Annex 9

<u>The Chief Financial Officer's report to the Council on the robustness of the estimates for the purposes of the Council's 2014/15 budgets and the adequacy of the reserves.</u>

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 2014/15. 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 2014/15 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 Finance Scrutiny Panel to challenge and debate the detailed budgets with the Finance 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 2014/15.**

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 difficulty in making these predictions is highlighted by inflation remaining stubbornly high and above the target for, and predictions of, the Monetary Policy Committee. Only the most recent figures for the year to December 2013, released on 14 January, have shown inflation actually at the target level of 2%, reducing from d from 2.1% for November. However, whilst recovery in the overall economy remains weak the Monetary Policy Committee are likely to continue their cautious stance and not intervene with increases in interest rates to reduce inflation. This has been re-affirmed in the forward guidance provided by the Bank of England's new Governor.

12. Inflation, as measured by CPI, has come down from its peak close to 3% but had remained above 2% and contributed to pressure for a pay award. Pay rates had been frozen for several years prior to the 1% increase for 2013/14. The Medium Term Financial Strategy (MTFS) includes an allowance of 1% for pay awards for 2014/15 and 2015/16. In the budgets the centrally held vacancy allowance has been reduced from 2.5% to 1.5%. This reflects the deletion of many vacant posts in January 2013 and the consequent reduction in the levels of salary under spends.

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, no significant disposals are anticipated in 2014/15.

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. Following the increase in Right to Buy discounts the number of sales has increased from previous years. The pattern of less than 10 sales per annum will end in 2013/14 with more than 30 sales likely, although this is expected to reduce to 20 for 2014/15. This indicates that the various Government initiatives to encourage lending have been effective and that it has become easier to obtain a mortgage.

15. Even with the Authority's substantial capital programme, which exceeds £91m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2018 will be £3.1m. 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

16. Demand led pressures have been evident on the benefits and homelessness services as the Welfare Reforms begin to impact. Although the pressure has been eased in part by the slow improvement in the economy. Locally the stagnation in the housing market seems to be improving, with some increases in key income streams like planning and land charges. The income from both these areas will be greater in 2013/14 than 2012/13.

17. The net savings for the 2014/15 budget have been achieved from three main areas. Firstly, the restructuring of top management has provided an ongoing saving in excess of £350,000. Secondly, the use of capital to invest in the long leasehold at Torrington Drive has boosted income by more than £220,000. The third significant item is changing pay and display parking fees, after five years of freezing them, which should provide £150,000. A number of other smaller savings have also been identified and together these provide a sound base for the 2014/15 budget. However, there is still a need for further savings in 2015/16 and 2016/17 and work is ongoing on a number of ideas to reduce net costs.

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 Authority is no longer debt free, due to self-financing for the Housing Revenue Account (HRA). Although this is not a significant concern as the 30 year business plan for the HRA has demonstrated that the Authority will be considerably better off in the long term. Revenue reserves for both the General Fund and the HRA are in a healthy state.

20. A major threat to the Authority's financial standing is further substantial reductions in central government funding. The period from 2011/12 to 2015/16 will see grant funding reduced by approximately 60%. The period beyond 2015/16 will be the subject of the next Comprehensive Spending Review and by then the improvement in the economy may have strengthened and there may have been a change of Government. This means predicting beyond 2015/16 is hazardous although if current trends are maintained there will be further reductions in revenue support grant and an increasing reliance on retained business rates.

21. Last year I expressed concern at the transfer of large financial risks to local authorities at a time of economic uncertainty. These risks were the localisation of Council Tax Benefit and the local retention of non-domestic rates. The implementation of Local Council Tax Support has been a success and the scheme has been managed within budget. In view of the success so far the scheme has been left largely unchanged for 2014/15. However, it may prove to be a concern again for 2015/16 if significant changes are necessitated by funding reductions.

22. Local retention of non-domestic rates has been more problematic and still represents a considerable financial risk. The major concern here arises from

the treatment of appeals and refunds. Even though DCLG have already had the benefit of non-domestic rates paid in respect of periods prior to 1 April 2013, all appeals regardless of start date are accounted for within the new system. This means billing authorities are refunding money that they have not benefited from in the first place. There are still more than 500 appeals outstanding and it is difficult to robustly predict what the combined outcomes will be.

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 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.

24. 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.

25. The quarterly budget monitoring reports on key budgets to both the Finance and Performance Management Cabinet Committee and Scrutiny Panel will continue throughout 2014/15. 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

26. 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 the Finance & Performance Management Cabinet Committee in the summer of each year.

h. The adequacy of insurance arrangements

27. On 23 July 2012 Cabinet decided to exercise the two year extension option to the three year contract which commenced in June 2010. The 2010 contract was entered into following a collaborative procurement exercise with twelve other authorities. Market intelligence suggested a re-tender at this time was unlikely to provide good value for money, particularly as Zurich had offered to freeze premiums in the first year of the extension. The Authority still maintains an insurance fund, which as at 31 March 2013 had a balance of £1.13m.

i. Pension liabilities

28. The latest triennial valuation as at 31 March 2013 showed an increase in the funding level of the scheme to 77% (the value of the scheme's assets only cover 77% 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 13% to 15.9% and this leaves the combined payment figure for 2014/15 and the two subsequent years similar to the current level.

29. In earlier years annual applications were made to DCLG for capitalisation directions, as separate directions are required for the Housing Revenue Account and the General Fund. It has been increasingly difficult to obtain capitalisation directions and for 2011/12 the qualifying criteria were doubled. Even though the applications for 2011/12 met the tougher criteria they were still rejected by DCLG. In view of this no applications were made for 2012/13 or 2013/14 and the full amounts of the deficit payments have been included in the CSB.

Statement on the adequacy of the reserves and balances

30. 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 2015 is £9.27m as shown in the Annex 4 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			800
Grant reduction being 10% instead of 3% beyond 2015/16	750	40	300
Pay award being settled 1% in excess of estimate for 14/15 and future years	800	25	200
Inflationary pressures between 1-4% higher than budget	600	20	120
Loss of North Weald Market Income	3,000	40	1,200
General Income between 1-4% less than budget	600	10	60
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	1,000	35	350
Renegotiating External contracts and partnership arrangements	4,000	25	1,000
Emergency Contingency	800	20	160
New Homes Bonus, income over MTFS greater than anticipated	(1,200)	30	(400)
Total	13,350		3,940

32. The estimates for income generated from the market at North Weald airfield have been reduced but this remains a key source of income. 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.

33. 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.

34. 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.

35. 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 £14.5m, which suggests a figure of £725,000.

36. 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 increased by £469,000 in 2012/13 to leave a balance of £9.67m at 31 March 2013.

37. A number of policies have been determined previously to bring about reductions and the current policy reflects that deficit budgets are necessary to support the structured reduction in spending. 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 £13.2m therefore 25% of that figure equates to £3.3m. The current four-year forecast shows balances still at £7.5m at the end of 2017/18.

38. 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 2018 balances will represent 59% of NBR, which is more than 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.

39. It has already been stated that the capital fund is expected to remain in a surplus position beyond 2017/18 and the capital programme is fully funded.

40. The main earmarked reserve is the District Development Fund (DDF) which is used to keep one off items of income and expenditure separate from the base budget. At 31 March 2013 the balance on the DDF was £3.6m, which was an increase of £0.1m in the year. The DDF is predicted to have a balance of £0.9m at the end of 2017/18, although this is likely to be reduced by the Local Plan and any further organisational changes. The only other earmarked reserve with

a significant balance is the Insurance Reserve, which stood at £1.1m at the end of 2012/13. There were no significant movements in the year on this fund.

41. The HRA revenue balance of £3.375m at 31 March 2013 is expected to increase, by £107,000 in 2013/14 and then decrease by £800,000 in 2014/15. The balance on the Housing Repairs Fund is expected to reduce over the next year, from £2.99m to £2.33m. Similarly the Housing Major Repairs Reserve is predicted to decrease from £9.998m to £6.532m. The 30 year business plan has demonstrated that under self-financing the overall financial standing of the HRA will improve significantly and its reserves going into 2014/15 remain healthy.

42. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2014/15 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term.