Leeds
CITY COUNCIL

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Report of the Director of Resources

Report to Corporate Governance & Audit Committee

Date: 15 June 2011

Subject: Council Budget 2011/12 Risk Assessment

Electoral Wards Affected:	**Specific Implications For:**
	Equality and Diversity ☐
	Community Cohesion ☐
☐ Ward Members consulted (referred to in report)	Narrowing the Gap ☐

Executive Summary

1. At the request of the Chair of this Committee, the Risk Management Unit (RMU) was asked to review the robustness of the 2011/12 budget risk assessments included in the Director of Resources' report, 'Revenue Budget and Council Tax 2011/12', that was presented to Executive Board on 11 February 2011.

2. Our report shows that throughout the Council there is an excellent understanding of the key budget risks. Monthly monitoring and reporting of them will aid in reducing the probability of these risks materialising if necessary actions are taken quickly and cohesively. Despite some issues around the consistency and scoring mechanism within the budget risk registers (which will be reviewed by the RMU and Corporate Financial Management in the coming weeks), the budget risk assessments included in the Director of Resources' report to Executive Board are comprehensive, based on a number of budget documents (including budget action plans) and, as such, can be considered rigorous. This is supported by good controls around the capital programme and a significant increase in our level of reserves, an increase carried out in recognition of the increased level of risk in the budget.

3. Whilst this puts us in as good a position as possible to deliver the 2011/12 budget, there remain significant risks due to the challenging targets and assumptions we have had to set and make and continued increases in demand-led services. Also, there are other knock-on risks to consider: we may come in within budget this year, but this will have an effect on our staffing/workforce planning, service continuity/delivery and future years' budgets. Officers and members therefore need to ensure that they continue to consider these wider risks when taking decisions on the 2011/12 budget and when developing the medium-term financial plan. At the moment that 3-year medium-term financial plan is not in place but officers are actively working on it.

4. The Committee may wish to replicate this budget risk review by requesting further specific reports on the robustness of other monitoring arrangements as part of its work programme. These may include, but are not limited to, the performance monitoring dashboard, the basket of indicators that enable an early warning system for budget monitoring and the arrangements for monitoring capital receipts' forecasts.

1.0 Purpose of this Report

1.1 This report has been prepared to provide an assessment to Corporate Governance and Audit Committee on the robustness of the 2011/12 budget risk assessments included in the Director of Resources' report, 'Revenue Budget and Council Tax 2011/12' presented to Executive Board on 11 February 2011. This is in line with this Committee's role to review the adequacy of the Council's corporate governance arrangements, including risk management.

1.2 The Risk Management Unit (RMU) has focused on the processes used to draw up, maintain and report on the revenue budget risks at directorate and corporate levels and also widened the scope to incorporate the capital programme risks.

1.3 The RMU has not carried out an audit of the financial systems and data extracted from these as assurance is provided to members through the external audit of the authority's financial statements. The Unit has also not assessed the strength of any controls described by the Director of Resources in his reports or that it has identified itself through this review. Neither has the Unit assessed the risks identified in the Finance reports nor that it has identified itself in terms of the probability and impact of the risks materialising.

2.0 Background Information

2.1 The report has been prepared in response to a request from the Chair of this Committee for the RMU to review the robustness of the 2011/12 budget risk assessments drawn up for all Council directorates. These were included in the *Revenue Budget and Council Tax 2011/12* report presented by the Director of Resources to Executive Board on 11 February 2011. Executive Board resolved at that meeting to recommend that Council approve the 20111/12 Revenue Budget which it subsequently did on 23 February.

2.2 As well as reviewing this report, the RMU analysed the earlier related report on Initial Budget Proposals discussed at Executive Board on 15th December 2010. Further, given the links between the revenue and capital budgets, the RMU expanded the scope of its work to cover the risks relating to the 2011/12 Capital Programme and so also reviewed the Capital Programme Update 2010–2014 taken to the same 11 February Executive Board meeting.

2.3 Having reviewed the reports in detail, the RMU met with the Chief Officer (Financial Management), Chief Officer (Financial Development) and Head of Finance (Corporate Services) in the Resources Directorate to explore the budget risk assessment and risk management processes undertaken corporately. The RMU then met with the Heads of Finance in Adult Social Care, Environments & Neighbourhoods and Resources Directorates to gain a better understanding of how these processes are enacted at a directorate level. It also held discussions with a small number of non-Finance senior managers. Several documents were provided by these members of staff which the Unit also reviewed. Finally, the Unit discussed this briefly with the Chief Executive and Council Leader through its meetings with them on other areas of risk work.

2.4 Following these discussions and document reviews, the RMU mapped out the processes, risks and controls around:

- Setting the revenue budget and how the directorate and corporate budget risk registers are used,
- The monthly budget monitoring processes at corporate and directorate levels and how the directorate and corporate budget risk registers are used; and
- The contingency fund process and how it is called upon during the year.

2.5 From this work, the RMU identified several areas for possible improvement in the processes which are now being considered by Corporate Finance staff.

3.0 Main Issues

Revenue Budget 2011/12: the Risk Processes

3.1 In response to the Chair’s specific request to review how robust the 2011/12 directorate budget risk assessments were as reported by the Director of Resources, it is of note that all were based on existing comprehensive budget information and issues arising from the routine budget monitoring processes; none just ‘appeared’. All were extracted from the directorate budget risk registers maintained by directorate Heads of Finance and reported to Corporate Financial Management on a quarterly basis (moving to monthly in 2011/12). These risk registers use a standard template and scoring mechanism to assign a probability and impact score which, combined, produce a risk rating.

3.2 However, there are issues with the impact scoring mechanism and the quality and consistency of information within the directorate and corporate budget risk registers. The quality and consistency of the ‘in-year’ budget action plans and those that are developed before the start of the new financial year also varies. With the exception of one directorate the RMU reviewed, there appears to be little or no cross-referencing of the budget risk information with the variety of other budget monitoring and action planning documents which could lead to duplication or gaps in the management of key risks. The corporate budget risk register is simply an amalgamation of all the directorate budget risk registers and so contains more than 90 risks making it difficult to identify the most significant and cross-cutting risks and focus attention and allocation of resources on their management. The various budget documents are reviewed by a number of different officer groups which is resource-intensive both for the members of staff who produce this information and for those who attend the meetings. Also, the corporate review processes are centred on a small number of experienced staff, which gives rise to other risks around capacity in terms of their workload and succession planning.

3.3 The RMU has discussed its findings with the Chief Officer (Financial Management) and he has requested that the RMU works with his team next quarter to review the budget risk register processes and impact assessments.

Revenue Budget 2011/12: the Risks

3.4 At section 8.3 of the Director of Resources’ report, he outlines the key risks to the 2011/12 revenue budget. These all correlate with the directorate risk assessments included in the appendix to that report and, as noted above, these in turn are based on existing comprehensive budget information as documented in directorate budget risk registers and directorate budget action plans. The risks are detailed below in the order they appeared in the Executive Board report with additional commentary added by the RMU in italics:

(a) ‘The level of demand and activity, within the children’s social care and looked after children budgets. The reconfiguration and integration of services at a locality level, wrapped around universal services such as schools and children’s centres, is a key part of the whole system strategy which is designed to manage the increase in demand and referrals.’

The financial risk could be exacerbated if we significantly underestimate such demand-led areas as looked-after children (LAC) and referrals as has happened in prior years. Also, the process of building effective and integrated locality working centred on at-risk children will take time and so the budget savings that will be achieved by reducing the numbers of referrals and LAC may not be achieved in 2011/12.

(b) ‘Assumptions around additional income from the trading of certain functions with schools are not realised.’

This is managed through ongoing review of income budgets. However, any shortfall in income would have to be offset by savings elsewhere.

(c) ‘Volatility of demand led budgets within Adults Social Care and the magnitude of price reductions to be negotiated for residential and nursing placements.’

Key controls to manage this include working with suppliers to negotiate their pricing structures and working with staff to ensure that the most appropriate levels of care for service users are prescribed. However, as with a number of these risks, if these price reductions cannot be achieved, this increases the risk both for the 2011/12 and future years’ budgets.

(d) ‘Inflation and pay awards greater than anticipated.’

Directorate Heads of Finance are very conscious of the inflation risk, and, in Environments & Neighbourhoods for example, sensitivity analysis has been carried out on the cost of fuel. However, it is difficult to accurately account for future price increases in the budget. Though the pay award risk for 2011/12 is low at the moment as increases are currently frozen, it may be increased again should there be significant changes to staff’s terms and conditions as a result of workforce planning arrangements which may lead to new job evaluation and pay and grading reviews.

(e) ‘Interest rate changes greater or sooner than anticipated’

Treasury Management within Corporate Financial Development undertakes significant sensitivity analysis of this risk but, in terms of risk probability, this remains beyond the control of the Council.

(f) ‘Failure to restrict capital spending results in additional debt costs.’

There are a number of key controls in place to manage this risk through the capital programme (see the next section of this report). However, the ‘people’ element may increase the risk as we rely on programme/project boards and managers and also members undertaking effective programme/project risk management. This may include stopping some projects, authorising others to proceed, revising scopes and re-allocating resources.

(g) ‘Uncertainty over the economic climate which may have a continuing impact on income budgets and the cost of borrowing.’

There appears to be a good level of control within the Financial Development Capital Section over the capital programme. Close links between the Capital and Treasury Management section allows an effective monitoring of the capital programme and its debt costs. There also seems to be a good appreciation of *the challenges facing the capital programme with less pressure to commit to undertaking schemes which are not fully justified in the current financial climate.*

(h) 'Challenging efficiency targets across the Council including reducing staffing numbers and generating significant procurement savings.'

Given the scale of the challenge in securing £25m procurement savings, there is a real possibility that we won't achieve this in 2011/12 which may well make this one of the most significant risks to delivering this year's and future years' budgets. Other efficiency targets include rationalisation of our building portfolio and reducing energy usage by 12.5% which are also very challenging and may take time to deliver. Though £0.8m has been included in the budget as part of the 'invest to save' initiative to help deliver the efficiency savings (for example, by reconfiguring services), this may not be enough.

If there are delays in implementing efficiency savings' measures, this will result in lower levels of savings than anticipated, which is brought out in the individual directorate risk assessments.

Should the savings be delayed or not achieved in 2011/12, this has implications not just for the setting of the 2012/13 budget and the medium-term financial plan will require additional savings to be identified in year, which will not be easy.

Any reduction in staffing numbers, whether through planned and voluntary means or not, leads to knock-on risks for those staff who remain (less capacity to potentially do more work and loss of skills/knowledge/contacts from those who have left the organisation) and therefore for the continuity of the services the Council delivers. These workforce planning risks are currently being reviewed by the RMU with Corporate HR and directorate staff.

(i) 'Review of the use of legal services will require changes to working practices. May also expose the Council to certain risks in that legal opinion will not always be requested for certain decisions and actions.'

The implications of not seeking legal advice may give rise to the knock-on risk of leaving the Council open to legal challenge. This is particularly relevant at a time of changes to the way the Council directly or indirectly provides services, for example in social care, which may give rise to more test cases being brought against the local authority .[1]

(j) 'Risk to Council buildings if essential maintenance work cannot be contained within the reduced budget.'

This risk equally applies to other Council assets such as fleet and highway maintenance which, if they are not kept in a reasonable condition, could give rise to increased insurance claims made against the authority and also reduce their asset value in the balance sheet, both of which will impact on the budget. The medium-term financial plan also needs to take into account that reducing the budgets for building, fleet and other asset maintenance is only a short-term measure: extra budget will be needed in 2-3 years' time to 'catch up' with maintenance, repair and replacement.

(k) 'The probability of a major ICT incident impacting on service delivery has increased.'

In February 2011 this risk was escalated to the Council's corporate risk register in recognition of its significance and detailed action plans have been drawn up to

[1] A current example is that of Birmingham City Council against whom the High Court ruled on 20/4/11 on the grounds that its business plan failed to comply with Section 49a of the Disability Discrimination Act. This was in relation to its plans to limit council-funded adult social care to those whose needs had been assessed as 'critical'. Following an appeal by the Council, the decision was upheld. Birmingham is now revising its plans and undertaking another round of consultation.

help mitigate it. Effective management of this risk relies both on ICT and on services themselves to have robust business continuity arrangements in place.

3.5 Other identified key risks for the 2011/12 budget which were not detailed in this section of the report may include:

- One or more programmes and major projects significantly overspending, for example through unforeseen costs arising.
- Decisions not taken forwards, revised or delayed – for example, to stop, reduce or change some services and close buildings.
- External providers being unable to pick up the reductions the Council is passing on to them, especially if their funding has also been cut. A £100k 'hardship fund' has been established to help address this but this may be insufficient.
- Linked to the previous point, section 2.6 of the Executive Board report refers to the Council reducing costs through better partnership working with the Health Service. However, given the major changes the NHS may experience, there is no guarantee yet of reducing costs. These changes in Health, alongside other changes on the horizon such as the Localism Bill, are being considered though in developing the Medium Term Financial Plan.

3.6 As reported by the Director of Resources at section 8.6 of his report, the scale of this year's grant reductions to the Council are unprecedented. At a time of huge demand pressures in social care in particular, the Director is clear that 'the budget does contain a higher level of risk than in previous years'. If the Council's expenditure exceeds the resources it has, he, as the Responsible Financial Officer, would have to issue a Section 114 notice which would effectively prevent us from entering into any new agreements that would involve incurring expenditure until members have agreed a range of effective actions within 21 days to rebalance the budget. Such a notice has never been issued in Leeds.

3.7 To mitigate this risk, the Director has detailed several very important controls at section 8.6 which are summarised below:

- The level of our reserves has been significantly increased from last year and is in line with the risk-based reserves strategy. The reserves policy requires directorates to maintain a budget action plan detailing how they will manage in-year variations up to 2%.
- Members and officers recognise that rigorous recording and monitoring of the budget, budget action plans, targets and risk registers is essential in order to give as much warning as possible of emerging risks and issues. Budget monitoring takes place monthly at various levels within the Council and it has now been agreed to enhance reporting to the Executive Board from quarterly to monthly.
- CLT will focus particularly on the challenging targets and actions within the budget and, at the time of writing, the Director therefore felt that they were 'reasonable and achievable.'
- Quick action was taken in 2010/11 to enhance the 2011/12 budget position: for example, through the early leavers initiative, a freeze on recruitment for the majority of posts and through restricting the authorisation of orders to Chief Officers and Heads of Service.

3.8 These are supplemented by additional controls throughout the monitoring and reporting processes.

<u>Capital Programme 2011/12</u>

3.9 The key risk in developing and managing the overall programme is that insufficient resources are available to fund the programme, leading to delays or stoppages of some schemes. A number of controls are in place to manage this risk which are included at section 7.1 of the Executive Board report, *Capital Programme Update 2010-14*, presented on 11 February 2011 and included below in full:

- ‘In developing the capital programme, risk assessments are carried out both in relation to individual projects and in formulating the overall programme.
- Monthly updates of capital receipt forecasts prepared by the (Acting) Director of City Development;
- The use of a risk based approach to forecasting of capital receipts;
- Monthly monitoring of overall capital expenditure and resources forecasts alongside actual contractual commitments;
- Quarterly monitoring of the council’s VAT partial exemption position to ensure that full eligibility to VAT reclaimed can be maintained; • Ensuring written confirmation of external funding is received prior to contractual commitments being entered into;
- Provision of a contingency within the capital programme to deal with unforeseen circumstances;
- Promotion of best practice in capital planning and estimating to ensure that scheme estimates and programmes are realistic;
- Compliance with both financial procedure rules and contract procedure rules to ensure the Council’s position is protected;
- The introduction of new schemes into the capital programme will only take place after completion and approval of a full business case and identification of the required resources;
- All Leeds funded schemes are subject to individual review at the point at which the client service seeks spending approval
- No new injections to the programme can be made without first identifying additional resources or substituting for an existing scheme
- No capital receipts assumed to fund the programme can be diverted to other projects or initiatives without identifying alternative resources that will be available within the same year.’

3.10 Through its review, the RMU found some additional controls in the close links and reporting arrangements between the Capital and Treasury Management sections of Financial Development and in the experience, qualifications and competencies of staff within those sections. When developing and monitoring the capital programme, the Council follows the Prudential Code for Capital Finance and CIPFA’s Code for Practice for Treasury Management in Local Authorities. New unsupported borrowing is generally only used to fund projects which generate savings in excess of the cost of borrowing with other capital investment ideally funded by external sources or receipts from the sale of assets. There are also business case reviews by stakeholder groups (e.g. officer boards, Strategic Investment Board, Asset Management Group). While risk assessments of individual projects are undertaken by project boards, the RMU is aware through its day-to-day work that the quality and consistency of these can vary.

4.0 Implications for Council Policy and Governance

4.1 The revenue budget risk assessments and how they are mitigated contribute to the effective management of 5 of the Council's most significant risks as recorded in the corporate risk register: this year's budget; the medium-term budget; capital programme; Children's Services' budget and Adult Social Care budget.

4.2 This report aids Corporate Governance & Audit Committee in fulfilling its role to review the adequacy of the Council's risk management arrangements, incorporating the corporate and supporting budget risk registers.

5.0 Legal and Resource Implications

5.1 The Risk Management Unit and Financial Management team will shortly review the budget risk register processes and impact assessments. This will be done within existing staffing resources.

6.0 Conclusions

6.1 Throughout the Council there is an excellent understanding of the key budget risks. Monthly monitoring and reporting of them will aid in reducing the probability of these risks materialising if necessary actions are taken quickly and supported by senior managers and members who act cohesively and take collective 'One-Council' organisational responsibility. Despite some issues around the consistency and scoring mechanism within the budget risk registers, the budget risk assessments included in the Director of Resources' report to Executive Board are comprehensive, based on a number of budget documents (including budget action plans) and, as such, can be considered rigorous. This is supported by good controls around the capital programme and a significant increase in our level of reserves, an increase carried out in recognition of the increased level of risk in the budget.

6.2 However, whilst this puts us in as good a position as possible to deliver the 2011/12 budget, there remain risks due to the challenging targets and assumptions we have had to set and make, and continued increases in demand-led services and the reduced levels of contingency. Also, there are other knock-on risks to consider: we may come in within budget this year, but this will have an effect on our staffing/workforce planning, service continuity/delivery and future years' budgets. Officers and members therefore need to ensure that they continue to consider these wider risks when taking decisions on the 2011/12 budget and when developing the medium-term financial plan. At the moment that 3-year medium-term financial plan is not in place but officers are actively working on it.

6.3 In conclusion, we refer to Paragraph 8.6 of the Director of Resources' report to Executive Board and Council in which he notes that he, 'can only consider the proposed budget for 2011/12 as robust and that the level of reserves are adequate with a clear understanding of the following:-

- 'the level of reserves is in line with the risk based reserves strategy, and is a significant increase from the previously determined minimum level of reserves.
- budget monitoring and scrutiny arrangements are in place which include arrangements for the identification of remedial action, and reporting arrangements to members will be enhanced
- the budget contains a number of challenging targets and other actions, these are clearly identified, and will be subject to specific monitoring by the Council's Corporate Leadership Team, and as such, are at this time considered reasonable and achievable.

- budget reporting to members will be enhanced - risks are identified, recorded in the budget risk register and will be subject to control and management.
- as part of the Council's reserves policy directorates are required to have in place a budget action plan which sets out how they will deal with variations during the year up to 2%.
- early actions have been taken to reduce spending including an early leavers initiative
- there is a clear understanding of the duties of the Council's statutory Financial Officer and that the service implications of them being exercised are fully understood by members and senior management alike.'

6.4 Finally, we would say that this has been a useful exercise and one which the Committee may wish to replicate through reviewing the robustness of other monitoring arrangements as part of its 11/12 work programme. These arrangements may include the performance monitoring dashboard, early warning systems for budget monitoring and the means by which capital receipts' forecasts are monitored.

7.0 Recommendations

7.1 The RMU recommends that Corporate Governance & Audit Committee notes the contents of this report.

7.2 We also recommend that the Committee requests further specific reports on the robustness of other monitoring arrangements as part of its work programme. These may include, but are not limited to, the performance monitoring dashboard, the basket of indicators that enable an early warning system for budget monitoring and the arrangements for monitoring capital receipts' forecasts.

8.0 Background Papers

- General Fund Risk Based Reserves Strategy 2010/11
- Financial Health Monitoring 2010/11 – Half Year Report, 3 November 2010. Report of the Director of Resources to Executive Board (EB)
- Initial Budget Proposals report, 15 December 2010. Report of the Director of Resources to EB
- Provisional Local Government Settlement report, 5 January 2011. Report of the Director of Resources to EB
- Revenue Budget and Council Tax report and subsequent minutes, 11 February 2011. Report of the Director of Resources to EB
- Capital Programme Update 2010-2014, 11 February 2011. Report of the Director of Resources to EB