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**Report to:** Cabinet **Date of Meeting:** 16 February 2017  
 Council 2 March 2017

**Subject:** Robustness of the 2017/18 Budget Estimates and the Adequacy of Reserves: Local Government Act 2003 - Section 25

**Report of:** Head of Corporate Resources **Wards Affected:** All

**Is this a Key Decision?** Yes **Is it included in the Forward Plan?** Yes

**Exempt/Confidential** No

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**Purpose/Summary**

To comply with statute the Chief Financial Officer is required to report to Council prior to the approval of the budget and the setting of the Council Tax, to give assurance that the budget is robust and that there are adequate reserves and balances. The report is based on the proposals presented to Council at this meeting.

**Recommendation(s)**

The Local Government Act 2003, (section 25 as amended) requires the Chief Financial Officer to report formally on the following issues:

- a) An opinion as to the robustness of the estimates made and the tax setting calculations
- b) The adequacy of the proposed financial reserves
- c) The production of longer term revenue and capital plans

The Cabinet and Council are requested to have regard to the matters raised in this report during the final stages of determining the budget for 2017/18.

**How does the decision contribute to the Council’s Corporate Objectives?**

	<u>Corporate Objective</u>	<u>Positive Impact</u>	<u>Neutral Impact</u>	<u>Negative Impact</u>
1	Creating a Learning Community		✓	
2	Jobs and Prosperity		✓	
3	Environmental Sustainability		✓	
4	Health and Well-Being		✓	
5	Children and Young People		✓	
6	Creating Safe Communities		✓	
7	Creating Inclusive Communities		✓	
8	Improving the Quality of Council	✓		

	Services and Strengthening Local Democracy			
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**Reasons for the Recommendation:**

The Local Government Act 2003, (section 25 as amended) requires the Chief Financial Officer to report formally on the issues contained within this report.

**What will it cost and how will it be financed?**

**(A) Revenue Costs**

Decisions taken as a consequence of this report will influence the Council’s Revenue Budget and Council Tax for 2017/18 and thereby shape the Council’s financial plan for future years.

**(B) Capital Costs**

**None**

**Implications:**

The following implications of this proposal have been considered and where there are specific implications, these are set out below:

<b>Legal -</b>	The Council is required to set a Budget and Council Tax level by 9 March 2017 and must consider the comments of the Chief Financial Officer before that decision is taken.
<b>Human Resources - None</b>	
<b>Equality</b>	
1. No Equality Implication	<input checked="" type="checkbox"/>
2. Equality Implications identified and mitigated	<input type="checkbox"/>
3. Equality Implication identified and risk remains	<input type="checkbox"/>

**Impact on Service Delivery:**

There is no direct impact on services.

**What consultations have taken place on the proposals and when?**

The Head of Corporate Resources is the author of the report (FD 4479/17)

Head of Regulation & Compliance has been consulted and (LD) 3762/17)

**Are there any other options available for consideration?**

No

**Implementation Date for the Decision**

Following the Budget Council Meeting

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**Background Papers:**

There are no background papers available for inspection.

## 1. **Introduction**

- 1.1 This report has been prepared in accordance with the statutory requirements of the Local Government Act 2003 which requires the Authority to report to Members on the robustness of budget estimates and the adequacy of proposed reserves.

## 2. **ROBUSTNESS OF BUDGET ESTIMATES**

- 2.1 When preparing the budget for 2017/18 and the three year financial strategy, the Council's Strategic Leadership Board have led and been fully engaged in the process and have been challenged to ensure that services can be delivered within the available funding and that estimates of expenditure and income are realistic. As a result the Strategic Leadership Board has confirmed that the proposals made within this budget package both from the Public Sector Reform projects and service options are deliverable.
- 2.2 The proposed budget due to the scale of the funding gap faced by the Council has been prepared with careful consideration and full acknowledgement of the risk and uncertainty around both the proposals made and existing pressures faced by the Council. It is therefore important that these proposals are considered alongside the level of reserves held.
- 2.3 In order to provide assurance that the Council's budget estimates are robust and that the Council is adequately protected against unbudgeted financial pressures and the impact on Council Taxpayers is minimised, a number of factors are considered as part of the budget planning process.

### **Factors to be Considered**

#### **Four year settlement and increased reliance on local funding estimates**

- 2.4 The financial settlement received for 2017/18 provided details of the funding levels to be received by the Council in the forthcoming year and the subsequent 2 financial years. These levels reflected the decision of the Council to accept central government's offer of a 4 year financial settlement (2016/17 to 2019/20).
- 2.5 Whilst this certainty is welcomed there are significant changes proposed to local government funding during the period of the Council's Medium Term Financial Plan 2017/18 to 2019/20, which will require careful monitoring and engagement. These include the introduction of the 100% Business Rates Retention Scheme, changes to the funding of Schools, reform of the New Homes Bonus Scheme and funding changes associated with Adult Social Care, namely the Improved Better Care Fund and the Adult Social Care Council Tax Levy.
- 2.6 The future years funding estimates in relation to these issues will be kept under review and refined accordingly as details become available. In respect of the 2017/18 budget, estimates are based upon confirmed funding due or latest detailed estimates e.g. council tax receipts.

- 2.7 As the Council has developed this budget package, in addition to having to meet the severe funding reductions of £64m over the period, it has to be mindful and is indeed cognisant that its future funding is now more closely aligned to the generation of local income as opposed to central government support than would have historically have been the case.
- 2.8 The budget proposed therefore acknowledges not only the need to reform current service delivery and make savings in a number of areas, but also that the future financial sustainability of the Council will need to be supported through the drive to deliver growth and develop additional and increased income streams. The current expenditure plans within this budget rely on sustaining existing levels of economic activity with a small element of growth in Council Tax. This has however been more than offset by the impact of New Homes Bonus reform that was announced by central government in December 2016.

### **Maintaining Service Delivery**

- 2.9 The scale of the budget reductions facing the Council over the next 3 years up until 2019/20 are severe and will require a transformational approach to ensure that the Council's core purpose can be delivered. This is subsequently reflected in the budget proposals presented.
- 2.10 Whilst there will be an impact on the level of service that the Council is able to provide, all proposed changes are subject to careful consideration, impact assessment and consultation before implementation. This factor is reflected in the phasing of the delivery of savings. The funding gap facing the Council over the next 3 years is 'front-loaded' in 2017/18, however due to the scale of change proposed and the nature of existing contracts, the majority of savings due will not be delivered until 2018/19 onwards. This reflects the careful planning and approach to risk that will be undertaken in order that the right outcomes are reached for residents. From a financial point of view, whilst this approach will require the use of some reserves to support the budget in 2017/18, the delivery of sustainable savings over the period of this medium term financial plan and beyond will ensure that both service delivery and financial management responsibilities are discharged effectively. Indeed it is proposed that the majority of the reserves used in 2017/18 will be replenished in 2019/20.

### **Anticipated New Demand Pressures**

- 2.11 The budget setting process has specifically taken into account the impact of demand for Council services. This is particularly reflected in the Council's approach to the demand led services such as Children's and Adults Social Care and the development of the Early Intervention and Prevention project.
- 2.12 Likewise the Council in developing its 3 year plan has been acutely aware of the impact of not receiving the budgeted funding from the CCG's in respect of the Better Care Fund in recent years and the pressure that this has placed on Adult Social Care. This is in addition to the pressure due from the introduction of the

National Living Wage up until 2019/20. As a result of these issues, the Council will utilise the Improved Better Care Fund and Adult Social Care levy to minimise the impact of funding reductions on Adult Social Care between 2017/18 and 2019/20, with other Council Services experiencing a disproportionately higher level of reductions

### **Resources to Deliver Change**

- 2.13 The approach to this 3 year budget package is transformational in nature and different to the approach taken by the Council in previous years as it seeks to address a funding shortfall of £64m. In order to deliver this, the shape of the Council and the approach to service delivery will change significantly in a number of areas. Within the budget, provision exists to enable the delivery of a number of projects. This provision will support investment in infrastructure to support front line services, investment in ICT and specialist advice and support as required. This funding will be held centrally and bids will be evaluated on a case by case basis by the Chief Executive and the Leader of the Council in order to determine allocation.

### **Inflation and Annual Cost Increases**

- 2.14 The Council, as in previous years has provision for specific allocations to provide funding for contractual and other inflationary pressures such as annual pay increases. This reflects the latest information available having conducted a Council wide review of existing contracts and the likely impact of future pay negotiations. Within this budget package however there is no provision for price inflation. Due to the severity of the financial challenge facing the Council over the next 3 years, services will be required to manage any such pressure within their existing cash limits.

### **Impact of Previous Years' Budget**

- 2.15 Throughout this budget process, Heads of Service have been engaged to understand the impact of any budget pressures that could impact upon the 2017/18 to 2019/20 budget plan from the 2016/17 budget. As a result of this work, some undelivered savings have been met through a residual central budget allocation. Any remaining issues have been resolved as far as possible through the re-alignment of existing budgets with services.

### **Financial Management**

- 2.16 The Council has an embedded process with regard to its Financial Management and its reporting strategy reflects the monitoring undertaken by The Strategic Leadership Board, budget holders and the central Finance team. Monthly reports are considered by Departmental Management Teams, Strategic Leadership Board and Cabinet. Overview and Scrutiny Committee also have a standing agenda item in respect of capital and revenue monitoring.

- 2.17 It has been stated both within this report and also the wider budget report that the budget estimates contained for the Council over the next 3 years reflect the Council's ambition to deliver services that align with its 2030 vision, core purpose and ensure that it remains financially sustainable.
- 2.18 In order to manage the delivery of these objectives and the different risks that are presented when compared to previous years, the Strategic Leadership Board and Members will need to monitor progress and delivery of each proposal and instigate remedial action where issues are identified. The Council, despite having to address budget shortfalls since 2010 of £169m has a strong track record of delivering savings, however due to the funding gap faced over the next 3 years and the transformational activity proposed, this monitoring will be of even greater importance.

### **Management of Risk**

- 2.19 The Council manages risk on an ongoing basis at all levels of the organisation. In doing so it has developed policies, processes and systems that reflect its internal governance arrangements and the constitution. As far as possible this allows the Council to anticipate risks as they emerge. These processes are supported by the Council's Internal Audit and Risk Section, the annual review of Corporate Governance and the completion of the Annual Governance Statement.
- 2.20 Given these controls and processes, the likelihood of unanticipated budget issues has been reduced as far as possible, however due to the continual issues presented in respect of the demand led services (particularly Adults and Children's Social Care) and the changes in local government finance, should any issues arise, alternative short term savings will be identified until longer term options are developed.

### **Capital Strategy and Strategic Investment**

- 2.21 As part of the reform process of local government finance, the Council now receives a modest level of capital grant to support investment. This budget provides for the utilisation of this funding in 2017/18 and indicative plans for 2018/19 and 2019/20.
- 2.22 In order to support the economic growth and strategic investment work streams it is likely that the Council will need to invest significant levels of resources over the course of this 3 year budget period in order to deliver the objectives and facilitate the financial returns associated with these areas.
- 2.23 The Council through its Treasury Management Strategy uses a range of prudential indicators to manage and control the impact of these capital investment decisions. This will ensure that the risk and debt profile of the Council is appropriate based upon its financial standing and performance and that repayment is affordable.

## **External Advice**

- 2.24 The Council is supported in its financial activities by its External Auditor, Ernst and Young LLP and its Treasury Management Advisors. Any material changes to Council policy, budget decisions or capital investment proposals will be undertaken in consultation with these organisations.

## **3. RESERVES STRATEGY 2017/2018**

- 3.1. The Council holds a range of reserves that it uses and holds for different purposes. This report considers each in turn.

### **General Fund**

- 3.2 The General Fund is the Council's primary reserve. It exists to provide the Council with a contingency against unexpected events which could otherwise undermine the Council's sound financial standing. The fund should only be utilised to address short term issues and should not be relied upon to finance ongoing budget deficits. Where it is used in the short term then this should be part of a plan to return it to a long term equilibrium position in the medium term.

- 3.3 Determining the level of General Fund Reserves forms a key part of the Council's medium term financial strategy and will be informed by an assessment of the risks presented by:

- State of the economy (and its impact on Council costs/funding)
- Knowledge of future changes to the Council's responsibilities
- Specific risks relating to the changes in Council services

- 3.4 A historical benchmark minimum level that is used by a number of authorities is for the General Fund Reserve to be maintained at between 3-5% of the Council's net budget. This can be considered to be a minimum level of reserves in keeping with the long term background risks the Council shares in common with all other councils. This is referred to as the normal risk accepted. However this rate will not take account of variable factors such as the economic climate, government policy and local factors. Therefore, alongside the normal risk the Council also needs to make an assessment of abnormal risks it may need to fund. These include the following elements.

## **National Considerations**

- 3.5 **Impact of economic climate on Council costs** - the current climate continues to prove challenging with the potential for business closure, lower than normal income levels and shortage of alternative funding sources from partners. As Council funding is now more dependent on the performance of the local business sector it is more exposed to the consequences of businesses failing or a lack of demand for local facilities.



- 3.6 **Anticipated reductions in Government funding** – the level of funding that it is anticipated that the Council will receive in 2017/18 reflects a reduction of £12.586m from the previous year and is anticipated to fall by a total of £29.653m by 2019/20. These funding reductions are addressed by the proposals within the Budget Report. However, the funding allocations for some elements in future years are indicative or are subject to an ongoing consultation period. These reductions and any future funding changes still represent a risk.

## **Local Considerations**

- 3.7 **Planned changes in service delivery methods/contracts** – The Council continues to review the way in which it delivers services in order to ensure best practice and best value for money for its residents. In addition, the budget proposals involve significant transformational change as to how services are provided. This will result in significant changes to working practices, commissioning relationships and governance arrangements. As these become embedded within the organisation this should reduce the risk to the organisation however there is still a degree of risk that needs to be allowed for.
- 3.8 **Impact of Rising Demand for Services** – The Council continues to face increasing demand for its services due to demographic growth pressures in Adult Social Care and pressures relating to Looked after Children. Investment has been included in the 2016-17 budget but there is still a degree of risk that needs to be allowed for in future years.
- 3.9 **Legal Challenges** – The Council from time to time make decisions (policy and operational) that could be subject to challenge or appeal from affected bodies. It is therefore prudent for the Council to have some capacity to safeguard against such challenges.

## **Budget Setting Assumptions**

- 3.10 **Sensitivity of budget assumptions** - The Council's budgets for 2017/18 are underpinned by a number of assumptions regarding the prevailing rates of inflation, interest earned and cost growth. While these estimates are believed to be prudent some costs are outside the Council's control, particularly in the medium term.
- 3.11 **Significant earmarked reserves** – The Council maintains a level of funding in earmarked reserves which, in some cases, could be used to moderate the impact of future cost increases. These include reserves for future potential insurance claims and funding that Members have set aside for specific purposes. The presence of these reserves for specific purposes reduces the scale of risk the General Fund has to guard against. It should be noted that these reserves have been set up for specific purposes and as such their use will be in accordance with that approved.

## Management / Member Actions

- 3.12 **Clear Corporate / Member messages** - The Council and its senior management have very clear expectations regarding the delivery of a 'balanced budget' and have instigated appropriate monitoring and reporting processes to ensure any emerging pressures are promptly addressed. This reduces the risk to be managed through the General Fund.
- 3.13 **Three Year Plan developed** – Given the scale of the funding reductions that the Council faces a three year plan has been developed which will allow it to plan ahead with more certainty and this has helped to ensure that savings plans are identified well in advance of their implementation and short term reactive measures have not been necessary.
- 3.14 A summary of the adjustments made for the above factors is set out in the table below.

<b>Factors Considered</b>	<b>Risk Impact % of net budget</b>	<b>Impact on General Fund Balances</b>
		<b>£m</b>
<b>Normal Risk Level (lower level)</b>	<b>3.0%</b>	<b>5.9</b>
<u>National Considerations</u>		
Impact of economic climate on Council costs	1.0%	2.0
Anticipated reductions in Government Funding	1.0%	2.0
<u>Local Considerations</u>		
Delivery of planned changes in service delivery methods/contracts	1.5%	3.0
Costs at risk from potential legal challenges	0.5%	1.0
Rising demand for services	1.0%	2.0
<u>Budget Setting Assumptions</u>		
Sensitivity of budget assumptions	1.0%	2.0
Significant earmarked balances	-2.5%	-5.0
<u>Management / Member Actions</u>		
Clear corporate / Member messages	-1.5%	-3.0
Three year plan developed	-1.0%	-2.0
<b>Total Abnormal Risk</b>	<b>1.0%</b>	<b>2.0</b>
<b>Total Risk</b>	<b>4.0%</b>	<b>7.9</b>

- 3.15 This analysis shows that a risk adjusted assessment of the required level for the General Fund in 2017/18 should be in the region of £7.9m. A range of £1.0m is advised around this figure so a General Fund between £6.9m and £8.9m would be considered prudent. This represents 4% of the net budget.
- 3.16 The Council started 2016/17 with a General Fund balance of £8.178m. Incorporating the latest projections of expenditure for 2016/17 and the planned use of General Balances it is estimated that the level of the General Fund by 31 March 2017 will be £7.209m. This would be within the assessed prudent range for 2017/18 and the risk assessed level will be kept under constant review.
- 3.17 The level of risk and the associated levels of General Fund balance required to hedge against that risk will be reviewed on an ongoing basis. In the current times of uncertainty, and financial pressures, the S151 officer considers it prudent to maintain reserves at a higher level than might be expected in a more stable economic climate, and to review against the extent of future ambitions and risks during the forthcoming year.

## **Earmarked Reserves**

- 3.18 Unlike the General Fund, earmarked reserves are held for a specific purpose. These purposes may be determined by the Council to coincide with its policy objectives, dictated by statute (e.g. schools funding) or agreed with partners who also contribute to the reserve.
- 3.19 Where the decision to set up a reserve rests with the Council, consideration needs to be given as to the benefits of holding an earmarked balance. The Council holds earmarked reserves separately from its General Fund to meet a number of distinct aims.
- Strategic Reserves - In accordance with policy decisions, funding may be set aside and ringfenced for the benefit of a particular service or project ensuring that there is funding to take the activity forward as planned.
  
  - Committed Reserves – Where the Council makes a decision that commits it to incurring additional costs in the future, it can set aside the funding necessary to meet that cost when it arises, ensuring that the costs of current decisions are recognised at the point that decisions are made and do not become a burden on future budgets.
  
  - Uncommitted Reserves – Where the Council is aware of an issue that may incur additional costs in the future, it can set aside the funding necessary to meet that cost if and when it arises, ensuring that the potential costs of these issues do not become a burden on future budgets.
  
  - Restricted Reserves – The Council sometimes receives contributions from partners or has to set aside its own funding in a way that restricts where it can be

spent in the future. These reserves can only be used to support eligible expenditure which may be restricted to a particular place, activity or service.

- Temporary Reserves – These are used to phase out timing differences between when the Council (or another body) funds expenditure and when it is incurred.

3.20 The current and anticipated balances on each of these classes of earmarked reserve are shown below.

	<b>April 2016</b>	<b>Anticipated March 2017</b>
	<b>£m</b>	<b>£m</b>
<b>Earmarked Reserves</b>		
- Strategic Reserves	35.370	25.931
- Committed Reserves	14.208	14.208
- Uncommitted Reserves	2.803	2.803
- Restricted Reserves	1.714	1.813
- Temporary Reserves	8.959	8.824
	<b>63.054</b>	<b>53.579</b>
<b>School Earmarked Reserves</b>	6.035	6.035
	<b>69.089</b>	<b>59.614</b>

3.21 The benefits of holding earmarked reserves needs to be weighed against the costs of doing so. Every discretionary earmarked reserve ties up funds that may otherwise be available to fund the core activities of the Council. Each reserve also carries with it an administrative overhead as they will need to be maintained, monitored and reported on.

3.22 Of the 50 existing earmarked reserves, 33 are to be retained over the medium term or beyond. Each of these reserves will be subject to a regular monitoring process to ensure they remain relevant and are achieving their stated objectives. The remaining 17 are expected to have fulfilled their purpose within the planning period and will be closed at that point. Any surplus funding on these reserves on completion of proposed activities will be appropriated to the General Fund or returned to the original funding source.

3.23 At present the budget package for 2017/18 to 2019/20 assumes that £5m of reserves will be used to support the phasing of savings over the 3 years as the Council delivers its Medium Term Financial Plan and financial sustainability. It is planned that £3m of this will be returned to reserves in 2019/20.

### **Comparison of all Revenue Reserves**

3.24 To confirm the appropriateness of the level of revenue reserves held (combining General Fund and Earmarked Reserves) they have been benchmarked against other similar Local Authorities. These comparisons are shown relative to the net budget of each Council to remove the effect of the different sizes of each body.

- 3.25 The latest available information for other councils reflects March 2016 balances. It can be seen from the analysis that the Council's reserves coverage has been similar to that of its comparator group in the last two years. Levels are currently marginally below the average. Whilst each authority's assessment of risk will vary, the benchmarking process provides a broad indication that levels are adequate but not excessive. The general pattern of increases across all councils reflects the greater risks and uncertainties they face given the reductions in future funding levels.

	<b>2012/13</b>	<b>2013/14</b>	<b>2014/15</b>	<b>2015/16</b>
<b>Comparator Average %</b>	30.5%	31.8%	33.4%	34.6%
<b>Sefton %</b>	22.0%	27.0%	33.2%	32.7%

## **Capital Reserves**

### **Capital Receipts Reserve**

- 3.26 The Council retains a capital receipts reserve to finance future capital expenditure. This reserve is financed by capital receipts set aside on the disposal of land, buildings and other assets as well as amounts received from One Vision Housing relating to the Council's share of Right to Buy receipts.
- 3.27 The nature of this reserve determines that the balance will vary with the timing of the receipts and the Council's capital schemes that the receipts are being used to fund. The balance at the end of 2015/16 was £5.402m.

### **Unapplied Capital Grants and Contributions Reserve**

- 3.28 The value of this reserve relates to capital grants and contributions received that have yet to be utilised to fund ongoing capital schemes. The balance at the end of 2015/16 was **£8.388m**. This funding will be utilised over the next three years. However, additional grants and contributions will be received that won't be fully utilised in the years they are received so will remain in the Reserve until utilised.

## **School Reserves**

- 3.29 The main element of this reserve is individual carry forward balances of schools' unspent budgets. It is the Council's responsibility to hold these balances and ensure they are ring-fenced for use against school activities. These balances are expected to gradually reduce over this planning period as the schools utilise their accumulated surpluses to support their activities.

4. **CONCLUSION**

- 4.1 As a result of considering the issues contained within this report, it is the view that the budget proposed is a robust budget package and the opinion provided is in accordance with Section 25 of the Local Government Act 2003.