

BUDGET 2019/20 - ADEQUACY OF PROVISIONS AND RESERVES

SUMMARY

This report sets out the Executive Head of Finance's statement on the *adequacy of provisions and reserves* used in the preparation of the Council's budget. This is a statutory requirement, under Section 25 of the Local Government Act 2003.

RECOMMENDATIONS:

Cabinet are recommended to agree:

1. the policy on reserves (Earmarked Reserves & General Balance) and provisions (to cover bad debts, redundancies etc) in Appendix C;
2. that based on current planning assumptions and risk forecasts set out in Appendix D:
 - a. for 2019-20, a minimum level of General Balances of £2.000m, and
 - b. a forecast minimum level for planning purposes of

i. 2020-21, £2.000m;

ii. 2021-22, £2.000m

as part of the consideration of the budget plans for 2019-22, reflecting the transfer of risk from Central to Local Government, and supporting recommendations;

3. that the Executive Head of Finance further reviews the level of the Council's Reserves and Provisions as part of closing the 2018-19 accounts in summer 2019.

1. INTRODUCTION

- 1.1 This report details the Council's reserves and provisions, including an assessment of their purpose and expected usage during 2019-22, at November. The report will be updated in February to take account of the Governments Settlement announcements.
- 1.2 Reserves. The report includes an assessment of the Council's financial risks that should be taken into consideration in agreeing the minimum level of General Balances. At April 2018, the reserves (General Balance and Reserves) stood at £11.8m, as follows:

Table 1a: Total Reserves April 2018

	£000	£000
General Fund Balance		2,000
Stability and Resilience Reserve	4,353	
Other Earmarked Reserves (45):	5,472	
		9,825
Total Reserves		11,825

- 1.3 Provisions. Unlike Reserves, Provisions are not an amount of cash, but an estimate of the level of income that might not be received, which reduces the income that is counted into the budget.

Table 1b: Total Provisions April 2018

	£000	£000
HB weekly (on ongoing benefit)	956	
HB sundry debts (no longer on benefit)	1,382	
Total HB		2,338
General bad debts		369
Homelessness Bed & Breakfast bad debt		6
Total Provisions		2,713

Note: Council Tax and Business Rates bad debts are contained in their Collection Funds.

- 1.4 A measure of whether the Provisions are adequate is to compare them as a percentage to the debt that is owed. Normal practice is that the Provision is less than the Debt, for it is expected that a degree of the debt will be paid, reducing the possible level of eventual write-off to the level of the Provision (or less). Table 2 shows the provision 'cover' for Debt at April 2018, which is just over three-quarters of outstanding debt

Table 2: Provision cover for Debt outstanding April 2018

	Provision	Debt	Cover
	£000	£000	%
HB weekly (on ongoing benefit)	956	1,140	83.9
HB sundry debts (no longer on benefit)	1,382	1,780	77.6
Total HB	2,338	2,920	80.1
General bad debts	369	570	64.7
Homelessness Bed & Breakfast bad debt	6	2	300.0
Total Provisions, Debt, percentage cover	2,713	3,492	77.7

- 1.5 The Cabinet will be asked to formally note the contents of this report prior to agreement of the budget report and recommendation of the budget and precept for 2019-20. This paper is one of a suite of reports to this Cabinet meeting that set out the strategic framework inside which the later budget recommendations to Council will sit.
- 1.6 The level of risk and budget assumptions underpin decisions when setting the revenue and capital budgets and affect the recommended level of General Balances held. Members must consider the level of risk and the assumptions set out in this report when later in the year, recommending the revenue budget and capital programme. *Appendices A and B* explicitly identify the risks, over ten categories, and the quantification of those risks, in arriving at the recommended level.

- 1.7 The MTF5 2019-22 rehearses the extra-ordinary increase in risk from 2019, as a consequence of leaving the European Union in early 2019, a new Settlement regime after 2019-20, and Treasury interest in ceasing New Homes Bonus in 2020/22 of £3.7m.
- 1.8 Additionally, the advent of Universal Credit, affects the recovery of overpaid Housing Benefit (HB) for existing HB claimants who move over to the new benefit. The DWP will be responsible for recovery of old HB overpayments from new awards of Universal Credit; the recovery of other debts will rank ahead of HB debt, being 5th or 6th in the DWP hierarchy of action on debt.

2. PURPOSE OF HOLDING RESERVES AND PROVISIONS

- 2.1. **Reserves** are an essential part of good financial management and are held to ensure the Council can meet unforeseen expenditure and to smooth expenditure across financial years. They enable councils to manage unexpected financial pressures and plan for their future spending commitments. While there is no universally defined level for councils' reserves, the reserves a Council holds should be proportionate to the scale of its future spending plans and the risks it faces as a consequence of these. Rushmoor Council's policy has been to set limits consistent with the Council's risk profile and with the aim that Council Taxpayer's contributions are not unnecessarily held in provisions or reserves.
- 2.2. Reserves are held in one of three main categories:
 - Reserves (or Earmarked Reserves) for special purposes or to fund expenditure that has been delayed, for example where money is set aside to replace equipment or undertake repairs on a rolling cycle, which can help smooth the impact of funding.
 - Reserves that are held on behalf of organisations. The balances are not available to support other Council expenditure.
 - General Balances – reserves that are not earmarked for a specific purpose. The General Balances reserve is held to enable the Council to manage unplanned or unforeseen events. The Executive Head of Finance is required to form a judgement on the level of the reserve and to advise Cabinet accordingly.
- 2.3. Reserves are held for revenue and capital purposes. However, some are specific, e.g. Usable Capital Receipts can only be used for capital purposes.
- 2.4. **Provisions** are made for liabilities or losses that are likely or certain to be incurred, but where it is uncertain as to the amounts or the dates which they will arise. The Council complies with the definition of provisions contained within CIPFA's Accounting Code of Practice.

3. CURRENT CONTEXT

- 3.1. It is recommended that the minimum level General Balances, is £2.0m for 2019-20. The projected actual level at 31 March 2019 is £2m, prior to allowing for the revenue budget year end position, which is currently forecasting an underspend of £288k (as at Quarter 2 monitoring reports). Chief Officers are taking action to ensure that a balanced outturn position will be achieved. The budget proposals reported on this agenda do not include

any use of General Balances. The level of minimum balance is informed by an assessment of the financial risk to which the Council is exposed, whilst also taking account of the level of financial controls within the Council. Financial management and reporting arrangements are considered to be in need of improvement, for example moving to monthly reporting.

- 3.2. In setting the annual budget, a further review of the level of reserves is undertaken, alongside any under /overspend in the current year, as to whether it is possible to release funding to support the following year's budget or whether additional funding is required to increase the level of reserves. That review is informed principally by an assessment of the level of financial risk to which the council is exposed and an assessment of the role of reserves in supporting future spending plans.
- 3.3. The overall level of General Balances needs to be seen also in the context of the earmarked amounts set aside and the Council's risk profile.

4. ASSESSMENT OF THE LEVEL OF GENERAL BALANCES

4.1. The framework for assessing the level of General Balances, detailed at Appendix A, is based on considering all risk areas and then quantifying the risk using the related budget and applying a percentage factor, which will vary according to the assessed level of risk. The total value against each risk provides an estimate of the level of balances required to cover the identified risk and overall provides an assessment of the level of general balances for the Council. It takes into consideration the most significant risks and issues including the following:

- Level of savings and transformation. One of the most significant risks continues to be the level of transformation that has to take place across the Council to deliver the required budget savings. Risk has been considered as part of our assessment of the robustness of the budget proposals, and reflected in the reprofiling and removal of some savings. The remaining risks will be monitored within and across services as part of the Council's ongoing risk management process and mitigating actions will be identified and monitored. Robust financial monitoring controls are in place and extra monitoring of the transformation programme is being undertaken.
- Managing the cost of change. The Council will need to budget for the cost of any redundancies necessary to achieve the required budget savings and service restructuring to the extent they are not contained in the budget proposals. The Council has a separate redundancy reserve for this purpose.
- The effect of economic and demand changes. There is always some degree of uncertainty over whether the full effects of any economy measures and/or service reductions will be achieved. Whilst the budget process has been prudent in these assumptions and that those assumptions, particularly about demand led budgets, should hold true in changing circumstances, an adequate level of general contingency provides extra reassurance the budget will be delivered on target. Changes in the economic climate which may also influence certain levels of income to be received at a lower level than previous years.
- Cost of disasters. The Bellwin scheme is intended to reimburse the cost of local authority actions taken in the immediate phase of an emergency, not those taken as part of the recovery phase. Following a disaster, the Council can claim

assistance from the Government using the Bellwin rules. These are still to be confirmed for 2019-20, but for 2017-18 the threshold below which the Council would have to fund emergency costs was set at £17,642. Central Government would then provide 100% grant funding for any expenditure incurred above this amount. Examples of natural disasters eligible for the scheme would include severe flooding and hurricane damage.

- Uncertainty arising from the introduction of new legislation or funding arrangements such as the retention of Business Rates.
- Risk of changes to the levels of grant funding and factors affecting key income streams such as Council Tax and Business Rates.
- Unplanned volume increases in major demand led budgets, particularly in the context of high and accelerating growth.
- The risk of major litigation, both currently and in the future, for example the change to EU membership from March 2019.
- The need to retain a general contingency to provide for any unforeseen circumstances, which may arise.
- The need to retain reserves for general day to day cash flow needs.

4.2. The ten areas of risk considered in the general contingency are detailed in Appendix A with an explanation of the potential risks faced by the Council. Appendix B details the calculation of the General Balances. Whilst the level of risk in the current year is low, at £290k, it rises in the following years to £2.5m by 2021-22. In part, this reflects the increased uncertainty, the further out one goes. It is proposed to adopt a simple approach, to provide 80% cover for the eventual higher figure, recognising the long lead in time to mitigate the problem.

Table 3: Recommended and forecast level of General Balances 2019-22

2018-19 (Forecast)		2019-20	2020-21	2021-22
£m		£m	£m	£m
2.0	Assessment of the level of General Balances	2.0	2.0	2.0

4.3. It is essential in setting a balanced budget that the Council has money available in the event of unexpected spending pressures. The “balances” need to reflect spending experience and risks to which the Council is exposed.

4.4. The latest budget monitoring position reported to Cabinet forecasts general balances at 31st March 2018 of £2.0m, prior to allowing for the revenue budget end of year position, which is currently forecasting an underspend of £288k (as at Q2 monitoring reports).

5. REVIEW OF EARMARKED RESERVES AND PROVISIONS

5.1. As part of the 2018-19 budget planning process, a *detailed review will be undertaken* of each of the reserves and provision held by the Council. In general, the earmarked

reserves and provisions are considered by the Executive Head of Finance to be adequate and appropriate to reflect the risks they are intended to cover. However, it is considered that changes could be made to some reserves, due to changing circumstances. Work on this will be *reported in the new year*.

- 5.2 The detailed use of reserves for 2019-20 is not known at this time and as such the balances have been rolled forward at the same level as 2018-19.
- 5.3. When taking decisions on utilising reserves or not it is important that it is acknowledged that reserves are a one-off source of funding and once spent, can only be replenished from other sources of funding or reductions in spending. The practice has been to replenish reserves as part of the closure of accounts; however this can be difficult to predict, and these contributions are therefore not reflected in the figures shown.
- 5.4. In view of the need to keep all financial risks under ongoing review and given the scale of change facing the Council, it is proposed that a further full risk assessment of earmarked reserves also be undertaken as part of the closure of the accounts, alongside the review of Council balances in the summer 2019.
- 5.5. Attached at **Appendix C** is the policy on reserves and provisions used to provide guidance in assessing their level. Attached at **Appendix D and E** is a full list of the reserves and provisions held by the Council including their purpose; *the next version of this report will show the expected usage over the medium term period*. The forecast year end position of all reserves and provisions will reported as part of the Quarterly monitor to Cabinet.

6. SUMMARY

- 6.3. Members could choose to agree different levels of reserves and balances, which could increase or decrease the level of risk in setting the revenue and capital budget. This would change both the risk assessment for the budget and the recommended level of balances.
- 6.4. The proposed level of reserves and balances set out in this report is considered to provide a prudent and robust basis for the Revenue Budget 2019-20, and will ensure the Council has adequate financial reserves to manage during the delivery of services and the proposed savings in the financial years covered by the associated Medium Term Financial Strategy.

7. ISSUES, RISKS AND INNOVATION

- 7.3. **Legal implications** – Statutory requirements relating to individual proposals will be reported to Council in February 2019. Legal requirements about setting the budget and level of Council Tax are in this report and are considered to be met.
- 7.4. **Risks** – The risks associated with the budget proposals will be reported to Cabinet in January 2019 and to Council in the separate report on the Robustness of Estimates. Reports on the Robustness of Estimates and the Statement on the Adequacy of Provisions and Reserves also set out financial risks that have been identified as part of the assessment of the level of reserves and provisions in order to evaluate the minimum level of General Balances.

APPENDIX A

	Appendix A Explanation of risk
1) Legislative changes	<p>Key government policy and legislative changes will impact on the Council's budget plans. Forecasts have been based on the latest information available but there is risk of variation and there is greater risk in future years, where estimates cannot be fully based on firm government announcements. Key elements include:</p> <ul style="list-style-type: none"> - Government grant – based on provisional government funding announcements. A new Settlement Funding Allocation for four years runs from 2020-21 and will not be known by Feb 2019. There will be winners and losers. - Business Rates. Councils' funding is affected by the level of business rates collected. However significant appeals such as Power Stations, GPs surgeries and NHS Foundation Trusts can result in significant volatility. - Council Tax base and collection. The council funding is affected if there is a reduction in the tax base or in the amount collected by the billing authorities. The budget is based on a prudent forecast, which minimises the financial risk to budgeted income.
2) Inflation	<p>Pay inflation has been assumed at 2% for 2019-20 and all following periods. Allowances have been made for differential increases for those staff affected by the implementation of the National Living Wage. However the Council is part of the national agreement and therefore pay awards for 2019-20 onwards will be subject to any agreements reached. There is a risk that pay awards could vary from this assumption over the planning period</p> <p>Price inflation has been included based on contractual need. There is a risk that inflation will be required during the planning period, even where there is no current contractual element. In addition many contracts are negotiated post budget agreement and therefore forecast inflation levels may be different in practice.</p> <p>.Inflation on fees and charges is set by Rushmoor District Council determined by RPIX for September 2018.</p>
3) Interest rates on borrowing and investment	<p>Budgeted interest earnings on investments are based on the London Intra Bank Bid rate for money market trades. The current rates are low and are likely to remain so until UK base rates are increased.</p> <p>The revenue cost of borrowing is based on the rates of interest payable on the Council's existing debt and assumptions in respect of capital expenditure to be funded from borrowing which has yet to be borrowed.</p>

	Appendix A Explanation of risk
4) Government funding	<p>2019-20 is the last year of the Governments four year funding allocation. The following 4-years will not be announced until the summer of 2019. However, there remain a number of issues which may impact on future funding levels:</p> <ul style="list-style-type: none"> • The Settlement will reset Council baselines, and will produce winners and losers. • There is a continued reduction in local government resources up to 2021-22. • The exit from the EU in March 2019 is a subject of great uncertainty and the OBR is unable to forecast any impact. • The national retention of Business Rates from 2020 could become unequally distributed over the next four years..
5) Employee related risks	<p>Staffing implications of budget planning proposals have been evaluated and reflected within the financial plans, including the cost of redundancy. However, variations could occur as detailed implementation plans are developed.</p>
6) Volume and demand changes	<p>Waste forecasts are based on the latest available information. If tonnage levels increase, this will lead to an increased pressure.</p>
7) Budget savings	<p>The medium term financial plan includes budget savings to be delivered across three years 2019-22 of £2.559m, £3.055m and £3.090m. A full assessment of all proposals has tested the robustness of each saving to minimise the financial risk, however a risk remains that the programme is delivered at a slower rate, or that some savings are not achievable at the planned level.</p> <p>In addition, further savings need to be identified to close the funding shortfall over the three years 2019-22 of £171k, £27k and £752k.</p>
8) Insurance and emergency planning provision	<p>Unforeseen events and natural disasters can increase the level of insurance claims faced by the Council.</p>
9) Energy, security and resilience	<p>Were a disaster to occur, we must have a reserve in place to pick up costs that will fall to the Council.</p> <p>Rushmoor includes flood risk areas and emergency procedures are in place to manage this.</p> <p>Resilience of ICT can create a risk. A programme of work aims to improve resilience of ICT.</p>
10) Financial guarantees, legal exposure	<p>The contracts containing obligations that, if not fulfilled, would attract a penalty.</p>

APPENDIX B

Balances Calculation

Grants												
Other General Fund Grants	2.400	0.50%	0.012	2.479	0.50%	0.012	2.561	0.50%	0.013	2.646	0.50%	0.013
Employee Related Risks												
Pensions actuarial evaluation	0.600	0.00%	0.000	0.620	2.00%	0.012	0.640	2.00%	0.013	0.661	2.00%	0.013
Volume/Demand Changes												
Capital Receipts	0.000	0.00%	0.000	0.000	0.00%	0.000	0.000	0.00%	0.000	0.000	0.00%	0.000
Customer and Client Receipts	11.200	0.75%	0.084	11.570	0.75%	0.087	11.951	0.75%	0.090	12.346	0.75%	0.093
Demand Led Budgets	0.000	1.00%	0.000	0.000	1.00%	0.000	0.000	1.00%	0.000	0.000	1.00%	0.000
Winter Pressures	0.000	25.00%	0.000	0.000	25.00%	0.000	0.000	25.00%	0.000	0.000	25.00%	0.000
Budget Savings												
Budget Reductions	0.192	7.50%	0.014	0.768	7.50%	0.058	0.917	10.00%	0.092	0.927	10.00%	0.093
Insurance/Public Liability Third Party Claims												
Uninsured Liabilities	0.000	0.00%	0.000	0.000	0.00%	0.000	0.000	0.00%	0.000	0.000	0.00%	0.000
Belwin rules	0.000	0.10%	0.000	0.000	0.10%	0.000	0.000	0.10%	0.000	0.000	0.10%	0.000
Energy Security and Resilience												
Carbon Tax Legislation	0.000	10.00%	0.000	0.000	10.00%	0.000	0.000	10.00%	0.000	0.000	10.00%	0.000
TOTAL			0.290			0.709			1.529			2.462

APPENDIX C

Objective

The objective of holding provisions and reserves is to ensure the Council can meet unforeseen expenditure and to smooth expenditure across financial years

The level of provisions and reserves are continually reviewed to ensure that the amounts held are within reasonable limits. Those limits should be consistent with the Council's risk profile and should ensure that Council Taxpayers' contributions are not unnecessarily held in provisions or reserves.

Provisions

Provisions are made for liabilities or losses that are likely to be incurred, or certain to be incurred, but uncertain as to the amounts or the dates which they will arise. The Council complies with the definition of provisions contained within CIPFA's Accounting Code of Practice.

The provision amounts are reported to Service Committees and Cabinet on a regular basis and are continually reviewed to ensure that they are still needed and that they are at the appropriate amount. If necessary, the amount is increased or decreased as circumstances change to ensure that the provisions are not over or understated.

Reserves

The Council's reserves consist of the following main categories:

- Reserves for special purposes or to fund expenditure that has been delayed
- General Balances (Reserves that are not earmarked for a specific purpose)

Further details of these categories is set out below. The Council complies with the definition of reserves contained within CIPFA's Accounting Code of Practice.

Similar to provisions, reserves are reported to Cabinet on a regular basis and are continually reviewed in the context of service specific issues and the Council's financing strategy. Reserves are held for revenue and capital purposes. Some reserves, such as General Balances, could be used for either capital or revenue purposes, whilst others may be specific e.g. Usable Capital Receipts can only be used for capital purposes.

Reserves for special purposes or to fund expenditure that has been delayed. Reserves can be held for a specific purpose. An example of a reserve is repairs and renewals. Money is set aside to replace equipment on a rolling cycle. This effectively spreads the impact of funding the replacement equipment when the existing equipment is no longer fit for purpose.

General Balances

The General Balances reserve is held to enable the Council to manage unplanned or unforeseen events. The Executive Head of Finance is required to form a judgment on the level of this reserve and to advise the Cabinet and Council accordingly.

In forming a view on the level of General Balances, the Executive Head of Finance takes into account the following:

- Provision for Unforeseen Expenditure
- Uninsured risks
- Comparisons with other similar organisations
- Level of financial control within the Council

Provision for Unforeseen Expenditure

Unforeseen expenditure can be divided into two categories:

- Disasters
- Departmental Overspends

In a disaster situation, the Council can have recourse to the Government using the Bellwin rules under which the Council would have to fund the first £MMm of costs (2018-19 threshold). Central government would provide grant funding of 100% for expenditure incurred above this amount. Examples of natural disasters are severe flooding and hurricane damage.

The Council also needs to be able to fund a Departmental overspend, should one occur.

Uninsured risks

A combination of external insurance cover and the Council's insurance provision provides adequate cover for most of the Council's needs. Considerable emphasis has been placed upon risk management arrangements within the Council in order to minimise financial risks.

However, there are some potential liabilities, such as closed landfill sites, some terrorism cover, and some asbestos cover, where it is not economical or practical to purchase external insurance cover. The Council needs to have some provision in the event of a liability arising.

Comparisons with similar organisations

As part of assessing the minimum level of General Balances to be held, comparisons will be made with other Councils.

Level of financial control within the Council

Factors that are taken into account in assessing the level of financial control are:

- The state of financial control of the Revenue Budget and the Capital Programme;
- The adequacy of financial reporting arrangements within the Council;
- Adequate financial staffing support within the Council, including internal audit coverage;
- Working relationships with Members and Chief Officers;
- The state of financial control of partnerships with other bodies; and
- Any financial risks associated with Companies where the Council is a shareholder.

In evaluating the level of General Balances, as part of producing the 2016-17 Budget, the Executive Head of Finance has used a framework based on considering all risk areas and then quantifying the risk using the related budget and applying a percentage factor, which will vary according to the assessed level of risk. The total value against each risk provides an estimate of the level of balances required to cover the identified risk and overall provides an assessment of the level of general balances for the Council.

The ten areas of risk considered in the general contingency are set out in a report to the Cabinet budget meeting, including an explanation of the potential risks faced by the Council. The report also details the calculation of the General Balances. The balances reflect spending experience and risks to which the Council is exposed.

Minimum Level of General Balances

Taking all of the above factors into account the Executive Head of Finance currently advises that the Council holds the following minimum level of General Balances for 2019-20 and indicative minimum levels for planning purposes for 2020-21 to 2021-22.

	2018-19 £m	2019-20 £m	2020-21 £m	2021-22 £m
Assessment of the level of General Balances	2.0	2.0	2.0	2.0

Chief Officers are expected to comply with financial regulations and deliver their services within the budget approved by the Council and therefore departments are not expected to draw upon the £2.0m above.

If the level of General Balances is reduced to below the minimum balance, currently £2.0m, the shortfall will be replenished as soon as possible or as part of the following year's budget.

APPENDIX E

Provisions

PROVISIONS	
Purpose	Future use
Doubtful Debts	
A provision to cover bad debts: Housing Benefits General Bad debts Homelessness Bad debts	This provision will decrease as bad debts are written off. They are of two types, specific and general.
Insurance	
Provision for insurance claims.	No provision
Redundancy	
A provision to meet redundancy and pension strain costs.	No provision