

Finance and Resources Committee

10am, Friday, 1 February 2019

Council Change Strategy: Risks and Reserves 2019-2023

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Report number	
Executive/routine	
Wards	n/a
Council Commitments	n/a

Executive Summary

The report advises members of the risks inherent in the revenue and capital budget framework and the range of measures and provisions established to mitigate these.

The report outlines the level of reserves held and the purpose for which they are maintained, including consideration of the adequacy of balances held to mitigate against known risks.

Council Change Strategy: Risks and Reserves 2019-2023

1. Recommendations

- 1.1 Members of the Finance and Resources Committee are asked to:
 - 1.1.1 note the content of this report; and
 - 1.1.2 remit the report to The City of Edinburgh Council for approval on 21 February 2019 as part of the budget-setting process.

2. Background

- 2.1 This report advises members of significant risks identified in the budget process, quantifying them wherever possible, and sets out the range of measures and provisions in place to mitigate these.
- 2.2 Unallocated reserves are held against the risks of unanticipated expenditure and/or reduced income arising in any particular year. In addition, there are specific earmarked reserves set aside to manage timing differences between the receipt of income and the incurring of related expenditure, in accordance with accounting rules.
- 2.3 The reserves held by the Council are reviewed annually as part of the revenue budget-setting process. This review considers the level of balances, the risks inherent in the budget process and the adequacy of arrangements in place to manage these known risks.
- 2.4 The external auditor's 2017/18 annual report noted that overall reserve levels, taking into account both sums earmarked for specific purposes and the unallocated General Fund balance, were assessed to be adequate based upon the risks the Council faces.

3. Main report

Risks

- 3.1 There are always risks inherent in the budget process. What is important, however, is that they are identified and, wherever possible, mitigated/managed effectively. Appendix 1 shows a risk matrix, setting out how it is planned that the known risks identified in this report will be managed. The list is, however, not exhaustive, due

both to the complexity of the changing environment within which the Council operates and the diversity of its activity.

Funding Settlements

- 3.2 Financial settlements and wider fiscal policy changes and, more specifically, their impact on the level of savings required to set a balanced budget, pose a significant risk to the financial stability of the Council. The overall quantum of funding contained within the 2019/20 Local Government Financial Settlement was announced on 12 December 2018, with provisional authority-specific grant allocations then intimated on 17 December. While the process of the Draft Budget Bill's Scottish Parliamentary consideration may result in changes in the level of external grant funding received, the provisional settlement provided a lower level of income than had been assumed within the budget framework, reflecting the underlying year-on-year Scotland-wide decrease in core revenue funding of about 2.3%. A more detailed update on the implications for the budget framework of this provisional level of grant funding is included elsewhere on today's agenda.
- 3.3 The level of funding for future years could vary for a number of reasons, including the use of updated population data and the complexities of the funding distribution formula, as well as Scottish and UK Government fiscal policy, relative national priorities and wider economic performance. The succession of one-year budget settlements has, in addition, made longer-term financial planning more difficult and underlying savings requirements more susceptible to change. Current expectations, however, are for continuing real-terms reductions in funding, at least into the medium-term, reinforcing the need for significant and sustainable savings rooted in process redesign, prevention and, ultimately, service prioritisation.
- 3.4 In this context, the Council has modelled a range of potential grant funding outcomes and is developing a four-year change strategy, with a view to allowing acceleration of later years' proposals should confirmed savings requirements in any given year exceed baseline projections. In addition, officers continue to engage actively in discussions through representative professional bodies, particularly the Scottish Directors of Finance Section, to ensure grant funding projections and other key expenditure and income factors contained within the framework are based on the best-available information, adjusted where appropriate to reflect the Council's particular circumstances.

Delivery of approved savings and management of underlying service pressures

- 3.5 The budget process makes assumptions on the level of savings that can be delivered in respect of individual proposals and those linked to wider projects and initiatives. There are risks around the ability to deliver both (i) the savings already approved for delivery by Council (although, for 2019/20, these are relatively few in number), and (ii) the additional proposals that will be brought forward in the revenue budget framework for decision on 21 February 2019 within the timescales stated and on a sustainable basis.

- 3.6 In 2016/17, following the introduction of enhanced senior officer and elected member scrutiny at the inception, development and implementation stages, some 88% of savings by value were subsequently delivered during the year. In 2017/18, however, this level of delivery reduced to 80%, with a further decrease to around 70% anticipated in the current year. In view of these reductions and the increasingly-challenging nature of savings delivery, particularly those approved measures concerned with more effective demand management, at the meeting of Council on 25 October 2018, members approved the use of up to £1m of previously-uncommitted monies to facilitate the engagement of dedicated internal project management resource to develop individual proposals comprising the broader Change Strategy.
- 3.7 Active management of service pressures forms an integral part of effective financial management. Services have, in the current year, identified a number of significant, primarily demand-led pressures in such areas as temporary accommodation, home-to-school transport, children's services and purchased adult social care. Other than where specifically provided for, the budget framework assumes that all such pressures are managed within approved resource allocations and on a sustainable basis. In this context, a number of recent service-wide budget re-alignments, consistent with this underlying aim, have been undertaken such that the integrity of the wider framework is not at risk of being compromised.

Demographic changes

- 3.8 Demographic changes continue to increase the overall level of demand for the Council's services and the ability to provide for this within available resources. Following a review of the appropriateness of current levels of provision in light of updated population and pupil roll projections, the budget framework now contains total additional demographic-related investment (including equivalent provision for health and social care) in 2019/20 of £9.3m, with similar incremental increases assumed in subsequent years. In order for this level of additional funding to be sustainable across the framework as a whole, however, more effective demand management, greater use of preventative approaches to service delivery and service prioritisation will be required.

Welfare reform and other legislative changes

- 3.9 The Council's revenue budget framework incorporates provision for anticipated additional expenditure demands, and where relevant, reduced income, of known welfare reform changes on its activities. Due to the evolving nature of some of these reforms, however, there is a risk that additional pressures become apparent, particularly following the full roll-out of Universal Credit in the city from November 2018. Alongside consideration of any required changes to budget framework assumptions as the impact of these changes becomes clearer, efforts will continue to provide debt-related advice and maximise take-up of all eligible income-based benefits.

- 3.10 The budget framework reflects provision for confirmed increases in employer's non-teaching staff superannuation contributions, linked to the most recent actuarial valuation, in both 2019/20 and 2020/21. Sums have also been set aside to meet the assumed unfunded element of the first year of equivalent contribution rate increases for the teachers' scheme resulting from the recent UK Treasury actuarial review. There is a risk, however, that further changes are made to devolved or non-devolved aspects of the UK taxation system, resulting in direct or indirect impacts on the Council's budget.

Income

- 3.11 Assumptions are made in the budget process on the level of income that will be generated by services. There are risks associated with these assumptions, primarily around (i) demand for chargeable services, (ii) timing of implementation of any new or amended charges and (iii) the ability to collect all income due. The Council has a range of measures in place to mitigate these risks, such as service level agreements with external users, application of appropriate debt policies (including, where appropriate, upfront payment for services delivered) and regular monitoring of income levels as a prompt to remedial action.

Other risks

Local Development Plan (LDP) and other major infrastructure-related projects

- 3.12 The detailed long-term revenue and capital implications of the Local Development Plan and other major infrastructure-related projects and facilities are still emerging, with updates on the LDP and Wave Four Schools Programmes to be presented to elected members later this year. While the revenue and capital budget frameworks incorporate some provision in these areas, there is a significant risk that the Council will require to support additional borrowing and/or running costs. The Council will therefore continue to review the adequacy of the level of provision made within the budget framework as funding requirements and their associated timing become clearer. Approval of additional capital expenditure, including Wave Four schools investment, is however dependent upon greater certainty concerning Scottish Government funding intentions and, more fundamentally, delivery of a balanced medium-term budget framework.

Pay awards

- 3.13 Following some relaxation of public pay policy at both UK and Scottish Government levels, there is a risk that the agreed pay award for 2019/20 and subsequent years exceeds the corresponding level of provision included within the budget framework. While the proposed level of settlement for 2018/19 gives rise to a pressure in the current year and a revised incremental savings requirement for 2019/20, the three-year deal for non-teaching staff that is currently the subject of trade union member consideration would, however, provide a degree of certainty for non-teaching staff for both 2019/20 and 2020/21. The proposed level of settlement in both of these years, at 3% for all staff, is additionally consistent with budget framework assumptions. It is assumed that any additional teachers' pay award beyond these

levels, as a departure from wider public sector pay policy, will be met by the Scottish Government. In view of COSLA's commitment to the principle of pay parity across all bargaining groups, however, there is nonetheless a risk that any additional teachers' pay award leads to a corresponding increase for other groups beyond the level of provision included within the budget framework.

- 3.14 As with all known expenditure and income factors, while these assumptions will be regularly reviewed, this risk reinforces the need for on-going tightening of workforce controls and prioritisation of the Council's activities to ensure that employee costs are maintained within affordable and sustainable levels.

Other external events

- 3.15 External events, particularly the United Kingdom's anticipated exit from the European Union in late March 2019, may result in economic uncertainty with a knock-on impact on availability of staff in key service areas, demand for the Council's services and wider levels of public expenditure. The Council has, however, sought to be proactive with regard both to providing support and advice to colleagues affected and, working with partners, maintaining Edinburgh's position as a successful economy and welcoming international city, with its level of preparedness favourably assessed in the 2017/18 Annual Audit Report.

Legal claims and inquiries

- 3.16 There is a further risk that the Council is exposed to reputational and financial consequences of legal claims and inquiries in relation to insured and uninsured losses or incidents. In the case of the Scottish Child Abuse Inquiry, the Scottish Government has confirmed the setting up of a financial compensation scheme but with, at this stage, the accompanying detail still to be determined.

Reserves

- 3.17 Members are aware that the Council holds a number of earmarked reserves within the General Fund. As of 31 March 2018, the General Fund balance stood at £151.285m, of which £138.260m was earmarked for specific purposes. The unallocated General Fund balance remained at £13.025m, in line with the medium-term strategy of the Council.
- 3.18 There are significant applications of earmarked reserves (in the region of £32m) planned during 2018/19, consistent with the assessment of the risks and commitments underpinning the Council's wider financial strategy, with a projected balance at 31 March 2019 of £106.5m. Over the longer-term, the Council plans to support a number of targeted service initiatives through use of reserves, particularly use of the Council Tax Discount Fund to support expanded provision of affordable housing within the city.
- 3.19 The current Council Change Strategy does not provide for any increase in the unallocated General Fund, which will remain at £13.025m. As part of the 2017/18 annual audit, the external auditor assessed the overall level of reserves, taking into

account sums earmarked for specific purposes, as adequate based upon the risks the Council faces.

4. Measures of success

- 4.1 The Council identifies and quantifies, where possible, risks that are inherent in the revenue budget in advance of these materialising and puts appropriate mitigating actions in place.
- 4.2 The Council maintains an adequate level of unallocated General Fund reserves.

5. Financial impact

- 5.1 The report identifies where funding has been made available for the risks set out. The Council holds unallocated General Fund reserves against the likelihood of unfunded risks occurring.

6. Risk, policy, compliance and governance impact

- 6.1 The aim of the report is to identify the key risks to the Council and outline actions to manage those risks through planning, mitigating actions and use of reserves as outlined in the attached appendices.

7. Equalities impact

- 7.1 There is no direct impact of the report's content on equalities and rights.

8. Sustainability impact

- 8.1 There is no direct additional impact of the report's contents.

9. Consultation and engagement

- 9.1 There is no external consultation and engagement arising directly from this report, although the Council's budget continues to be subject to a process of regular consultation and engagement, as reported elsewhere on today's agenda.

10. Background reading/external references

- 10.1 [City of Edinburgh Council 2017/18 Annual Audit Report to the Council and the Controller of Audit](#) – Governance, Risk and Best Value Committee, 25 September 2018.

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11. Appendices

Appendix 1 – Risk Matrix

Appendix 2 – Projected Movement in General Fund

Risk Matrix

The table below summarises how the risks identified in the report are managed.

Risk	Provisions and other actions to manage
Financial settlements	<p>Provisions made in the Long-Term Financial Plan (LTFP)</p> <p>Regular monitoring of public expenditure projections and active membership of relevant professional forums, recognising potential or actual grant variations in LTFP</p> <p>Development of longer-term Change Strategy to recognise the potential for variation from baseline assumptions in any given year and, by extension, the need for additional savings measures</p>
Delivery of approved savings and management of underlying pressures	<p>Regular CLT and elected member scrutiny of proposed savings at the inception, development and delivery stages</p> <p>Approval of up to £1m of additional project management support to facilitate development of proposals comprising the Change Strategy</p> <p>Regular SMT consideration of overall service budgetary position, including known or emerging risks and pressures, with a view to taking prompt corrective action</p> <p>Budget re-alignment, where required, to facilitate enhanced ownership, accountability and transparency of reporting</p>
Demographic changes leading to rising service demands	Provisions made in LTFP and regular reviews of the adequacy thereof
Welfare reform and other legislative changes	<p>Provisions made in LTFP and regular reviews of the adequacy thereof</p> <p>Ongoing monitoring of impacts of welfare reform on expenditure and income</p>
Income	Service Level Agreements with external users, application of appropriate debt policies (including, where appropriate, upfront payment for services delivered) and regular monitoring of income levels as a prompt to remedial action
Legal claims and inquiries	The Council provides for a number of known risks and liabilities. Funding could, however, be drawn down from the unallocated General Fund balance to meet unanticipated or additional costs.

Projected Movement in General Fund

Appendix 2

General Fund	Projected Balance at 1.04.19 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.20 £000	
<u>Balances Set Aside to Manage Financial Risks and for Specific Investment</u>				
Balances set aside for specific investment	27,067	(6,972)	20,095	Funding set aside for specific projects, including monies for Enterprise Resource Planning, Welfare Reform and Asset Management Strategy.
Contingency and workforce restructuring	18,143	0	18,143	Monies held to cover costs of workforce management changes including staff severance costs, which may be utilised to support future change programmes.
Council Priorities Fund	3,749	0	3,749	Monies set aside from previous years' underspends which will be utilised to fund emerging Council priorities or expenditure pressures.
Dilapidations Fund	6,054	0	6,054	Monies set aside to meet costs arising from the termination of property leases and other related contractual commitments.
Insurance Fund	14,974	103	15,077	Insurance Funds are held to defray any loss where the Council could have insured against a loss but has not done so, and for paying premiums on an insurance policy. This includes the power to meet excesses on insurance policies and other claims arising from ongoing legal inquiries.

General Fund	Projected Balance at 1.04.19 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.20 £000	
<u>Balances Set aside from Income Received in Advance</u>				
Licensing and Registration Income	2,690	(500)	2,190	Monies representing licensing income related to cabs, houses in multiple occupation, liquor and landlord registration. The Council is not permitted to use these monies for other services.
Lothian Buses	1,000	2,000	3,000	Holds dividend income received from Lothian Buses which is being drawn down to support the Tram Extension project.
Other Minor Funds	208	(10)	198	Minor funds for other specific projects
Pre-paid PPP monies and lifecycle costs	2,951	306	3,257	Monies set aside in recognition of the phasing issues related to grant monies, for lifecycle costs of projects.
Council Tax Discount Fund	17,284	(15,800)	1,484	Monies set aside as a result of reducing Council Tax second home discounts. Use of the fund is prescribed by the Scottish Government and is restricted to supporting the development of affordable housing. It forms part of the Strategic Housing Investment Fund (SHIF), alongside income from the Repair and Renewals fund. The SHIF is fully committed to the delivery of new affordable homes by the Council and housing association partners over the next ten years and investment in services to reduce tenants' living costs.
Unspent revenue grants	2,500	(2,500)	0	Monies set aside at the year end, in accordance with proper accounting practice, where income has been received prior to the relevant expenditure being incurred. Funds will be drawn down in accordance with the grant conditions to match planned expenditure. The majority of funds will be drawn down in year and then new unspent grant funding will be carried forward.

General Fund	Projected Balance at 1.04.19 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.20 £000	
City Strategic Investment Fund	3,552	(1,205)	2,347	Funds set aside to sit alongside private sector finance to create new city development opportunities. Confirmed or approved uses include drawdown for Powderhall Stables and monies to support, if required, EDI transition.
<u>Balances Set Aside for Investment in Specific Projects which will Generate Future Savings</u>				
Spend to Save Fund and Salix CEEF	1,377	544	1,921	Funds set aside to assist service areas deliver revenue savings in future years through provision of one-off upfront revenue investment.
<u>Balances Set Aside under Devolved School Management Scheme and Pupil Equity Fund</u>				
Balances held by schools under DSM / Pupil Equity Fund	5,000	(1,000)	4,000	Balances set aside for Devolved School Management Scheme and Pupil Equity Fund. There will always be a balance at 31 March as the DSM scheme and PEF are based on an academic year.
<u>Unallocated General Fund</u>	13,025	0	13,025	Unallocated funds held against the risk of unanticipated expenditure and / or reduced income arising in any particular year, in line with Council reserves policy.
Total General Fund	119,574	(25,034)	94,540	