Agenda Item No: **8b**

Wolverhampton City Council

Audit Committee

23 September 2013

Report Title	**Medium Term Financial Strategy Review – Report of PricewaterhouseCoopers**
Cabinet Member with Lead Responsibility	Councillor Andrew Johnson Resources
Accountable Strategic Director	Keith Ireland, Delivery
Originating service	Delivery
Accountable officer(s)	Mark Taylor — Assistant Director - Finance Tel — 6609 Email — Mark.Taylor@wolverhampton.gov.uk

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Recommendations for noting:

The Committee is asked to note:

1. The report prepared by PricewaterhouseCoopers on the Medium Term Financial Strategy of the council

1.0 Purpose

1.1 PricewaterhouseCoopers (PwC) as the Council's external auditors are required to assess the arrangements for securing economy, efficiency and effectiveness in the use of resources. As part of their work in this area they have undertaken a review of the Council's Medium Term Financial Strategy (MTFS). This focused on testing the assumptions that underpin the MTFS:

- inflation;
- spending reductions on savings;
- formula grant allocation;
- council tax, and;
- use of reserves.

1.2 They have taken into account the Council's recent track record of:

- setting realistic budgets;
- delivering services with budget;
- delivering planned savings targets;
- monitoring adequate levels of reserve balances.

1.3. PwC's conclusions are outlined in the attached report;

- the assumptions used in Wolverhampton's MTFS are broadly in line with other authorities;
- they have not identified any significant concerns;
- they have not identified any issues that would impact on their value for money conclusion.

2.0 Financial Implications

2.1 The report provides assurances on the arrangements the Council has in place to ensure effective stewardship and accountability for resources at a time of unprecedented financial pressures.

[CF/18092013/I]

3.0 Legal implications

3.1 Statutory authority for the external auditor role set out in paragraph 1.1 of this report which provides external accountability and control is currently contained in the Audit Commission Act 1998.

[JH/18092013/X]

4.0 Equalities implications

4.1 There are no equalities implications arising from this report.

5.0 Environmental implications

5.1 There are no environmental implications arising from this report.

6.0 Schedule of background papers

None

Appendix 1

PricewaterhouseCoopers LLP

Cornwall Court
19 Cornwall Street
Birmingham
B3 2DT

Dear Sirs

Representation letter – audit of Wolverhampton City Council's (the Council) statement of accounts for the year ended 31 March 2013.

The Council is responsible for preparing consolidated statement of accounts in respect of itself and its subsidiary undertakings (together "the group").

Your audit is conducted for the purpose of expressing an opinion as to whether the statement of Accounts of the Council and the group give a true and fair view of the state of affairs of the Council and group as at 31 March 2013 and of the deficit and cash flows of the group for the year then ended have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 supported by the Service Reporting Code of Practice 2012/13.

Subsequent references in this letter to "the Statement of Accounts" refer to both the statement of accounts of the Council and the consolidated statement of accounts of the group.

I acknowledge my responsibilities as the Assistant Director Finance (Section 151 Officer) for preparing the Statement of Accounts as set out in the Statement of Responsibilities for the Statement of Accounts. I also acknowledge my responsibility for the administration of the financial affairs of the Council and that I am responsible for making accurate representations to you.

I confirm that the following representations are made on the basis of enquiries of other chief officers and members of the Council and the group with relevant knowledge and experience and, where appropriate, of inspection of supporting documentation sufficient to satisfy myself that I can properly make each of the following representations to you.

I confirm, to the best of my knowledge and belief, and having made the appropriate enquiries, the following representations:

Statement of accounts

- I have fulfilled my responsibilities for the preparation of the Statement of Accounts in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 supported by the Service Reporting Code of Practice 2012/13; in particular the Statement of Accounts give a true and fair view in accordance therewith.

- All transactions have been recorded in the accounting records and are reflected in the statement of accounts.

- Significant assumptions used by the Council and group in making accounting estimates, including those surrounding measurement at fair value, are reasonable.

- All events subsequent to the date of the statement of accounts for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 requires adjustment or disclosure have been adjusted or disclosed.

- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the statement of accounts as a whole. A list of the uncorrected misstatements is attached to this letter.

Information Provided

- I have taken all the steps that I ought to have taken in order to make myself aware of any relevant audit information and to establish that you, the Council's auditors, are aware of that information.

- I have provided you with:
  - access to all information of which I am aware that is relevant to the preparation of the statement of accounts such as records, documentation and other matters, including minutes of the Council and its committees, and relevant management meetings;
  - additional information that you have requested from us for the purpose of the audit; and
  - unrestricted access to persons within the group from whom you determined it necessary to obtain audit evidence.

- So far as I am aware, there is no relevant audit information of which you are unaware.

Accounting policies

I confirm that I have reviewed the Council’s and the group’s accounting policies and estimation techniques and, having regard to the possible alternative policies and techniques, the accounting policies and estimation techniques selected for use in the preparation of Statement of Accounts are appropriate to give a true and fair view for the Council's and the group’s particular circumstances.

Fraud and non-compliance with laws and regulations

I acknowledge responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

I have disclosed to you:

- the results of our assessment of the risk that the statement of accounts may be materially misstated as a result of fraud.

- all information in relation to fraud or suspected fraud that we are aware of and that affects the group and involves:
    - management;
    - employees who have significant roles in internal control; or
    - others where the fraud could have a material effect on the statement of accounts.

- all information in relation to allegations of fraud, or suspected fraud, affecting the Council and group's statement of accounts communicated by employees, former employees, analysts, regulators or others.

- all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing statement of accounts.

I am not aware of any instances of actual or potential breaches of or non-compliance with laws and regulations which provide a legal framework within which the Council and the group conducts its business and which are central to the Council's and the group's ability to conduct its business or that could have a material effect on the statement of accounts.

I am not aware of any irregularities, or allegations of irregularities including fraud, involving members, management or employees who have a significant role in the accounting and internal control systems, or that could have a material effect on the statement of accounts.

The pension fund has not made any reports to the Pensions Regulator nor am I aware of any such reports having been made by any of our advisors. I confirm that I am not aware of any late contributions or breaches of the schedule of contributions that have arisen which I considered were not required to be reported to the Pensions Regulator. I also confirm that I am not aware of any other matters which have arisen that would require a report to the Pensions Regulator.

There have been no other communications with the Pensions Regulator or other regulatory bodies during the year or subsequently concerning matters of non-compliance with any legal duty.

Related party transactions

I confirm that we have disclosed to you the identity of the Council and group's related parties and all the related party relationships and transactions of which we are aware.

Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of Section 3.9 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

We confirm that we have identified to you all senior officers, as defined by the Accounts and Audit Regulations 2011, and included their remuneration in the disclosures of senior officer remuneration.

Employee Benefits

I confirm that we have made you aware of all employee benefit schemes in which employees of the Council and the group participate.

Contractual arrangements/agreements

All contractual arrangements (including side-letters to agreements) entered into by the Council and the group have been properly reflected in the accounting records or, where material (or potentially material) to the statement of accounts, have been disclosed to you.

Litigation and claims

I have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the statement of accounts and such matters have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

Taxation

I have complied with UK taxation requirements and have brought to account all liabilities for taxation due to the relevant tax authorities whether in respect of any direct tax or any indirect taxes. I am not aware of any non-compliance that would give rise to additional liabilities by way of penalty or interest and I have made full disclosure regarding any Revenue Authority queries or investigations that we are aware of or that are ongoing.

Pension fund assets and liabilities

All known assets and liabilities including contingent liabilities, as at the 31 March 2013, have been taken into account or referred to in the statement of accounts.

Details of all financial instruments, including derivatives, entered into during the year have been made available to you. Any such instruments open at the 31 March 2013 have been properly valued and that valuation incorporated into the statement of accounts.

The pension fund has satisfactory title to all assets and there are no liens or encumbrances on the pension fund's assets.

The value at which assets and liabilities are recorded in the net assets statement is, in the opinion of the Council, the market value. We are responsible for the reasonableness of any significant assumptions underlying the valuation, including consideration of whether they appropriately reflect our intent and ability to carry out specific courses of action on behalf of the pension fund. Any significant changes in those values since the date of the statement of accounts have been disclosed to you.

Pension fund registered status

I confirm that the West Midlands Pension Fund is a Registered Pension Scheme. We are not aware of any reason why the tax status of the scheme should change.

Bank accounts

I confirm that we have disclosed all bank accounts to you including those that are maintained in respect of the pension fund.

Accounting Estimates

Regarding accounting estimates that were recognised in the financial statements:

- The Council has used appropriate measurement processes, including related assumptions and models, in determining the accounting estimate in the context of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13;
- Measurement processes were consistently applied from year to year;
- The assumptions appropriately reflect our intent and ability to carry out specific courses of action on behalf of the Council, where relevant to the accounting estimates and disclosures;
- Disclosures related to accounting estimates are complete and appropriate under the Code; and
- No subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

Financial Instruments

All embedded derivatives have been identified and appropriately accounted for under the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2012/13.

Provisions

Provisions for depreciation and diminution in value including obsolescence have been made against property, plant and equipment on the bases described in the financial statements and at rates calculated to reduce the net book amount of each asset to its estimated residual value by the end of its probable useful life in the Council's and the group's business. In this respect I am satisfied that the probable useful lives have been realistically estimated and that the residual values are expressed in current terms.

Full provision has been made for all liabilities at the balance sheet date including guarantees, commitments (in particular in relation to redundancy plans) and contingencies where the items are expected to result in significant loss. Other such items, where in my opinion provision is unnecessary, have been appropriately disclosed in the financial statements.

Full provision has been made for all liabilities at the balance sheet date including guarantees, commitments and contingencies where the items are expected to result in significant loss. Other such items, where in my opinion provision is unnecessary, have been appropriately disclosed in the consolidated financial statements. The provision of £26.5 million that we have included in our accounts for the potential liability for equal pay and back pay claims complies with International Accounting Standard (IAS) 37 and is supported, in good faith, by the external legal advice received.
This represents our best estimate of the most likely future costs to the Council and we have not received any other additional or contradictory advice that has not been shared with you.

The Council has determined a proper application of the statutory provisions for the neutralisation of the impact of Single Status provisions on the General Fund balance.

Investments

I confirm that all significant assumptions made in relation to fair value measurement and disclosures are reasonable and appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the Council and the group to the fair value measurements or disclosures.

I confirm that we believe the inclusion of the Council's investment in Birmingham Airport Holdings Ltd at £18.6 million is appropriate because:

- this materially reflects the latest valuation of the Ordinary Shares and preference shares provided as at the balance sheet date as provided by Solihull Council and BDO (£18.9 million versus prior year £18.6m).
- there remains in place a side agreement which restricts the sale of shares by all seven stake-holding councils and therefore, whilst the valuation given provides a best estimate of a price that could be achieved on the open market, the restrictions mean that the open market value (OMV) is always likely to overstate the value that any Council would actually be willing to pay. This is deemed particularly significant in the current economic climate when there is unlikely to be any Council with sufficient spare resources to purchase an additional share in the Airport - especially at an OMV;
- the terms of the work had been agreed by all relevant Appointed Auditors;
- the methods followed are reasonable given the requirements of the Code; and
- the findings are fed by a number of factors and because many of these are judgements, every valuer is bound to make different assumptions but the assumptions taken do not appear unreasonable.

Using the work of experts

I agree with the findings of Solihull Council and BDO, experts in evaluating the Airport Valuation, regarding their valuation of our share of Birmingham Airport Holdings Ltd and have adequately considered the competence and capabilities of the experts in determining the amounts and disclosures used in the preparation of the financial statements and underlying accounting records. The Council did not give or cause any instructions to be given to experts with respect to the values or amounts derived in an attempt to bias their work, and I am not otherwise aware of any matters that have had an impact on the objectivity of the experts.

Valuation of Property, Plant and Equipment

I have considered indicators of impairment for our Property, Plant and Equipment asset based and am satisfied that there are no indicators that the Council's asset base has been materially impaired.

Depreciation of housing stock

The Council has assessed the impact of using the Major Repairs Allowance as an estimate for depreciation of council dwellings in the Housing Revenue Account and is satisfied that this amount is a reasonable estimate of the amount of depreciation charge for these assets.

Completeness of Fixed Asset records on the General Ledger

I am satisfied that the general ledger system is complete and that there are no material differences between the assets recorded on the Property Services Database and those recorded on the general ledger system (FMIS), that is used to populate the financial statements.

Revenue provision

I am satisfied that our revised methods for determining an annual revenue provision, and for splitting interest cost between the HRA and General Fund are appropriate, prudent and compliant with the requirements of The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended by Statutory Instrument 2008 no. 414 s4).

Deficiencies in internal control

I have communicated to you all deficiencies in internal control of which I am aware.

Subsequent events

Other than those already disclosed, there have been no circumstances or events subsequent to the period end which require adjustment of or disclosure in the statement of accounts or in the notes thereto.

Accounting for Academy Schools

All schools that have transferred to Academy status have been removed from the appropriate balance sheet. All current school assets for which the future use is unknown have been valued at the most appropriate market value. No decisions have been taken about the future use of school assets that have not been reflected in their valuation.
As minuted by the Audit Committee at its meeting on 23 September 2013.

....
Assistant Director Finance (Section 151 Officer)
For and on behalf of Wolverhampton City Council

Date ……………………

No	Description of misstatement	Income statement		Balance sheet		Management comment
		Dr	Cr	Dr	Cr	
1	Valuation of Birmingham Airport investment Dr Non Current Investments Cr (Surplus) or Deficit on Revaluation of Non-Current Assets Wolverhampton City Council owns 4.7% of the ordinary shares in Birmingham Airport Holdings Ltd. The measurement basis for this investment is 'Fair Value'. In order to ensure an accurate fair value is used at each balance sheet date the Council receives an annual valuation from a third party provider. The valuation for 31 March 2013 was received after the draft 2012/13 accounts had been produced. The valuation indicated that the most accurate valuation for the Council's shares had risen by £283k from last year to a new valuation of £18,903k. The valuation in the final accounts has not been amended so remains at £18.6m. *NOTE: This amendment, if made, would have been reversed out of the Total Comprehensive Income and Expenditure position as a required 'Adjustment between Accounting Basis & Funding Basis under Regulations' so that there would have been no net impact on the tax payer.*		283	283		The revised estimate is materially similar to the value in the draft accounts. We understand that none of the other Councils are amending for the update so our decision is consistent with all the other Councils.
	Total	**0**	**283**	**283**	**0**	

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Wolverhampton City Council

Government and Public Sector

August 2013

Medium Term Financial Strategy report

Contents

Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and of audited bodies'. It is available from the Chief Executive of each audited body. The purpose of the statement is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and letters are prepared in the context of this Statement. Reports and letters prepared by appointed auditors and addressed to directors or officers are prepared for the sole use of the audited body and no responsibility is taken by auditors to any director or officer in their individual capacity or to any third party.

Introduction

Use of Resources

Our Use of Resources Code responsibility requires us to perform sufficient and relevant work to conclude on whether you have put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources.

In accordance with updated guidance issued by the Audit Commission, in 2012/13 our conclusion will be based on two criteria, whether:

- the organisation has proper arrangements in place for securing financial resilience; and
- the organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

The focus of these criteria will be on whether:

- the organisation has robust systems and processes to manage financial risks and opportunities effectively, and to secure a stable financial position that enables it to continue to operate for the foreseeable future; and
- the organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We will not be required to reach a scored judgement in relation to these criteria and the Audit Commission will not be developing 'key lines of enquiry'. Instead, we will be carrying out sufficient work to allow us to reach a conclusion on your arrangements. As part of our work in this area we have reviewed your Medium Term Financial Strategy.

Background

On 20 October 2010 the coalition government published the Spending Review 2010, which set out government department budgets for the period 2011/12 to 2014/15. The impact of the reductions in central government funding on individual local authorities in the two final years of this period was finalised in December 2012.

The Chancellor's Autumn Statement was given on 5 December 2012 and described a medium term position characterised by lower than anticipated economic growth and, as a result, higher forecast public sector borrowing requirement. It included the following key headlines:

- Economic growth forecasts were revised down to 1.2% for 2013, 2% in 2014 and 2.3% in 2015.
- The deficit was due to fall from 7.9% to 6.9% of GDP this year, and to continue falling to 1.6% by 2017/18.
- Public sector pay rises would be limited to 1% after the end of the pay freeze in 2013.

In June 2013, the Chancellor released the Government's spending plans for 2015/16, confirming a further £11.5 billion of savings to be identified, in part to fund a number of infrastructure projects. Though the impact of this on individual bodies is not yet known, a total reduction in the Communities budget of £2.6 billion is expected, with a corresponding impact on Council funding in the region of 10%.

Medium Term Financial Strategy

In our audit plan we highlighted the significant financial challenge facing the Council as a specific audit risk. Your Medium Term Financial Strategy (MTFS), approved by Cabinet in January 2013, reflects this challenge; a cumulative budget deficit of £59.1 million is forecast over the five year period to 2018. This forecast also assumes that required savings of £38.6 million are successfully delivered over the same period.

Although a balanced budget is forecast for 2013/14, almost £60 million of additional recurring savings will need to be realised to achieve breakeven over the forecast period, including £16 million during the 2014/15 financial year.

The Council has a good track record in recording surpluses and achieving financial targets. In each of the last three financial years there has been a net contribution to the General Fund balance, and in 2011/12 the Council achieved 100% of its £36 million savings target.

In 2012/13, you have reported an small adverse variance against the 2012/13 budget (a £3.6 million deficit was recorded), and though a good level of savings (£11.5m) were delivered in-year, this fell someway short of initial projections (£21.2 million of in-year savings were initially budgeted), although additional recurring cost reductions have been recorded though updating of the Council's Treasury Management Strategy. Furthermore, there was a significant use of earmarked reserves (£18.9 million additional draw down; primarily reflecting £10 million set aside to fund voluntary provision for the redemption of debt).

These figures provide strong evidence of the additional pressures faced by the Council in the current economic environment.

In 2012/13, the most significant areas of savings included additional NHS funding of health and social care (£1.6 million) review of the Schools Improvement Service (£0.9 million) and restructuring at the Senior Manager level (£0.7 million). Savings identified for 2013/14 total £17.2 million; at the end of July 2013, £6.6 million of this target have been reported as achieved in-year, and all bar £2.9 million of forecast savings had been identified.

We have reviewed your MTFS, including comparing it with other similar plans, to review how you secure financial resilience. The areas of focus for this work have been:

- Assumptions;
- Sensitivity analysis;
- Reserves; and
- Economy, efficiency and effectiveness

Section I: Analysis

Key Assumptions

The MTFS is underpinned by a number of key assumptions. These include:

- Inflation – for both pay and non-pay expenditure;
- Growth – your estimate of future cost and budget pressures from changes in demand and volume;
- Efficiency savings – the level and timing of the savings you need;
- Council tax; and
- Use of reserves.

Each of these assumptions has varying degrees of inherent uncertainty. Assumptions applied to forecasts can often have a significant impact on balancing budgets. You have delivered a significant level of savings over recent years, and though reporting a small deficit for 2012/13, have a track record of strong financial management and achievement of financial targets. In spite of this, the current economic climate is difficult and the future uncertain; with many assumptions required there is an increased risk that one of the influencing factors may vary significantly from the assumptions you have applied.

In the current economic and political climate there are clear difficulties in providing robust medium term forecasts, however contrasting key assumptions with those adopted by comparable organisations can provide a useful sense check of the consistency and robustness of the Council's projections.

We have reviewed key assumptions in your MTFS and compared them to our other External Audit clients. We have also taken into account our wider understanding of the sector, and the Council's financial performance for the year to date. A summary of our findings is included on the following pages.

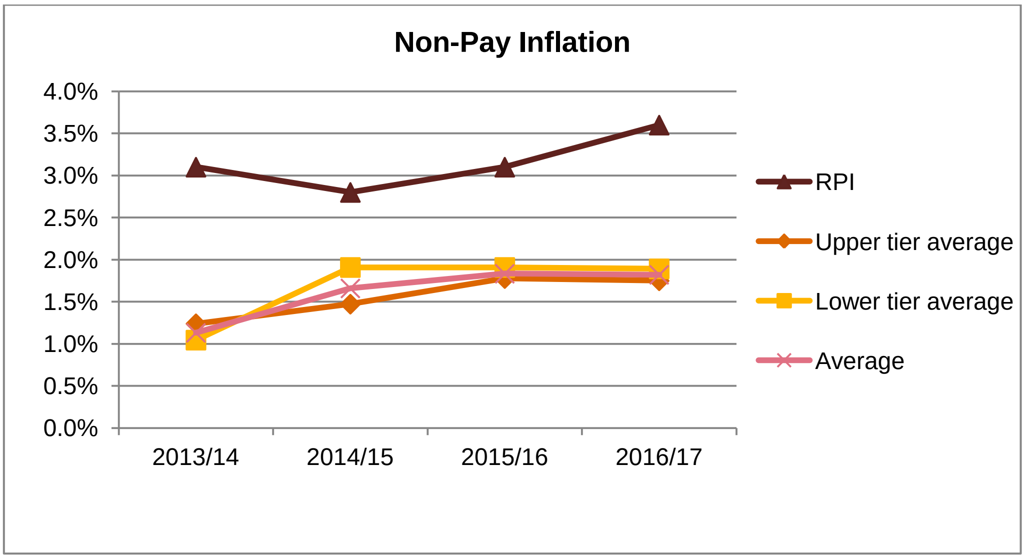
Please note that the majority of figures and analyses within this report reference the MTFS as approved by Cabinet on 26 February 2013. Where relevant we have referenced subsequent updates to the strategy; we have clearly stated where this is the case.

Inflation – non-pay costs

The Retail Prices Index (RPI) has shown 12 month percentage changes in prices of between 2.6% and 3.3% for the period of June 2012 to June 2013. Predictions currently forecast similar increases across 2013-2016.

In your MTFS calculations you have used 0% as the base level for inflationary increases (save for specific areas such as gas and electricity, where a 4% increase has been forecast), reflecting the expectation that price increases will – to the extent possible – be absorbed within existing budgets. However, on top of this you have included inflationary increases in specific areas, where cases have been put forward by the service teams; you have also built in a level of contingency to respond to additional pressures that may develop during the forecast period.

This equates to annual forecast inflationary increases of around £3 million across the full five year period.



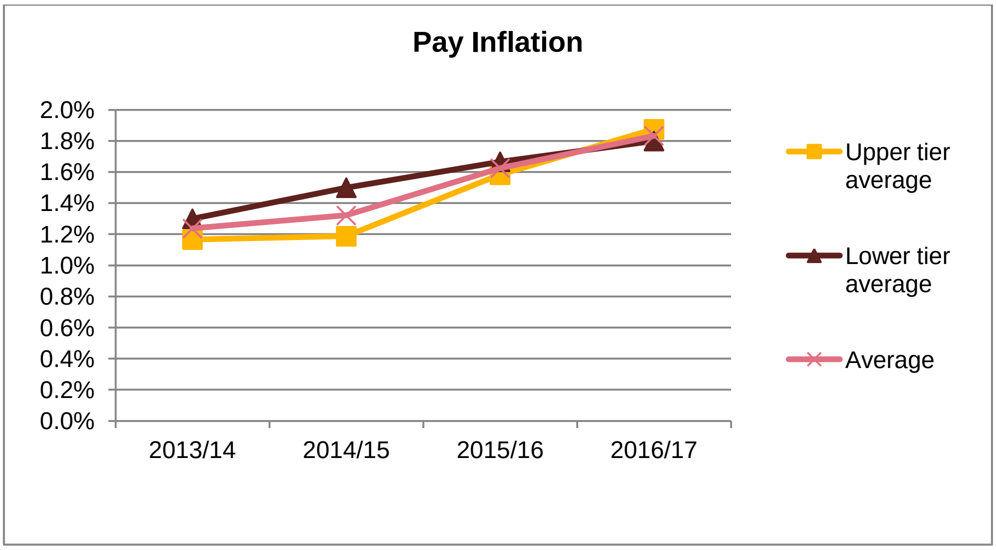
As seen from the above chart, average budgeted inflationary increases fall well below current forecast levels. The same is true, though less significantly, when using CPI as the benchmark. You have recognised the need for inflationary increases to be absorbed by existing budgets where possible, to meet your outturn targets; but have also recognised where specific additional pressures are likely to be experienced.

Whilst accepting the difficulties in forecasting inflation over the medium term, a relatively small shift in inflationary rates could have a significant impact on the achievement of budgeted outturn.

Inflation – pay costs

The Council has budgeted pay pressures over the five year forecast period totalling £34.8 million. This incorporates the impact of inflationary pay increases, alongside increases in NIC and Superannuation payments, annual increments and the impact of single status. The pay inflation element has been budgeted at 1% for 2013/14 and 2014/15 (reflecting Government policy), and 3% for subsequent periods.

Budgeted pay inflation across our clients within the sector is detailed in the graph below.

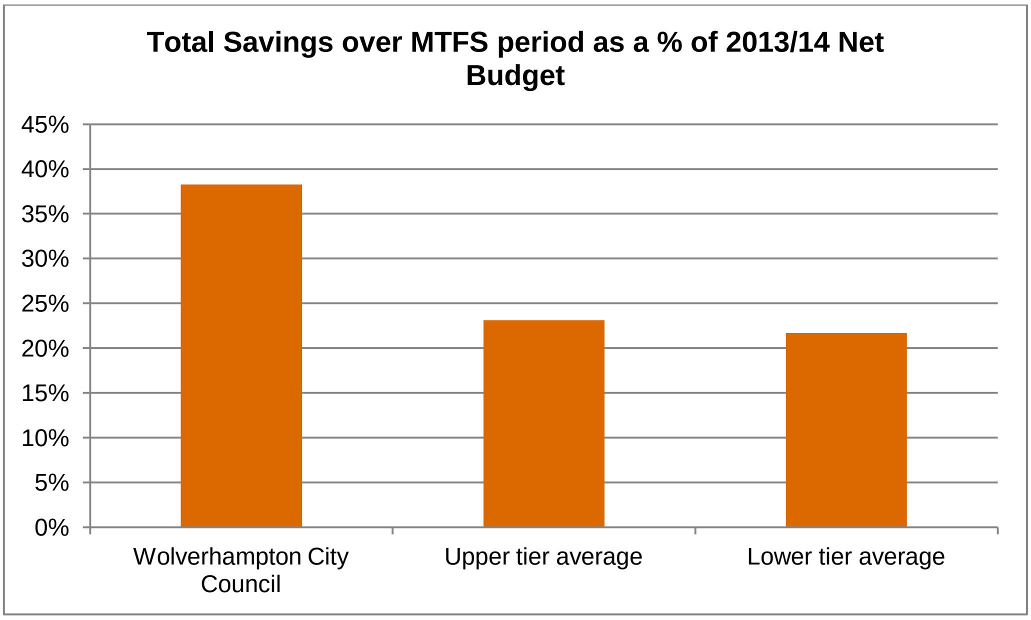


The graph shows a consistent trend between Wolverhampton City Council and our benchmarked group, with greater inflationary increases towards the tail end of the forecast period. The graph also shows that the average rates budgeted by other Authorities for 2015/16 onwards fall below the 3% assumption applied by the Council. This would therefore seem a prudent assessment of the impact of future cost of living increases, accepting the difficulties of forecasting for 2015/16 onwards.

Review of the latest iteration of the MTFS, presented at the July 2013 Cabinet meeting, identifies further changes to pay assumptions, with an additional £1 million budgeted for 2015/16 onwards, to cover forecast increases in employer pension contributions arising from the ongoing pension fund valuation (though this could vary significantly depending on the results of the exercise). At the same time, pay increases have been revised downwards by a total of £5 million over the three periods commencing 2015/16, reflecting wider pressure on budgets.

Total Savings

The Council has included £38.6 million of expected savings within its MTFS, including £28.5 million over 2013/14 and 2014/15. To balance its budget in the medium term, £59.1 million of additional savings will be required based on the MTFS forecasts. The graph below provides a comparison of total savings required over the duration of the MTFS to balance your budget, as a proportion of net budget, versus upper and lower tier averages.



As is evident from the graph, the levels of savings included within your MTFS are significantly greater – proportionate to net budget – than our benchmark sample.

The July 2013 report to cabinet includes a number of revisions to the MTFS to take into account year to date performance, additional pay pressures (referenced above), the Chancellor's spending plans for 2015/16 and other matters. This has increased the cumulative projected deficit over the forecast period, as follows:

Period	*2014/15*	*2015/16*	*2016/17*	*2017/18*
January 2013 MTFS: Projected cumulative budgeted deficit (before use of reserves).	£16.5m	£33.8m	£48.1m	£59.2m
July 2013 MTFS: Projected cumulative budgeted deficit (before use of reserves).	£18.3m	£34.4m	£49.8m	£68.2m

The updated forecast also provides an initial forecast for the 2018/19 position; this projects an in-year deficit of £17.9 million, and a cumulative deficit of £86 million. This cumulative deficit represents almost 40% of the Council's net budget (before the use of reserves).

Meeting the 2013/14 budget has proved challenging during the year so far, with a £5.0 million deficit reported to Cabinet in July. The main driver for this variance is increasing demand for specific services (notably in Looked After Children).

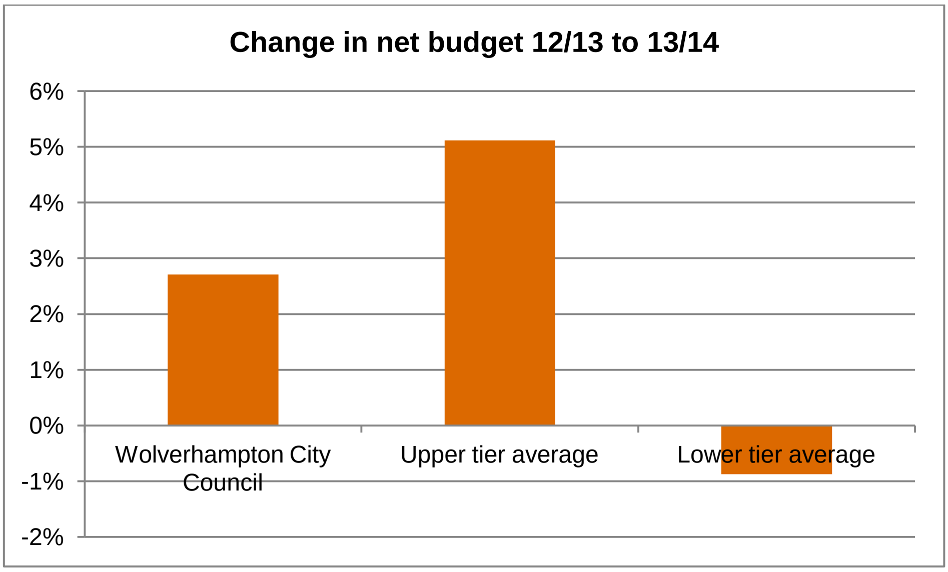
£6.6 million of savings have been delivered against the 2013/14 target of £17.3 million, and therefore the Council is on track to achieve a significant proportion of its in-year savings target. However year to date performance will add yet more pressure by requiring identification of further savings and avoid a call on reserves at year end.

Change in Net Budget

The 2013/14 budget details a £59 million reduction in total forecast spend relative to the 2012/13 baseline , without taking into account new savings identified in 2013/14, specific grant income or use of reserves. That reduction is primarily linked to corresponding reductions in grant funding. However the overall net budget requirement before use of reserves and including the impact of new savings proposals has increased by £6.3 million (2.7%) from 2012/13.

Key drivers behind this include significant pay pressures forecast for 2013/14 (£8.9 million budgeted impact) primarily related to single status, inflationary pressures of £2.3 million and a reduction in grant funding for specific services of £10.6 million.

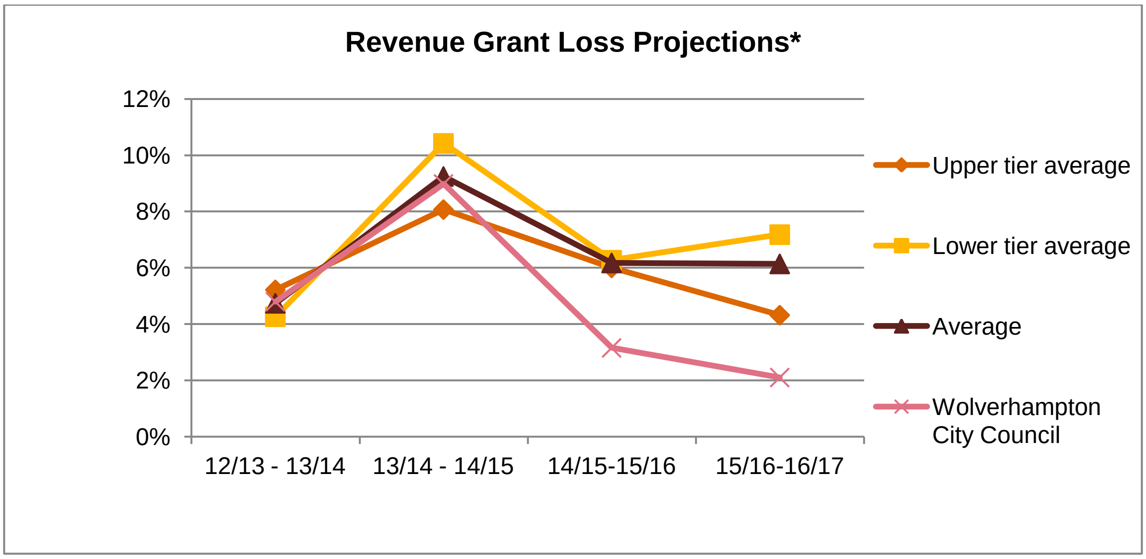
The net budget requirement for 2013/14 also includes £17.3 million of new savings in addition to the recurring impact of £19.9 million of budgeted savings in 2012/13.



Relative to its peers, Wolverhampton is showing a lower than average increase in net budget requirement, although greater than that forecast in lower tier authorities.

Level of Grant Funding

Funding levels from Central Government have been in decline since the 2010 CSR, and further reductions are forecast over the five year forecast period. Though funding allocations for 2015/16 onwards have yet to be announced, significant reductions have been forecast in the MTFS, with core RSG funding (now incorporating a number of previously separate funding streams) reducing from £104.6 million in 2013/14 down to £67.4 million in 2017/18.



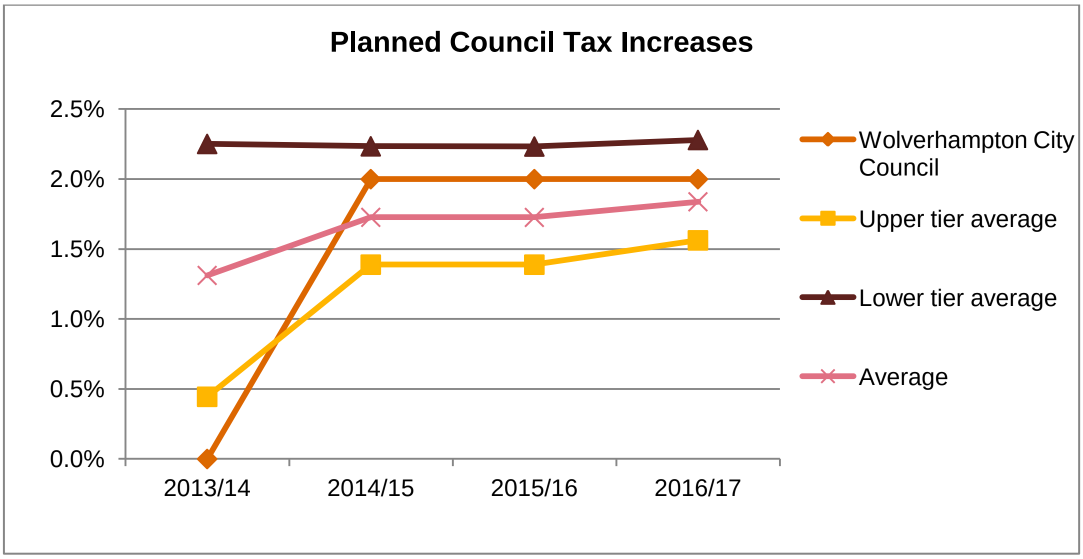
* Considers movements in forecast Revenue Support Grant, Locally Retained Business Rates and Top Up Funding.

The graph above shows that for 2013/14 and 2014/15 your predictions in respect of core revenue funding are broadly in line with our benchmark sample. Subsequent years show greater variation, and whilst the overall trend is in line with your peers the data does suggest that the initial MTFS forecast is less prudent than others in the sector in this respect.

However, following the June 2013 announcement of further cuts to Communities budgets in 2015/16, you revisited the above assumptions and have factored in additional reductions for total revenue grant funding in 2016/17 and 2017/18 (as well as including further forecast reductions for 2018/19). This has equated to an annual forecast reduction in RSG funding of 9%, as well as reducing the level of forecast increases in NNDR receipts, reflecting revised city growth forecasts.

Council Tax

The Council has frozen Council Tax charges for 2013/14, and has received additional government funding of £0.9 million as a result. In the MTFS annual increases of 2% are predicted for 2013/14 onwards, representing a greater than average forecast increase and in part making up for four years of frozen council tax charges.



The degree of uncertainty over any proposed increase is recognised; any proposal would first have to be ratified by Council and would be an unpopular decision with residents. Taking this into account, has the Council considered the impact of not achieving the desired increase in rates, and what this would mean for its existing financial targets and required savings?

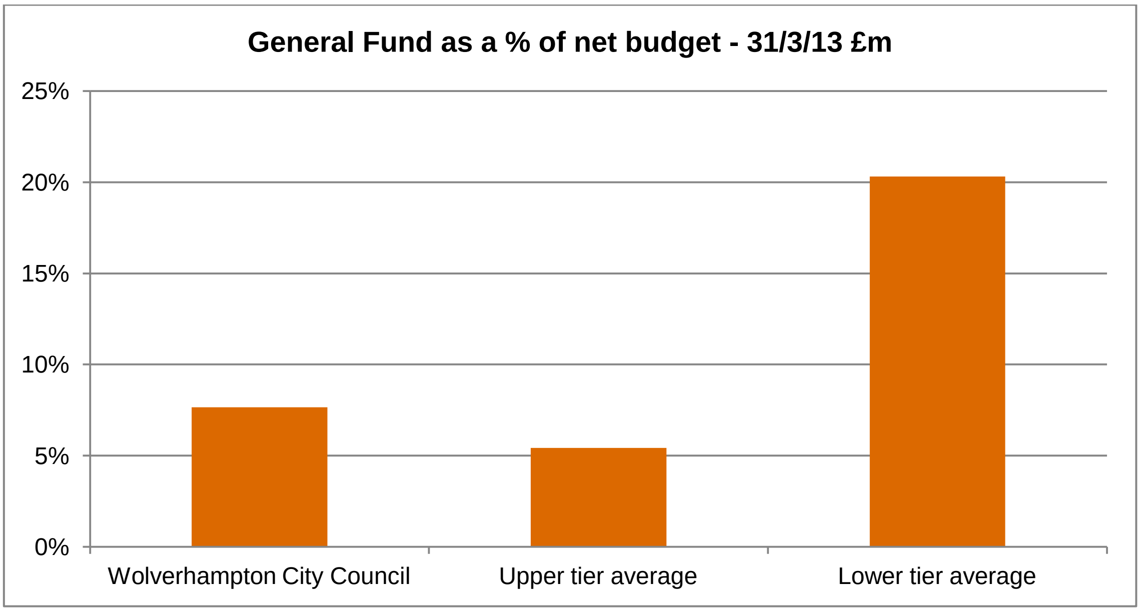
Sensitivity Analysis

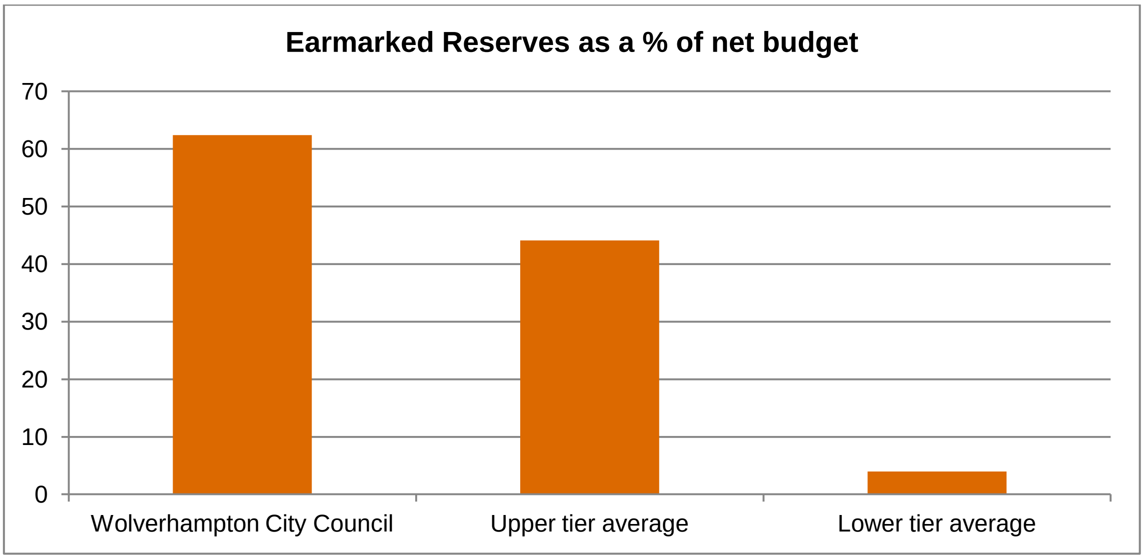
Sensitivity analysis of your inflation assumptions was performed to give an idea of what total expenditure would look with a 1%, 2%, 3% and 4% increase and decrease in inflation. In broad terms, a 1% increase in inflation above your assumptions would result in a cost pressure of approximately £6.3 million in 2013/14. The Council has an earmarked reserve of £2.0 million to help absorb un-forecast inflationary increases, however this only provides a limited amount of contingency in such a situation.

Reserves – General Fund

The Council's financial policies have stressed that the General Fund balance is only to be used in specific circumstances, not simply to support overall financial position. During 2012/13 a total of £3.6 million of the opening £19.5 million balance was used to balance the budget.

Other usable reserves include £20 million designated as a 'budget support reserve', to assist the Council in responding to financial challenges over the medium term. Of this £2 million has been allocated to reduce pressures over the forecast period (expected to be recognised during 2013/14), however it is acknowledged that balancing the medium term deficit needs to be driven by identifying 'new' savings rather than placing reliance on the draining of existing reserves.





As evidenced in the graphs above, the Council holds a reasonable General Fund balance compared to our benchmark sample and its other earmarked reserves are significantly larger than its peers as a proportion of the Council's net budget requirements. This inevitably provides an additional level of contingency should savings plans not be fully realised, though as noted, the use of reserves to support financial performance is not a sustainable budgetary strategy.

We note that you have an annually approved 'Use of Reserves and Provision' policy which helps to ensure the proper and effective use of reserves. It is important to continue to focus on achieving sustainable savings to balance the Council's budget, and that any proposed drawing of reserves is properly justified by management, and appropriately challenged.

Section II: Conclusions

Summary of assumptions:

The key assumptions supporting your MTFS are broadly consistent with those seen elsewhere in the sector, and whilst there are some notable deviations the assumptions employed appear reasonable and acknowledge the scale of the financial challenge presented.

In those areas where assumptions appear less prudent than our benchmark sample you have subsequently revisited the appropriateness of those assumptions in light of updated information, and have adapted your forecasts accordingly.

Conclusion

We have reviewed your MTFS and the assumptions which lie behind it. We have compared you with other, similar Local Authorities and taken into account our wider understanding of the Local Government sector. We have also considered the Council's track record in:

- setting realistic budgets;
- delivering services within budget;
- delivering planned saving targets; and
- maintaining adequate levels of reserve balances.

Despite the preparation you have undertaken and the prudent assumptions you have made, there continues to be a risk around delivery of your MTFS. The main risks you face as an organisation to non achievement of your medium term financial strategy include:

Slippage: you may not be able to achieve the savings you want either from a service reduction or through efficiencies

Timing: The timing of savings, service reductions and funding announcements will impact how you deliver against your MTFS

Assumptions: We have gone some way above to assess the assumptions you have applied in your MTFS. If these assumptions turn out to be inaccurate, this would have a significant impact on your ability to deliver a balanced budget over 5 years.

You need to ensure that you continue to monitor progress against the plan, paying particular attention to changes in the original assumptions you have made.

This work will contribute to our use of resources conclusion; we expect to report the outputs of this work in September 2013.