

Finance and Resources Committee

2.00pm, Tuesday, 2 February 2021

Council Business Plan and Budget 2021/26 - Risks and Reserves

Executive/routine Wards Council Commitments	Executive All
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1. Recommendations

- 1.1 Members of the Finance and Resources Committee are recommended to:
 - 1.1.1 note the content of this report and the proposed realignment and reprioritisation of the Council's usable reserves in light of the potential additional impacts of the COVID-19 pandemic and wider risk factors; and
 - 1.1.2 remit the report to The City of Edinburgh Council for approval on 18 February 2021 as part of the budget-setting process.

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Council Business Plan and Budget 2021/26 – Risks and Reserves

2. Executive Summary

- 2.1 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.
- 2.2 The report outlines the level of reserves held and the purposes for which they are maintained, including consideration of the adequacy of the balances held to mitigate against known risks. In this regard, it also sets out a proposed realignment and reprioritisation of the Council's usable reserves in light of the potential additional impacts of the COVID-19 pandemic and wider risk factors.

3. Background

- 3.1 This report advises members of significant risks identified within the budget process and sets out the range of measures and provisions in place to mitigate these.
- 3.2 Unallocated reserves are held against the risk 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 incurring related expenditure, in accordance with accounting rules.
- 3.3 The reserves held by the Council are reviewed annually as part of the revenue budget-setting process. The 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.

4. Main report

Risks

- 4.1 Risks form an integral part of the business and budget planning process. What is important, however, is that these risks are identified, actively managed and, where appropriate, mitigated. Appendix 1 shows a matrix, setting out how it is planned that the known risks identified in this report will be managed. This list is, however, not exhaustive due to the complexity and diversity of the changing environment within which the Council operates.

COVID-19 specific impacts on service expenditure/income loss and savings delivery

- 4.2 The on-going impact of the COVID-19 pandemic poses significant risks, both in terms of the immediate ability to set a balanced budget for 2021/22 and undertaking longer-term financial planning. The increases in service expenditure and losses of income for both the Council and its Arm's-Length External Organisations (ALEOs) may be higher than assumed in the budget framework. The effects of the pandemic have also affected management's ability to deliver the level of pre-approved savings and manage on-going pressures to the extent assumed.
- 4.3 Financial "flexibilities" announced by the Scottish Government will allow the Council to mitigate some of these uncertainties by enabling relevant additional expenditure, and losses of income, to be spread across a longer timeframe. Further details of these flexibilities are included in the Council Business Plan and Budget 2021/26 report elsewhere on today's agenda.
- 4.4 The Council's Best Value Assurance Report (BVAR) also noted a number of observations concerning the setting and subsequent implementation of the Council's revenue budget. These included continuing shortfalls in savings delivery (and consequent reliance on savings in non-service budgets), an underlying lack of robustness in the implementation plans for some proposals and the potential for the Council's use of reserves to become unsustainable without decisive action.
- 4.5 In seeking to address these concerns whilst acknowledging the continuing short- and longer-term uncertainty resulting from the pandemic, a number of further enhancements have been introduced into this year's process as summarised in Appendix 1, with additional detail included within the Council Business Plan and Budget 2021/26 report elsewhere on this meeting's agenda. A proposed realignment and reprioritisation of the Council's reserves, consistent with the risks within the budget framework, is also set out later in this report.

Future funding settlements

- 4.6 Uncertainty around future funding settlements poses a significant risk to the Council's ability to set a balanced budget, given its impact on the overall level of savings required. The 2021/22 Local Government Financial Settlement (LGFS) is

due to be confirmed on 28 January 2021, with the announcement covering only one year as opposed to the multi-year settlement originally envisaged. It is also possible that, as in previous years, changes to the Draft Scottish Budget (and by extension the LGFS) will be introduced as part of the Bill's Parliamentary consideration.

- 4.7 As of the time of writing, however, a detailed timetable of scrutiny and debate had not been finalised, meaning that changes could be intimated after the Council's budget-setting meeting on 18 February. As this Parliamentary consideration is unlikely to reduce the overall level of funding provided or extent of associated flexibilities, however, the provisional LGFS announcement should provide a baseline from which to develop the Council's detailed plans.
- 4.8 Future years' funding allocations could also vary for a number of other reasons, including the use of updated population and other needs-based data and the complexities of funding distribution formulae, as well as wider Scottish and UK Government fiscal policy. The Council's actual funding allocations are additionally affected by the influence of the stability and 85% per capita funding floors, from each of which it currently benefits.

Delivery of approved savings and management of underlying service pressures

- 4.9 Shortfalls in the delivery of approved savings and management of underlying service pressures are an on-going risk to the budget. In 2019/20, only 77% of approved savings by value were delivered, although this headline figure comprised 83% for service-specific savings and 56% for Council-wide savings, including efficiencies. In light of this recurring trend, subsequent years' efficiency and Council-wide savings targets have been significantly reduced. The preparedness assessment of accompanying implementation plans undertaken by Finance staff has in addition informed the level of contingency included within the framework for delayed implementation or non-delivery, reducing the potential influence of optimism bias.
- 4.10 Corresponding measures are also required to offset significant pressures within a number of demand-led areas of service, with many of the mitigations applied in 2020/21 being of a non-recurring nature. The Council Business Plan and Budget 2021/26 report elsewhere on the agenda proposes the inclusion of some £12m of additional investment within the budget framework in 2021/22 (in addition to £10m specifically for homelessness services given likely recurring increases in demand) in recognition of these pressures. As with savings delivery above, work will continue to identify further mitigations to serve as a contingency against adverse movements in other budget assumptions during the year.

Demographic changes leading to rising service demands

- 4.11 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.

Levels of provision were reviewed in late 2019 in light of updated population and pupil roll projections, resulting in the inclusion of total demographic-related investment of £4.2m in the 2020/21 budget framework plus full pass-through of additional health and social care funding provided within the LGFS, with similar incremental increases assumed in subsequent years. More effective demand management, greater use of preventative approaches to service delivery and service prioritisation will, however, likely be required in order for this level of funding to prove sustainable over the medium to longer term.

Income

- 4.12 Assumptions are made in the budget process on the level of income that can be generated by services. There are risks associated with these assumptions, primarily around (i) demand for and/or price sensitivity of chargeable services, (ii) timing of implementation of 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 application of appropriate debt policies, service level agreements with external users and regular monitoring of income levels as a prompt to remedial action.
- 4.13 These areas have all been reviewed in light of the pandemic, with detailed monthly monitoring being undertaken and adjustments reflected in future years' budgets for the anticipated on-going loss of the Lothian Buses dividend and parking and commercial rental income. These assumptions will continue to be regularly reviewed.

Legislative changes

- 4.14 Legislative changes present on-going risks to the budget framework, and while provision has been made for the projected impact of known factors, there is a risk that further changes are made, resulting in direct or indirect impacts on the Council's budget. It is additionally assumed that all of the savings measures included in the budget framework are fully within the Council's gift. This remains to be confirmed in the case of both the proposed level of Council Tax increases and application of a savings target to the Integration Joint Board, each of which is based on the equivalent treatment in the 2020/21 LGFS.
- 4.15 The ending of the transition period following the United Kingdom's withdrawal from the European Union may result in short-term economic uncertainty with a knock-on impact on the availability of staff in key service areas, increased demand for the Council's services and higher prices for some goods and services (particularly food), as well as wider levels of public expenditure. The Council has, however, on-going risk assessment arrangements in place (including an EU exit-specific risk register) and staff within Commercial and Procurement Services have engaged extensively with current suppliers.

Legal claims and inquiries

- 4.16 There is a risk that the Council is exposed to reputational and financial consequences of legal claims and inquiries in relation to uninsured and insured incidents. The on-going Scottish Child Abuse Inquiry has potentially significant financial implications with effect from 2022/23 but, at this stage, the precise impact on the Council (and any associated financial liability) remains to be confirmed. There is a risk, nonetheless, that substantial additional funding to meet liabilities will require to be identified either directly or top-sliced from the level of funding provided within the LGFS.

Major infrastructure projects

- 4.17 The long-term financial implications of some major infrastructure projects, particularly the Local Development Plan, are still emerging and subject to change in light of the longer-term implications of the pandemic. While the revenue and capital budget frameworks incorporate some provision in these areas based on current projections, there is a risk that the Council will require to support additional borrowing and/or revenue running costs associated with these projects. On-going review of the projects and potential timing and value of funding requirements will therefore continue to be undertaken through relevant project boards and risks escalated as appropriate.

Reserves

- 4.18 Members are aware that the Council holds a number of earmarked reserves within the General Fund. As of 31 March 2020, the General Fund balance stood at £120.111m, of which £106.184m was earmarked for specific purposes. The unallocated General Fund stood at £13.927m, in line with the medium-term strategy of the Council.
- 4.19 As shown in Appendix 2, there are significant projected net movements in earmarked reserves during 2020/21 (some £9.181m). These represent a combination of planned transfers and the unbudgeted £7m contribution from reserves (after taking account of the £5m year-end contribution in 2019/20) required to deliver a balanced overall in-year position, with a projected balance of £110.930m at 31 March 2021. Appendix 2 also shows the planned use of these balances in financial year 2021/22, insofar as they are known at this stage.
- 4.20 In light of the risks outlined in the preceding sections of this report, it is proposed to realign and reprioritise the Council's reserves with effect from 31 March 2021 as follows:
- (i) an **increased unallocated General Fund balance** of £25m, equating to around 2.3% of the Council's net expenditure and being more in line with other authorities in Scotland;

- (ii) a series of **ringfenced reserves maintained for statutory¹ or specific policy² reasons** or to reflect timing differences between the receipt of income and its subsequent application, together totalling £55m;
- (iii) a **workforce transformation reserve** of £15m, less commitments incurred as part of the recent targeted staff release programme for senior managers, to facilitate organisational restructuring and deliver associated recurring efficiency savings; and
- (iv) a **COVID contingency reserve** of £16m, acknowledging the continuing uncertainty of the recurring impacts of the pandemic on, in particular, income levels in key areas such as parking, commercial rentals and other fees and charges.

4.21 The £28m used to increase the level of the Council's unallocated General Fund balance and to create a COVID-specific contingency has been identified through a rigorous re-assessment of the overall available level of reserves and need to maintain non-statutory balances previously, or newly proposed to be, set aside for specific investment.

4.22 The overall level of available reserves has been influenced, in particular, by two factors: an assumed reduction in the in-year call on reserves given the balanced overall position now being projected (totalling £14.8m, comprising the £8.0m reduction reflected in the period eight monitoring report considered by the Committee on 21 January and, additionally, the need not to draw upon further reserves to address the previously-projected £6.8m overspend) and timing-related in-year transfers to reserves that have now been redirected (totalling £7.0m). The process has also reflected the transfer of non-essential service reserves to address Council-wide pressures, the principle of which was indicated in the month five position report considered by the Committee on 29 October 2020.

4.23 The increase of £12m in the level of the Council's unallocated General Fund balance has been enabled by reprioritising a number of discrete sums, including the uncommitted element of the current risk management contingency, funding for LDP-related expenditure (provision for which will not now be required until later years of the framework), reserves currently earmarked to support transformational initiatives and a number of uncommitted reserves previously held within specific service areas.

4.24 Creation of a COVID contingency reserve, alongside both what are considered to be prudent planning assumptions in respect of grant funding levels and the potential for further pressures mitigations and savings implementation plans to be developed following the setting of the 2021/22 budget, provides a degree of assurance against potential downside risks within the budget framework,

¹ Including the Insurance Fund, Council Tax Discount Fund (ringfenced for the provision of affordable housing), licensing reserves and sums set aside under the Devolved School Management (DSM) scheme.

² Including the Spend to Save and City Strategic Investment Funds.

particularly the ability to apply the assumptions around Council Tax increases and IJB savings targets.

5. Next Steps

- 5.1 Following Committee's consideration, the report will be referred to The City of Edinburgh Council for approval as part of the budget-setting process.

6. Financial impact

- 6.1 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. In light of wider risks inherent within the budget framework, it is proposed to increase the level of these unallocated reserves to £25m, as well as creating a COVID-specific contingency reserve.

7. Stakeholder/Community Impact

- 7.1 There are no direct impacts arising from this report.

8. Background reading/external references

- 8.1 [Revenue Budget 2020/21: month eight position](#), Finance and Resources Committee, 21 January 2021

9. Appendices

- 9.1 Appendix 1 – Risk Matrix
- 9.2 Appendix 2 – Projected Movement in General Fund

Appendix 1

Risk Matrix

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

Risk	Provisions and other actions to manage
<p>COVID-19 specific impacts on service expenditure/ income loss and savings delivery</p>	<p>Regular CLT and elected member scrutiny of the impacts of COVID-19 on budget framework assumptions</p> <p>Examination of all non-service budgets, reserves and available financial “flexibilities” to spread the cost impacts of the pandemic over a longer timeframe</p> <p>Creation of dedicated COVID-19 mitigation reserve, alongside wider re-alignment of existing reserves, including increasing level of unallocated General Fund balance</p> <p>On-going mitigating actions which also relate to wider risk management actions detailed below</p>
<p>Future funding settlements</p>	<p>Provisions included in the Long-Term Financial Plan (LTFP)</p> <p>Regular monitoring of public expenditure projections and active membership of relevant professional forums, promptly recognising potential or actual grant variations in LTFP</p> <p>Development, in due course, of a longer five-year planning timeframe to recognise the potential for variation from baseline assumptions in any given year and, by extension, an ability for additional savings measures to be accelerated</p>
<p>Delivery of approved savings and management of underlying pressures</p>	<p>Updated, detailed and consistently-applied guidance for Finance staff in assessing the rigour of accompanying savings implementation plans</p> <p>Earlier recognition, through discussion and agreement at Corporate Leadership Team, of the impact of underlying service pressures and savings shortfalls on the robustness of the budget framework</p> <p>Early consideration of likely required project management and other support</p> <p>Regular CLT and elected member scrutiny of proposed savings at the inception, development and delivery stages</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, resulting in increased provision in 2020/21 and subsequent years of the framework
Income	<p>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</p> <p>Detailed monthly monitoring of actual income losses during pandemic, additionally informing preparation of income compensation scheme submissions</p>
Legislative changes	<p>Provisions made in LTFP and regular reviews of the adequacy thereof</p> <p>On-going monitoring of impacts of welfare reform and other relevant legislation on expenditure and income</p> <p>Active membership of relevant professional forums</p>
Legal claims and inquiries	The Council explicitly 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.
Major infrastructure projects	<p>Regular progress monitoring through Change Boards, particularly at key milestones, with documented escalation procedures</p> <p>Senior Finance representation on all Project Boards</p>

Projected Movement in General Fund

Appendix 2

NB The precise make-up of the drawdown from reserves currently projected to be required in 2020/21 will be determined as part of the year-end closure process. As such, the projected balances for non-statutory reserves shown below should be seen as indicative at this stage.

	Opening Balance at 1.04.20 £000	Actual/planned use 2020/21 £000	Reprioritisation/ realignment £000	Projected Balance at 1.04.21 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.22 £000	
General Fund							
<u>Balances Set Aside to Manage Financial Risks and for Specific Investment</u>							
Balances set aside for specific investment	44,444	(1,766)	(28,148)	14,528	(3,830)	10,698	Funding set aside for specific projects, including monies for Enterprise Resource Planning and Tram Extension.
Contingency and Workforce restructuring	13,358	1,764	0	15,122	(7,500)	7,622	Monies held to cover costs of workforce management changes including staff severance costs, which may be utilised to support future change programmes.
Dilapidations Fund	3,227	(654)	0	2,573	0	2,573	Monies set aside to meet costs arising from the termination of property leases and other related contractual commitments to facilitate rationalisation of property.
Insurance Fund	20,097	(1,016)	0	19,082	0	19,082	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 on-going legal inquiries.

General Fund	Opening Balance at 1.04.20 £000	Actual/planned use 2020/21 £000	Reprioritisation/ realignment £000	Projected Balance at 1.04.21 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.22 £000	
<u>Balances Set aside from Income Received in Advance</u>							
Licensing and Registration Income	2,981	(437)	0	2,544	0	2,544	Monies representing licensing income related to cabs, houses in multiple occupation, liquor and landlord registration. The Council is not permitted to use these monies on other services.
Lothian Buses	308	0	0	308	0	308	Holds dividend income received from Lothian Buses which is being drawn down to support the Tram Extension project.
Other Minor Funds	204	0	0	204	(14)	190	Minor funds for other specific projects.
Pre-paid PPP monies and lifecycle costs	3,318	289	0	3,607	272	3,879	Monies set aside in recognition of the phasing issues related to grant monies, for lifecycle costs of projects.
Council Tax Discount Fund	4,304	(2,500)	0	1,804	0	1,804	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 Repairs and Renewals fund.
Unspent revenue grants	3,176	(3,002)	0	175	(122)	53	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.
City Strategic Investment Fund	2,795	0	0	2,795	(1,400)	1,395	Primarily represents funds set aside for strategic regeneration priorities (£2.150m) and to provide match funding for new city development opportunities (£0.5m).

	Opening Balance at 1.04.20 £000	Actual/ planned use 2020/21 £000	Reprioritisation/ realignment £000	Projected Balance at 1.04.21 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.22 £000	
<u>Balances Set Aside for Investment in Specific Projects which will Generate Future Savings</u>							
Spend to Save Fund, Energy Efficiency and Salix CEEF	3,301	(786)	0	2,515	(2,050)	465	Funds set aside to assist service areas deliver revenue savings in future years through provision of one-off upfront revenue investment. Scheme repayments will be used to support further new initiatives.
<u>Balances Set Aside under Devolved School Management Scheme and Pupil Equity Fund</u>							
Balances held by schools under DSM / Pupil Equity Fund	4,671	(171)	0	4,500	0	4,500	Balances set aside for Devolved School Management Scheme and Pupil Equity Fund. There will always be a balance at March as the DSM scheme and PEF are based on an academic year.
<u>Unallocated General Fund</u>	13,927	(902)	12,000	25,025	0	25,025	Unallocated funds held against the risk of unanticipated expenditure and/or reduced income arising in any particular year, in line with Council reserves policy.
<u>COVID-19 mitigation reserve</u>	0	0	16,148	16,148	0	16,148	Newly-established reserve in recognition of the potential for the net costs of the pandemic to exceed the level of provision contained within the budget framework.
Total General Fund	120,111	(9,181)	0	110,930	(14,644)	96,286	