Annex 14

The Chief Financial Officer’s report to the Council on the robustness of the estimates for the purposes of the Council’s 2010/11 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 2010/11. 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 2010/11 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 “Credit Crunch” are still ongoing and represent significant risks to the Council’s ability to assess properly 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. Changes to the process have also created the facility for far greater consultation, particularly with the development of the Overview and Scrutiny Panel which deals with finance and performance management issues. With a Cabinet system the onus is on Portfolio Holders to deliver acceptable and accurate budgets. This role has been taken seriously and has helped enhance the detailed knowledge of the Cabinet.

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 2010/11.**

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 inevitably vary against the estimates made. This is particularly relevant in the current unstable economic climate. Efforts have been made to predict the level of inflation in the coming year, although the difficulty in making these predictions has been highlighted by the December inflation figures. Inflation, as measured by the annual rate of increase in the Retail Prices Index, rose from 0.3% for November to 2.4% for December. To find a larger month on month increase you have to go back to July 1979. By co-incidence this was also an election year but the problem of inflation was much greater then as the increase was from 11.4% to 15.6%.

12. If inflation remains at the current level for long there will inevitably be pressure for a higher pay award. Negotiations for 2009/10 were protracted and resulted in a settlement of 1.25% for the lowest paid staff (scale points 4 to 10) and 1% for most other staff (scale point 11 up to and including Assistant Directors). Directors and Chief Executives received no increase in 2009/10. The Medium Term Financial Strategy (MTFS) includes an allowance of 1.5% for pay awards, which is believed to be prudent. Recruitment and retention is less of a concern, but some difficulty is still being experienced in certain areas. In the budgets the centrally held vacancy allowance has been maintained at 2%. This reflects the ongoing underspends, with total salaries at December 2009 being 3.7% underspent. It is unlikely that the Authority will have a full establishment throughout 2010/11 and so this allowance is reasonable.

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, a position justified by past experience. 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. Cabinet is unlikely to agree further disposals until the property market has improved and so no significant disposals are anticipated in 2010/11.

14. The exception to this relates to receipts from council house sales. In this instance because sales occur throughout the year assumptions are made about their generation. Although sales have fallen dramatically from previous years and the pattern of less than 10 sales per annum is expected to continue.

15. Clearly if the forecasts contained in this report are not realised in full, there could be a financial impact on the General Fund because investment income to that account has been based on that level of sales. However, this is relatively unlikely given the low numbers involved.

16. Even with the Authority's substantial capital programme, which exceeds £54m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2014 will be £9.9m. The Capital Strategy continues to emphasise that priority will be given to capital schemes that will create future revenue benefit, either through increased income or reduced costs.

c. Treatment of demand led pressures and savings

17. Last year, the largest demand led pressure facing the Council was for the green waste service. To address this need and reduce the reliance on biodegradable sacks an amended service was introduced with a second wheeled bin. This has required considerable investment in terms of CSB, DDF and capital. However, this is a key service and by moving forward in this way it has been possible to secure significant ongoing revenue support from Essex County Council and one-off capital assistance to help purchase the necessary equipment.

18. The increase in demand for bus passes has reduced. The number of passes in issue had increased by more than 50% from 10,490 at 31 March 2008 to 15,564 at 31 March 2009. This is still increasing but more slowly with the current number in issue being 17,600. The Department for Transport has confirmed that responsibility for the scheme is likely to change as part of the next Comprehensive Spending Review. This will require a re-working of the grant support formulas and recent history has shown that this Authority has not benefited from such changes.

19. The "Credit Crunch" has seen new benefit claims increase by more than 25% and has also increased demand for the Council's homelessness service. These are not the only Council services to face extra demands in the current economic climate. Against this background, it is clear that in order to avoid breaching the guideline on reserves it will be necessary to achieve substantial savings in the last three years of the period covered by the medium term financial strategy.

d. Risks inherent in partnership arrangements etc

20. 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)

21. The Authority is currently debt free and intends to remain so in the medium term. Revenue reserves for both the General Fund and the Housing Revenue Account are in a healthy state.

22. The largest threat to the Authority's financial standing is the probable reduction in grant support as part of the next Comprehensive Spending Review (CSR). The overall public finances are in a very poor state and it is inevitable that the next government will have to reduce spending. It will only become clear after the general election how much of a reduction will be imposed on district councils. The MTFS assumes a reduction of 10% over the next CSR, this sees grant reduce from £9.4m in 2010/11 to £8.5m by 2013/14.

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

23. The Authority has a proven track record in financial management as borne out by the Use of Resources assessments from the Authority's external auditors. A comparison of actual net expenditure with estimates over a number of years shows that the Council rarely experiences under or over spends of any significance.

24. However, the discipline of Financial Regulations - not incurring spending without a clear budget - must be rigidly observed, and the monitoring of the riskier budgets, particularly income budgets, needs to be maintained. The quarterly budget monitoring reports on key budgets to both the Finance and Performance Management Cabinet Committee and the Finance and Performance Management Scrutiny Panel will continue throughout 2010/11. 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 Authority 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 Authority does have an approved carry forward scheme for capital and DDF which is actioned through the formal provisional outturn report to Cabinet in the summer of each year.

h. The adequacy of insurance arrangements

26. The Council is now in the final year of a five-year agreement, which was subject to a competitive tendering process. A collaborative procurement exercise is currently underway with twelve other authorities to establish new long term agreements. As part of this process a number of options on excess levels and joint arrangements are being examined. The Authority still maintains an insurance fund, which has been capped at £500,000.

i. Pension liabilities

27. Previously Members decided to take the option to phase in the increase required in employer's contributions, following receipt of the 2007 triennial valuation of the Pension Fund. The previous ongoing employer's contribution was 10.1%, which has to increase to 13.1% over the three-year life of the valuation. Members decided to introduce the increases by 1% per annum and consequently make higher deficit payments, although total payments over the three years are lower with this option.

28. Council agreed in December 2007, as part of approving the Capital Strategy, that the policy of capitalising deficit payments would continue and a further £2.5m of capital receipts were moved to the Pension Deficit Reserve to fund this. Annual applications are made to Department for Communities and Local Government (DCLG) for a capitalisation directions, as separate directions are required for the Housing Revenue Account and the General Fund. These applications have been made since 2005/06 and the only year when a full direction was not given was 2006/07 when the capitalisation was limited to 57.19% of the value of the application.

29. The regulations for issuing capitalisation directions were changed for 2006/07, with a "Two Gate" system being introduced. Applications must satisfy the previous criteria to clear Gate 1 but applications will not pass Gate 2 until the national economic impact has been considered in total. Confirmation that the applications have been successful at Gate 1 has now been received, although Gate 2 confirmations are not issued until the end of January. If capitalisation

directions had not been provided the additional charges to revenue for 2008/09 would have been £662,000 General Fund and £311,000 HRA. As the deficit payments have not changed significantly the amounts at risk in future years are broadly similar.

Statement on the adequacy of the reserves and balances

30. The Use of Resources assessment conducted by the external auditors has 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 2011 is £6.9m as shown in the Annex 11 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.

31. 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 level of financial risk £000	Level of risk %	Adjusted level of risk £000
Basic 5% of Net Operating Expenditure			1,100
Grant reduction being 20% instead of 10% over next CSR	500	40	200
Pay award being settled 1% in excess of 1.5% est. for 10/11 and future years	600	20	120
Inflationary pressures between 1-4% higher than budget	600	20	120
Loss of North Weald Market Income	4,000	20	800
General Income between 1-4% less than budget	600	10	60
Interest Rates 1% less than budget	500	10	50
Emergency Contingency	800	20	160
Capitalisation applications refused for 09/10 and 10/11	1,300	40	520
Renegotiating External contracts and partnership arrangements	Say 1,000	10	100
Total	9,900		3,230

32. The income generated from the market at North Weald airfield is significant to the ongoing financial well being of the Authority. Uncertainties surrounding the future of the airfield create a risk to the Authority that needs to be recognised and quantified hence its inclusion in the list above. A number of contracts have been granted to outside bodies for the provision of Council services. The failure of any of these contracts would inevitably 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.

33. 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.

34. 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 £18.2m, which suggests a figure of £910,000.

35. The Council has always been conscious of its balances position as can be demonstrated by budget reports over many years. Fortunately for the Authority the question had not been whether it had a sufficient level of balance but rather that it had too much. Balances have been increasing since 2003/04 and are predicted to have peaked at £8.2m at 31 March 2010.

36. A number of policies have been determined previously to bring about reductions and the current policy reflects that deficit budgets are now necessary for the balances to fall. 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 £17.3m therefore 25% of that figure equates to £4.3m. The current four-year forecast shows balances still at £6.7m at the end of 2013/14.

37. The risk assessment undertaken above suggests that 20-25% of NBR is about the range that this authority should be maintaining its balances within. By 31 March 2014 balances will represent 38% of NBR, which is perfectly adequate. However, Members are aware that this situation can only be achieved with CSB savings and have stated a clear target of reducing expenditure throughout the period of the medium term financial strategy.

38. It has already been stated that the capital fund is expected to remain in a surplus position beyond 2013/14 and the capital programme is fully funded.

40. The Council has a few earmarked reserves (e.g. DDF), which are intended to be used for specific purposes over a period of time of more than a single financial year. These earmarked reserves have been excluded from the assessment for this reason.

41. The HRA revenue balance of £6.1m at 31 March 2009 is expected to decrease slightly, by £25,000 in 2009/10 and £7,000 in 2010/11. The balance on the Housing Repairs Fund is expected to reduce over the next year, from £4.3m to £4.1m. Similarly the Housing Major Repairs Reserve is predicted to reduce from £5.2m to £4.9m. Even though reductions in reserves are budgeted the overall financial standing of the HRA and its reserves going into 2010/11 remain healthy.

42. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2010/11 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term.