



INFRASTRUCTURE AND GOVERNMENT

# **Bolton MBC**

## **Review of the Medium Term Financial Strategy**

September 2006

AUDIT

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# 1 Executive summary

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## 1.1 Introduction

The Medium Term Financial Strategy (MTFS) is the key financial document that underpins the strategic direction of an organisation. The MTFS reflects the overall service plans and strategies that are in place and the identified corporate issues. Its purpose is also to provide guidance and direction to the production of the Bolton Plan and to the subsequent year's service strategies. We have reviewed the processes surrounding the MTFS and have undertaken a "healthcheck" to ensure it recognises national and local risks.

## 1.2 Key findings

Overall the Council has a relatively robust approach to its MTFS, but there are a number of areas where good practice can be adopted and the MTFS further strengthened. The key findings are:

- a strong business planning cycle is in place, both Corporately and at a Service Area level. The MTFS is one of the products of this cycle, rather than the sole aim;
- the MTFS takes account of and reflects the strategic direction within the Bolton Plan;
- areas for Corporate investment are identified via a formal process as part of the business planning cycle, with input both Corporately and at a Service Area level;
- a risk register is maintained and reviewed to ensure that it is up to date and appropriately reflects the risks facing the Council; and
- the un-audited financial statements demonstrate that levels of General Fund balances have been successfully maintained above the minimum level recommended by the Director of Finance. Current financial reporting forecasts that this will continue in 2006/07.

# Executive summary *(Cont.)*

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## 1.3 Key Learning Points

- All significant costs should be considered within the MTFS where appropriate. Where costs are unknown but likely to be incurred it would be prudent to establish balances to support estimated future outflows;
- increasing corporate accountability for Service Areas in respect of financial performance against the MTFS would provide additional assurance that Service Area MTFSs are being achieved and that the overall financial position of the Authority is maintained; and
- ongoing reductions in available resources increases the need for Local Authorities to ensure that Service Areas are held accountable for Corporate investment and can demonstrate that planned outputs have been achieved.

## 1.4 Way forward

We will discuss the findings of the review with officers to agree an action plan to address the key issues going forward. In addition, we shall continue to work with officers to constructively challenge the delivery of action plans.

## 2 Introduction

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### 2.1 Background

Financial management is a key element of a Council's overall management arrangements. In May 2004, CIPFA introduced its new model of financial management which included the following definition:

*"Financial management is the system by which the financial aspects of a public body's business are directed and controlled to support the delivery of the organisation's goals."*

The Medium Term Financial Strategy (MTFS) is an instrumental document in this process and should assist the Council in determining policy and financial choices.

### 2.2 Objectives and scope of the review

The scope of our audit is to undertake a health-check of the MTFS and associated processes to ensure that they meet the requirements laid out within the Use of Resources key lines of enquiry. Specifically, this health-check will ensure that:

- the MTFS reflects the strategic direction of the Council (Section 3);
- key national and local initiatives are incorporated (Section 3);
- arrangements to monitor and review the MTFS are in place (Section 3);
- the MTFS incorporates areas of good practice (Sections 3, 4 & 5);

It will also consider how investments in services are monitored, reviewed and assessed in terms of the service outcomes they achieve, a specific requirement of the Value for Money element of the Use of Resources work (section 4).

Finally, it will consider the degree to which the Council's approach to reserves and the MTFS are integrated (section 5).

We have considered these objectives both at a Corporate and service level. Our work at a service level has focused on Environmental Services.

# Introduction (*Cont.*)

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## 2.3 Audit approach

Our approach has been to:

- review key documentation
- review selected service plans
- interviews and discussions with key officers
- compare with other Councils and best practices identified through both our Use of Resources work and specific MTFS reviews .

## 2.4 Acknowledgements

We would like to take this opportunity to thank all those staff at the Council who have supported this review.

## 3 The medium term financial strategy

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### 3.1 Introduction

This section reviews the MTFS to ensure that it reflects developments in the Council's strategic and service planning framework and associated corporate projects and issues in the Council's medium-term horizon. The section also considers the plans for developing, maintaining and monitoring the MTFS.

### 3.2 Background

The Council's MTFS was updated in April 2006 to incorporate the 2006/07 budget decisions. This followed a business planning process in late 2005 and early 2006 which provided a three year perspective of the Council's financial planning.

The MTFS is supported by an annual business planning cycle, both corporately and at a Service Area level. This sets out the factors and inputs that it has been driven by, including:

- the Bolton Plan;
- Service Area three year strategic plans and the financial impact of these strategies;
- financial factors that will affect the Council over the next three years;
- cost of capital investment, in line with the investment strategy;
- anticipated levels of Government support;
- the Council's response to the Gershon efficiency initiative;
- overall availability of resources; and
- levels of Council Tax.



# The medium term financial strategy (Cont.)

## 3.3 Strategic direction

Our review confirms that the MTFS and Service Area MTFSSs take account of and reflect the strategic direction within the Bolton Plan. One of the key objectives of the MTFS is to ensure that financial resources are used to contribute to the achievement of the Council's ambitions, priorities, plans and targets. The Council's planning cycle allows for the MTFS to be one of the products of the business planning process rather than the sole aim. Various documents underpin the MTFS, which provides an executive summary of the budget over a three year period. These documents demonstrate a clear link between the aims and objectives set out in the Bolton Plan and the service developments and improvements featuring within strategic budgets.

## 3.4 Key national and local issues

Annually, each Service Area produces a Big Issues report, the purpose of which is to identify the issues impacting on the service over the next three years. This is produced as part of the Corporate Business Planning Process (CBPP), and requires each Service Area to take a three year view of issues arising from legislative or other changes that are likely to have a financial or other impact. The potential financial consequences, both in terms of revenue and capital, are then assessed over the period. Information will also feed down from the centre via Big Issues guidance circulated by the Director of Finance, thus ensuring that they are included within the CBPP.

The MTFS reflects some of the key national and local issues faced by the Council. These issues include:

- Efficiency savings. The MTFS and Service MTFSSs reflect the Gershon efficiency savings requirement determined by the Council. The Service MTFSSs identify specific efficiency savings, and the Corporate MTFS incorporates these savings to minimise Council Tax increases.
- Capital requirements of the Bolton Plan. A combination of capital receipts and prudential borrowing has been identified to support capital investment in services.
- Government waste recycling targets. In order to achieve recycling targets investment in new facilities will be required by the Waste Disposal Authority, which in turn is likely to increase the Council's waste disposal levy.

## The medium term financial strategy (Cont.)

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A number of issues that have been disclosed within the current MTFS have not been costed. These include:

- Pay and grading review which has been undertaken across all the Council's operations. This will not impact on the current financial year but the Council will need to incorporate these costings within the new MTFS covering 2007/08-2009/10.
- Neighbourhood Renewal Funding (NRF) is likely to come to an end in 2008/09. The Council currently receives £5-6m per annum via NRF, and it is anticipated that either NRF will be extended or that some of the provision will be incorporated within the RSG. The impact of these changes need to be considered and incorporated into the MTFS as the situation becomes clearer.

The current MTFS does not include any reference to the ongoing equal pay compensation. This will have a future financial impact on the Council, but has not been costed or disclosed as an unknown cost or uncertainty in the current MTFS. It is recognised that there are a number of areas of uncertainty and sensitivity in relation to this that would limit the scope of the MTFS, and although the future costs of the equal pay review were not known at the time of the production of the current MTFS, it is highly likely that significant additional costs will be incurred in 2007/08 and beyond. There will be a potentially significant financial impact on all Local Authorities and therefore it would be prudent for the MTFS to have reflected these liabilities by starting to build up a balance within the General Fund reserves to fund such costs.

### **Recommendation 1**

The MTFS should recognise issues that will significantly impact on the Council over the current three year period. It would also be prudent to provide balances within the MTFS to support significant costs, even where they have not yet been fully quantified.

# The medium term financial strategy (Cont.)

## 3.5 Monitoring and review of the MTFS

Performance against the MTFS at a Service Level is reported to the relevant Executive Member, with copies of reports also being provided to Corporate Finance. Quarterly monitoring of the MTFS at a corporate level is produced for the Executive Member for Corporate Strategy and Finance (the Leader of the Council) who meets with the shadow executive members. This report covers the following:

- General Fund balances;
- high level summary of budget issues at Service Area level;
- high level update of risks to the budget position;
- high level update of the efficiency saving forecast;
- monitoring of the capital programme; and
- summary of the Prudential Indicators.

The formal Corporate monitoring of the in-year financial performance of the Service Area MTFSs could be further strengthened. Budget difficulties or underperformance at Service Area level may not immediately impact on the MTFS as Service Area balances may be sufficient fund deficits. However, where Service Areas have deficit reserve positions, this impacts on the Council's overall financial position, and there may be a future requirement to fund such deficits from General Fund balances where these cannot be recovered at a service level. As such, the Council should ensure that Corporate monitoring of Service Area financial performance is undertaken, and assurance should be gained that action is being taken either Corporately or at a Service Area level to recover deficits. The devolved approach adopted by the Council potentially results in a lack of incentive for Service Areas to efficiently manage resources. As a result, individual Service Areas may build up deficit reserve balances which will directly impact upon the Council's overall reserve balances and also on its in-year financial position.

### Recommendation 2

The Council should ensure that the financial position of Service Areas is formally monitored and assurance gained that action is being taken to address in-year budget deficits.

## The medium term financial strategy (Cont.)

Usually, any year-end under or overspend will be accounted for within the reserve balances of a Service Area, and is therefore retained by the Service Area. This is a traditional approach to budget monitoring, with emphasis of accountability placed at Service Area level rather than Corporately.

Good practice identified at other Local Authorities is for Service Areas to be directly accountable to the Corporate centre, with budget surpluses and deficits returned centrally at year-end. This ensures that all Service Areas are fully accountable for their financial performance and that resources can be effectively directed to priority areas. This is an increasingly relevant issue with the continuing reduction in resources available to Local Authorities.

### Recommendation 3

The Council should consider whether it would be appropriate for year-end surpluses and deficits against individual Service Area budgets to be retained Corporately. This will provide additional accountability at Service Area level for financial performance, and will ensure that any surpluses realised can be redirected Corporately depending upon need and priorities.

### 3.6 In year changes to the MTFS

The MTFS is unlikely to change in year at a Corporate level. As discussed in section 3.5, service budget pressures would not usually be funded Corporately. Pressures would instead be managed within the current budget (i.e. the bottom line allocated in the MTFS at the start of the year) or via the use of reserves, to be recovered in future years. Any Service Area that has a deficit reserve position is required to devise an action plan to enable balances to be recovered. Our review of Environmental Services has identified current reserve deficits of £3.471m at the start of 2005/06 and a projected closing deficit of £3.860m. We have been unable to identify an action plan to recover these balances.

### Recommendation 4

The Council should ensure that formal action plans are in place within Service Areas that hold deficit reserve balances. Progress against action plans should be monitored to provide assurance that any deficits are recovered as planned.

## The medium term financial strategy (Cont.)

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Any corporate issues that arise in year would be funded from balances, unless an issue was significant to the extent that balances were considered insufficient to support this. In this instance, the MTFS would be reconsidered. It is recognised that the Council has adopted a risk based approach to the setting of General Fund balances that would be expected to account for such events, thus ensuring that current balances are sufficient to support any such issues (see Chapter 5).

To ensure that financial plans continue to be relevant throughout the year, individual departments within Service Areas are able to vire between budgets. In some circumstances, changes to a Service Area budget may be financed Corporately. Environmental Services has received an additional £508,000 in 2006/07 following the Corporate decision to revert back from bi-weekly to weekly grey bin collections. This is not a regular occurrence and is usually the result of a political decision that has a direct impact on budgets. Any such funding would come from the General Fund balance.

## 4 The MTFS and service improvements

### 4.1 Introduction

This section considers how investment in services is monitored, reviewed and assessed in terms of service outcomes achieved. This is a specific requirement of the Value for Money element of the Use of Resources work.

Local Authorities should assess the degree to which the allocation of additional resources have resulted in service improvements and they should map investment in priority areas to the measurement of outcomes / quality of improvement in services.

### 4.2 Background

Additional resources are usually directed to priority areas to tackle priority issues. The Bolton Plan sets out the Council's main purpose, which is to improve the quality of life for everybody in Bolton. The Council has developed six key aims which sit at the core of the business planning process, providing a clear focus for corporate resources and for departmental goals. The table below sets out these key aims:

**Table 1: The key aims**

Key aims	
Regenerating Bolton's deprived communities	Strengthening the economy and improving skills, image and culture
Improving health, care and support for people living in the community.	Combating crime, the fear of crime and tackling substance misuse
Improving homes and the local environment	Improving achievement and outcomes for children and young people

# The MTFS and service improvements *(Cont.)*

## 4.3 Additional resources for corporate priorities

The Council funds additional investment for corporate priorities from General Fund balances. As such, balances are transferred to individual Service Areas and become part of that Service Area's annual budget. The current level of balances held has been greater than the minimum level recommended by the Director of Finance but below that recommended by the Audit Commission. As such, to a large degree, the Council has not been in a position financially to centrally fund investment in Service Areas. Service Areas are instead charged with funding the cost of internal growth, and these tend to be managed by in-house savings and increased income generation. As a result, such growth is more likely to be incremental over a number of years. In 2005/06, corporate resources were allocated as follows:

- Waste management measures - £0.4m;
- Environmental investment - £0.1m.

As part of the current MTFS, corporate resources have been allocated for 2006/07 as follows:

- Foster Care growth - £0.5m;
- Additional Waste Collection costs - £0.764m.

Areas for investment are determined via a formal process assessing potential areas for investment, as identified either Corporately or by Service Area.

Good practice states that Service Areas receiving funding for corporate priorities should be asked to demonstrate how additional resources are to be spent, how this is coherent with the corporate priorities, the expected service improvements and indicators to measure these. Growth areas should be linked to Best Value Performance Indicators (BVPIs) or other measures of performance. BVPIs are monitored both at a Service Area level and also Corporately via quarterly at Executive Management Team, where BVPIs that are critical to the Council in terms of CPA are reported.

At present, there is no explicit link between Corporate investment in Service Areas and a monitoring of the output to provide assurance that investment is resulting in improvements in outcomes and is furthering the objectives of the Council. The ongoing reductions in available resources for Local Authorities increases the need to ensure that Service Areas are accountable corporately and that investments result in positive change.

## The MTFS and service improvements (*Cont.*)

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### **Recommendation 5**

The Council should explicitly consider the outcomes of Corporate investment in services to provide assurance that value for money is being achieved and that Corporate priorities are being met. This could be undertaken at Service Area level, with a high level overview provided corporately within current quarterly reporting arrangements.



## 5 Reserves strategy and risk management

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### 5.1 Introduction

This section considers the extent to which the MTFS and reserves strategy are integrated, including how well risk management arrangements are integrated into financial planning.

### 5.2 Reserves policy

The General Fund reserve is used to support areas of growth and investment, and to provide financial support across the Authority for any cross-cutting issues. Any issues that are specific to an individual Service Area would usually need to be funded from within existing budgets.

The financial risks and levels of reserves are considered as part of the annual budget setting process. This balance is held separately from the individual reserves maintained by each Service Area. The Council has assessed the levels of reserves and balances that it requires and these are reflected in the MTFS. Although reserves are not within the 3% of spend indicated as a minimum level by the Audit Commission (equating to £9m for 2005/06 and £10.5m for 2006/07), the Council's balances are above the risk-based minimum level of balance of £5.5m recommended by the Director of Finance for 2006/07 (£5.2m for 2005/06). The recommended minimum balance is made following the assessment of factors and financial risks that may create a requirement for the use of reserves. For 2005/06 and 2006/07 these include the following generic considerations:

- revenue contingencies for unexpected demands such as price variations and pay awards;
- fluctuations in interest rates on Council debt;
- overspends against the capital budget;
- unpredicted demand-led expenditure;
- service deficits that may require Balances to offset budget deficits carried forward or generated in year; and
- general risks with a potential financial impact. Contaminated land, pay and grading reviews, potential LATs penalties, and land drainage / flood control have been identified as such risks.

## Reserves strategy and risk management (*Cont.*)

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The appropriate level of reserves is determined based on previous years' experience as to the required level. The required balance is not arrived at via a formal calculation. We note that the level of balances has been effectively managed in the past and that levels of reserves have been maintained. However, the lack of a formal approach increases the risk of balances being insufficient when called upon.

The current reserves policy does not explicitly consider the financial consequences of known corporate risks in determining the level of reserves that are required. The Council should ensure that a formal risk based reserve strategy is in place which explicitly considers the financial consequences of known corporate risks in determining the level of reserves that are required. A good practice example can be found at Section 5.6.

### **5.3 Council Risk register**

The Council's reserves policy allows the minimum level of reserves to be set following an assessment of the major issues which could affect the Council. For 2006/07 the Council has set this at £5.5m. As part of the risk management arrangements, the Council maintains a risk register. The risk register is held centrally but is contributed to by individual Service Areas. All the risks identified at both the Corporate and Service Area level will be included on an overall Council-wide Risk Register which is used to regularly review the risks identified, ensure monitoring is in place and seek to identify any correlation or overlap of risks so that efforts can be focussed effectively and efficiently on managing those risks.

These risks are considered at a Service Area as part of the Big Issue reporting process, and financial consequences are incorporated into subsequent budgeting and financial forecasting. They are also taken account of Corporately when appropriate levels of reserves for the year are identified (see Section 5.1). The top corporate risks are reviewed and considered by the Executive Management Team to provide assurance that such risks are adequately controlled. A risk management process is in place which involves an annual review of the Council's risks, and in 2005, Zurich Management ran a Corporate risk management exercise in which the Council re-examined previously identified risks.

# Reserves strategy and risk management (*Cont.*)

## 5.4 Level of reserves

Section 5.2 identified that the minimum reserves level for 2005/06 has been set at £5.2m. It is noted that the un-audited balance sheet as at 31 March 2006 showed a general fund balance of £7.6m (after excluding a provisions to provide “bridging finance” for Bolton Market refurbishment).

The minimum level of reserves for 2006/07 has been set at £5.5m. £2.09m of the 2005/06 closing balance has been committed to support the 2006/07 budget as part of the budget strategy. Other movements have seen the reserve increase (largely due to the Airport dividend being greater than that budgeted for). The current General Fund balance is above the minimum level recommended by the Director of Finance. A year-end balance of £5.951m has been forecast, as at the end of the first quarter of 2006/07. Again, this is above the minimum level recommended by the Director of Finance.

## 5.5 Risk management techniques in financial management

Risk management arrangements in financial planning are becoming an increasingly important part of effective financial management arrangements. Environmental Services financial management arrangements reviewed have confirmed that detailed quarterly monitoring takes place. This covers:

- Performance information reports on best value performance indicators;
- Revenue expenditure, setting out variations in budget and projected outturn position;
- Capital expenditure, outlining the capital position against available programmes;
- Reserve movements, outlining the projected outturn position of the department’s reserves;
- Gershon targets, analysing targeted efficiency savings and their projected performance against targets set; and
- Areas of risk that threaten financial forecasts and the budget position.

## Reserves strategy and risk management (*Cont.*)

### 5.6 Good practice example

Appendix 2 identifies an example of a risk based approach to formulating required levels of General Fund reserves through the use of a risks register process by which budget risks are identified and rated using a risk matrix. This matrix is shown in the table below.

**Table 2: Budget Risk Matrix**

	Probability		Impact
Score	Description	Score	Description
1	Rare	1	Insignificant (£0 - £k)
2	Unlikely	2	Minor (£k - £k)
3	Possible	3	Moderate (£k - £k)
4	Probable	4	Major (£k - £k)
5	Almost certain	5	Highly significant (Over £k)

The scores from each category (Probability and Impact) are multiplied to produce a total score, which determines the risk classification as high, medium or low. For these risks the good practice council has produced a corporate budget risk register and action plan for the risk as shown in Appendix 2. The risks as identified in the budget risk register and other corporate risks can then be used to start to formulate the target level of reserves.

## Reserves strategy and risk management (*Cont.*)

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### **Recommendation 6**

The Council should ensure that appropriate risk management techniques are used to explicitly consider the financial consequences of known Corporate risks when determining required levels of reserves.

# Appendix 1 - Recommendations and action plan

*** <i>Significant residual risk</i>		** <i>Some residual risk</i>		* <i>Little residual risk</i>
	<b>Recommendation</b>	<b>Priority</b>	<b>Management response</b>	<b>Responsibility and timescale</b>
1	The MTFS should recognise issues that will significantly impact on the Council over the current three year period. It would also be prudent to provide balances within the MTFS to support significant costs, even where they have not yet been fully quantified.	**	<p>The point raised is accepted, but sensitivity surrounding some issues means that it is not always practical to disclose all costs within the current MTFS. Members are informally made aware of any such issues and, where appropriate, funds are set aside to contribute to meeting these liabilities.</p> <p>The particular issues arising in this review are being formally discussed with Members and incorporated into the MTFS process.</p>	Not applicable.

## Appendix 1 - Recommendations and action plan (*Cont.*)

*** <i>Significant residual risk</i>		** <i>Some residual risk</i>		* <i>Little residual risk</i>
	<b>Recommendation</b>	<b>Priority</b>	<b>Management response</b>	<b>Responsibility and timescale</b>
2	The Council should ensure that the financial position of Service Areas is formally monitored and assurance gained that action is being taken to address in-year budget deficits.	**	<p>The Council is satisfied with the current approach to budget ownership, by which Service Areas are responsible for financial performance and monitoring. Corporate input is achieved via Director of Corporate Resources liaison with policy accountants on a quarterly basis to provide central monitoring.</p> <p>It is therefore felt that adequate arrangements are already in place.</p>	Not applicable.

## Appendix 1 - Recommendations and action plan (Cont.)

*** <i>Significant residual risk</i>		** <i>Some residual risk</i>		* <i>Little residual risk</i>
	<b>Recommendation</b>	<b>Priority</b>	<b>Management response</b>	<b>Responsibility and timescale</b>
3	The Council should consider whether it would be appropriate for year-end surpluses and deficits against individual Service Area budgets to be retained Corporately. This will provide additional accountability at Service Area level for financial performance, and will ensure that any surpluses realised can be redirected Corporately depending upon need and priorities.	*	The Council's approach, by which Service Areas retain budget surpluses and deficits, ensures that ownership is taken for financial performance, and also enables longer term financial decisions to be made.  It is felt that this is the most appropriate way for the Council to operate to ensure the effective use of resources.	Not applicable.
4	The Council should ensure that formal action plans are in place within Service Areas that hold deficit reserve balances. Progress against action plans should be monitored to provide assurance that any deficits are recovered as planned.	**	Agreed.  Formal action plans will be prepared by Service Areas to provide assurance that any deficit reserve balances are recovered within agreed timeframes.	Steve Arnfield  July 2007

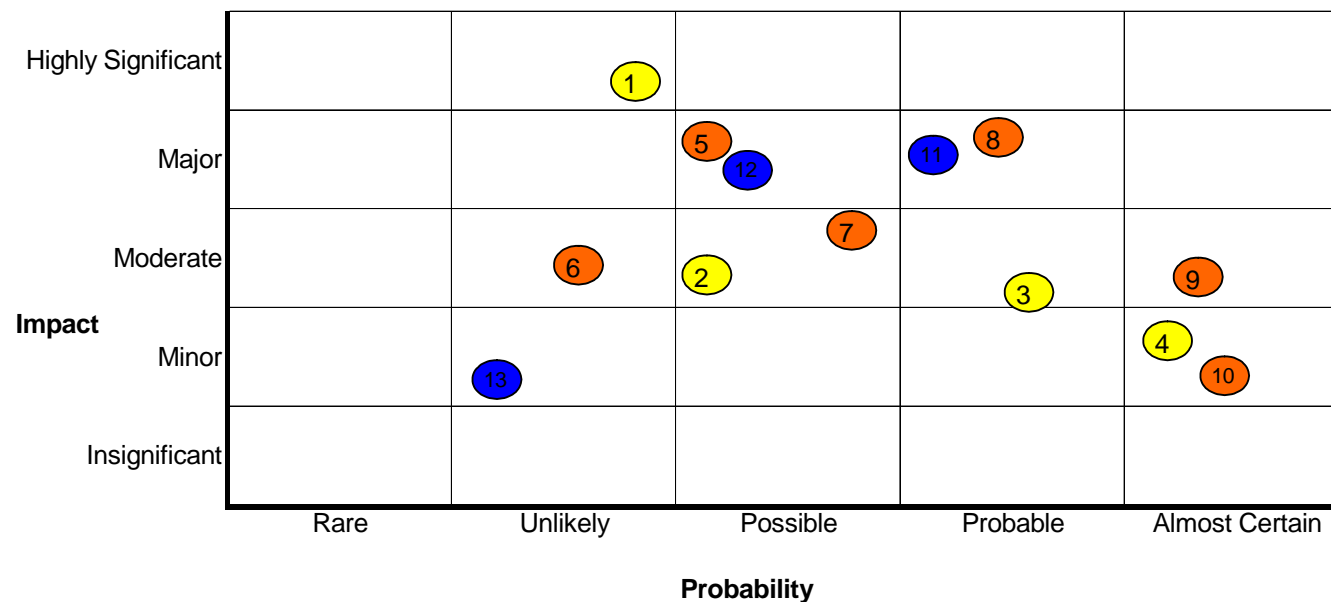


## Appendix 1 - Recommendations and action plan (Cont.)

*** <i>Significant residual risk</i>		** <i>Some residual risk</i>	* <i>Little residual risk</i>	
	<b>Recommendation</b>	<b>Priority</b>	<b>Management response</b>	<b>Responsibility and timescale</b>
5	The Council should explicitly consider the outcomes of Corporate investment in services to provide assurance that value for money is being achieved and that Corporate priorities are being met. This could be undertaken at Service Area level, with a high level overview provided corporately within current quarterly reporting arrangements.	**	Agreed.  Service Areas will explicitly consider achievements and outcomes in relation to areas of corporate investment. Corporately, this will be monitored by exception within current reporting arrangements.	Steve Arnfield  October 2006
6	The Council should ensure that appropriate risk management techniques are used to explicitly consider the financial consequences of known Corporate risks when determining required levels of reserves.	**	Agreed.  Financial consequences in relation to risks faced by the Council are formally assessed by the Director of Corporate Resources as part of his advice on Balances. However, an audit trail via appropriate supporting documentation will be produced to demonstrate the assessment of the minimum required level of General Fund balances.	Steve Arnfield  February 2007

## Appendix 2 - Good practice example from another council

### Budget Risk Example



## Appendix 2 - Good practice example from another council (Cont.)

The colour of the risk refers to the Service Area and the number in the risk circle refers to number of the risk in the action plan. The table below then shows the above in a register format, which can be organised by either risk number, risk rating or department order.

No	Risk description	Key budget impacted	P	I	Rating	Department
					High risk	
					Medium risk	
					Low risk	