

Finance and Resources Committee

10.00am, Thursday, 3 February 2022

Revenue Budget 2022/23 - Risks and Reserves

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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 updated profile of the Council's usable reserves in light of the continuing impacts of the pandemic and wider risk factors; and
 - 1.1.2 remit the report to The City of Edinburgh Council for approval on 24 February 2022 as part of the budget-setting process.

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Revenue Budget 2022/23 – 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. This profile reflects the realignment undertaken as part of approving the 2021/22 budget.

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 continuing impacts of the COVID-19 pandemic pose significant risks, both in terms of the immediate ability to set a balanced budget for 2022/23 and undertaking longer-term financial planning. In particular, the combined impact of current restrictions, levels of customer confidence and changes in working patterns on future patronage for the services provided by the Council's Arm's-Length External Organisations (ALEOs) is not yet fully known. The actual increases in service expenditure and losses of income for both the Council and its ALEOs may therefore be higher than assumed in the budget framework.
- 4.3 The budget framework approved in May 2021 included explicit provision for some £25.3m of continuing COVID-related impacts in 2022/23, with further sums also put aside in the following two years. The update report considered by the Finance and Resources Committee on 9 December 2021 increased these provisions by extending up to and including 2026/27 the period during which the core Lothian Buses dividend (which supports the Council's main revenue budget) is assumed not to be available. The revenue budget update report contained elsewhere on today's agenda furthermore proposes that additional provision be made to reflect the impacts of likely changes in patronage on the tram extension business case.
- 4.4 As similarly outlined in the complementary revenue budget update report included elsewhere on the agenda, total additional provision of £17.6m relative to 2019/20 levels has now been included within the framework in recognition of increased homelessness-related expenditure, in part reflecting significant growth in the number of those with no recourse to public funds (NRPF) presenting in the city since the beginning of the pandemic. Overall numbers accommodated in temporary accommodation increased from 3,570 as of 31 March 2020 to 4,525 as of 30 September 2021, necessitating increased overall use of more expensive bed and breakfast and shared accommodation.
- 4.5 While the budget framework does not assume their use, the Cabinet Secretary for Finance and the Economy confirmed as part of the 2022/23 Local Government Finance Settlement (LGFS) announcement that the availability of the capital receipts and loans fund principal deferral financial "flexibilities" would be extended for a further year. If utilised, application of the loans fund deferral flexibility would allow the Council to fund up to £30m of COVID-related expenditure over a longer timeframe. Based on current-year monitoring projections, it is also anticipated that an element of the approved £39m COVID-related provision in 2021/22 may not be required and it is proposed that this be used to supplement sums identified to mitigate future years' impacts until there is greater certainty in this area.

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. While covering only one year, in contrast to recent years when

announcements were made in January and February respectively, the Council's provisional revenue and capital funding allocations were confirmed on 20 December 2021.

- 4.7 In previous years, these allocations were also subject to change as part of the Draft Budget's Parliamentary passage. As any changes are unlikely to reduce the overall level of funding provided or extent of associated flexibilities, however, the provisional LGFS announcement should therefore 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, and the required level of pass-through to the Integration Joint Board.
- 4.9 While provisional council-specific allocations for 2022/23 have been confirmed, only high-level Scottish block grant allocations for the following two years have been provided. Given Scottish Government priorities and the profile of this future block grant funding, there is the potential for the Council's actual settlement to be worse than the "flat cash" currently assumed in these years. At this stage, it is anticipated that further detail on future years' grant funding allocations will be provided in June 2022 and current forecasts will therefore be reviewed when these details become available.

Delivery of approved savings and management of underlying service pressures

- 4.10 The effects of the COVID pandemic have, to an extent, also affected management's ability to deliver the level of pre-approved savings and manage on-going pressures to the extent assumed. In setting the 2021/22 budget, however, members approved some £12m of additional core service investment and this, alongside more robust scrutiny at the savings identification, development and implementation stages, has resulted in the continuation of the improving trend apparent in recent years, with some 91% of savings by value on track for delivery in 2021/22 and a slight overall underspend forecast.
- 4.11 While not detracting from the more fundamental need to identify significant recurring savings through prioritisation of the Council's activity going forward, of the £19.7m of pre-approved savings included in the baseline for 2022/23, the vast majority are in corporate budgets or represent the full-year impacts of actions already taken and are thus anticipated to be delivered in full.

Demographic changes leading to rising service demands

- 4.12 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 2021 in light of updated population and pupil roll projections, resulting in the inclusion in the 2022/23 budget framework of total demographic-related investment of £4.9m (with similar incremental increases assumed in subsequent years) plus full pass-through of additional health and social care funding provided within the LGFS. 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

- 4.13 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.
- 4.14 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 reduced levels of parking and commercial rental income. These assumptions will remain subject to regular review until the longer-term position becomes clearer.
- 4.15 Income from Council Tax finances around 27% of the Council's net expenditure. Changes in collection rates, the size and profile of the Council Tax base, required bad debt provisions and sums paid through the Council Tax Reduction Scheme therefore all affect the total level of available resourcing. Despite the impacts of the pandemic, collection rates have, however, largely been maintained (the in-year collection rate to the end of December 2021 was only 0.54% lower than the equivalent level in December 2019) and growth in the overall base has continued, with a favourable in-year variance in this area now projected. These projections will continue to be kept under regular review.

Legislative changes

- 4.16 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 implementation of all of the savings measures included in the budget framework is fully within the Council's gift.
- 4.17 The Cabinet Secretary for Finance and the Economy's announcement on 20 December 2021 confirmed that councils would have full flexibility to set Council Tax rates appropriate to their local area. The Council's budget framework assumes a

baseline increase of 3% in 2022/23, with similar increases in each of the following four years.

- 4.18 The budget framework also includes recurring annual provision of £5.9m for the estimated additional expenditure pressures resulting from increases in employer's National Insurance rates effective from April 2022.

Legal claims and inquiries

- 4.19 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. Local authority contributions to the redress scheme have, however, been agreed at national level, with the corresponding funding already deducted in arriving at the amount of distributable funding to local authorities.
- 4.20 Liabilities may also arise from wider reviews undertaken, including, for example, actions taken as part of the Barclay Review on Non-Domestic Rates or, at a more local level, the independent inquiry and review of the Council's whistleblowing arrangements and organisational culture. There is a risk that these sums are higher than assumed within the budget framework.

Major infrastructure projects

- 4.21 The long-term financial implications of some major infrastructure projects, particularly the City Plan and energy-efficient retrofitting of the Council's property estate, 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.
- 4.22 The Council has also secured £165m of required borrowing from the Public Works Loan Board to date in 2021/22, all at an interest rate below 2%. This, alongside temporarily using available cash balances to fund capital expenditure, has served to manage both borrowing-related risks and upward pressure on project costs due to pandemic-related delays, labour and materials shortages while providing on-going savings to the revenue budget.

Inflation and pay awards

- 4.23 As noted above, inflationary pressures have increased in recent months, driven in part by high energy prices and global supply chain disruptions linked to the pandemic. The Scottish Fiscal Commission expects Consumer Price Index (CPI) inflation to be around 4.4% in the second quarter of 2022, before then gradually returning to the Bank of England target of 2% by the second half of 2024.

4.24 Inflation levels affect the Council's activities in a number of ways; directly through increasing prices of purchased goods and services and the level of uplifts applied to relevant contracts and indirectly through consumer spending and expectations for wage awards. The budget framework currently provides for inflation and pay awards at 3% in each of the five years of the budget framework. While the maximum permitted level of increase on some contracts is capped, these assumptions will be kept under review, particularly those in respect of energy costs, and remedial action taken as appropriate.

Reserves

4.25 Members are aware that the Council holds a number of earmarked reserves within the General Fund. As of 31 March 2021, the General Fund balance stood at £221.033m, of which £196.008m was earmarked for specific purposes.

4.26 The level of these reserves reflected the receipt, late in 2020/21, of significant COVID-related funding to be applied against relevant expenditure commitments in subsequent years. The level of reserves was further influenced by the prudent prior identification, and earmarking, of savings prior to the confirmation of this external funding. As part of the year-end closedown process, the unallocated General Fund was also increased from £13.927m to £25.025m, in line with the Council's revised strategy. The earmarked reserves held at this time comprised four broad categories:

- (i) **balances set aside to manage financial risks and for specific investment which are likely to arise in the medium-term future**, including maintenance of an insurance fund, dilapidations and workforce transformation. The Council held £141.295m against these future risks, including £78.473m of general COVID- and other pressures-related funding and £11.237m to cover workforce management costs of change management programmes;
- (ii) **balances set aside from income received in advance**, including the Council Tax Discount Fund and City Strategic Investment Fund. The Council held £46.305m of such income, of which £22.382m related to service-specific COVID funding to be offset against relevant expenditure in future years;
- (iii) **balances set aside to support investment in specific projects**, such as Spend to Save, which will deliver savings in future years. The Council held £3.720m for such projects; and
- (iv) **balances held under the Devolved School Management Scheme and unallocated Pupil Equity Funding**. The Council held £4.688m of these funds.

4.27 As shown in Appendix 2, there are significant projected movements in the level of earmarked reserves during 2021/22 (an overall reduction of some £49.6m). In net terms, this movement is primarily attributable to the application of COVID-related

funding received late in 2020/21 (and therefore carried forward into 2021/22) against in-year liabilities. A further £52.6m is anticipated to be utilised in 2022/23.

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 also holds unallocated General Fund reserves against the likelihood of unfunded risks occurring. As part of the 2021/22 revenue budget process, the level of these unallocated reserves was increased from £14m to £25m in recognition of the wider risks to which the Council is exposed, resulting in a revised position more in line with other Scottish local authorities.

7. Stakeholder/Community Impact

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

8. Background reading/external references

- 8.1 [Revenue Budget Monitoring 2021/22 – month six position](#), Finance and Resources Committee, 9 December 2021
- 8.2 [Revenue Budget Framework 2021/26 Update](#), Finance and Resources Committee, 20 May 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>Creation of dedicated COVID-19 mitigation reserve, providing significant funding for relevant impacts from 2022/23 to 2024/25 inclusive, alongside wider re-alignment of existing reserves, including increasing level of unallocated General Fund balance</p> <p>Examination/consideration of all non-service budgets, reserves and available financial “flexibilities” to spread the cost impacts of the pandemic over a longer timeframe</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>Progress in development 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>

	Budget re-alignment, where required, to facilitate enhanced ownership, accountability and transparency of reporting
Demographic changes leading to rising service demands	Provisions made in LTFP and regular reviews of the adequacy thereof, resulting in increased provision in 2022/23 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, informing, where applicable, 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> <p>Opportunities considered to lock out borrowing rate risk</p>

Projected Movement in General Fund

Appendix 2

General Fund	Opening Balance at 1.04.21 £000	Actual/planned use 2021/22 £000	Projected Balance at 1.04.22 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.23 £000	
<u>Balances Set Aside to Manage Financial Risks and for Specific Investment</u>						
Balances set aside for specific investment	28,384	11,941	40,325	(11,224)	29,101	Funding set aside for specific projects, including monies for Enterprise Resource Planning and Tram Extension.
Contingency and Workforce restructuring	10,858	(850)	10,008	(2,000)	8,008	Monies held to cover costs of workforce management changes including staff severance costs, which may be utilised to support future change programmes. Additional sums may be required in respect of organisational reviews undertaken in the coming year.
Dilapidations Fund	4,000	0	4,000	(1,000)	3,000	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	19,580	(202)	19,378	(500)	18,878	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.
COVID-19 mitigation reserve	78,473	(36,255)	42,218	(33,540)	8,678	Newly-established reserve created primarily in recognition of the continuing cost and income impacts of the pandemic. The opening balance reflects significant COVID-related funding provided by the Scottish Government late in 2020/21 but for use in subsequent years.

General Fund	Opening Balance at 1.04.21 £000	Actual/planned use 2021/22 £000	Projected Balance at 1.04.22 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.23 £000	
<u>Balances Set aside from Income Received in Advance</u>						
Licensing and Registration Income	3,973	233	4,206	0	4,206	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.
Other Minor Funds	175	0	175	(14)	161	Minor funds for other specific projects.
Pre-paid PPP monies and lifecycle costs	3,668	272	3,940	254	4,194	Monies set aside in recognition of the phasing issues related to grant monies, for lifecycle costs of projects.
Council Tax Discount Fund	6,063	1,249	7,312	0	7,312	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	8,010	(5,299)	2,711	(181)	2,530	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	2,034	(1,143)	891	(891)	0	Primarily represents funds set aside for strategic regeneration priorities (£2.150m) and to provide match funding for new city development opportunities (£0.5m).
COVID-19 advances	22,382	(21,516)	866	(866)	0	Newly-established reserve reflecting service-specific COVID funding received in 2020/21 but to be spent in future years (primarily in 2021/22).

	Opening Balance at 1.04.21 £000	Actual/ planned use 2021/22 £000	Projected Balance at 1.04.22 £000	Planned (Uses) / Contributions £000	Projected Balance at 31.03.23 £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	3,720	(102)	3,618	(406)	3,212	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	4,688	(188)	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>	25,025	2,243	27,268	(2,243)	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. The movements in 2021/22 and 2022/23 reflect the decisions of Council on 27 May 2021, alongside the subsequent approved use of up to £0.5m to address any costs associated with accommodating Afghan refugees not met by Home Office funding, subject to reinstatement in 2022/23.
Total General Fund	221,033	(49,617)	171,416	(52,611)	118,805	