

The Chief Financial Officer's report to the Council on the robustness of the estimates for the purposes of the Council's 2016/17 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 2016/17. 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 2016/17 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 2016/17.**

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 low and below the target for, and predictions of, the Monetary Policy Committee. The most recent figures for the year to December 2015, released on 19 January, have shown inflation at 0.2%. The last time inflation was at the target level of 2% was December 2013 and it has been below that level on a generally declining path since. As it is more than 1% below the target the Governor of the Bank of England will be required to write another letter of explanation to the Chancellor of the Exchequer. This ongoing low inflation makes any increase in the rate of interest unlikely in the near future.
12. The trend of low inflation and even lower increases in pay has been reversed, with the 2% increase in earnings for the year to November 2015 comfortably exceeding the rate of inflation. This means people are now seeing the real value of their earnings increase. Higher pay increases are being driven by labour shortages as the employment rate of 74% is the highest since records began in 1971. 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 1% for pay awards for 2016/17 and 2017/18. In the budgets the centrally held vacancy allowance has been increased from 1% to 1.5%. This reflects the higher level of salary underspend currently being seen in 2015/16.

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 2016/17.
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 increased significantly. During 2012/13 there were 13 sales but 2013/14 saw the number increase to 53, with a further 46 in 2014/15. Although the first 9 months of 2015/16 have seen only 15 sales so the surge in sales during the last two years now seems to be slowing.
15. Even with the Authority's substantial capital programme, which exceeds £171m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2020 will be just under £3.5m. 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 are increasing on the benefits and homelessness services and additional resources have been allocated to address this. Locally the economy is improving, with increases in key income streams like development control and parking. The income from both these areas will be greater in 2015/16 than 2014/15.
17. The net savings for the budget have been achieved from three main areas. Firstly, the new leisure management contract is predicted to generate CSB savings of £75,000 in 2016/17 and £175,000 in 2017/18. Secondly, increases in income for Development Control contributing £55,000 in 2015/16 and £75,000 in 2016/17 to the CSB. The third significant item is changing pay and display parking fees, which should provide £189,000 in 2015/16 and £31,000 in 2016/17. A number of other smaller savings have also been identified and together these provide a sound base for the 2016/17 budget. However, there is still a need for further savings in 2017/18 and 2018/19 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 only borrowing 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 to contribute to the funding for the introduction of right to buy for housing association tenants mean the HRA business plan will need to be re-examined in 2016/17.
20. It is evident from the draft settlement 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 Revenue Support Grant is not a major concern. The most worrying aspect of the draft settlement is what might happen to New Homes Bonus. The consultation on sharpening the incentive sets out a variety of different possibilities and whilst the MTFS is based on prudent assumptions if each aspect of the consultation followed a worst case then an additional £1m of income could be lost very quickly.
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. The most significant concern here is still the number of outstanding appeals. There remain several hundred appeals outstanding, 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 how other members of the pool perform.

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 2016/17. 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 has now entered into a new 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 2015 had a balance of £1.07m.

i. Pension liabilities

27. 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 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 left the combined payment figure for 2014/15 and the two subsequent years similar to pre-valuation level. It is not anticipated that any applications will be made to DCLG for capitalisation directions and the full amounts of the deficit payments have been included in the CSB.

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 2017 is £7.7m as shown in the Annex 6 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 | 50 | 250 |
| Loss of New Homes Bonus more quickly than anticipated | 2,000 | 50 | 1,000 |
| Pay award being settled 1% in excess of estimate for 17/18 and future years | 800 | 25 | 200 |
| Inflationary pressures between 1-4% higher than budget | 600 | 20 | 120 |
| Loss of North Weald Market Income | 2,800 | 20 | 560 |
| 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 |
| Failure to build retail park | 4,000 | 10 | 400 |
| Renegotiating External contracts and partnership arrangements | 4,000 | 25 | 1,000 |
| Emergency Contingency | 800 | 20 | 160 |
| Total | 20,500 | | 5,590 |

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 £13.3m, which suggests a figure of £665,000.
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 £591,000 in 2014/15 (after a transfer of £0.5m to the Invest to Save Reserve) to leave a balance of £9.29m at 31 March 2015.
34. 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 £12.7m therefore 25% of that figure equates to £3.2m. The current four-year forecast shows balances still at £7.3m at the end of 2019/20.
35. 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 2020 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.
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 2016/17. Further borrowing is affordable but Members have stated that new borrowing should only be for capital schemes with positive revenue consequences.
40. 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 2015 the balance on the DDF was £3.6m, which was a decrease of £0.25m in the year. The DDF is predicted to have a balance of £0.9m at the end of 2019/20, 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 £1.07m at the end of 2014/15. There were no significant movements in the year on this fund.
41. The HRA revenue balance of £2.57m at 31 March 2015 is expected to decrease, by £83,000 in 2015/16 and then by £450,000 in 2016/17 to remain above £2m. The balance on the Housing Repairs Fund is expected to reduce over the next year, from £436,000 to £189,000. Similarly the Housing Major Repairs Reserve is predicted to decrease from £9.1m to £514,000. The HRA business plan will be reviewed during 2016/17 to assess the steps necessary to respond to new Government policies such as the requirement to reduce rent and dispose of high value voids.

- 42. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2016/17 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term. Given the current consultation there are particular concerns about New Homes Bonus and until all of the old business rates appeals are resolved these will continue to represent a significant risk.**