

**CYNGOR SIR POWYS COUNTY COUNCIL.**

**AUDIT COMMITTEE**

**29<sup>th</sup> July 2022**

**REPORT AUTHOR:** Head of Finance (Section 151 Officer)

**REPORT TITLE:** Price Inflation Variation and Volatility Pressures

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**REPORT FOR:** Information

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**1. Purpose**

- 1.1 The purpose of the report is to inform the Governance and Audit Committee of the processes which have been employed to monitor and manage the price increases for Councils goods and services in response to rising inflation and supply demand.
- 1.2 Explain the actions taken by the Head of Financial Services to identify, manage and control all requests and their impact on services and Council budgets.

**2. Background**

- 2.1 The Council are, and have been, receiving requests from its suppliers, providers, and contractors for increases in contract values to take account of their increased costs brought about by the volatility in current markets.
- 2.2 Some of these have been as a result of the Ukraine War and rising inflation, with others derived from the impact of Covid, Brexit Transition and other forces, all are having an impact with requests for increases above and beyond levels set out in terms and conditions of some contracts.
- 2.3 There are stated inflationary variation clauses in many of the Councils contract clauses (e.g., Retail Price Index (RPI) or Consumer prices Index (CPI)), though some of these are capped at a maximum of 3%. Current Inflation however is running at 11.7% (RPI).
- 2.4 Other contracts are governed by wholesale prices of product or market commodity prices (e.g., energy and steel) and the council has limited options to manage these.
- 2.5 Whilst the Welsh Government has not issued any specific guidance to assist local authorities with these demands, the Council is relying on Welsh Procurement Policy Note 09/21 Sourcing Material for

Construction Projects issued in October 2021 at a time when there was considerable increases on commodities and shortages of material affecting the viability of the delivery of construction projects and contractors. The Council is following the principles set out in the policy note when experiencing demands for inflationary rates over and above contracted value.

- 2.6 In summary it also states that it is reasonable to expect contractors to absorb price fluctuations within moderate tolerances as prices for materials/service and supplies will change regularly depending on the level of supply and demand within markets and based on what they knew at the time they set their prices. However, where these tolerances are exceeded then Contracting Authorities could consider appropriate variations using processes highlighted within the policy, one of which is the requirement that suppliers agree to provide transparency and supporting evidence for any claim.

### **3. Example of Market Price Increases**

- 3.1 Prices are increasing in a significant way for many products and services that are purchased by the Council. Front Line Services across the County generally require transportation of one form or another and the effect of fuel increases is being felt across social care, highways, transport and for many other services.
- 3.2 Tender prices will be affected by these increases for any future retender or new requirements and the cell is keeping a watchful eye on market prices from various sources.
- 3.3 A good example of sudden price change is where British Steel imposed a 25% average increase on their customers in April this year in the face of soaring costs. This is likely to affect prices for construction, new vehicles, vehicle spares etc. Others that we are aware of include:
- Gas Increases of between 55% and 70% or more (larger and smaller sites)
  - Electric estimated at 73%
  - Food - some products increasing by between 20 and 30% and some shortages on product available
  - Building materials generally 25 to 35%
  - Fuel has increased by 60 to 70%
  - CPI is currently standing at 9.1%
  - RPI is currently standing at 11.7%

### **4. Ukraine Procurement Supply and Costs Cell**

- 4.1 The Head of Finance has some time ago set up a specific cell to help the Council manage the impacts of any significant increases from our supply

chains and its effect on services and service budgets. Terms of reference have been agreed (see Appendix 1), protocols developed to help services identify specific inflationary and budget pressures or shortages in supply and for the Section 151 Officer and Heads of Service to jointly consider budgetary impacts.

- 4.2 A register is maintained so we can track each request and its impact and undertake, where above normal contract provisions, an exercise with the supplier or contractors to an 'open book' review of their increased costs enabling the Council to challenge and consider the requests being made.
- 4.3 An example of this consideration would be where an increase of 60 % on fuel might have been demanded but will only have an overall impact on a contract of 6% if we jointly calculate that only 10% of the costs of the contract is spent on fuel as it may be for instance in a transport contract which has high reliance of the prices of fuel.
- 4.4 The options considered when demands for large increases are received are:
  - Product Substitution
  - Doing Less or lessening the requirement e.g., for Capital schemes living within overall budget and therefore reducing the range of works to be carried out
  - Reorganise services to lower the use of specific products or services
  - Look at alternatives to reduce energy consumption over the medium to longer term e.g., Photovoltaics/electric vehicles etc (aligns with sustainable decarbonisation agendas)

## 5. **Current Contract Position**

- 5.1 The increase can be divided into two separate categories. There are increases that cannot be negotiated as they are imposed or governed by commodities or by national price rises imposed by wholesalers and manufacturers for instance who may not directly be contracted to Powys. This would include Fuel and Energy but also Food items from wholesalers which are distributed by our contracted suppliers.
- 5.2 Other contracts which may be affected by increased costs are governed by variation clauses or may even be silent on inflationary increases and in some cases the suppliers have not received increases for several years though these may have been built in at time of tender and procurement. Some contracts have not received increases for many years but when we wish to exercise extension options suppliers will increase prices at that point.

5.3 Many clauses offer inflationary options such as CPI but to a threshold of 3% and this has worked very well for many years, but the recent and substantial increases have suggested that this may not be viable in the current market climate.

5.4 It's important that to ensure competition and a strong market that officers may need to reconsider this approach within its tenders for the immediate future or suppliers may not bid or may build in extra costs to cover this risk or even force suppliers out of the market.

## **6. Contract Increase Register**

6.1 A register of all price variations being dealt with is maintained and being informed by services through the cell. So far, the list is limited but we are expecting an increase in requests. Concern being expressed in areas such as social care, transport, and construction projects either through requests from current suppliers or through tender price.

## **7. Budgetary Implications**

7.1 Services will need to consider any cost implications as part of their service budgets and manage as much as possible within them. Any movement of budget between headings is governed by the virement process set out in the Financial Procedure Rules which forms part of the Council constitution.

7.2 Where services cannot contain costs within their budgets a business case will be submitted to the Executive Management Team for consideration to draw down additional funding, again this process is governed by the virement process.

7.3 The situation will be closely monitored and reported through the quarterly budget monitoring reports. In part Council did agree the potential use of reserves for pressures held at risk, such as Covid and rising inflation, estimated to be at a level of £2.8 million.

7.4 If these costs are deemed recurrent they will need to be reflected in the Services Finance Resources Model as a cost pressure and funding be considered as part of the budget setting process for 2023-24.

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# APPENDIX 1

## UKRAINE PROCUREMENT SUPPLY AND COST CELL

### Terms of Reference

23<sup>rd</sup> March 2020

#### Aims and Objectives

The purpose of the Procurement Cell (the “Working Group”) is to aid support, provide guidance and oversight to Gold to manage monitor to services who are experiencing supply difficulties, demands for higher prices, and reluctance of companies to fix pricing for any projects

The Working Group members undertake to:

1. Monitor Market conditions and supply chain issues and provide support
2. Provide oversight of any substantial pricing issues and any effect on budgets and to provide protocols and type of evidence required in line with guidance for acceptance or otherwise of increase to maintain services.
3. Compare Increases against contractual obligations and advise services of any necessary changes required
4. The Working Group members role will be to bring any increases requested to the working group to consider any market issues which ay effect service delivery or delivery of projects and/or budgets
5. Ensure consistency is applied across the authority in dealing with these issues
6. Implement and Policy or guidance notes issued by Welsh Government
7. All services to feed into group which in turn can be fed back to Welsh Government and WLGA

#### Membership

The Steering Group membership reflects the importance of the working group during the volatile market conditions and the future effects on service budgets

Current Steering Group members are:

Jane Thomas Head of Finance and S151 Officer	Vince Hanly Commercial Services
Clive Pinney	Ellen Sullivan
Marianne Evans	Dylan Macphee
Sarah Quibell	Anwen Orrells
Graham Evans	Paul Bradshaw
Catherine Richards	John Forsey
Sally Beech	Dylan Owen (Jo Harris)
Neil Clutton	

#### Governance and Management

The Steering Group will be chaired by Jane Thomas and Vince Hanly to Deputise.

The Working Group shall meet (regularly) and build intelligence on market conditions. Briefings to be written and provided to Gold regularly.