIL</b>
<b>DATE:</b>	<b>26<sup>th</sup> FEBRUARY 2018</b>

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**SUBJECT: The Robustness of the 2018/19 Budget and the Recommended Level of Reserves**

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## **1. PURPOSE OF THE REPORT**

Section 25 of the Local Government Act 2003 places a statutory requirement on the Council's Chief Financial Officer to report on:

- a) the robustness of the estimates within the overall budget, and
- b) the adequacy of the proposed level of financial reserves

In setting the Budget for 2018/19, Council is required to have regard to this report when making its budget decisions.

## **2. RECOMMENDATIONS**

An overall assessment of the current budget and the assumptions on which this is based, as well as future budget proposals, savings plans and activity forecasts, has identified that whilst there are risks, the overall budget provisions are considered sufficient to meet the Council's legal responsibilities and obligations.

A review of risks, mitigations and contingencies has also been undertaken alongside the review of reserves and provisions.

Finance Council is recommended to consider the assessment by the Director of Finance and IT of;

- the robustness of the Revenue Budget and Capital Programme for 2018/19 (as outlined in the report of the Executive Member for Resources) and
- the adequacy and recommended level of proposed financial reserves (detailed in **Section 5.2** below).

## **3. RATIONALE**

The information provided below is to assist Members in their review of the overall Revenue Budget and Capital Programme and to provide assurance to them that financial advice has been provided throughout the budget setting process.

## **4. POLICY IMPLICATIONS**

The Budget Strategy reflects the corporate priorities of the Council and policy requirements at both a corporate and departmental level.

## **5. FINANCIAL IMPLICATIONS**

### **5.1 Robustness of the 2018/19 Budget**

#### **5.1.1. Budget Strategy**

The Council's overall framework for its medium term budget is contained within the Medium Term Financial Strategy (MTFS). In developing the MTFS, the Council has been mindful of the consultations currently underway and those which have recently closed but have yet to report their findings, specifically;

- Fair Funding Review
- Business Rates Retention
- Adults Social Care Funding consultations and Green Paper

We are also cognisant of the work that is still in progress to significantly change the way Councils are funded from 2020 onwards. As such, whilst the strategy would normally extend to cover the 3 year period beyond the end of the budget year, i.e. to 2021/22, as for the MTFS presented in 2017, this MTFS has been limited to 2 rather than 3 additional years, i.e. to 2020/21, until more clarity is provided on the changes to the funding framework and mechanisms to be introduced by central Government. Announcements and direction on this are anticipated over the next 12 months.

The strategy provides for Council-wide involvement with an integrated approach to the preparation of soundly based capital and revenue plans and the associated strategies of managing risk and internal control. Together this ensures effective financial management and governance.

#### **5.1.2 Budget and Tax Setting Process**

The annual budget preparation and tax setting process involves the development of robust medium term revenue forecasts and capital plans. In any financial year, the level of Government funding, additional cost pressures (including inflation, service specific pressures and areas of investment and growth), together with an increasing demand for services, necessitates a re-appraisal of service delivery and identification of efficiency savings to address any funding shortfall in order to deliver a balanced budget. The Budget Strategy and proposals submitted have been formulated to reflect these issues.

Throughout the formulation of the Budget Strategy, Portfolio Executive Members have been advised by the Chief Executive, the Deputy Chief Executive and Directors in relation to the operational requirements around policy and legislative initiatives. Likewise, the Director of Finance and IT and senior finance representatives have advised on financial impact and provided comprehensive input to demonstrate financial viability throughout the process. In doing so, and to ensure the robustness of the budget and the budget setting process, we have been mindful of;

- Availability of reliable information;
  - we have sought to ensure that the budget is based on the most up-to-date and realistic assumptions (for example Government and Bank of England forecasts for pay and price increases and interest rate movements)
  - we have made assumptions relating to future levels of Government funding based on the information provided in the recent Local Government Finance Settlement, which reflects the Council's acceptance of the 4 year settlement for 2016/17 to 2019/20 back in October 2016
  - we have utilised demographic and trend data to project future levels of demand, given that demand in respect of adult social care and children's services are the biggest cost pressures and present the greatest financial risk to the Council at present
  
- Council's guidance and strategy;
  - the Council's Constitution which contains a clear Budget and Policy framework
  - the Council's Budget Strategy and approach to budget setting which is clearly defined and communicated
  - consultation with residents, partners and businesses within the Borough and targeted engagement with service users
  
- Corporate approach and integration;
  - service departments have identified budget pressures and risks at an early stage in the process and have clearly demonstrated realistic service plans linked to the budget resource available
  - the system of cash limited budgets for each Portfolio provides a transparent and accountable arrangement to budget setting; the allocated cash limit takes account of service specific cost pressures and inflation and also includes an apportionment of corporate cost pressures from which each Portfolio has had to formulate a strategy to deliver savings and ensure a balanced budget
  - the Council continues to closely monitor and instigate early action to meet both its immediate and medium term financial challenges. This approach has been effective in providing a level of resilience to address the Government's funding reductions over the period to 2019/20 and has encompassed savings relating to;
    - the 3 year savings programme of £26.0m approved by Council Forum in September 2014,
    - the £3.6m in-year budget savings programme of 2016/17,
    - the £15.0m savings programme developed during 2016/17 for implementation by the end of 2017/18
  - further savings options have been developed for implementation in 2018/19 and, for 2019/20 and beyond, a thematic savings review programme is in development covering digital, procurement, alternative service delivery models, Council Tax discounts and income, commercialisation and traded services.
  
- Flexibility;
  - mechanisms to review options for service delivery are linked into the budget process
  - flexibility to free up resources to deliver service improvement and to deliver the Council's priorities
  - flexibility in budget management as included within the Council's Constitution

### **5.1.3 Capital Programme**

Affordability of capital expenditure plans is important in determining the overall robustness of the budget and adequacy of reserves to deal with potential variations.

The proposed Capital Programme for 2018 to 2021 of £72.9m is included within the report from the Executive Member for Resources. This predominantly comprises of existing commitments including investment:

- in our local transport plan
- in aids and adaptations through provision of disabled facilities grants
- in regeneration of the borough
- in facilitating housing and business growth
- in support of income generation and commercialisation opportunities
- in support of continued investment in IT services to underpin our 'digital first' approach to delivering efficiencies and in turn, cash savings
- in support of our accommodation review which again will drive efficiencies and savings through rationalisation and a more cost effective use of space

Before projects are allocated funding however, they are subjected to a rigorous business case approval process and detailed Member reports are produced in line with financial procedures as required.

These schemes will require strong project management and effective monitoring to ensure they are achieved on time and within budget. Failure to deliver against budget on such large schemes could lead to potential overspends which could impact on the overall future capital programme as additional costs could put pressure on the funding available for delivery of other schemes within the programme. To mitigate this risk, sound systems of internal control are in place with project boards established to provide the necessary governance structure, ensuring appropriate and timely reporting mechanisms.

### **5.1.4 In year financial Monitoring Process**

The Council continuously seeks to strengthen its financial processes and controls. This approach, combined with existing effective arrangements, will provide a strong foundation enabling Members and Officers to continue to deliver the demanding targets and plans set within the Budget Strategy and the challenges identified for future years. In any budget however there are likely to be risks. In year financial monitoring processes are in place to mitigate these;

- overall budget monitoring takes place throughout the year at both Portfolio and Executive Board level to identify potential areas of pressure and to develop and implement corrective action. This in itself provides a strong control environment and is commensurate with sound corporate governance. Progress against efficiency targets is also monitored and reported to Executive Members.
- the Chief Executive and Deputy Chief Executive meet at least once a month with the Director of Finance and IT and senior finance staff, to review both the Councils' overall financial position and the progress made in delivering the savings programme, as well as considering the impact of emerging changes in the local government financial landscape

- the Policy & Corporate Resources Overview & Scrutiny Committee meets regularly with the Executive Member for Resources, and with the Director of Finance and IT and Director of HR, Legal and Corporate Services, to review the Council's budget position and progress made against the agreed savings programme.
- other specific Boards and Groups such as the Growth Board, the Digital Board, the Workforce Review Board and the Commissioning and Procurement Board, who each meet regularly to oversee the sphere of activities within their specific remit.
- the financial model that underpins the MTFS is subject to continuous review throughout the year to enhance forward planning, policy prioritisation, resource allocation and assess opportunities to invest in achieving future efficiency savings. The assumptions, variables and information within the model are regularly updated to ascertain the impact of known changes (e.g. legislative changes such as the National Living Wage), potential changes (such as adjustments to government funding and precept levels), and also for the refinement of variables (such as inflation, interest rates and employers pension rates) in light of emerging information.
- the Council adopts a risk based approach to financial management which provides added value to the governance process and identifies risks associated with both the revenue and capital programme. The provision of sufficient levels of Unallocated Reserves, and for specific contingencies within the budget, mitigates against the financial risks from unforeseen financial issues so that these can be addressed in a responsive and controlled manner. As part of its approach to risk management the Council also makes provision for Earmarked Reserves, i.e. funding reserved to address specific future needs.

### **5.1.5 Risk**

Ultimately the robustness of the budget is dependent on the strength of the arrangements in place to deliver the component parts and to manage the associated risks of these.

It must be recognised that given the significant reduction in resources over the past 8 years, and the resulting reconfiguration of the organisation and its services, the Council faces significant risks which impact upon the financial estimates included in this budget.

These risks include:

- potential increase in demand for services from residents, particularly social care services for the most vulnerable, which may be exacerbated by reductions in public sector expenditure in other areas such as the NHS and as a result of Welfare Reform
- the reaction by residents to changes to services
- the ability to raise revenue from taxes, fees and charges
- changes in statutory and legislative requirements, including employment law
- changes by government in funding
- contractual obligations
- the challenging timescales in which to deliver the reductions required
- potential loss of skilled and experienced staff
- the development of free schools and academies and further education reforms

Whilst the 4 year settlement effective from 2016/17 has provided some stability to assist in financial planning through to 2019/20, for 2020/21 and beyond, the uncertainty with regards to Government's plans for;

- the development and implementation of a Business Rates Retention Scheme,
- the development and implantation of a new Fair Funding formula,
- the future of Government grant funding including Public Health Grant and Improved Better Care Fund,
- plans for integration of the NHS and adult social care and
- the impact of Brexit,

all present significant risk upon which it is impossible to model a longer term strategy without any degree of confidence in the underlying assumptions.

However, the approaches outlined in this paper in relation to risk management, scrutiny, continuous monitoring of both the current and forecast financial position, as well as regular modelling through the MTFS of the financial impact of changes in the external environment, should mitigate these risks; by identifying the risks and providing an assessment of exposure, magnitude and potential financial impact, plans can be developed and implemented to address them. Therefore this Budget Strategy, whilst undoubtedly challenging, is achievable with strong project and risk management and with effective financial control.

## **5.2 Adequacy of Proposed Financial Reserves**

Reserves are an essential part of good financial management; they help the Council to cope with unpredictable financial pressures, help to smooth the impact of known spending requirements over time and help to fund any in-year overspends. As funding levels have continued to reduce, local authorities have had to utilise reserves to cover any shortfalls in year to bridge the gap whilst cost and service reductions are fully implemented to address the imbalance; this has also been the case in Blackburn with Darwen.

There is no set formula for deciding the level of reserves that is appropriate and every Council is free to determine the level they hold; holding a low level of reserves offers little resilience to financial shocks and sustained financial challenges however if reserves are too high, there may be opportunity costs involved resulting in a lack of investment in services that could provide better outcomes for residents, and/or increased savings, and/or revenue generation for the Council.

As such the level, purpose and planned use of reserves are important factors to consider in developing the MTFS and the annual budget.

### **5.2.1 Unallocated Reserve**

A General or Unallocated Reserve has been established within the budget to provide a contingency to cushion the impact of unexpected events or emergencies and to meet potential, future liabilities.

The calculation to support the 2018/19 budget is detailed at **Appendix A**. This is based on a framework that has been developed to identify areas of risk, an estimate of their financial value and an assessed level of that risk coming to fruition. This process produces a value from which a risk assessed, minimum level of Unallocated Reserves

can be determined. The calculation also allows for the current pressures on the Council's finances e.g. pressures in demand for social care.

The sensitivity and risk analysis identifies a General Reserve requirement of £4.0m to provide financial resilience in the event of unexpected spending pressures.

## **5.2.2 Earmarked Reserves and Provisions**

Earmarked Reserves are established to meet known or expected future liabilities where it is difficult to be specific about the exact financial amount of liability.

There are several categories of Earmarked reserves that the Council holds;

- sums set aside for specific significant schemes or projects such as the revenue costs of implementation of the digital programme, those associated with the accommodation review and those to support business growth
- reserves to fund the cost of workforce review, reorganisation and the part year effect of delivering savings
- reserves specifically retained for service departments for example the Future Demand Reserve in respect of adult social care and children's services
- School balances

The current forecast for Earmarked reserves at 31<sup>st</sup> March 2018 comprises;

£10.12m - total reserves of Council Use

£15.48m – Other reserves (including Schools)

A full breakdown of the Earmarked Reserves is attached at **Appendix B**

A review of the Earmarked Reserves held by the Council has also been undertaken to establish the purpose of the reserves and the likely timescale for their use.

## **6. LEGAL IMPLICATIONS**

This report is a requirement under Section 25 of the Local Government Act 2003.

## **7. RESOURCE IMPLICATIONS**

There are no resource implications as a direct consequence of this report

## **8. EQUALITY IMPLICATIONS**

There are no equality implications as a direct consequence of this report

## **9. CONSULTATIONS**

None applicable to this report

Contact Officer: Louise Mattinson, Director of Finance and IT,  
Date: 26<sup>th</sup> February 2018  
Background Papers: Budget Papers elsewhere on this agenda

## GENERAL FUND UNALLOCATED RESERVES

General reserves are available to assist as working balances to help cushion the impact of uneven cash flows, and as a contingency against unexpected events or emergencies. They can also serve to provide short term funding in advance of funding allocations. The table below identifies a number of issues that pose risks against the budget. These figures have then been scaled back by a factor of 50% as it is unlikely that all these events would occur, or indeed happen at the same time.

<u>Risk Event</u>	<u>£ 000's</u>
<p><b>General budget risks</b></p> <ul style="list-style-type: none"> <li>• Demand pressures – significant parts of the Council's budget, particularly in Adults and Children's Social Care, are 'demand led' and can create significant demands for increased expenditure during the year</li> <li>• Overspend of budgets within service areas</li> <li>• National Living Wage – provisions made for increases in contracts for services, particularly in the care sector where many employees are currently paid at or close to the National Living Wage, will be insufficient to meet the increase in contract costs</li> <li>• Inflation is underestimated or cannot be contained within existing budgets</li> <li>• Cost increases e.g. large scale increases in gas and electricity</li> </ul>	3,000
<p><b>Savings</b></p> <p>In order to contain cost pressures, portfolios have developed a number of saving proposals where implementation may be delayed or may not be achieved. Whilst the Council holds a Part Year Effect of Savings Reserve to mitigate the financial impact of such occurrence, and monitors and manages achievement of the these through budget management at Director, Executive Member and Executive Board level, non-delivery presents a risk</p>	1,250
<p><b>Risk of reduced revenues from rents, fees and charges</b></p> <p>In addressing the reductions in funding, the Council has sought to maximise all available income streams to reduce the budget gap. Given the economic climate, and the risk that as schools convert to Academies they will not require support from the Council, income streams could be at risk.</p>	500
<p><b>Interest rates</b></p> <p>Although interest rates have been historically low for several years, the difficulties in the global economy expose the UK to potential, but unexpected, interest rate changes. As such there is a risk that in relation to borrowing, rates are understated and interest receivable estimates are overstated.</p>	100
<p><b>Emergencies</b></p> <p>The Council is required to maintain provision to meet the cost of emergencies that cannot be met from budgets or by insurance cover. Significant costs on emergencies are met by Central Government under the "Bellwin" scheme but these are only triggered once the Council's expenditure has exceeded a pre-determined limit (0.1% of the revenue budget). Only 85% of the costs above this limit are then covered.</p>	250



<u>Risk Event</u>	<u>£ 000's</u>
<p><b>Contingent liabilities</b></p> <p>The Council does not maintain a 'general' contingency within its revenue budget but relies on in-year savings and balances to meet any unexpected demands. Unexpected demands, particularly those that result from a legal decision, a change in government legislation or a determination in government legislation, could present a risk to the Council's finances.</p>	1,500
<p><b>Welfare Reform and Universal Credit</b></p> <p>The impact of the changes on the Council's financial position are difficult to predict and therefore as the reforms and changes are rolled out, there is a risk of increase in demand for services from those hardest hit financially</p>	500
<p><b>Litigation Claims</b></p> <p>As the Council faces reductions in resources for future provision of services there is an increased risk of litigation, albeit that robust risk assessment procedures and sufficient insurance policies are in place.</p>	400
<p><b>Risk of business rates shortfall</b></p> <p>The risk of a reduction in collection rates due to the recent revaluation, to both in terms of outstanding and potential future rating appeals and due to the economic climate.</p>	500
<b>SUBTOTAL</b>	<b>8,000</b>
Adjustment to reflect the unlikely probability that all of these events take place simultaneously (50% likelihood)	- 4,000
<b>Recommended minimum level of Balances</b>	<b>4,000</b>

	<b>2018/19</b> <b>£'000</b>	<b>2019/20</b> <b>£'000</b>	<b>2020/21</b> <b>£'000</b>
<b>Projected level of balances at start of each year</b>	5,279	5,279	*5,279
Budget proposals – contributions from (-) or to (+) balances	0	*0	*0
<b>Balances estimated at end of each year</b>	5,279	*5,279	*5,279

\* as noted in Appendix E of the Revenue Budget 2018/19, Medium Term Financial Strategy and Capital Programme 2018-2021 Report, the budget gap of £4.9m in 2019/20 and £13.3m in 2020/21 do not reflect the savings to be realised through the programme of thematic reviews that will shortly commence across digital change, procurement, alternative service delivery models, income, commercialisation and traded services and also Council Tax (in respect of single person discount and empty homes). Whilst the areas for review have been identified and agreed, the business cases and programmes to underpin these are currently in development and the savings attributable have yet to be quantified in detail; until such time, it is assumed that the budget gap will be addressed through the application of both ear-marked reserves and through the unallocated, general reserve, the allocation of which will be determined over the course of 2018/19 and will be reported to Council.

With regards to the forecast budget gap of £13.3m in 2020/21, as noted in the following reports, reliance cannot be placed on the figures for this final year of the MTFs given the significant risks around the assumptions made, particularly given the lack of information provided by central Government in relation to future funding and the mechanisms for its distribution at this time including;

- Business Rates Retention and the future tariff and top-up system,
- the implementation of the Fair Funding Review,
- the future funding of adult social care and the potential integration of social care with health
- the future changes in the schools funding formula
- the uncertainty around the impact of Brexit

## APPENDIX B

### EARMARKED RESERVES

The Council has a number of reserves which have been earmarked for specific purposes. These reserves are listed below, together with the purpose of the reserve and the amounts.

Name	Purpose	Balances estimated at 1 April 2018 £ 000's	Planned movements 2018/19 £ 000's	Balances estimated at 31 Mar 2019 £ 000's
<b>Reserves held for discretionary use by the Council</b>				
Specific project/ expenditure reserves	Revenue savings that have been earmarked for specific projects or purposes in future years	4,628	0	4,628
Highways Winter Maintenance	This reserve has been built up from budget underspends on winter maintenance and supplementary allocations to provide additional maintenance requirements in the event of severe winter weather conditions	24	0	24
Support for Future Redundancy Costs	This reserve is to support future remodelling of services	1,706	0	1,706
Part Year Effect of Future Savings Plans	This reserve is to support the delivery of future budget reductions	1,242	0	1,242
Digital Programme	This reserve is to meet the costs and requirements of the Digital Programme	1,059	0	1,059
<b>Reserves held for specified (non-discretionary) purposes</b>				
Maintenance of Wainwright Bridge	This reserve is the result of a contribution from Network Rail as maintenance of the new Wainwright Bridge becomes the responsibility of the Council – the reserve will support the portfolio once ongoing maintenance liabilities start to arise	506	0	506
Sc 106 income (under the 1990 Town and Country Planning Act)	Developers' contributions to be applied to enhance or maintain infrastructure and facilities	239	0	239
Highways Claims	This reserve is required to support anticipated future highway claims in respect of current and previous years	434	0	434
Contingent liabilities – MMI scheme of arrangement	Following the liquidation of Municipal Mutual Insurance (MMI) in 1992, the Council will be liable for a share of claim liabilities in the event of an insolvent run-off, which is increasingly more likely	250	0	250
Arts Acquisition Fund	This fund was established so that new pieces of art can be purchased as and when they become available	14	0	14
Winifred Ferrier Bequest	The money was bequeathed to the Council to enable the purchase and exhibiting of items associated with the life of Kathleen Ferrier	20	0	20
<b>TOTAL RESERVES FOR COUNCIL USE</b>		<b>10,122</b>	<b>0</b>	<b>10,122</b>

<b>Name</b>	<b>Purpose</b>	<b>Balances estimated at 1 April 2018</b>	<b>Planned movements 2018/19</b>	<b>Balances estimated at 31 Mar 2019</b>
		<b>£ 000's</b>	<b>£ 000's</b>	<b>£ 000's</b>
<b>Reserves held in respect of joint arrangements and charitable bodies</b>				
Darwen Market Traders	Funds held by the Council on behalf of Darwen Market Traders' Association	2	0	2
Joint Building Control Account	Accumulated surpluses in relation to the Joint Building Control agreement	182	0	182
Turton Tower Charity	Funds held by the Council in its role as trustee for the charity	45	0	45
Local Safeguarding Children's Board Fund	This fund was established from specific contributions to be used to support the LSCB	156	0	156
<b>Reserves held in relation to schools</b>				
Dedicated Schools Grant - surplus	DSG received but not yet deployed to meet eligible expenditure	8,844	0	8,844
LMS Schools balances	Funds held by schools under a scheme of delegation	*6,253	0	*6,253
<b>TOTAL OTHER RESERVES</b>		<b>15,482</b>	<b>0</b>	<b>15,482</b>

\*use of reserves to be determined through the Schools' Forum