

Appendix T (updated draft)

Section 25 Report (2013/14 Budget Process)

Robustness of Estimates and Adequacy of Reserves

Background

Section 25(1) of the Local Government Act 2003 requires that the Chief Financial Officer (CFO) must report to the Council, when it is making the statutory calculations required to determine its Council Tax or precept, on the following:

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

Section 25(2) of the Act requires the Council to have regard to this report in approving the Budget and Council Tax.

The majority of the material required to meet the requirements of the Act has been built into the key reports prepared throughout the corporate planning and budget cycle, in particular :

- The Medium Term Strategy (MTS) [September 2012]
- The Revised Budgets, as part of the January cycle of meetings
- The main budget reports to the January cycle of meetings
- The Budget-Setting Report (BSR) to Strategy and Resources Scrutiny Committee on 21 January 2013, which forms the basis for the subsequent decisions by the Executive (24 January 2013), Strategy and Resources Scrutiny Committee (15 February 2013) and Council (21 February 2013).

This reflects the fact that the requirements of the Act incorporate issues which the Council has, for many years, adopted as key principles in its financial

strategy and planning; and which have therefore been incorporated in the key elements of the corporate decision-making cycle.

This also reflects the work in terms of risk assessment, and management, which is built into all of the key aspects of the Council's work, together with the sensitivity analysis for key activity areas and the analysis of significant events.

This approach governs the work that is undertaken in developing spending plans and financial strategies for both the General Fund and Housing Revenue Account.

The integration of the Council's risk framework with the main corporate planning and decision-making cycle, is based on the identification of key stages during the year designed to match the major documents which underpin the cycle.

It is also important to note that these considerations are assessed by the Council within a medium and longer-term framework, which is ensured through supporting financial modeling conducted over :

For the ...	Period	Purpose / Use
MTS & Budget	5 years	Detailed budget & Council Tax setting
Longer-term projections	25+ years	Demonstrate long-term effects & thus sustainability

The new Business Plan, which has been developed to support the introduction of Self-Financing of the HRA from 1 April 2012, covers a period of 30 years.

This approach is of particular importance during a period of economic volatility.

Figures are generally shown within reports covering the 5-year medium-term forecast period, with any significant longer-term implications specifically highlighted.

Robustness of Estimates

Approach

Each year, as part of the development of the budget, analysis is undertaken of the key financial assumptions on which the budget will be based. An overview of this work is included in the MTS and the BSR.

The key areas covered included :

- Economic factors, such as inflation
- Treasury Management, including interest rates
- Demographic pressures on spending
- Other spending pressures & opportunities (revenue and capital)
- External funding sources
- Earmarked Funds
- Asset Management
- Reserves

Review of the MTS Forecasting Model and Projections

Council officers identified errors in the budget forecasts in December 2012, which understated the Council's spending requirements. The errors occurred in the way actual spend within the Council's general ledger had been incorporated within the Council's financial model to project future spend. The Council had asked Ernst and Young, the Council's external auditors, to undertake an external review of its financial forecasts in light of those errors. Ernst and Young have reviewed the work undertaken by the Council's finance team to re-base the Council's budget forecasts.

The review work undertaken identified an understatement of the base budget costs of £2,266,690 in 2012/13. This resulted in the September 2012 MTS showing the available level of Reserves at the end of 2012/13 overstated by that amount. Had this been identified as part of the preparation of the MTS it would also have resulted in a higher Net Savings Requirement for 2013/14 being identified. This is shown in the tables below:

	Factor	2013/14 (£'s)	2014/15 (£'s)	2015/16 (£'s)	2016/17 (£'s)
	Net Savings Requirement (February 2012 BSR)	1,505,320	1,515,260	887,350	959,450
add	Increase / (decrease) in Net Savings identified in Sept 2012 MTS	(935,620)	431,190	14,380	373,900
	MTS 2012 Net Savings Requirement	569,700	1,946,450	901,730	1,333,350
	Revisions required due to understatement of 2012/13 base	3,748,150	(1,373,490)	(782,250)	674,970
	[Revised] MTS 2012 Net Savings Requirement	4,317,850	572,960	119,480	2,008,320

Factor	2012/13 (£'s)	2013/14 (£'s)	2014/15 (£'s)	2015/16 (£'s)	2016/17 (£'s)
MTS 2012 GF Reserves – Closing Balance	7,049,740	5,000,000	5,000,000	5,000,000	5,000,000
Revisions required due to understatement of 2012/13 base	(2,266,690)	0	0	0	0
[Revised] MTS 2012 Reserves – Closing Balance	4,783,050	5,000,000	5,000,000	5,000,000	5,000,000

As this was identified at an advanced stage in the 2013/14 Budget process work had already been undertaken based on the assumptions and target set in the September 2012 MTS. As a result, the following tables show the implications for the Net Savings Requirement (NSR) and Reserves, assuming that the 2013/14 NSR target is not changed at this stage.

	Factor	2013/14 (£'s)	2014/15 (£'s)	2015/16 (£'s)	2016/17 (£'s)
	Net Savings Requirement (February 2012 BSR)	1,505,320	1,515,260	887,350	959,450
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	[Revised] MTS 2012 Net Savings Requirement		4,512,360	119,480	2,008,320

Factor	2012/13 (£'s)	2013/14 (£'s)	2014/15 (£'s)	2015/16 (£'s)	2016/17 (£'s)
MTS 2012 GF Reserves – Closing Balance	7,049,740	5,000,000	5,000,000	5,000,000	5,000,000
Revisions required due to understatement of 2012/13 base	(2,266,690)	(3,748,150)	(3,748,150)	(3,748,150)	(3,748,150)
[Revised] MTS 2012 Reserves – Closing Balance	4,783,050	1,251,850	1,251,850	1,251,850	1,251,850

This shows that without any remedial action the level of Reserves would fall to below the Council's self-determined minimum reserves level by the end of 2013/14. The BSR shows the achievement of net savings against this position, and outlines the measures that have been proposed to deal with the consequences of this.

In reviewing the re-forecasting work Ernst and Young concluded that "The budget working papers, adjusted for year-end and other known changes, may be considered by the Council to represent a sensible foundation upon which it can model its future budgetary requirements. Whilst there is considerable scope for improving the Re-Forecast Model, our review has not identified any issues to suggest that it is not operating as the Council intends."

This re-forecasting exercise has formed the basis for the projections which underpin the BSR and its recommendations, and this independent review provides assurance that it is suitably robust for the purpose.

Re-Basing Exercise

When the error was identified the approach taken was to seek to undertake a re-basing exercise (in early December 2012) in order to identify the scale and implications of the error for the Budget process, and to provide a sound base position for the completion of the 2013/14 Budget process. The information on which greatest reliance could be placed for 2012/13 was identified as the position in the ledger system, and this was used as the re-basing point.

A new version of the forecasting model was created by removing the existing data. The review process had identified problems with the data rather than the functionality of the model, and this has been confirmed by the work of Ernst & Young. The model was then re-populated with all the required data. The model was repopulated and reviewed by the Director of Resources and the Head of Accounting Services.

The resulting model ('version 6.0') was the basis for the identification of the scale of the understatement of the 2012/13 position used in the forecast model, and was the model reviewed by Ernst & Young as part of their Phase 1 work.

Budget-Setting Work

The 'version 6.0' model was used as the basis for applying the subsequent changes that are required in finalising proposals for the 2013/14 Budget, so as to maintain an effective audit trail.

This was achieved through the use of a series of separately identified and archived models, each of which dealt with one specific aspect of the changes that needed to be applied to arrive at a final BSR position.

In order to provide co-ordination and an overview of these stages a spreadsheet was created which fulfilled the role of version control document. This detailed each model (named sequentially in a series from 1 to 15 (Part 2)),

with a summary of the changes each contained and showing the effects in terms of closing level of reserves, net savings requirement and total inflation costs included for each of the 25 years. It identified final values for each of these at each stage, together with the marginal change from the previous version to enable effective review of the outcome.

The models were also structured to reflect a number of 'categories' of actions/changes, as shown below:

Category	Model Ref.	Key Change	Source	Changes to
Re-Basing	1	Re-basing for error	Ledger	D & A
	2	MTS Changes from 2013/14 and £2,770 appropriation	Full & part-year effects from previous MTS and BSR approvals	D
	3	Long-term external interest re-based	External interest projection	D
	4	Inflation calculation reviewed	Actual effect known from ledger / BWPs	D
<i>Position at 'version 6-0'</i>				
Autumn Statement	5	CT increase reduced to 2% & 2014/15 Formula Grant reduced by a further 2%	Autumn Statement publication	D & A
Provisional LG Finance Settlement	6	Council Tax Taxbase updated & Growth provision reviewed	Local CT Support scheme, Taxbase & updated Growth projections	D & A
	7	Government Grant updated for Settlement announcement	Settlement papers	D & A
	8	New Homes Bonus updated	NHB provisional notification	D
BSR Options	9	Proposals to be included in BSR confirmed following discussion with controlling group	BSR proposal papers	D
	10	NHB Contribution re: top-sliced Government support	-	D
	11	NHB funding to replace DRF for capital	-	D & A
	12	Re-profiling of DRF to reflect actual Capital Plan spend	Capital Plan & capital funding statement	D

Category	Model Ref.	Key Change	Source	Changes to
	13	Additional BSR submissions	Additional bids & savings received and agreed by Executive Councillors	
	14	PPFs reduced to £300k from 2013/14	-	D
	15	Additional savings to raise Reserves level	-	D & A

Key:

D – Changes to data

A – Changes to model architecture

The first category (i.e. stages 1 to 4) relates to the work resulting in ‘version 6.0’ of the model, as referenced above.

Architecture of the Model

The process in arriving at the Budget-Setting Report inputs has necessitated changes to the version of the architecture of the model that existed at ‘version 6-0’, as reflected in the table above. This reflects two main areas:

- o Technical changes such as the move from Formula Grant to Start-Up Funding Assessment or the new basis for the Council Tax Taxbase following introduction of the Local Council Tax Support Scheme, which require the creation of new input lines in the relevant tabs within the model
- o Changes to reflect the current year position, such as creation of a new earmarked fund (Project Facilitation Fund) and associated appropriations

Model changes were, in this context, made by the Director of Resources and scrutinised by the Head of Accounting Services. The monitoring and review process for the effects of the changes (and the fact that they were broken down into stages with a relatively small number of specific changes) contributed to identifying that the model changes had the expected results.

Process for Reviewing and Checking

Many of the changes in the above list of modelling stages are of a corporate or technical nature and were undertaken by the central Finance team, but were completed by the Head of Accounting Services with scrutiny by the Director of Resources.

Changes resulting from the standard Budget process, i.e. inputs from departments such as bids and savings, were populated by service managers and checked with them and Directors / Heads of Service to provide overview and validation.

Changes from the main Budget process were also reconciled to the Budget database, which co-ordinates and reports on all of the electronic submissions of bids and savings by services across the Council.

Briefing sessions were held with the Chief Executive and Leader to provide an overview as part of the lead-up to reporting the outcomes to Strategic Leadership Team and the Executive.

Government Grant

The aspect of the General Fund which has, for a number of years, required the greatest attention during the annual budget process has been government grant support.

Formula Grant

Details of the final Local Government Settlement for 2011/12, together with provisional settlement figures for 2012/13, were announced on 31 January 2011. This announcement was used for the purposes of financial modelling for the MTS 2011. Although it had been expected that a 4-year settlement would be announced in conjunction with spending review 2010, details of the final two years (2013/14 and 2014/15) were deferred until the completion of the government's Local Government Resource Review.

In the absence of provisional grant entitlements for years after 2012/13, the assumptions made for the purposes of financial modelling for the MTS were unchanged from those adopted for the February 2011 Budget Setting Report.

An overall reduction in grant over the four-year period 2011/12 to 2014/15 of 31% was assumed, with equal percentage reductions over the latter two years, following the cumulative reduction of 23.1% over 2011/12 and 2012/13. This broadly reflected the profile of the reduction in national control totals contained within the spending review.

As part of the 2012 Autumn Statement announcement, the Government indicated that their Departmental Resource Budgets were to be reduced by a further 1% in 2013/14 and 2% in the following year. However, in recognition of the fact that local government budgets were already being held down in 2013/14 to facilitate the delivery of a freeze in Council Tax the Government determined that the additional 1% requirement for that year should not be applied to local government.

As a result, the MTS projection for the level of Government support in 2014/15 was reviewed as follows:

Core Government Funding	2013/14 £	2014/15 £
Projected Formula Grant/Retained Business Rates Entitlement at MTS	8,161,400	7,740,670
Homelessness Grant (now part of core funding)	575,470	575,470
Projected Core Government Funding	8,736,870	8,316,140
Effect of Additional 2% reduction in 2014/15	-	(219,240)
Revised projection	8,736,870	8,096,900

This is based on anticipation of a 2% reduction from the start point for the current Spending Review period in 2011/12 (i.e. £10,961,863). This implied a requirement for increased savings in 2014/15 unless offset by other factors.

Start-Up Funding Assessment

The Provisional Local Government Settlement was announced on Wednesday 19 December 2012, marking the start of a four-week consultation period which ended on 15 January 2013. Once consultation responses have been considered, and any amendments have been incorporated, the final local government finance settlement 2013/14 will be considered by the House of Commons in February.

The Government is changing the way in which local government is funded through the introduction of a business rates retention scheme. The new system replaces the current Formula Grant system with an initial Start-Up Funding Assessment for each authority. The new arrangements are designed to enable local authorities and fire and rescue authorities, collectively, to benefit directly from supporting local business growth as they will be able to keep half of any increases in business rates revenue to invest in local services.

For the City Council, the retained element of any Business Rate growth is subject to a 50% levy by Central Government. This levy will be used to provide a partial safety net for any authorities which experience a fall in their Business Rates, for example through closure of a major business in their area. However, it should be noted that the safety net will only apply after an authority's Business Rates income falls by more than 7.5%; and that such a level of potential reduction would represent a significant risk to the Council in any particular year (i.e. a maximum risk of around £280,000 in 2013/14).

Under the Government's new funding regime the opportunity is provided for authorities to agree to come together to form a 'Pool' in order to further incentivise them to drive economic growth. By forming a pool, member authorities could mitigate some of the risk associated with adverse impacts on their growth in Business Rate and allow them to reduce the levy on growth that is returned to Central Government, allowing the local areas to retain a greater share of Business Rates income than would have been the case without a pooling arrangement.

The effects and benefits of pooling depend upon economic circumstances and Business Rates growth levels and the City Council has undertaken modelling with potential partners for a local pool in order to better understand the benefits that it may convey. Based on the Government's original pooling proposals, the formation of a Cambridgeshire Pool was projected to be beneficial for average growth levels of -0.25% and above. On this basis an initial expression of interest was submitted as required by the Government's timetable, on 27 July 2012. However, the Government's final scheme has proved to be significantly less favourable and when considered in the context of the level of risk faced (being based on projected levels of growth) no

longer justified the creation of a Cambridgeshire pool in the view of the potential partners.

Whilst a Cambridgeshire pool for 2013/14 is not felt to be viable, the partners still believe that the concept has value and will reconsider the potential for 2014/15 or future years based on data and any scheme changes applicable at the appropriate times.

The 2013/14 Local Government Finance Settlement is the first under the new arrangements and has provided each local authority with its starting position under the business rates retention scheme. A number of key calculations for each authority in relation to business rate retention will be fixed until the first 'reset' that the Government intends will not take place until 2020.

The local government finance settlement also provided local authorities with information on how much Revenue Support Grant they have been allocated for 2013/14 as well as provisional allocations for 2014/15. Provisional figures provided for 2014/15 took account of the additional overall 2% funding cut to local government announced in the Autumn Statement on 5 December 2012.

Revenue Spending Power

The Government has introduced the new key definition of revenue spending power. For district councils, such as the City, this is defined, for 2013/14, as:

- Council Tax yield in 2012/13
- Government's start-up funding assessment for 2013/14, and
- Specific grants for 2013/14 (including New Homes Bonus)

For the City Council, the Government has determined spending power for the next two years to be as follows:

Element of revenue spending power	2013/14 £	2014/15 £
2012/13 Council Tax income	6,831,370	6,831,370
Start-Up Funding Assessment	9,341,182	8,198,084
Community Right to Challenge Grant	8,547	8,547
Community Right to Bid Grant	7,855	7,855
2013/14 Council Tax Freeze Grant	69,089	69,089

Element of revenue spending power	2013/14 £	2014/15 £
New Homes Bonus (NHB) Grant	2,085,283	2,649,022
Spending Power	18,343,326	17,763,967
Reduction from 2013/14		579,359
		3.16%

On the face of it, this suggests that the City Council will only see a reduction of 3.16% between 2013/14 and 2014/15 (this compares to the national overall reduction in spending power, announced by the Minister, of 1.7%). However, this serves to disguise the fact that:

- The level of Start-Up Funding Assessment is reduced by some 12.24% from 2013/14 to 2014/15.
- The notion of revenue spending power effectively assumes that all new NHB income from 2014/15 onwards is available to fund standard spending by local authorities.

In comparing the level of government support, as part of the announcement, with the assumptions made as part of the September 2012 MTS, a number of adjustments need to be made to the figures to ensure direct comparability. These are shown in the table below:

Core Government Funding	2013/14 £	2014/15 £
December 2012 Provisional Settlement		
Start-Up Funding Assessment	9,341,180	8,198,090
Less Council Tax Support Scheme funding	(625,320)	(625,320)
	8,714,860	7,572,770
September 2012 MTS		
Comparable provision for Core Government Funding	8,736,870	8,096,900
Difference above / (below) MTS assumption	(22,010)	(524,130)
	(0.25%)	(6.47%)

Council Tax Support Scheme funding (CTSSF) is required to offset the reduction in Council Tax yield resulting from the introduction of the new local scheme for Council Tax Support. 2013/14 is the only year in which the government intends to specifically identify the element of CTSSF which is included in the Start-Up Funding Assessment (SUFA). The table above assumes that CTSSF element will be maintained in cash terms in 2014/15 so as not to put any additional pressure on the local scheme of Council Tax Support.

Although the level of Government support for 2013/14 is very close to that assumed in the MTS, the level of support for 2014/15 is some £524,140 (6.47%) below the projected level. This reflects the fact that the Government's assessment of revenue spending power from 2014/15 reflects additional annual tranches of NHB. For 2014/15, the Government is assuming a level comparable to 2013/14 i.e. £563,740. The Council will need to decide whether, and to what degree, it is prepared to use NHB to support existing revenue spending and this is dealt with in the New Homes Bonus section below.

The potential for further significant changes to the system of central government support constitutes a material risk for the Council, particularly with the new Spending Review period starting from 2015/16, and this has been reflected in the approach to Reserves.

Future Government Funding Prospects

The 2011 Autumn Statement set plans for public spending in 2015/16 and 2016/17 in line with the spending reductions over the Spending Review 2010 period. The level of Government support from 2015/16 onwards will be the subject of the Government's next Spending Review, however, as part of the September 2012 MTS the Council had assumed that the level of support would be reduced by 2.3% in each year. This assumed that the additional spending reductions, which the March 2012 Budget highlighted would be required in those years, would be met through further welfare spending reductions (around £8b nationally assumed) as well as reductions in local government spending in line with the average reduction across Government departments.

Future levels of Government support will continue, under the new funding arrangements, to be influenced by changes in population. At MTS stage, it

was uncertain whether Census 2011 data would be the base for population projections used in determining the new Start-Up Funding Assessments. In addition, the Office of National Statistics (ONS) had been consulting on a proposed new methodology for estimating net immigration to local authorities. Whilst seeking to improve the basis for estimation, the methodology resulted in significant % changes for a number of local authorities, including Cambridge, which could not be reconciled to local knowledge and other official data sources, such as the electoral roll and Valuation Office Agency records of dwelling numbers.

Despite extensive representations to both ONS and Central Government, projections of population using the revised methodology have been used by Government in arriving at the provisional Settlements for 2013/14 and 2014/15. Although based on Census 2011 data, the Council estimates that the mid-year forward projections used will understate the City's actual population by approximately 4,000 by mid-2013.

The Council is continuing to challenge the basis on which population projections are made and is seeking recognition, in the form of financial compensation, for the shortfall in core funding that will result. It is understood that ONS is planning to undertake a review, in 2014, of the methodology used in making population projections and the Council is pressing for that review to be undertaken.

These factors highlight the degree of uncertainty that still exists with regard to the level of future Government support. It is intended that further reviews will be included as part of future MTS and BSR documents, particularly once details of the new Spending Review become available.

Other Government Grants

In addition to Formula Grant the Council still receives a number of other revenue grants from central government although these are reduced in number following incorporation of a number of them into core funding. In terms of financial projections, the most significant of these other grants is New Homes Bonus.

New Homes Bonus

The New Homes Bonus (NHB) is a funding scheme, introduced from 1 April 2011, designed to encourage local authorities to deliver new homes and to reduce the number of empty homes in their areas. The NHB is designed so that provision of additional housing in a particular year is recognised through the provision of additional funding for a period of six consecutive years, starting in the following year. Entitlement is based on the actual numbers of housing completions and empty homes brought back into use together with an affordable housing component.

Final NHB entitlements for 2011/12 and 2012/13 have been determined but forward projections are based on estimated housing completions and are, therefore, dependent on achieving the projected growth rates each year. Nationally, funding for the NHB scheme was explicitly provided for the period of the Spending Review, i.e. to 2014/15.

As part of the change in the Government's funding model, from 2014/15 it has indicated that the scheme will continue but it will be financed by top slicing from the overall level of funding available for local authority support.

Forward projections of NHB entitlement are as follows:

	2012/13 £	2013/14 £	2014/15 £	2015/16 £
2011/12 allocation (Housing Completions & Empty Homes)	(786,646)	(786,646)	(786,646)	(786,646)
2012/13 allocation	(734,898)	(734,898)	(734,898)	(734,898)
2013/14 provisional allocation		(563,739)	(563,739)	(563,739)
Confirmed New Homes Bonus Funding at February 2013 BSR	(1,521,544)	(2,085,283)	(2,085,283)	(2,085,283)
<i>add</i>				
Projected NHB Receipts for 2014/15 based on projection of future housing completions & empty homes			(1,038,000)	(1,038,000)
Projected NHB Receipts for 2015/16 based on projection of future housing completions & empty homes				(1,074,000)
Potential New Homes Bonus Total	(1,521,544)	(2,085,283)	(3,123,283)	(4,197,283)

The above table assumes that the NHB scheme will continue under the next Spending Review (i.e. from 2015/16 onward), based on indications from ministerial statements.

Given the uncertainty about the continuation of this scheme in the longer-term, the Council has adopted a prudent approach by putting the funding received into an earmarked fund so that its use can be effectively considered in terms of fixed-period funding requirements. The BSR includes detail on the planned use of these funds, in light of the change to the national funding basis.

Council Tax Thresholds

2012/13 saw the introduction of Council Tax referendum thresholds, such that increases proposed above this level are deemed as 'excessive' and subject to the outcome of a public referendum. This introduces the risk that if the referendum does not demonstrate public support the level of Council Tax increase and associated spending plans would need to be revised, in addition to the cost of holding a referendum (in the region of £50k).

As part of the provisional settlement announcement, Council Tax referendum thresholds for 2013/14 were confirmed. These have been set at 2% for single tier, county councils and shire districts, police and crime commissioners and fire and rescue authorities (compared with 3.5% for 2012/13).

Financial projections of the Council Tax level made for the MTS included the assumption of a 2.5% per annum increase from 2013/14. This was based on the government CPI target level for inflation (2.0%), but increased by a further 0.5% to offset the eroding of the council taxbase in real terms that would otherwise have resulted from implementing the Government's Council Tax Freeze Scheme for 2012/13.

For the City Council, adopting a freeze of the Council Tax level in 2013/14 would result in the receipt of two grant payments, each of around £70k. However, the effect on the Council Tax yield would be to reduce this by around £170k in 2013/14 compared with MTS projections. As the loss of spending power (and hence ability to provide services) implied by the freeze would affect all future years it is difficult to determine that the freeze scheme

for 2013/14 can be supported taking the medium-term view. In accepting the scheme for 2012/13 the Council had sought to assist Council Tax payers by removing the immediate effect of any increase but then maintaining overall spending power by increasing future increases to compensate. The significant reduction in the thresholds for referendums effectively negates this approach.

The BSR, therefore, contains the recommendation for a 2.0% increase in Council tax for 2013/14 over the level for 2012/13; which would be below the threshold level.

Spending Reviews

The adoption by Governments in recent years of a process of periodic Spending Reviews has provided key contextual information to support the forward financial planning process.

These Reviews have previously provided indications of support covering a 3-year period, however Spending Review 2010 incorporated indications covering a 4-year period, designed to coincide with the planned life of the Parliament. This was expected to confer improvements in financial information available to the Council, which would serve to further reduce the level of residual risk associated with the key question of the level of support from Government.

Although the last Review period only included figures for the first two years at a detailed level, with the final two years having only recently been announced in the provisional Settlement, it is hoped that the next Spending review will return to longer, period, announcements.

In the current economic climate the prospects for the next Spending Review period do not look positive for local authority funding. There must be an expectation of the continuation of a tight financial position with increasing pressures in terms of efficiency expectations. The Council's forecasts will need to be considered carefully in light of the next Spending review announcement – the date for which is yet to be announced.

Control Totals Within the Budget Process

The budget process specifically identifies and controls the requirements for the delivery of savings from all areas of spending, managed through a process of Cash Limits. The Cash Limit process allows the inclusion of (specifically identified, and justified) unavoidable bids, and bids where the additional funding requirement can be met through additional compensating savings.

Further bids for service development are determined centrally by the Executive, and prioritised against the requirements in delivering the Council's Vision Statements. This includes the specific test of affordability and sustainability of the overall level of funding for this Priority Policy Fund (PPF), which is clearly shown within the final decision-making framework adopted in the BSR.

The level of funding which is deemed affordable within the initial MTS projections (in this case in September 2012) is reviewed in light of updated information in the final Budget-Setting Report to Strategy Scrutiny Committee in the January cycle of meetings.

The September 2012 MTS identified a target level of ongoing funding for PPF Bids for 2013/14 of £500k per annum. In reviewing this proposal as part of the BSR the level of funding was reduced from £500k per annum to £300k in both 2013/14 and future years. This was part of the actions undertaken to reflect the outcome of the re-forecasting exercise detailed above.

The retention of the PPF mechanism, albeit at a lower level, reflects the fact that it continues to provide an important means of moving resources to the areas of greatest need whilst also retaining the flexibility to reflect the Council's overall financial position.

Capital Spending and Controls

Approval of new capital spending is dependent on the identification of the appropriate levels of revenue and capital funding, thus demonstrating its affordability. If this cannot be achieved, the schemes may be approved in principle and added to the Council's capital Hold List until such time as the funding is identified and approved.

The February 2013 BSR has included actions to seek to identify alternative funding sources to enable the level of Direct Revenue Financing (DRF) to be reduced as part of the response to the outcome of the re-forecasting exercise. This is shown in the use of the balance of £706,910 of NHB funding in 2013/14 and £880,000 of NHB funding in each of the subsequent 3 years to replace DRF. The viability of this has been shown in the projections for the earmarked NHB funds, which includes retaining uncommitted sums from 2014/15 onward. This ensures that the currently approved Plan can still be delivered.

Capital spending during the year is monitored on a monthly basis by the Asset Management Group, and on a quarterly basis by the Strategic Leadership Team; based on a consistent financial monitoring and reporting framework. This ensures that current performance is effectively challenged, and the need for any remedial measures identified at the earliest opportunity.

The review of the progress with the delivery of the approved Capital and Revenue Projects Plan for 2012/13 has identified a significant level of variation anticipated for year end; despite actions taken in the MTS to improve the deliverability of the Plan as scheduled. If the re-phasing requests are approved this will result in a higher level of closing Reserves at the end of 2012/13 by some £2.308m, which will be used as DRF in 2013/14 to fund the re-phased spending.

Whilst the BSR deals with the proposed re-phasing, it also identifies key reasons for the significant elements of the variations in order to enable consideration to be given to additional actions to improve delivery in future years.

The review of capital provides the context for considering the affordability of the capital bids which have been submitted as part of the 2013/14 budget process, as shown below:

	2012/13 £000	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000
Revised Capital funding availability	0	(305)	(164)	(862)	(1,380)
Capital bids	0	(1,525)	(1,600)	1,700	1,700
(Surplus) / Shortfall in Funding	0	(1,830)	(1,764)	838	320
Re-profiling of revenue funding to actual capital spend	0	1,500	1,264	(1,382)	(1,382)
Net Capital Funding Availability		(330)	(500)	(544)	(1,062)

This demonstrates that, although the spending requirement is very uneven (reflecting, in particular, the projected costs of the refurbishment works to the Park Street Car Park) the funding available is sufficient to allow all of the bids to be approved if they are deemed to be appropriate and necessary.

The existing test of affordability for capital spending was reinforced by the introduction of the Prudential Code, with effect from 1 April 2004. The indicators identified as part of the Code have been included with the final budget reports, and have been taken into account in arriving at the final recommendations on the Capital Plan.

The BSR specifically considers the potential need for future prudential borrowing. This includes the requirement for Housing Revenue Account borrowing associated with the introduction of the new Self-Financing regime, together with new projected schemes. It also identifies the potential requirement to borrow to support the provision of multi-agency community facilities as part of the Clay Farm Development.

The Council continues to require annual revenue contributions to Repair and Renewal Funds to ensure the sustainability of all major assets, and has implemented medium-term replacement programmes for key asset areas. It has undertaken a major exercise to review the adequacy of the coverage and level of such provisions, and this is scheduled to report back in Spring 2013.

Financial Reserves

Reserves are established and maintained in line with the Code of Practice on Local Authority Accounting, and are reviewed annually by the Council's External Auditors taking into account their knowledge of the Council's performance over a period of time.

There are two main categories of reserves to be considered :

- Earmarked reserves
- Unallocated general reserves.

Earmarked Reserves

Earmarked reserves are those which the Council builds up over a period of time to fund known or predicted liabilities.

Specific examples include :

- Repair & Renewal Funds - individual Funds have been established to cover key items of vehicle and plant, in line with the Council's policy of ensuring sustainability of services. New Funds, or contribution requirements, are assessed as part of any new project appraisal
- Developer Contributions – negotiated under Section 106 of the Town and Country Planning Act 1990, to offset the costs associated with new developments, for example community infrastructure
- Funds set up to meet material costs which occur regularly, but over a longer period than annually, where it is deemed prudent to make contributions every financial year, e.g. Local Plan
- Insurance Fund - which underpins the Council's policy and practice on self-insurance, and reflects the analysis of potential and contingent claims over time.

The Council reviews each of the Funds during each year to ensure that the levels, and the ongoing contributions, are appropriate to achieve the purpose for which it was set-up. A further review is completed as part of the final accounts process, at year-end, in conjunction with the review work of external audit.

Earmarked Funds are reviewed as part of the General Fund Resources section in the BSR (Section 3 in the February 2013 BSR), together with proposed

spending against a number of the main funds. This ensures an appropriate context for wider spending decisions and prioritisation.

Unallocated General Reserves

As part of its financial strategy the Council has determined two levels by which the appropriateness of the general reserve for the General Fund will be assessed:

- Minimum Level - set at £1.5m (approximately 10% of the net expenditure level), to deal with timing issues and uneven cashflows and avoid unnecessary temporary borrowing
- Target Level - set at £5m, reflecting the level which provides the target over the longer-term.

In the September 2012 MTS it was noted that the Council was facing a number of changes in areas of activity which would represent the potential for increases in the level of risk. It was agreed, at that point, that this should be reconsidered as part of this BSR when more complete information would be available.

With details of the new local Council Tax Support Scheme and the new government funding mechanism for local authorities now finalised, it is clear that both of these changes effectively serve to move material elements of financial risk associated with each of these areas from central to local government.

In considering the implications for the level of general reserves held, it is felt that the main impact is on the Minimum level that the Council sets for itself. Given the materiality of the additional areas of risk it is recommended that the Council increases the Minimum level held from £1.5m to £2.5m with effect from 1 April 2013 (when the two schemes apply). At this stage it is not proposed that the Target level (currently set at £5m) for the medium-term should be increased, but this will be kept under review as experience of the changes and the risk levels associated with them increases.

The reserves projections are based on the expectation that the Council will be able to achieve the Net Savings Requirements identified in each of the years from 2014/15, as detailed below.

The key elements which are considered in setting the Target level have been :

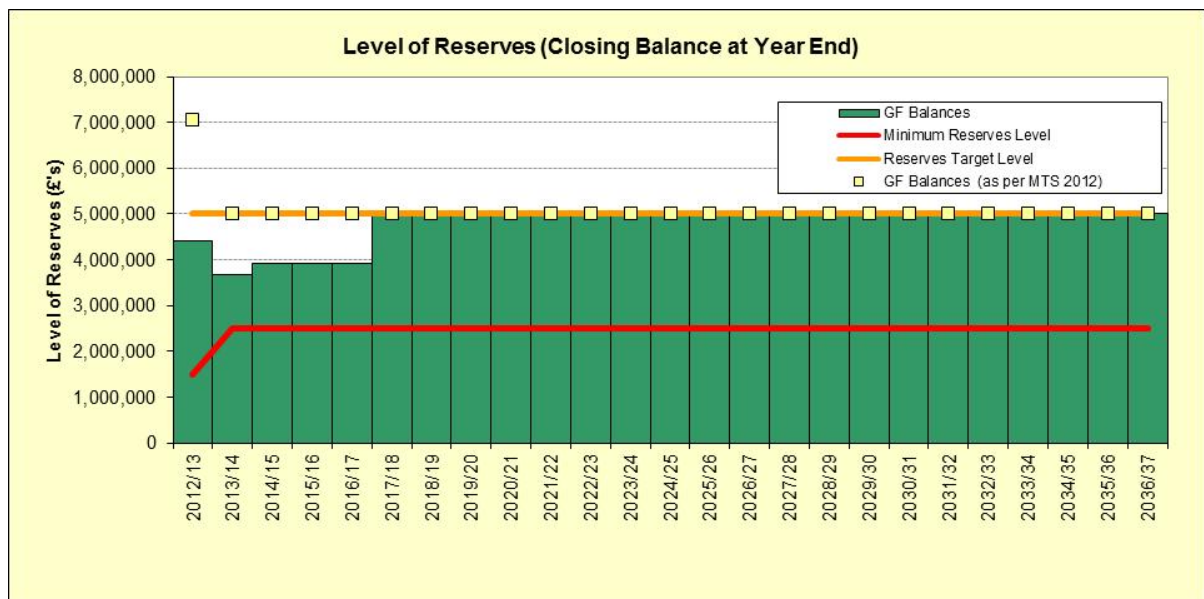
- The potential need to 'cushion' the impact of an unexpected events or emergencies (above the levels supported directly by the government, under the 'Bellwin' scheme).
- The need to deal with major incidences of uneven funding associated with schemes or initiatives. Previous examples include the initial investment requirements associated with projects such as the implementation of the outcomes of the Council's Customer Access Strategy.
- The level of risk / uncertainty associated with the budget and financial strategy, particularly the continuing uncertainty over grant entitlement and the effects of the current economic recession.

Where temporary use of reserves is approved to meet timing issues, the decision will be based on a specific payback period and this will be explicitly shown in the Reserves Projections (shown in MTS and BSR documents) so that anticipated movements on the level of reserves are clear. The maintenance of sufficient reserves to be able to pump-prime 'Invest-to-Save' schemes in the future is part of the Council's approach to being confident in meeting the significant net savings targets identified for future years.

The September 2012 MTS noted that the level of Reserves was above the Target level, and that the BSR should include consideration of the appropriate use of the additional funds. However, in considering the question of adequacy in the context of the revised Minimum level set by the Council, it is clear that although some short-term use of reserves is reasonable in order to manage the unforeseen impact of the forecasting error, the resulting level of reserves is too low to maintain over the medium and longer-term.

As a result, consideration has been given to the potential to target net savings requirements over the medium-term in order to achieve a planned return to the £5m Target level. This is recommended to be achieved through a two-step process, with an additional £250k being added to reserves in 2014/15, and then a further £1,082,740 in 2017/18, at which point the reserves will return to the Target level.

The projection through to 2036/37 is shown graphically below, compared with the projections contained within the September 2012 MTS:



This shows that the overall effect of the measures recommended in the BSR has:

- Served to address the potential issue of the level of Reserves falling below the revised Minimum level at the end of 2013/14, with a projected level of £3,667,260 being achieved at that point.
- Actively managed the Reserves levels over the period 2014/15 to 2017/18 in order to move the level back towards the medium-term Target level of £5m.

A similar approach has been adopted in respect of the Housing Revenue Account (HRA), which has identified :

- Minimum Level - set at £1.5m (approximately 3 weeks of rental income), to deal with timing issues and uneven cashflows and avoid unnecessary temporary borrowing
- Target Level - set at £3m, reflecting the level which provides the target over the longer-term.

Risk Management

The Council has a long-established commitment to risk management, as a key element of effective internal control. This includes the operation of a corporate risk database, which forms the basis for the Risk and Assurance Framework which, in turn, informs the Annual Governance Statement and Head of Internal Audit Opinion documents as part of each Statements of

Accounts. The database also informs the strategic internal audit plan, ensuring that all cross-cutting, project and service issues are effectively prioritised for coverage.

As part of the budget process, areas of uncertainty are identified in the summer / autumn each year as part of the MTS, and are then reviewed and updated throughout the process to identify the level of residual risk at the point of budget-setting.

The main issues which remain outstanding at the point of budget-setting this year are detailed in Section 7 of the BSR.

In addition, an assessment of the key areas of financial risk to the Council has been undertaken and the results are included in Appendix Q, in the form of a sensitivity analysis. This is a particularly important consideration for the current budget process, in light of the continuing volatility within the projections for the economy and changes in funding.

This analysis is supplemented by a review of the timing and nature of 'Significant Events' over the MTS period, which has been detailed in Appendix R of the BSR.

A further review of these areas, and the others still unresolved, will take place as part of the next (2013) MTS.

The Council's financial strategy also supports the provision of funding for known commitments, which commence beyond the specific budget year, as part of the prudence and sustainability concept.

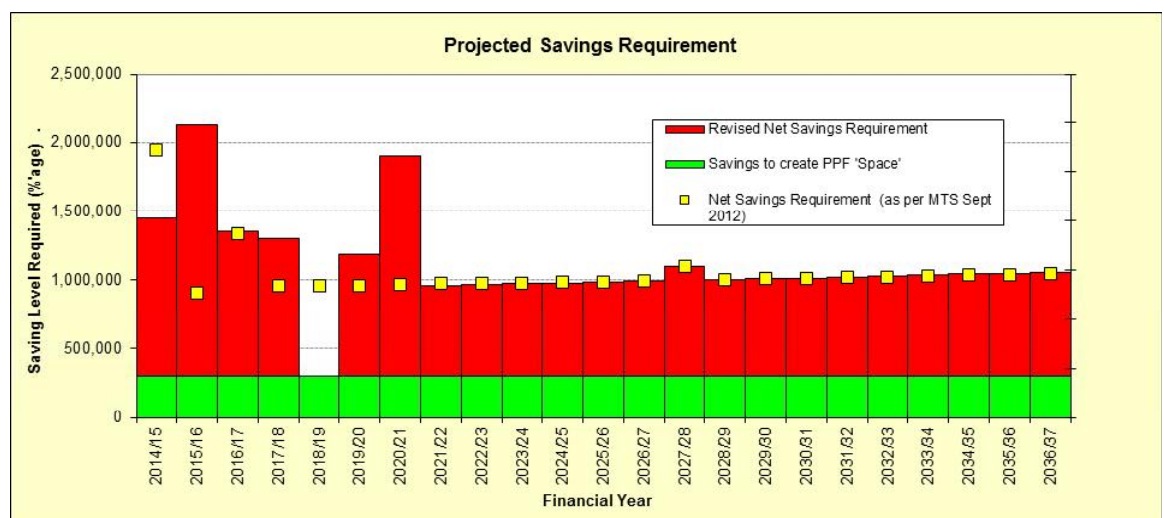
Period Budgeting

Part of the Council's established financial strategy is to ensure that funding for future spending is not dependent on the use of reserves, so as to demonstrate long-term sustainability. This is reflected in the basis for the calculation of the net savings requirements for 2014/15 and future years. As previously stated, additional net savings have been built into 2014/15 (£250,000) and 2017/18 (£1,082,740) in order to return the level of general reserves to the Target level over the medium-term.

The BSR identifies the need for an ongoing net savings target totalling £5.948m across the period from 2014/15 to 2018/19, compared with a total of £6.095m for the same period as projected in the original MTS. This confirms that the effects of the re-basing (requiring an additional £3.312m over that period) have been addressed as part of the BSR.

The net savings requirement for the next budget year (2014/15) of £1,450,830, can be viewed as achievable in the context of the level of additional Service Review savings already projected to be available for that year (some £1.3m).

For the longer-term, the profile of savings provides a reasonable timescale for developing further Service Review proposals to deal with the significant net savings requirement levels in the following two years in an informed manner.



The increased level of net savings requirement in 2020/21 relates to the assumption of the end of NHB grant receipts, leaving Growth-related posts costs of £785,380 unfunded. At that point, if the NHB scheme is not continued, decisions would need to be made with regard to the ongoing requirement for these posts.

The contribution of Service Reviews to the overall level of savings reflected in the BSR has been significant (ranging from 1.5 times the total net savings requirement in 2013/14 rising to 2.6 times more by 2016/17).

This serves to confirm the significant role of the Service Review process, and the robustness of the projections included in the September 2012 MTS. This is particularly important as Service Reviews, will undoubtedly be a critical part of the Council's future savings strategy.

This also demonstrates the success in adopting a period-budgeting approach in recent years, and this focus on medium-term budgeting will be further developed and emphasized as part of the Council's budget processes.

Future Savings Strategy

The Council is planning for a significant "step change" in its budget profile through to 2017/18. The budget and service delivery plans for 2013/14 represent a continuation of the process to deliver that change.

Future work is expected to include further exploration of shared service opportunities, an exploration of income generation opportunities and a review of Council assets.

A key element of both the MTS and BSR is consideration of the achievability of the reductions in net spending which are required to produce a balanced budget. As noted above, a key element in this analysis has been the robustness and outcomes delivered through the Council's Service Review process. This has demonstrated a strong track-record in delivering targeted reductions in the last few years.

The Council's budget includes provision, through the Efficiency Fund, of funding to enable service transformation to be undertaken. This provides greater assurance that the resources will be available to undertake the work needed to achieve the savings targets set.

This contributes to the confidence that the targeted levels of net spending reductions for future years can be met, and that suitable monitoring processes exist to highlight any variations in the actual timing or level of planned savings in practice so that remedial actions can be implemented.

Conclusion

The 2013/14 budget process has resulted in recommendations for spending and tax-setting which has met the additional challenges presented through the continued economic downturn, the reductions in core government funding and the pressures identified through the re-forecasting exercise.

This has involved the identification of tangible measures to effectively address the implications of the significant pressures on the Council's budgets. The medium and longer-term projections, and plans, have also confirmed that the future net savings requirements are set at an achievable level, whilst general reserves are returned to the target level over the medium term.

Integral to the process has been the testing of assumptions and associated risks underlying the financial projections, which have been determined in line with the adopted principles of prudence, affordability and sustainability.

The work contained within the BSR demonstrates the robust nature of the work on which the Council's spending plans are based, and that the plans and associated reserves projections represent a prudent and sustainable position.

This report is based on the budget proposals contained within the BSR, which are being recommended by the Executive to Council on 21 February 2013.

David Horspool

Director of Resources