

The Chief Financial Officer's report to the Council on the robustness of the estimates for the purposes of the Council's 2018/19 budgets and the adequacy of the reserves.

**Introduction**

1. The Local Government Act 2003 section 25 introduced a specific personal duty on the "Chief Financial Officer" (CFO) to report to the Authority on the robustness of the estimates for the purposes of the budget and the adequacy of reserves. The Act requires Members to have regard to the report when determining the Council's budget requirement for 2018/19. If this advice is not accepted, the reasons must be formally recorded within the minutes of the Council meeting. Council will consider the recommendations of Cabinet on the budget for 2018/19 and determine the planned level of the Council's balances.
2. Sections 32 and 43 of the Local Government Finance Act 1992 also require billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the net budget requirement.
3. There are a range of safeguards, which exist to ensure local authorities do not over-commit themselves financially. These include:
  - The CFO's s.114 powers, which require a report to the Cabinet and to all Members of the local authority if there is or is likely to be unlawful expenditure or an unbalanced budget
  - The Prudential Code, which applied to capital financing from 2004/05.

**The Robustness of the Recommended Budget**

4. A number of reports to the Cabinet in recent years have highlighted the difficulties inherent in setting budgets, not least because of significant changes in the level and complexity of Government funding and continuing pressure to protect and develop services. At the same time major changes have been introduced to the way the Council is structured and managed and the way services like waste and leisure are delivered. These changes and the extended period of low economic growth are still ongoing and represent significant risks to the Council's ability to evaluate all the financial pressures it faces.
5. However the Council's budget process, developed over a number of years, has many features that promote an assurance in its reliability:
  - The rolling four year forecast provides a yardstick against which annual budgets can be measured
  - The early commencement of the budget process and the clear annual timetable for both Members and officers including full integration with the business planning process promotes considered and reasoned decision making
  - The establishment of budget parameters in the summer is designed to create a clear focus before the budget process commences

- The analysis of the budget between the continuing services and one off District Development Fund items smoothes out peaks and troughs and enables CSB trends to be monitored
  - The adoption of a prudent view on the recognition of revenue income and capital receipts
  - The annual bid process whereby new or increased budgets should be reported to Cabinet before inclusion in the draft budget
  - Clear and reasoned assumptions made about unknowns, uncertainties or anticipated changes
6. With a Cabinet system the onus is on Portfolio Holders to work closely with Directors to deliver acceptable and accurate budgets. This role has been taken seriously and has helped enhance the detailed knowledge of the Cabinet. There is an established process that allows the Resources Select Committee to challenge and debate the detailed budgets with the Finance and Performance Management Cabinet Committee.
  7. The budget is therefore based on strong and well-developed procedures and an integrated and systematic approach to the preparation of soundly based capital and revenue plans and accurate income and expenditure estimates. The risks or uncertainties inherent in the budget have been identified and managed, as far as is practicable, and assumptions about their impact have been made.
  8. **The conclusion is that the estimates as presented to the Council are sufficiently robust for the purposes of the Council's overall budget for 2018/19.**

**Factors to be taken into account when undertaking a Risk Assessment into the overall Level of Reserves and Balances**

9. Guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA) states that the following factors should be taken into account when the CFO considers the overall level of reserves and balances:
  - Assumptions regarding inflation;
  - Estimates of the level and timing of capital receipts;
  - Treatment of demand led pressures;
  - Treatment of savings;
  - Risks inherent in any new partnerships etc;
  - Financial standing of the authority i.e. level of borrowing, debt outstanding etc;
  - The authority's track record in budget management;
  - The authority's capacity to manage in-year budget pressures;
  - The authority's virements and year-end procedures in relation to under and overspends;
  - The adequacy of insurance arrangements.
10. These issues have formed the basis for budget reports in the past and they remain relevant for the current budget.

## **Factor Assessment**

### **a. Inflationary pressures**

11. Every year base budget estimates are produced and then different inflation factors are applied to the resultant figures to take budgets to out-turn prices. It is inevitable that there will be either over or under provision for the full cost of inflation, as prices will vary against the estimates made. Efforts have been made to predict the level of inflation in the coming year, although the uncertainty around the overall economic position makes this more difficult. We have already seen growth in inflation being caused by the weakness of the pound after the Brexit vote. How the Brexit negotiations proceed and the general state of other economies across the world will have implications for the United Kingdom.
12. The Consumer Price Index (CPI) rose by 2.7% in the year to December 2017, down from 2.8% in November. This figure was below market expectations of 2.8%. It is likely that CPI will continue at a similar level through 2018 and the Bank of England's target rate of 2% will not be achieved. This is likely to result in reductions in real wage growth and restrain household spending. Pay increases for the year to October 2017 were running at 2.5%, inclusive of bonuses. However, pay rises in the public sector will not match those in the private sector so the Medium Term Financial Strategy (MTFS) includes an allowance of 2% for pay awards for 2018/19 and 2019/20 and 1% for subsequent years. In the budgets the centrally held vacancy allowance has been maintained at 1.5%. This reflects the level of salary underspend currently being seen in 2017/18.

### **b. Estimates on the level and timing of capital receipts**

13. The Council has always adopted a prudent view on the level and timing of capital receipts. Capital receipts are not recognised for budgetary purposes unless they have been received or their receipt is contractually confirmed prior to the budget being ratified. Currently, the only significant disposal anticipated in 2018/19 is the St Johns road site.
14. The exception to this is receipts from council house sales. In this instance because sales occur throughout the year assumptions are made about their generation. Following the increase in Right to Buy discounts the number of sales increased significantly. During 2012/13 there were 13 sales but 2013/14 saw the number rise to 53, with a further 46 in 2014/15. This dipped back to 20 for 2015/16 but a higher level was evident again in 2016/17 with 46 sales for the year. Going forward, it is anticipated that there will be 30 sales in 2017/18 and that this will then reduce to 24 per annum for subsequent years.
15. Even with the Authority's substantial capital programme, which exceeds £127m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2022 will be just under £2.1m. By this stage the amount in the reserve will consist entirely of one for one receipts to be re-invested in new housing stock. Priority will be given to capital schemes that create future revenue benefit, either through increased income or reduced costs. The Treasury Management Strategy has been amended to state that new borrowing will only be undertaken for capital schemes with positive revenue consequences.

**c. Treatment of demand led pressures and savings**

16. Demand led pressures have stabilised on the benefits and homelessness services and the additional resources previously allocated appear adequate. It is disappointing that none of the £0.5m of CSB growth for the waste contract included in the 2016/17 revised budget has been recovered through changes to the service. Key income streams are generally on target, with the exception of development control. The income from development control should be greater in 2018/19 as some large developments are currently stalled by the local plan process.
17. The net savings for the budget have arisen from two main areas. Firstly, the treatment of capital as part of the new leisure management contract has been different to what was anticipated. This has had the effect of increasing capital expenditure but has generated greater CSB savings. Payments fluctuate over the life of the contract so the MTFS will need to be reviewed and updated accordingly. Secondly, the saving from the People Strategy which, like the new leisure contract, is spread over the period of the MTFS. With the phases of the restructure expected to take varying times to complete a saving of £437,000 has been included for 2018/19 followed by further amounts of £1,058,000 in 2019/20 and £200,000 in 2020/21. A number of other smaller savings have also been identified and together these provide a sound base for the 2018/19 budget. However, there is still a need for further savings in 2020/21 and beyond and action is needed to take forward a new development scheme.

**d. Risks inherent in partnership arrangements etc**

18. There are several partnership arrangements, some of which carry risks of varying degrees in monetary terms. The risks have not been specifically identified in the budget but are underwritten through the Authority's balances.

**e. Financial standing of the authority (i.e. level of borrowing, debt outstanding etc)**

19. The only borrowing, as at 1 February 2018, is due to self-financing for the Housing Revenue Account (HRA). This had not been a significant concern as the 30 year business plan for the HRA demonstrated that the Council would be considerably better off in the long term. However, the requirement to reduce rents and support the house building programme meant the HRA business plan had to be re-examined in 2017/18 and it will be kept under review.
20. It has been evident for a while that the future for local authorities is financial self-sufficiency, based on income from local taxation and service generated revenues. This Council has already moved a long way in that direction and the loss of funding from both Revenue Support Grant and New Homes Bonus has been allowed for in the MTFS. The reductions in the draft settlement were larger than had been anticipated in the MTFS, with the combined effect for 2018/19 being £100,000 worse than anticipated.
21. Local retention of non-domestic rates has been helpful and has resulted in far higher levels of income to the Council than DCLG had predicted. However, significant concerns remain about the new 2017 rates list and changes to transitional relief and the appeals process. The combination of changes makes it difficult to predict the amount of our income. There also remain several hundred appeals outstanding on the current rating list, including one against the

largest item on our rating list, and it is difficult to robustly predict what the combined outcomes will be. It is also difficult to predict the outcome from pooling and whilst this reduces the levy the Council pays there is additional risk in 2018/19 with the widening of the pool.

**f. The authority's track record in budget management, including its ability to manage in-year budget pressures**

22. The Authority has a proven track record in financial management as borne out by the Annual Audit Letters from the Authority's external auditors. A comparison of actual net expenditure with estimates over a number of year's shows that the Council rarely experiences over spends of any significance.
23. Most managers have received training on budget management. A course involving an external trainer, the CFO and the Chief Internal Auditor has now been supplemented with additional detailed training on a directorate basis being provided by accountancy staff.
24. The quarterly budget monitoring reports on key budgets to both the Finance and Performance Management Cabinet Committee and the Resources Select Committee will continue throughout 2018/19. The production of these reports during the year is essential in identifying emerging problems at the earliest opportunity. This allows maximum benefit to be accrued from any corrective action taken.

**g. The authority's virement and year-end procedures in relation to under and overspends**

25. The Council has recognised and embedded virement procedures that allow funds to be moved to areas of pressure. Although underspends and overspends are not automatically carried forward, the Council does have an approved carry forward scheme for capital and DDF which is actioned through the formal provisional outturn report to the Finance & Performance Management Cabinet Committee in the summer of each year.

**h. The adequacy of insurance arrangements**

26. The Council is in a five year agreement following an OJEU procurement exercise. This exercise attracted interest from several insurance companies but the best overall package of cover was offered by the Council's existing insurer, Zurich Municipal. Despite the general increases seen in the market for insurance, the new long term agreement was procured at a lower cost with some increases in indemnities. The Council still maintains an insurance fund, which as at 31 March 2017 had a balance of £1.01m.

**i. Pension liabilities**

27. The latest triennial valuation as at 31 March 2016 showed an increase in the funding level of the scheme to 85% (the value of the scheme's assets cover 85% of the liabilities). This has allowed the actuaries to reduce both the deficit payments and the projected recovery period. However, ongoing contributions have increased from 15.9% to 18% and this results in small amounts of CSB growth in 2018/19 and 2019/20.

## Statement on the adequacy of the reserves and balances

28. The Use of Resources assessment previously conducted by the external auditors moved on from the formulaic approach of CPA to achieve the 'good' ranking for reserves. The old formula had suggested that the Council should maintain a General Fund balance of at least £0.89m but no more than £17.86m. The Council's current best estimate of the General Fund balance at 31 March 2019 is £5.4m as shown in the Annex 5 b. This is clearly within the range specified but as a benchmark is not particularly useful. Therefore a risk assessment related to the Authority's individual circumstances is provided as a more meaningful benchmark against which the adequacy of the balances can be determined.
29. The following table lists those developments and cost pressures within the four-year forecast that offer the greatest risk to financial stability.

Item of risk	Estimated value of financial risk £000	Level of risk %	Adjusted level of risk £000
Basic 5% of Net Operating Expenditure			700
Negative RSG earlier and larger than draft settlement	500	20	100
Failure to achieve savings from People Strategy and other transformation projects	3,000	40	1,200
Pay award being settled 1% in excess of estimate for 18/19 and future years	800	25	200
Inflationary pressures between 1-4% higher than budget	600	40	240
Loss of North Weald Market Income	2,800	10	280
Unintended consequences of HRA reform impacting on General Fund	2,000	10	200
Localisation of Council Tax Benefit - Increase in caseload not covered by funding	1,000	20	200
Retention of non-domestic rates – losses on appeals	2,000	40	800
Additional costs arising on waste contract and not being mitigated	2,000	40	800
Renegotiating External contracts and partnership arrangements	4,000	25	1,000
Emergency Contingency	800	20	160
Total	19,500		5,880

30. A number of contracts have been granted to outside bodies for the provision of Council services. The failure of any of these contracts would lead to the Council incurring costs, which may not be reimbursed. Other than certain bond arrangements there is no specific provision made in the estimates for this type of expenditure, which therefore would have to be covered by revenue balances.

31. The presentation in this table is not a scientific approach, but a crude attempt to put a broad order of scale on the main financial risks potentially facing the Council. It is meant to be thought provoking rather than definitive. It is certainly not a complete list of all the financial risks the Council faces but it shows the potential scale of some of the risks and uncertainties and the impact they may have on the Council's balances if they were to come to fruition.
32. Based on the old CPA formula there is an expectation that an authority should carry a level of balance that equates to at least 5% of the net operating expenditure (NOE) of the Authority. During the period of the four-year plan NOE is expected to average out at £13.6m, which suggests a figure of £682,000.
33. The Council has always been conscious of its balances position as can be demonstrated by budget reports over many years. Fortunately for the Council the question had not been whether it had a sufficient level of balance but rather that it had too much. The General Fund balance reduced by £1.07m in 2016/17 (after use of £1m to fund the capital programme) to leave a balance of £6.21m at 31 March 2017.
34. Policies have been determined previously to bring about reductions, including the use of revenue to finance the capital programme, and the current MTFs has deficit budgets in the final two years. The current policy allows for balances to fall to no lower than 25% of Net Budget Requirement (NBR). This is slightly different from the NOE stated above, the average NBR figure for the next four years is expected to be £12.9m therefore 25% of that figure equates to £3.2m. The current four-year forecast shows balances still at £4.9m at the end of 2021/22.
35. The risk assessment undertaken above suggests that 20-25% of NBR is an appropriate range for this authority to be maintaining its balances within. By 31 March 2022 balances will represent 38% of NBR, which is adequate. However, Members are aware that this situation can only be achieved with both the planned CSB savings being delivered and significant further savings or income being identified in the final two years of the MTFs.
36. The only balances in the capital fund going forward will be receipts from the sale of Council houses that will need to be re-invested in the new build programme. Additional borrowing will be required to fund the capital programme in 2018/19. Further borrowing is affordable but Members have stated that new borrowing should only be for capital schemes with positive revenue consequences.
37. The main earmarked reserve is the District Development Fund (DDF) which is used to keep one off items separate from the base budget. At 31 March 2017 the balance on the DDF was £4.19m, which was an increase of £0.45m in the year. The DDF is predicted to have a balance of £1.09m at the end of 2021/22, although this requires transfers in from the General Fund Reserve of £2.65m over the period of the MTFs. The only other earmarked reserve with a significant balance is the Insurance Reserve, which stood at £1.01m at the end of 2016/17. There were no significant movements in the year on this fund.
38. The HRA revenue balance of £3.85m at 31 March 2017 is expected to decrease by £1.56m in 2017/18 and then a further £0.27m in 2018/19 to remain above £2m. The balance on the Housing Repairs Fund is expected to reduce slightly over the next year, from £1.26m to £1.13m. The Housing Major

Repairs Reserve is predicted to decrease from £12.2m to £11.4m. The HRA business plan will be reviewed during 2018/19 to assess any further steps necessary to respond to the ongoing reductions in rent levels.

- 39. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2018/19 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term. There are particular concerns about the delivery of the savings from transformation, the introduction of a new system of “Fair Funding” and the difficulties of estimating income from the retention of business rates.**