Supplementary Committee Agenda

Epping Forest District Council

Finance and Performance Management Cabinet Committee
Monday, 27th September, 2010

Place:	Committee Room 1 Civic Offices, High Street, Epping
Time:	6.30 pm
Democratic Services:	Gary Woodhall (The Office of the Chief Executive) Tel: 01992 564470 Email: gwoodhall@eppingforestdc.gov.uk

---

10. AUDIT OF ACCOUNTS - ANNUAL GOVERNANCE REPORT 2009/10 (Pages 159 - 184)

(Director of Finance & ICT) To consider the attached report (FPM-013-2010/11).

The External Auditor's ISA260 report is attached for consideration.

11. FINANCIAL ISSUES PAPER (Pages 185 - 198)

(Director of Finance & ICT) To consider the attached report (FPM-014-2010/11).

This page is intentionally left blank

Accountants & business advisers

Epping Forest District Council

Annual Governance Report 2009/10

September 2010

DRAFT

Contents

Appendices

Code of Audit Practice and Statement of Responsibilities of Auditors and Audited Bodies

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission contains an explanation of the respective responsibilities of auditors and of the audited body. Reports and letters prepared by appointed auditors are addressed to members or officers. They are prepared for the sole use of the audited body and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party.

1 Executive summary

1.1 Auditing standards require that we report to "those charged with governance" the key findings of our audit prior to issuing our opinion on the financial statements.

Findings and conclusions

1.2 A summary of the audit findings and conclusions is included in the table below:

Area of audit	Findings and Conclusion
Financial statements	
Key financial systems	The **key financial systems are adequate as a basis for preparing the financial statements.** However control weaknesses were identified during the course of our work.
Financial statements	**A material misstatement of £25.5m was identified as a result of audit work** in respect of the accounting for the reversal of impairment of the Council's housing stock. The correction of this amount impacted on the Council's Income and Expenditure Account by £25.5m, changing the reported outturn position from a £4m deficit to a £21m surplus, but did not have an impact on the General Fund balance. This misstatement has been corrected and the Council has decided to re-present the revised financial statements for approval. Also a number of non-trivial but not material errors have been identified and corrected. **Some areas of work are still outstanding at the time of drafting this report.** In particular, due to issues with the timely preparation of reconciliations of benefit expenditure to the financial ledger, we have not yet been able to satisfy ourselves of the material accuracy of rent allowance expenditure of £17.1m. Should the completion of our audit result in any significant issues, we will give a verbal update to the Audit and Governance Committee. We are satisfied that the Annual Governance Statement (AGS) is not inconsistent or misleading with other information we are aware of from our audit of the financial statements. **Subject to satisfactory completion of the outstanding work, we anticipate issuing an unqualified "true and fair" opinion.**
Value For Money conclusion	**We anticipate issuing an unqualified value for money conclusion.**

Acknowledgement

1.3 We would like to thank staff for their co-operation and assistance during the audit and throughout the period.

2 Introduction

2.1 This report summarises the results of our audit work completed to date in respect of the financial statements and arrangements to secure economy, efficiency and effectiveness in the use of resources for the year ending 31 March 2010.

2.2 Our report is presented to the Members in accordance with the provisions of International Auditing Standard 260 ("ISA 260"), which requires us to report key findings from the audit to "those charged with governance", prior to issuing our opinion on the financial statements.

Findings

2.3 Recommendations in response to the key findings identified by our audit of the financial statements are provided in the action plan at Appendix A. These recommendations have been discussed with appropriate officers and responses are included in the action plan. Further recommendations may result from completion of the work outstanding at the time of drafting this report, should this occur we will provide an updated Action Plan to the Audit and Governance Committee.

2.4 We would highlight that in this report we do not provide a comprehensive statement of all weaknesses that may exist in the accounting and control systems, but only those matters which have come to our attention as a result of the audit procedures performed. We have re-reported weaknesses already reported by Internal Audit where we consider them relevant to our responsibilities as external auditor.

Independence

2.5 We confirm that we are not aware of any relationships that may bear on our independence and objectivity as auditors and that our independence declaration, included in the Audit Plan for 2009/10, has remained valid throughout the period of the audit.

3 Financial statements

Requirements

3.1 We are required to provide an opinion on whether your financial statements give a true and fair view of your financial position and income and expenditure and whether they have been prepared properly, in accordance with appropriate legislation and relevant accounting guidance.

3.2 We carry out procedures designed to obtain sufficient appropriate audit evidence to determine with reasonable confidence whether the financial statements are free from material misstatement and evaluate the overall presentation in order to ascertain whether they have been prepared in accordance with relevant legislation and accounting standards.

3.3 We identify the principal areas of risk of material misstatement from our knowledge of the Council, of the environment in which it operates and from discussions with management. We address these risks by carrying out appropriate audit procedures.

3.4 We apply an appropriate level of materiality and as such the audit cannot be relied upon to identify all risks or potential and actual misstatements. Materiality is the expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole.

3.5 We set a triviality level of £48,750 for the 2009/10 financial statements audit and have not reported to you any matters arising below this level.

Reporting to those charged with governance

3.6 We are required to report to you:

- our assessment of and response to **significant risks in the financial statements**
- qualitative aspects of **accounting practices and financial reporting**
- **corrected and uncorrected misstatements**
- final draft **letter of representation** to be agreed by management and those charged with governance
- expected modifications to the **audit report**
- material weaknesses in **accounting and internal control systems** identified during our work
- **matters required to be reported by other auditing standards**
- any **other audit matters of governance interest**.

3.7 Our comments in these areas are set out in order below.

Significant risks in the financial statements

3.8 Auditing standards require that we bring to your attention areas that require additional or special audit procedures in response to areas of significant risk, such as a weakness in controls or areas requiring a higher degree of estimation by management.

3.9 We reported to you our updated risk assessment in the 2009/10 Audit Plan issued in December 2009. We have since undertaken a more detailed assessment of risk following our completion of the interim review of financial controls and review of the Council's draft financial statements. Our updated risk assessment was reported to you in our letter dated 15 September 2010.

3.10 The table below sets out the significant risks and other areas of audit focus identified in our original and updated risk assessment:

Risk area	Overall conclusion
Significant audit risks	
Housing stock valuation and numbers	The district valuer's report for housing was agreed through to the fixed asset note and revaluation reserve within the financial statements. There were no issues identified with the number or valuation of properties included within the financial statements.
Changes in the accounting treatment within the Collection Fund	The amendments the Council made within the financial statements were agreed through to the accounting treatment required under the Statement Of Recommended Practice (SORP). No issues were identified and we concluded that the agency accounting requirements of the SORP had been correctly applied in all material respects.
Benefit reconciliations of income and expenditure	Reconciliations of income and expenditure in relation to Council Tax and Rent Rebates have been tested in greater detail to ensure the figures included within the financial statements agree through to the Academy system. No issues were identified with the reconciliations, which we concluded were materially accurate and complete. At the time of drafting this report the reconciliation of Rent Allowances transactions to the financial ledger had not been audited because it was received on 14 September 2010. We will give a verbal update to the Audit and Governance Committee on the audit results on 20 September 2010.
Creditors cut off	Testing was carried out on a sample of 30 invoices either side of the year end. An error was identified with the accounting treatment of one invoice posted pre year end. As we were unable to establish that this was an isolated error an additional sample of 30 invoices was tested pre year end. We identified a further 4 invoices which were accounted for incorrectly. The absolute value of the misstatement was trivial, as was the extrapolated potential additional error, and therefore did not require adjusting.
Areas of audit focus	
Remuneration report	Testing was carried out on a sample of employees to ensure that the correct figures had been included within the new disclosure in the financial statements. No issues were identified from the testing and we concluded that remuneration disclosures were accurately stated and SORP compliant.
Consideration of service concessions under IFRIC 12	We considered the Councils assessment for the accounting treatment of service concessions under IFRIC 12, which concluded that there were no arrangements captured by IFRIC 12. We concurred with that assessment.
Expenditure raised through manual orders	At the time of drafting this report the results of our work in this area have not been finalised as we are awaiting responses to our queries on the proper quantification of the impact of a control failure, which was that some orders (excluding those in respect of the Works and Fleet departments, and those types of goods or service on the Council's exception list) had not been processed through the Marketplace system as required. A verbal update will be given to the Audit and Governance Committee on 20 September 2010.
Accuracy of benefit expenditure	Until the audit of the rent allowances benefit expenditure is complete, as referred to above, we are unable to conclude on the material accuracy of benefit expenditure. A verbal update will be given to the Audit and Governance Committee on 20 September 2010.

Accounting practices and financial reporting

Application of accounting policies

3.11 The key changes introduced by the 2009 SORP were:

- the introduction of service concession arrangements under International Financial Reporting Interpretations Committee (IFRIC) 12
- the introduction of agency accounting for the collection of council tax and national non-domestic rates (NNDR)
- the introduction of Statutory Instrument 3322/2009 and requirement to disclose remuneration information for senior officers earning over £50,000.

3.12 The Council has dealt with the implementation of these changes in an appropriate manner and assisted the audit in the review of the changes required.

The accounts preparation process

3.13 The draft financial statements were approved by Members on 29 June 2010 which was in line with the statutory deadline of 30 June 2010. As part of our planning for the audit, we prepared a detailed document request which outlined the information that we would require to complete the audit. We also met with finance staff during the audit preparation process to discuss progress with completion of the working papers.

3.14 The Council provided us with files of working papers and draft financial statements in electronic format for the first time this year, which was beneficial to the audit. However not all of the working papers requested were provided in time for the agreed start date of the audit, 9 August 2010, most significantly the reconciliations of housing and council tax benefit expenditure to the financial ledger and working papers that support the figures in the Cash Flow Statement.

Staff availability

3.15 At our request we were provided with a schedule of the planned annual leave of finance staff key contacts during the audit period. However, the schedule was incomplete which led to difficulties for our planned delivery of the audit. Although every effort was made to maximise access to those key staff during the time they were available, this put pressure on the audit timetable and increased the burden on the Assistant Director of Finance, and some other staff, as audit queries were rerouted by necessity in the absence of the key contacts.

Adequacy of disclosures

3.16 We identified a small number of departures from the expected presentation of the financial statements or where notes and other disclosures had not been presented in accordance with the SORP. These have been amended.

3.17 It is a requirement of the SORP that authorities disclose any related party transactions. As part of the process for identifying whether there are any relevant related party transactions that require disclosure, Members and Officers are requested to complete and sign declarations outlining any potentially relevant transactions. At the time of drafting this report one declaration had not been received from a serving Member.

Corrected and uncorrected misstatements

3.18 As part of our audit approach, all material balances were subject to audit testing and agreement, on a sample basis, to supporting documentation. Issues arose in respect of the following matters, which we bring to your attention:

Corrected non-trivial misstatements

3.19 Non-trivial misstatements were identified in the following areas and corrected by the Council:

- **Fixed asset revaluation:** The Council had an upward revaluation of their fixed assets of £48.4m in the financial year which was taken to the Revaluation Reserve. A significant proportion of this (£48.2m) was in relation to Council dwellings and garages. To comply with the SORP the Council should have reversed any previous impairment of these revalued assets, which had been originally charged to the Income and Expenditure Account, back through the Income and Expenditure Account, net of the depreciation which would have been charged if the impairment had not occurred. This adjustment had not been made in the draft approved financial statements. To correct this position the Council adjusted the Revaluation Reserve by £25.5m, which is the net of the value of the previous impairment (£27.2m) and the calculated value of the depreciation that would have been charged if this impairment had not occurred (£1.7m). The other side of this entry was to reflect the reversal of the impairment in the Income and Expenditure Account, which changed the reported outturn from a £4m deficit to a £21m surplus.

  Furthermore, the Council has not completely updated the spreadsheet that it maintains which records the valuation of council dwellings and garages on an asset by asset basis. This spreadsheet forms the link between the summarised Fixed Asset Register, the Valuer's report and the Revaluation Reserve. Whilst we have been able to satisfy ourselves that the values recorded in the financial statements are materially accurate (after the adjustments referred to above), failure to update the current asset values for all individual assets prevents full compliance with the SORP, which requires the Revaluation Reserve to be maintained on an asset by asset basis.

- **Debtors and creditors within financial instruments note:** The Council had not excluded all statutory debtors and creditors, for example amounts due from council tax payers, from debtors and creditors included within the financial instruments note to the accounts. The Council also included debtors net of bad debts, which is contrary to the SORP. Adjustments of £5.5m and £1.1m have been made to debtors and creditors within financial instruments respectively. The corresponding entries for 2008/09 were also restated.

- **Heritable bank impairment:** The Council have correctly calculated the most up to date position in relation to the Heritable bank impairment. However, the whole of the investment had been disclosed as a short term investment. As the impaired investment is now due back to the Council over more than one year, the invested balance should have been split between short and long term depending on when the Council are due to receive the instalments of the carrying amount. An adjustment of £673,000 was made to accurately reflect the value of the long term proportion of the invested balance receivable. A similar adjustment to disclosure for the prior year was required of £1.4m.

- **Net assets employed:** The Council had calculated cash balances for net assets employed based on the reserves available for the relevant funds. The split was not calculated correctly across all relevant expense areas, the correction of which required £333,000 to be reapportioned from the General Fund to the Housing Revenue Account within net assets employed.

- **Charitable trust fund balances:** The Council included £53,068 within creditors for amounts owed to a trust fund, for which the Council administers the bank account. This is contrary to the SORP, which requires exclusion of trust fund balances from the balance sheet, and has been corrected.

3.20 As one of the required corrections was material the Council has decided to re-present the amended financial statements for approval. We understand that this will be done by Council on 28 September.

Uncorrected non-trivial misstatements

3.21 At the time of drafting this report there are no uncorrected non-trivial misstatements to bring to your attention, as indicated in Appendix B.

3.22 We will provide an update at the Audit and Governance Committee meeting should we identify any additional items during the final clearance of outstanding issues.

3.23 The letter of representation at Appendix C includes provision for written representation, both from the Director of Finance and ICT and on behalf of the Council, of the reason for not making amendments should any come to light during the completion of the audit.

Letter of representation

3.24 The draft letter of representation has been attached as Appendix C. We do not anticipate any changes being required, other than determining whether a representation will be required in respect of uncorrected misstatements, before providing our opinion on the financial statements.

Audit report

3.25 Subject to satisfactory resolution of the following outstanding issues and final clearance of the audit, we anticipate issuing an unqualified audit opinion on the accounts:

- Receipt of two outstanding investment confirmation letters
- Receipt and audit of working papers that support the figures in the Cash Flow Statement
- Audit of the recently completed reconciliation, between the benefits system (Academy) and the financial ledger (Cedar) of rent allowances benefit expenditure for the year
- Clearance of assistant manager, manager and partner review points.

3.26 We will provide a verbal update on these outstanding issues at the Audit and Governance Committee.

Accounting and internal control systems

3.27 We have reviewed the key financial systems, which contribute to the preparation of materially accurate financial statements, to assess the extent to which we can place reliance on them for this purpose. In carrying out this work we consider:

- the extent to which your accounting and internal control systems are a reliable basis from which to prepare the financial statements
- the robustness of your accounts preparation processes.

3.28 In assessing the reliability of systems as a basis for providing financial information that is free from material misstatement, we prepared systems notes for each financial system and we evaluated the controls within those systems, with particular focus on assessing whether the controls in place to mitigate significant risks are suitably designed and operating as intended to meet their objective.

3.29 Your key financial systems are:

- Main accounting
- Cash and bank
- Payments and creditors
- Non-contracting income and debtors
- Payroll and employment costs
- Information technology
- Council tax
- Housing and council tax benefits
- National Non Domestic Rates
- Housing rents income
- Investments and investment income

3.30 We also have a responsibility to give specific consideration to the potential risk of material misstatement of your financial statements due to fraud and error, including the risk of fraudulent financial reporting. This requires us to:

- review internal controls that are designed to prevent, or detect and correct, misstatements in the accounts
- review the arrangements for preparing the financial statements
- select and test transactions and balances, including review of significant balances against expectations and substantiate individual items
- assess the significant estimates and judgements made by officers in preparing the accounts
- consider the adequacy of presentation and disclosures included in the financial statements.

Internal audit

3.31 The Council outsourced the audit of some of their key financial systems to Deloitte.

3.32 Where possible, we have placed reliance on Internal Audit's and Deloitte's work and thereby avoided unnecessary duplication of audit effort. To ensure this approach was valid, we have undertaken the following:

- reviewed Internal Audit's and Deloitte's working papers and reports
- considered the robustness of the key financial systems on the evidence of this work
- re-performed Internal Audit's and Deloitte's evaluation of controls and a sample of its testing of the effectiveness of controls, to ensure that its conclusions are soundly based.

3.33 We were able to place reliance on Internal Audit's and Deloitte's work for the testing of the effectiveness of specific controls.

3.34 As a result of our work, we have concluded that the key financial systems are generally adequate as a basis for preparing the financial statements. However, we would like to draw to your attention the following control failures which arose from work performed to underpin our opinion on the financial statements:

3.35 Internal control failures identified and previously reported by Internal Audit and Deloitte are as follows:

- **Creditors:** 5 out of 30 orders tested had not been processed through Marketplace, the Council's electronic ordering system. There are exceptions to certain areas for which orders through Marketplace are not required but none of the 5 orders were allowable as exceptions under the Council's agreed procedures. At the point of drafting this report we have not been able to quantify the value of orders that are being inappropriately raised outside of the Marketplace system and other control frameworks or, consequently, evaluate the resultant potential for material misstatement in the financial statements as a result. We will give a verbal update to the Audit and Governance Committee on this issue.

- **Council tax:** The Council has been unable to effectively complete monthly reconciliations of the amounts reported by the council tax revenue and the benefits modules within Academy throughout the year.
- **Benefits:** The rent rebate, rent allowance and council tax benefit expenditure recorded within the housing and council tax benefit system (Academy) have not been reconciled to the Council's financial ledger (Cedar) during the year. Since this matter was reported to the Audit and Governance Committee in June 2010 the reconciliations have been completed, although the rent allowance reconciliation is still to be audited, as referred to previously.
- **Benefits:** Senior benefits officers are required to perform 100% checks on claims processed by new staff and 5% checks on all daily claims processing activity. This control was not fully implemented until October 2009.

3.36 Other internal control failures pertinent to our audit that we wish to bring to your attention are:

- **Benefits:** Benefit claims should not be processed until the Anite@Work checklist of evidence is fully completed, to confirm that all necessary documentation has been received to support the benefit claim being made. Internal audit identified that claims can be processed without a completed checklist therefore the effectiveness of the control is reduced.

3.37 We will need to complete our testing of the recently received year end rent allowances reconciliation before we can conclude on the impact of the failure of this control during the year. A verbal update will be given to the Audit and Governance Committee on this matter.

Fraud risks

3.38 The primary responsibility for ensuring that your internal control frameworks are robust enough to prevent and detect material fraud and corrupt practices lies with management and those charged with governance.

3.39 In order to identify the fraud risks, and the controls you have put in place to mitigate those risks, we have:

- discussed your anti fraud and corruption arrangements with officers, and those charged with governance
- considered the extent to which the work of Internal Audit is designed to detect material misstatements in the accounts arising through fraud
- made enquiries regarding instances of actual fraud you have brought to our attention.

3.40 We did not identify any significant fraud risks that affected our audit programme for the financial statements.

Matters required to be reported by other auditing standards

3.41 There are no other matters arising from our work that we are required by other auditing standards to bring to the attention of those charged with governance.

Other audit matters of governance interest

Collection Fund creditor write back

3.42 As part of the Collection Fund restatement process, the Council identified a creditor from prior years of £126,855 which is believed to have been created through small differences on refunds processed using previous revenues and benefits IT systems. The amount is believed to have accumulated over several years but because the system has now been replaced no further analysis is available of the individual transactions making up the balance. As the Council was unable to substantiate the balance, or determine the exact nature of the liability, an adjusting entry was made to reduce creditors and increase the District Development Fund (earmarked reserve) during the accounts preparation process to reverse the balance out of the financial statements.

3.43 It is not possible to determine, with the information currently available to us, whether the write back of this sum is appropriate. A more prudent treatment would have been to continue to hold the creditor in the balance sheet until further investigations are completed. In any event, we recommend that further investigations are carried out to see if it can be determined, with any finality, whether any individuals or other entities are owed monies. If no creditor can be identified a reasonable decision on the appropriateness of the write back should be documented.

Annual governance statement

3.44 The Council has a responsibility to publish a Governance Statement, including the outcome of a review of its effectiveness, with its 2009/10 financial statements.

3.45 The initial draft of the Annual Governance Statement was not approved by the Audit and Governance Committee at its meeting of 21 June 2010. We have reviewed the revised Annual Governance Statement, received on 9 September 2010, and the supporting review of effectiveness that has been undertaken. We are satisfied that the revised Statement is not inconsistent with the evidence provided in the review of effectiveness and our knowledge of the Council.

International financial reporting standards

3.46 International Financial Reporting Standards (IFRSs) will be adopted in local government from 2010/11 and will require transitional arrangements to be put in place by the Council. Management should prepare for the adoption of IFRSs based on the Treasury timescales and ensure that staff have sufficient knowledge of IFRSs to restate the current financial statements.

3.47 The Council has made some progress since the previous Audit Commission IFRS survey in November 2009 and has completed a review of all of its leases against the IFRIC 4 criteria. The Council expects that the 2009/10 accounts will be restated prior to 31 December 2010, along with production of a set of IFRS compliant skeleton accounts. A report detailing the IFRS impact and progress is due to be presented by Officers at the November Audit and Governance Committee.

4 Use of resources

4.1 We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money).

4.2 In June 2010 the Government announced the abolition of Comprehensive Area Assessment. As a result the Audit Commission announced changes to its use of resources approach, effective immediately, which included removal of the requirement to give a score for each of the key lines of enquiry (KLOE) use of resources assessments in local government bodies. It was still necessary, however, for auditors to complete sufficient key lines of enquiry use of resources assessment work to support their statutory duty to give a value for money conclusion on the adequacy of arrangements to secure economy, efficiency and effectiveness in the Council's use of resources.

4.3 In practice, much of the use of resources assessment had already been completed at the time of the announcement, in order to meet the prior deadline of submitting indicative scores to the Audit Commission by 21 April 2010. The outcome of our considerations as to whether the Council had adequate arrangements in respect of each key line of enquiry assessment criteria is set out in the table at 4.11 below.

4.4 Our findings in respect of the work completed to the date when the removal of the scoring of judgements was announced showed that the Council had maintained its adequate arrangements in the year in those KLOE previously assessed, with some areas of improvement evident, such as the development of a more robust strategic planning framework that demonstrates an improving integration of financial and corporate processes and strengthening its strategic approach to procurement.

4.5 With regard to the new assessment area of "Natural Resources" the Council's arrangements are weaker but adequate overall. The Council is endeavouring to set a clear sustainability agenda and has a partial track record in addressing environmental issues. A strategy is in place (although it does not address all elements of the organisation) supported by an understanding of impact and target setting (which is variable in detail).

4.6 The Council has in place a Climate Change Strategy (linked to the Safer, Cleaner, Greener initiative) but has not yet completed a Carbon Management Plan and there is no single sustainability strategy in place - the Council's use of natural resources is addressed in several strategies across individual directorates/plans. The Council is making progress against its actions in the Climate Strategy e.g. introduction of double glazing/heating system; installation of smart meters but many of these actions are work in progress.

4.7 Energy and fuel usage data is collected from the Council's own operations and a database of energy use for all buildings is maintained. This information is used to identify the buildings with the worst performance. There is a 5 year maintenance plan for improvement aimed at reducing electricity usage. Records of all the Council's water usage have been kept since 2003 but no in depth monitoring has been carried out to establish usage patterns. The Council signed up to the 10:10 initiative in 2010 to reduce the carbon footprint from its own activities, however, at the time of our review the baseline year for this was still being calculated.

4.8 A staff travel survey was undertaken in 2009 and a staff travel plan was being produced at the time of our assessment. A Green Fleet Review was carried out by the Energy Saving Trust in 2009 and a more efficient system of recording mileage and fuel use has been implemented. A staff awareness campaign was piloted but there is no evidence that this has been followed up. However, a Green Champions initiative was also created in 2008/09 and will be more fully implemented to raise staff awareness. The Council is planning to provide Staff Green Driver training to contribute to staff awareness.

4.9 A Green Infrastructure Working Group meets on a quarterly basis to review the responsibilities of the Council with regards to the district's natural environment. The Working Party is updating the Council's publicly available documentation on natural resources sustainability.

Use of resources risks

4.10 The findings from our review of use of resources risks identified in our audit plan are summarised as follows:

Risk area	Findings and Conclusion
Health inequalities follow up	Epping Forest LSP (One Epping Forest) has strengthened its arrangements for tackling health inequalities. Further improvements are needed, but it has a stronger base for delivery and for having an impact on health inequalities in the future than demonstrated when we carried out our previous review. Progress against our original recommendations and the outcomes achieved are largely assessed as "amber" (indicating reasonable progress but with more to do) or "green" (indicating strong progress with the LSP on track to fulfil the recommendation).
Leadership and strategic capacity of the Council	The lengthy process around the departure of a senior officer, in our view, led to the Council not making the degree of progress in its own continued improvement agenda which could otherwise have been made.

Value for money conclusion

4.11 Our value for money conclusion is based on our judgements from the results of risk based audit work, as well as consideration of the processes underpinning your review of the effectiveness of your controls as described in the Annual Governance Statement. Our judgements against the value for money conclusion criteria are set out in the table below:

Value for money conclusion criteria	Yes/No
1. Does the organisation plan its finances effectively to deliver its strategic priorities and secure sound financial health?	Yes
2. Does the organisation have a sound understanding of its costs and performance and achieve efficiencies in its activities?	Yes
3. Is the organisation's financial reporting timely, reliable and does it meet the needs of internal users, stakeholders and local people?	Yes
4. Does the organisation commission and procure quality services and supplies, tailored to local needs, to deliver sustainable outcomes and value for money?	Yes
5. Does the organisation produce relevant and reliable data and information to support decision making and manage performance?	Yes
6. Does the organisation promote and demonstrate the principles and values of good governance?	Yes
7. Does the organisation manage its risks and maintain a sound system of internal control?	Yes
8. Is the organisation making effective use of natural resources?	Yes

Value for money conclusion criteria	Yes/No
9. Does the organisation manage its assets effectively to help deliver its strategic priorities and service needs?	Yes
10. Does the organisation plan, organise and develop its workforce effectively to support the achievement of its strategic priorities?	Yes

Overall conclusion

4.12 Our overall conclusion is that adequate arrangements are in place to secure value for money.

Appendix A: Action Plan

(Please note this Action Plan includes some more minor issues not referred to in the main body of our report)

Conclusions from work	Recommendations	Priority	Management response	Responsibility	Timing
Financial statements					
The Council has not completely updated the spreadsheet that it maintains which records the valuation of council dwellings and garages on an asset by asset basis. This spreadsheet forms the link between the summarised Fixed Asset Register, the Valuer's report and the Revaluation Reserve. Whilst we have been able to satisfy ourselves that the values recorded in the financial statements are materially accurate, failure to update the current asset values for all individual assets prevents full compliance with the SORP, which requires the Revaluation Reserve to be maintained on an asset by asset basis. This also increases the risk of error arising when accounting for fixed assets.	1. Update all of the council dwellings' and garages' asset values within the spreadsheet that supports the Fixed Asset Register and Revaluation Reserve to reflect their latest valuation.	High			

Conclusions from work	Recommendations	Priority	Management response	Responsibility	Timing
The Council had previously received 'on deposit' funds from housing developers of £55,027 to assist with the development of roads. The works were completed over 10 years ago and the Council has been unable to determine whether they used their own capital or the funds which had been provided. There is a risk that the Council are overstating creditors as they can not support figures included within creditors. It is prudent, however, to include these balances as creditors within the accounts until further investigations have been completed.	2. Investigate the status of the deposits in question, by tracing the accounting transactions relating to the works to which they relate, to determine the correct accounting treatment for them going forward.	Medium			
An unidentified creditor balance of £126,855 has been written back to the District Development Fund (earmarked reserve). The Council believes the balance to have accumulated over several years prior to 2009/10, before implementation of the Academy revenues and benefits system. It has not been possible to determine, on the basis of information currently known, whether this is appropriate accounting treatment.	3. Conduct further investigations to determine whether any monies are owed to individuals or other entities and, if necessary, document the Council's reasoned decision as to why the amount should be written back to revenue.	Medium			

Conclusions from work	Recommendations	Priority	Management response	Responsibility	Timing
Financial systems					
The Council has not been able to reconcile the council tax revenue and the benefits modules within the Academy system throughout the year although the year-end reconciliation has now been completed. This control is operated by Benefit Department staff. This control weakness increases the risk of undetected material misstatements within the financial statements.	4. Complete monthly reconciliations of the council tax revenue and the benefits modules of Academy, reporting any difficulties or unreconciled differences to the Director of Finance and ICT.	High			
The Council has not been able to reconcile the benefit expenditure reported by the Academy system to the financial ledger (Cedar) throughout the year although the year-end reconciliations have now been completed. This increases the risk of material misstatement of benefit expenditure within the financial statements.	5. Complete monthly reconciliations between the benefits system (Academy) and the financial ledger (Cedar) of benefit expenditure.	High			
It was identified that not all orders were being processed through Marketplace as included within the Council's Financial Regulations. This could result in the Council being committed to unauthorised expenditure and increases the risk of fraud on purchases.	6. Remind staff of their responsibility to exercise proper control over the processing of orders, by utilising the Marketplace system to raise orders for all types of goods and service that aren't included within the Council's exemption list, or subject to the separate control system operated over works and fleet orders.	High			

Page 176

Conclusions from work	Recommendations	Priority	Management response	Responsibility	Timing
The Benefits department have not been ensuring that the Anite @ Work evidence checklist is being fully completed before awarding benefits. This increases the risk of inappropriate or inaccurate award of benefit.	7. Remind benefit processing staff of the requirement to complete the Anite @ Work checklist is before awarding benefit.	Medium			
A reconciliation between the housing system, OHMS, and the information system that records dwelling numbers is completed on a weekly basis but the reconciliations are not signed to evidence that these are performed by the Senior Housing Officer.	8. The senior housing officer should sign the reconciliations performed to evidence that she has completed them.	Medium			
The housing system automatically generates reminder letters but these are not retained to evidence that the letters have been sent. This prevents us from being able to conclude that the control is operating effectively.	9. Include in the Internal Audit programme observation tests of the effective operation of the reminder letter control process, to be done at random intervals throughout the year.	Low			

Appendix B: Uncorrected misstatements

The table below details the potential differences recorded during the audit that have not been adjusted for within the financial statements:

Uncorrected misstatements	Income Over/ (Under) £'000	Expenses (Over)/ Under £'000	Assets (Over)/ Under £'000	Liabilities Over/ (Under) £'000	Reserves Over/ (Under) £'000
Misstatements of fact (specific misstatements)					
None					
Misstatements of subjective decisions (estimates or application of accounting policy)					
None					
Likely misstatements (extrapolation of errors)					
None					
Total net misstatements					
- Net overstatement of costs					
- Net overstatement of net assets					

Appendix C: Draft letter of representation

PKF (UK) LLP
Farringdon Place
20 Farringdon Road
London
EC1M 3AP

28 September 2010

Dear Sirs

Financial statements of Epping Forest District Council for the year ended 31 March 2010

Representations of the Director of Finance and ICT

I confirm to the best of my knowledge and belief, and having made appropriate enquiries of other officers and members of the Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2010.

Responsibility for the financial statements

I acknowledge as the Director of Finance and ICT and s151 Officer my responsibilities for the financial statements.

Completeness of information

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and related information, including minutes of all management and committee meetings (held during the year and up to the date of this letter) have been made available to you.

Internal control

I acknowledge my responsibility for the design, implementation and maintenance of internal control relevant to the preparation and presentation of the financial statements that are free from misstatement, whether arising from fraud or error.

Fraud

I have disclosed to you the results of my assessment of the risk that the financial statements could be materially misstated as a result of fraud.

I am not aware of any fraud or suspected fraud affecting the financial statements, nor have any allegations of fraud or suspected fraud affecting the financial statements been communicated to me by employees, former employees, councillors, regulators or others.

Compliance with law and regulations

I am not aware of any possible or actual instances of non-compliance with laws or regulations whose effects should be considered when preparing financial statements of the Council.

Transactions with related parties

I confirm that I have put in place appropriate arrangements to identify related party transactions.

I am satisfied that the disclosure in the financial statements of related party transactions is appropriate and complete and contains all the elements necessary for an understanding of the financial statements.

Contingent liabilities

I am not aware of any significant contingent liabilities, including pending claims, proceedings or litigation involving the Council.

Pension fund assumptions

I confirm that the actuarial assumptions underlying the valuation of the Local Government Pension Scheme (LGPS) scheme liabilities, as applied by the scheme actuary, are reasonable and consistent with my knowledge of the business. These assumptions include:

• Rate of inflation	3.3%
• Rate of increase in salaries	4.8%
• Rate of increase in pensions	3.3%
• Rate for discounting scheme liabilities	5.6%
• Take up option to convert the annual pension into retirement grant	50%

I also confirm that the actuary has applied up-to-date mortality tables for life expectancy of scheme members in calculating scheme liabilities.

Uncorrected misstatements

[You have brought to my attention uncorrected misstatements in the financial statements as listed in Appendix 1 to this letter. I do not wish to correct these misstatements as I consider them to be immaterial to the view given by the financial statements.]

Fair value measurements and disclosures

I confirm that the valuation at which land and buildings are carried in the financial statements is a reasonable approximation of their fair values, on the bases required by the Statement of Recommended Practice (SORP).

Subsequent events

There have been no events since the balance sheet date which necessitate revision of the figures included in the financial statements or inclusion of a note thereto that have not already been disclosed to you. Should any material events occur, which may necessitate revision of the figures included in the financial statements or inclusion of a note thereto, I will advise you accordingly.

Yours faithfully

Bob Palmer

Director of Finance and ICT

Representations of the Council

We confirm to the best of our knowledge and belief, and having made appropriate enquiries of other officers and members of the Council, the following representations given to you in connection with your audit of the Council's financial statements.

Responsibility for the financial statements

We acknowledge our responsibilities to make arrangements for the proper administration of the Council's financial affairs and to approve the financial statements.

Uncorrected misstatements

[We have considered the uncorrected misstatements in the financial statements as listed in Appendix 1 to this letter together with the explanations provided by the Director of Finance and ICT for not correcting these misstatements, and we consider them to be immaterial to the view given by the financial statements.]

Annual Governance Statement

We confirm that the Council has conducted a review during the year of the effectiveness of its system of internal control. We are satisfied that the Annual Governance Statement appropriately reflects the circumstances of the Council and includes an outline of the actions taken, or proposed, to deal with significant internal control issues.

Yours faithfully

Councillor Anne Grigg
Chairman of Council

Signed on behalf of the Council

Note: Appendix 1 referred to in this letter relates to Appendix B in this report although at the time of drafting this report there are no uncorrected misstatements to report.

Appendix D: Draft independent auditors' report

Independent auditors' report to the Members of Epping Forest District Council

Opinion on the accounting statements

We have audited the accounting statements of Epping Forest District Council for the year ended 31 March 2010 under the Audit Commission Act 1998. The accounting statements comprise the Income and Expenditure Account, the Statement of Movement on the General Fund Balance, the Balance Sheet, the Statement of Total Recognised Gains and Losses, the Cash Flow Statement, the Housing Revenue Account, the Statement of Movement on the Housing Revenue Account, the Collection Fund and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Epping Forest District Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 49 of the Statement of Responsibilities of Auditors and of Audited Bodies published by the Audit Commission in April 2008.

Respective responsibilities of the Director of Finance and ICT and auditor

The Director of Finance and ICT's responsibilities for preparing the accounting statements in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice are set out in the Statement of Responsibilities for the Statement of Accounts.

Our responsibility is to audit the accounting statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounting statements give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice, of the financial position of the Council and its income and expenditure for the year.

We review whether the Annual Governance Statement (governance statement) reflects compliance with 'Delivering Good Governance in Local Government: A Framework' published by CIPFA/SOLACE in June 2007. We report if it does not comply with proper practices specified by CIPFA/SOLACE or if the statement is misleading or inconsistent with other information we are aware of from our audit of the accounting statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Council's corporate governance procedures or its risk and control procedures.

We read other information published with the accounting statements, and consider whether it is consistent with the audited accounting statements. This other information comprises the Explanatory Foreword, the Summary of Outturn and the Glossary. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounting statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounting statements. It also includes an assessment of the significant estimates and judgments made by the Council in the preparation of the accounting statements, and of whether the accounting policies are appropriate to the Council's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounting statements.

Opinion

In our opinion the Council's accounting statements give a true and fair view, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice, of the financial position of the Council as at 31 March 2010 and its income and expenditure for the year then ended.

Conclusion on arrangements for securing economy, efficiency and effectiveness in the use of resources

Council's Responsibilities

The Council is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance and regularly to review the adequacy and effectiveness of these arrangements.

Auditors' Responsibilities

We are required by the Audit Commission Act 1998 to be satisfied that proper arrangements have been made by the Council for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion in relation to proper arrangements, having regard to relevant criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in October 2009. We report if significant matters have come to our attention which prevent us from concluding that the Council has made such proper arrangements. We are not required to consider, nor have we considered, whether all aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Conclusion

We have undertaken our audit in accordance with the Code of Audit Practice and having regard to the criteria for principal local authorities specified by the Audit Commission and published in May 2008 and updated in October 2009, and the supporting guidance, we are satisfied that, in all significant respects, Epping Forest District Council made proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2010.

Certificate

We certify that we have completed the audit of the accounts in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Richard Bint
Partner, on behalf of PKF (UK) LLP
London, UK

28 September 2010

This page is intentionally left blank

Report to the Finance and Performance Management Cabinet Committee

Epping Forest District Council

Report Reference: FPM-014-2010/11
Date of meeting: 27 September 2010

Portfolio: Finance and Economic Development.

Subject: Financial Issues Paper.

Responsible Officer: Bob Palmer (01992 564279).

Democratic Services: Gary Woodhall (01992 564470).

Recommendations/Decisions Required:

(1) To recommend to the Cabinet the establishment of a new budgetary framework;

(2) To recommend to the Cabinet, as part of the new budgetary framework, the setting of following budget guidelines for 2011/12:

(a) The Continuing Services Budget, including growth items;

(b) District Development Fund items;

(c) the use of surplus General Fund balances; and

(d) the District Council Tax for a Band 'D' property; and

(3) To recommend to the Cabinet the agreement of a revised Medium Term Financial Strategy for the period to 2014/15, and the communication of the revised Medium Term Financial Strategy to staff, partners and other stakeholders.

Executive Summary:

This report provides a framework for the Budget 2011/12 and updates Members on a number of financial issues that will affect this Authority in the short to medium term.

In broad terms the following represent the greatest areas of current financial uncertainty and risk to the Authority:

- Likely reductions in grant as part of the next Comprehensive Spending Review
- Changes in the block grant allocation formulas
- Effects of the "Credit Crunch" and reduced activity in the housing market
- Transfer of commercial property from the Housing Revenue Account to the General Fund
- Using up of capital reserves on non-revenue generating assets
- Next triennial pension valuation
- Capitalisation of pension deficit payments
- Public sector re-organisation/shared services

These issues will be dealt with in the following paragraphs, taking the opportunity to discuss some areas in greater detail following recent developments. Based on the information

contained in the report Members are asked to set out, for consultation purposes, the budgetary structure for 2011/12.

Reasons for Proposed Decisions:

By setting out clear guidelines at this stage the Committee establishes a framework to work within in developing growth and savings proposals. This should help avoid late changes to the budget and ensure that all changes to services have been carefully considered.

Other Options for Action:

Members could decide to wait until later in the budget cycle to provide guidelines if they felt more information, or a greater degree of certainty, was necessary in relation to a particular risk. However, any delay will reduce the time available to produce strategies that comply with the guidelines.

Report:

General Fund Out-Turn 2009/10

1. Members have already received the outturn figures and the Statutory Statement of Accounts for 2009/10 together with explanations for the variances. In summary the General Fund Revenue outturn for 2009/10 shows that Continuing Services Budget (CSB) expenditure was £569,000 lower than the original estimate and £702,000 lower than the revised. The main variance, as in 2008/09, related to staff savings arising from vacancies and a lower than anticipated pay award.

2. The revised CSB estimate for 2009/10 increased from £18.015m to £18.148m with the actual being £17.447m. The largest variance on growth and savings items was on waste management where growth of £359,000 had been estimated, but actual growth was only £204,000. A significant variance was also seen on the opening CSB figure, which is consistent with the main variance arising from salary savings.

3. Net District Development Fund (DDF) expenditure was £1.213m lower than the revised estimate. However £523,000 of this resulted from slippage so both expenditure and financing for this amount has been carried forward to 2010/11, giving a net saving of £690,000. Net portfolio DDF spending was £526,000 below the revised estimate, due to under spends of £264,000 in Planning & Economic Development and £164,000 in Corporate Support Services. In addition to this, non-portfolio income items exceeded the revised estimate by £687,000 to give the total DDF saving of £1.213m.

4. The non-portfolio items include the “Fleming Claim” for the repayment of VAT. This had initially been budgeted at £375,000 to match the investment impairment the Council was required to include in the 2010/11 budget. A net refund of £1.158m was achieved, exceeding the estimate by £783,000. The inclusion of the “Fleming Claim” income and the underspend mean the balance on the DDF is higher than previously predicted at £4.041m at 31 March 2010. However, the vast majority of this amount is committed to finance the present programme of DDF expenditure, particularly the Local Development Framework.

5. As the underspend on the DDF is matched by the variance on appropriations, the overall variance in the use of the General Fund Revenue balances is equal to the CSB underspend of £569,000, compared to the original estimate. This translates into a reduction in balances of £135,000 compared to the original estimate of £704,000.

The Updated Medium Term Financial Strategy

6. Annexes 1(a/b) show the latest four-year forecast for the General Fund. This is based on adjusting the balances for the 2009/10 actuals, allowing for items already approved by

Council and other significant items covered in the report. The annex (1b) shows that revenue balances will decrease by £0.632m in 2010/11, £0.408m in 2011/12, £0.456m in 2012/13 and £0.758m in 2013/14 and 0.426m in 2014/15.

7. For some time Members have aligned the balances to the Council's 'Net Budget Requirement' (NBR), allowing balances to fall to no lower than 25% of NBR. The predicted balance at 1 April 2011 of £7.668m represents just over 46% of the anticipated NBR for next year (£16.656m) and is therefore somewhat higher than the Council's current policy of 25%. However, predicted changes and trends mean that by 1 April 2015 the revenue balance will have reduced to £5.620m. This still represents nearly 36% of the NBR for 2014/15 (£15.750m).

8. The financial position as at 1 April 2010 was better than had been anticipated, however the change in the key assumption about future grant funding has increased the level of savings that need to be identified. This may prove difficult to achieve, particularly given indications from the Government that Council Tax should not be increased for the next two years.

9. The target saving for 2011/12 has been set at £500,000; this increases to £900,000 for 2011/12 and then reduces to £500,000 for 2013/14 and £400,000 for 2014/15. These net savings could arise either from reductions in expenditure or increases in income. What is clear is that given the levels of savings now required, it is no longer sufficient to talk in terms of "efficiencies". Members will have to make difficult decisions about reducing or stopping some non-priority services. If Members feel that the levels of net savings being targeted are appropriate, it is proposed to communicate this strategy to staff and stakeholders.

10. Estimated DDF expenditure has been amended for carry forwards, supplementary estimates and income shortfalls and it is anticipated that there will be £562,000 of DDF funds available at 1 April 2015. The four-year forecast approved by Council on 16 February 2010 predicted a DDF balance of £156,000 at the end of 2013/14 and this has improved slightly.

11. Capital balances have been updated for recent outturn figures and updated assumptions on capital receipt generation. The reduction in estimated capital receipts means that the predicted balance at 1 April 2015 falls to £9.238m. Over this four-year period the capital programme has some £50m of spending. As capital balances are used up the revenue benefit from interest earnings is reduced and so care needs to be exercised in expanding the capital programme any further, particularly on non-revenue generating assets.

Continuing Services Budget

12. The CSB saving against revised estimate was £0.702m, compared to £0.187m in 2008/09. The prime cause of this under spend was again salary savings, actual salary spending for the authority in total, including agency costs, was some £19.351m compared against an original estimate of £20.082m. There is currently an under spend on the salaries budget in 2010/11, although in part this is due to an anticipated pay award of 1.5% which will not now occur.

13. In addition to the salaries savings, a number of CSB budgets were under spent and these will be closely scrutinised going forward to ensure budgets are more closely aligned with actual spending in prior years.

14. Previously it has been agreed that CSB expenditure should not rely on the use of balances to provide support but should be financed only from Government grant (RSG + Distributable NDR) and council tax income. This means that effectively the level of council tax will dictate the net expenditure on CSB or the CSB will dictate the level of council tax. As Members have not indicated any desire to contradict Government guidance that council tax increases should be frozen for the next two years, it is clear that the former will be the determinant. The four-year forecast, agreed in February, had included an assumption that

Council Tax would increase annually by 2.5%. Amending the four-year forecast for the revised assumption on Council Tax takes approximately £1m of income out of the forecast for the three years 2011/12 to 2013/14. Clearly if there is to be no increase in Council Tax the link between Council Tax increases and the rate of inflation is no longer relevant. For information, RPI is currently 4.7% and CPI 3.1% and inflation forecasts retain an important role in estimating future costs.

15. The latest four-year forecast (annexes 1a & b) show that the original budget for 2010/11 did not achieve that objective, as funding from Government grants and local Taxpayers fell £0.6m below CSB. The revised estimate for this year shows a small increase in CSB at this time although that is likely to change as we go through the budget process.

The Comprehensive Spending Review

16. When setting the budget in February the Medium Term Financial Strategy (MTFS) assumed a reduction in formula grant of 10% over the life of the next Comprehensive Spending Review (CSR). Whilst it is not yet clear what the exact reduction will be, we can be sure that it will be more than 10%.

17. Rumours of funding cuts of between 25% and 40% have been circulating. Although more recently speculation has focused on cuts in specific grants instead of formula grant. A broad indication will be given on 20 October when some of the headlines from the CSR will be announced. However, specific grant figures for individual authorities will not be provided until late November. During 2010/11 the Council will receive £9.4m of formula grant, an illustration of the effect of different % reductions in grant is shown below:

% Reduction	£ Reduction (M)
20	1.88
30	2.82
40	3.76

18. In terms of specific grants it is worth mentioning the grant received from the Department for Work and Pensions (DWP) to administer the benefit system. Currently the Council receives £0.9m per annum in administration grant. If the DWP has a budget cut imposed by the Treasury of 25% it is likely that will be passed straight on to local authorities. Therefore the MTFS includes an assumption that over the CSR annual administration subsidy will be reduced by some £225,000.

Government Grant Formulae

19. There is a separate report earlier on the agenda setting out the possible changes to the grant formulae and their impact. The key elements worth mentioning again are concessionary travel and the floor mechanism. From 1 April 2011 the responsibility for administering the national concessionary fare scheme moves from district councils to county councils. DCLG have modelled four different scenarios to achieve this transfer. Two of the models leave this authority in a worse position by approximately £100,000 and two in a worse position by approximately £1,000,000.

20. The outcome of the grant formulae calculations has previously been moderated by a system of floors and ceilings that average out the changes so that authorities are prevented from either gaining or losing too much grant. The consultation includes a question about the level at which the floor should be set to allow the outcomes of the formulae to be effective. Given the recent history of poor grant settlements and the impact shown by the exemplifications in the consultation, the proposed response is to seek a high floor averaging out the reductions to give all authorities similar reductions to deal with.

21. The vagaries of the grant system and how this authorities' fortunes have fluctuated since the introduction of the "Four Block" method of allocation are illustrated in the table below.

	2006/07 £m	**2007/08 £m**	**2008/09 £m**	**2009/10 £m**	**2010/11 £m**
Relative Needs Amount	5.728	5.742	5.455	5.457	5.464
Relative Resource Amount	-4.465	-4.724	-5.228	-5.096	-4.956
Central Allocation	7.854	8.332	8.793	8.834	8.871
Floor Damping	-0.490	-0.189	0.302	0.173	0.036
Formula Grant	**8.627**	**9.161**	**9.322**	**9.368**	**9.415**

22. The figures shown above represent a poor settlement for the Council and give grant increases of only 1% (against the adjusted 07/08 figure) for 2008/09 and only 0.5% for 2009/10 and 2010/11. This seems odd given the sizeable grant increase seen under this system for 2006/07 and 2007/08.

	2006/07 £m	**2007/08 £m**	**2008/09 £m**	**2009/10 £m**	**2010/11 £m**
Formula Grant (adjusted)	8.627	9.161 (9.229)	9.322	9.368	9.415
Increase £	0.711	0.534	0.093	0.046	0.047
Increase %	9.0%	6.2%	1.0%	0.5%	0.5%

23. The introduction of the four block system saw the Council change from receiving floor support of £412,000 to losing £490,000 to support the floor for others. It had been hoped that the move away from the floor would last longer than two years. However, the benefit of the previous large increase was not lost, as this provided the base that the floor increase of 1% has been added to.

The "Credit Crunch" and Reduced Housing Market Activity

24. The Council's CSB contains a number of income streams that have been adversely affected, to varying degrees, by the current state of the housing market. Most recent surveys have shown house prices are falling and new mortgage approvals remain at a very low level. Confidence is fragile and a clear direction is needed from Government on what will replace the regional planning structures and housing targets that have been set aside.

25. The main areas of income related to the housing market are land charges, building control and development control. For 2010/11 land charges income had been estimated at £177,300, consistent with the actual of £183,000 for 2009/10 but less than half the 2006/07 figure of £394,000. At the end of August the cumulative income achieved was less than £1,000 behind the estimate. However, changes to the regulatory regime will result in a reduction in CSB income of at least £25,000 and possibly more once the full changes are confirmed. There is also a possibility of some past fees having to be repaid and this could have a £100,000 impact on the DDF.

26. Building Control fees may fall short of the estimate of £642,000 by as much as £170,000. This is a ring-fenced account and costs within it were successfully managed down last year so that, despite the lower income level, a small surplus was generated. To date Development Control income is doing better, although the outturn here is likely to be closer to £500,000 than the £605,000 originally estimated.

27. Moving briefly off of housing market related income it is worth noting that some of the Council's other income streams are doing well. The MOT income from Fleet Operations may exceed the estimate of £292,000 by £30,000. Total licensing income is also currently slightly ahead of expectations and should exceed the estimate of £256,000.

28. All of the above income streams will continue to be monitored on a monthly basis. Adjustments have previously been made to CSB income levels and no further reductions are planned at this time, although some extra allowance may be needed in the DDF.

29. The Council's interest earnings have also been hit by the "Credit Crunch". Earlier in the crisis in 2008/09 as banks struggled for liquidity they were prepared to pay high interest rates to borrow from the Council. This position has now reversed and the base rate has remained at 0.5% for a year and a half with no imminent sign of any upward movement. The original estimates were prepared using the interest rate predictions of the Council's previous treasury management consultants, who had anticipated an increase in interest rates. The outturn is likely to be £342,000 short of the original estimate of £0.897m, although a large portion of this is credited to the HRA. The Medium Term Financial Strategy (MTFS) has taken a prudent view on future interest rate movements, based on advice from the Council's new treasury management consultants.

<u>Transfer Of Commercial Property From The Housing Revenue Account To The General Fund</u>

30. The recent consultation on reform of the Housing revenue Account (HRA) highlighted that this account should be a dwelling based landlord account. Since the formation of the Council a substantial number of commercial properties have been accounted for as part of the HRA as they transferred to the authority at the same time as the housing stock. The benefit of this commercial income to the HRA over the last 36 years has meant that it has been possible to achieve the Decent Homes standard whilst still retaining ownership of the housing stock. The HRA is currently on a very sound financial footing with various reserves totalling some £16m.

31. The issues around the transfer were fully set out in a report to Cabinet on 13 September. At that Cabinet meeting, after requests from non-Cabinet Members, it was decided that before any decision is recommended to Council a joint meeting of the Housing and Finance & Performance Management Scrutiny Panels should be held to consider the transfer. This meeting is scheduled to take place on 12 October.

32. The importance of the transfer of these assets is illustrated by the differences in annexes 1 and 2, which show the predicted level of savings needed in the General Fund with and without the income from the commercial properties. For ease of reference this is summarised in the table below.

Financial Year	Savings with transfer £m	Savings without transfer £m
2011/12	0.50	1.00
2012/13	0.90	1.50
2013/14	0.50	0.50
2014/15	0.40	0.40
Total	2.30	3.40

33. It should also be noted that in the model without the transfer of commercial property the balance on the General Fund is £112,000 lower at the end of 2014/15. If Council decides that the commercial properties should be transferred an application will then need to be made to the Secretary of State, although initial indications from the Department of Communities & Local Government (DCLG) are that this should be a straightforward process.

<u>Use Of Capital Resources On Non-Revenue Generating Assets</u>

34. In recent years the Capital Strategy has stressed the need for capital projects to be used to improve the Council's revenue position, either by saving costs or increasing revenues. This issue has also been recognised on the Council's Corporate Risk Register.

Capital receipts generate investment income and so if they are used up on non-revenue generating assets there is a “double whammy” whereby the Council loses out on income and takes on additional costs.

35. This principle has been applied to recent decisions such as procuring equipment for the leisure centres to reduce the CSB payments to SLM and the purchase of the Black Lion car parking area to save on rental costs.

36. The updated Capital Programme will go to Cabinet next month and the figures show spending of £50m over five years. Of this spending, £37m is funded from revenue or grants but the remainder will reduce the balance of capital receipts from £21.1m to £9.2m. In view of this Members should carefully consider whether existing schemes are essential and any additional schemes should only be approved where there is a positive revenue contribution, after allowing for any loss of investment income.

Pay Awards

37. The MTFS approved in February included assumed annual pay awards of 1.5%. However, the employer’s organisation has made it clear that there will be no pay award for 2010/11 and the Government have announced that they expect no pay awards for 2011/12 and 2012/13. The lack of any pay award for three years will produce a considerable saving against the previous MTFS.

38. Having set out the Government’s expectations above, a question clearly exists over whether this position is sustainable if RPI remains close to 5%. It is worth considering this Council’s pay bill and the effect that different levels of pay awards might have. The total salary estimate for 2010/11 is £20m; therefore for every 1% the pay award increases the Council’s pay bill by £200,000. The MTFS has assumed the Government will enforce the extended pay freeze, although if inflation does not reduce significantly this assumption may prove incorrect.

Next Triennial Valuation of the Pension Scheme

39. The Local Government Pension Scheme (LGPS) is an umbrella term for a number of schemes across the country, most commonly administered at a county level. Most local government bodies in Essex pay contributions into the fund administered by Essex County Council. The level of contributions is based on an actuarial evaluation of the fund’s assets and liabilities at a given date. These valuations are conducted on a triennial basis, with annual interim valuations being used only to update the annual accounts.

40. The last triennial valuation was undertaken as at 31 March 2007 and showed a significant improvement on the 2004 valuation. As at 31 March 2004 the scheme was only 71% funded (the value of the scheme’s assets only covered 71.4% of the liabilities), by 2007 the funding level had improved to 81.2%. The results of the full valuation as at 31 March 2010 are still to be released, but initial indications are that the funding level has dipped back down to a level similar to the 2004 valuation at 71%.

41. The increase in the funding level as at 31 March 2007 meant that it was possible to reduce the amount of the deficit contributions but due to other factors, such as increasing life expectancy, it was necessary to increase the ongoing contribution rate from 10.1% for 2007/08 to 13.1% for 2010/11. Whilst full valuation results and an updated Funding Strategy Statement are still awaited, indications from Essex County Council are that ongoing contribution rates are unlikely to change.

42. Recent years have seen a number of changes to the LGPS, with increased contribution rates for employees and a rising of the normal retirement age. Further options for reform are still being examined and it is likely that in the long term the defined benefit scheme could be closed to new entrants or pensions could be based on average earnings instead of

final salary. There is a general acceptance that the scheme in its current form is not sustainable, although at this time it is not possible to predict the outcome of these discussions with any certainty.

Capitalisation of Pension Deficit Payments

43. The Council has an established policy of seeking annual capitalisation directions for pension deficit payments. There are strict financial criteria laid down by the Government that you must satisfy to be eligible for a capitalisation direction. If you satisfy the criteria you get a Gate 1 approval but it is only after the Government has considered all Gate 1 approvals in aggregate that it decides the amount of Gate 2 or final approvals.

44. Since the capitalisation policy was put in place the Council has generally been successful in obtaining directions. A direction was first applied for in 2005/06 and one was obtained for the full amount requested. It was in 2006/07 that the Two Gate System was introduced and that year saw all applicants receive directions for only 57% of the amounts applied for. In all subsequent years the Government has issued directions for the full amounts applied for.

45. The amounts that will be applied for are set out in the table below and given recent history it has been assumed that full directions will be obtained. To fund the capitalisations £2.5m was moved to the Pension Deficit Reserve in 2007/08. If this assumption proves incorrect any amounts that cannot be capitalised will have to be charged to revenue. At 31 March 2010 the balance on the Pension Deficit Reserve was £728,000 so a further transfer of £200,000 will be needed to fund the 2010/11 capitalisation.

	2008/09	2009/10	2010/11	Total
	£'000	£'000	£'000	£'000
General Fund	662	644	626	1,932
HRA	311	302	294	907
	973	946	920	2,839

Public Sector Re-Organisation/Shared Services

46. Whilst the Government has said it will not legislate to achieve a formal re-organisation of local government it is encouraging a number of shared service initiatives and a major re-structuring of the National Health Service. The possibility of a joint Building Control service was examined with neighbouring authorities. However, it was concluded that this was likely to create a financial burden on this authority and lead to a reduction in the level of service.

47. One successful example of a shared service is within Accountancy, where an insurance claims service is provided for Uttlesford District Council. This has created savings for both authorities and is working well. In evaluating any proposals from any other bodies care needs to be taken to ensure that the legal and financial consequences are fully understood and that arrangements are only entered into where they are genuinely in the best long-term interests of the authority. Entering into any arrangements for short-term expediency is likely to create bigger problems later on.

District Development Fund

48. The carry forward of £523,000 represents an increase of £243,000 on the £280,000 of slippage for 2008/09. This highlights the need for tighter controls on DDF budgets and this issue is covered by an earlier report on this agenda. Given that DDF funding is limited, it should only be used to support high priority projects. If a project takes several years to be implemented questions may arise over whether it was really a priority and if that money could have been used for a more urgent purpose.

49. The financial forecast shows that not all DDF funding is currently allocated to schemes. It is currently anticipated that there will be some £562,000 of DDF available at 1 April 2015.

The Capital Programme

50. The total of 9 Council house sales in 2009/10 was in line with the estimate and was a slight improvement on the all time low figure of 7 in 2008/09. It is not anticipated that sales will return to their previous levels for some time. This is consistent with the two completions so far in the first four months of 2010/11. The Capital Programme has already been adjusted to reflect this anticipated lower level of Council house sales.

51. Significant receipts have previously been generated through the sale of other assets. Land values in some areas are starting to improve again and a number of potential projects are currently being evaluated. As non-housing receipts are not included in the estimates before completion has occurred no allowance has been made in the MTFS.

52. The capital outturn report considered by the Finance and Performance Management Cabinet Committee on 14 June 2010 highlighted that the underspend of £1m was an improvement on the £2.4m under spend in 2008/09. Non-housing expenditure was £0.85m below the estimate at £4.06m, whilst housing expenditure of £9.16m was £0.14m below the estimate of £9.3m. The slippage in the programme will be carried forward to subsequent periods.

The Council Tax

53. Band D Council Tax increased by 1.5% for 2010/11 following increases of 2.5% in the previous two years. The Government has made it clear that it expects authorities to freeze the Council Tax for two years; beyond this it is assumed that future increases will not exceed 2.5%.

A Revised Medium Term Financial Strategy

54. Annex 1(a) & 1(b) shows a four-year forecast with target levels of savings to bring the projections closer to the policy of keeping reserves above 25% of the NBR. The net savings included are £500,000 in 2011/12, increasing to £900,000 in 2012/13 before reducing to £500,000 for 2013/14 and £400,000 in 2014/15. These savings would give total CSB figures for 2010/11 revised of £18.160m and 2011/12 of £17.064m.

55. This proposal sets DDF expenditure at £2.389m for the revised 2010/11 and £0.909m for 2011/12, and given the possibility of other costs arising, it is likely that the DDF will be used up in the medium term.

56. No predicted non-housing capital receipts are being taken into account, as any sales are still some way off. Over the period of the MTFS the balance shown at Annex 1 (b) on the Capital Fund reduces significantly from £21.1m at 1 April 2010 to £9.238m at 1 April 2015. This has impacted on interest earnings within the forecast and it is important that any new capital schemes either save revenue costs or generate income.

57. Previously the Council has taken steps to communicate the MTFS with staff, partners and other stakeholders. This process is still seen as good practice and a failure to repeat the exercise could harm relationships and obstruct informed debate. If Members agree, appropriate steps can be taken to circulate either the full strategy or a summarised version.

Conclusion

58. The current level of uncertainty on future government grant, the ongoing effects of the "Credit Crunch" and potential changes to the public sector make it difficult to produce robust

financial forecasts. Although the Council is better placed than most to face these challenges, at 1 April 2010 the General Fund balance exceeded £8m, the DDF £4m and capital receipts £21m. These balances can be used over the medium term to support a structured reduction in net expenditure and it is clear that Members will need to make tough decisions in prioritising the allocation of resources. The need to seek net savings now far exceeds any possible contribution from "efficiencies" and therefore service reductions are inevitable.

Resource Implications:

The report covers resource implications over a four-year period and provides an updated Medium Term Financial Strategy.

Legal and Governance Implications:

None.

Safer, Cleaner, Greener Implications:

The Safer, Cleaner, Greener initiative is considered in the report.

Consultation Undertaken:

None.

Background Papers:

None.

Impact Assessments:

There are no equalities impacts.

The report sets out some of the key areas of financial risk to the authority. At this time the Council is well placed to meet such challenges, although particular care needs to be exercised in taking on any additional capital projects.

GENERAL FUND MEDIUM TERM FINANCIAL STRATEGY 2010/11 - 2014/15

ORIGINAL 2010/11		REVISED FORECAST 2010/11	FORECAST 2011/12	FORECAST 2012/13	FORECAST 2013/14	FORECAST 2014/15
£'000	**NET REVENUE EXPENDITURE**	£'000	£'000	£'000	£'000	£'000
18,314	Continuing Services Budget	18,033	18,510	17,254	16,646	16,499
-237	CSB - Growth Items	127	-946	73	155	77
0	Net saving	0	-500	-900	-500	-400
18,077	Total C.S.B	18,160	17,064	16,427	16,301	16,176
1,879	One - off Expenditure	2,389	909	194	-13	0
19,956	Total Net Operating Expenditure	20,549	17,973	16,621	16,288	16,176
-24	Contribution to/from (-) Insurance Res	-24	0	0	0	0
-1,879	Contribution to/from (-) DDF Balances	-2,389	-909	-194	13	0
-549	Contribution to/from (-) Balances	-632	-408	-456	-758	-426
17,504	Net Budget Requirement	17,504	16,656	15,971	15,543	15,750
	FINANCING					
			-9%	-8%	-8%	
9,379	Government Support (NNDR+RSG)	9,379	8,568	7,882	7,252	7,252
36	RSG Floor Gains/(-Losses)	36	0	0	0	0
9,415	Total External Funding	9,415	8,568	7,882	7,252	7,252
8,089	District Precept	8,089	8,089	8,089	8,291	8,498
0	Collection Fund Adjustment	0	0	0	0	0
17,504	To be met from Government Grants and Local Tax Payers	17,504	16,656	15,971	15,543	15,750
	Band D Council Tax	148.77	148.77	148.77	152.49	156.30
	Percentage Increase %		0.0	0.0	2.5	2.5

GENERAL FUND MEDIUM TERM FINANCIAL STRATEGY 2010/11 - 2014/15

	REVISED FORECAST 2010/11	FORECAST 2011/12	FORECAST 2012/13	FORECAST 2013/14	FORECAST 2014/15
REVENUE BALANCES	£'000	£'000	£'000	£'000	£'000
Balance B/forward	8,300	7,668	7,260	6,804	6,046
Surplus/Deficit(-) for year	-632	-408	-456	-758	-426
Balance C/Forward	7,668	7,260	6,804	6,046	5,620
DISTRICT DEVELOPMENT FUND					
Balance B/forward	4,041	1,652	743	549	562
Transfer Out	-2,389	-909	-194	13	0
Balance C/Forward	1,652	743	549	562	562
CAPITAL FUND (inc Cap Receipts)					
Balance B/forward	21,091	13,753	11,427	10,339	9,773
New Usable Receipts	201	235	295	295	295
CR Used to Fund Capital Expenditure					
- Transistional Relief Receipts	0	0	0	0	0
- Other Capital Receipts	-7,539	-2,561	-1,383	-861	-830
Balance C/Forward	13,753	11,427	10,339	9,773	9,238
TOTAL BALANCES	23,073	19,430	17,692	16,381	15,420

GENERAL FUND MEDIUM TERM FINANCIAL STRATEGY 2009/10 - 2013/14

ORIGINAL 2010/11		REVISED FORECAST 2010/11	FORECAST 2011/12	FORECAST 2012/13	FORECAST 2013/14	FORECAST 2014/15
£'000	**NET REVENUE EXPENDITURE**	£'000	£'000	£'000	£'000	£'000
18,314	Continuing Services Budget	18,033	18,510	17,897	16,620	16,337
-237	CSB - Growth Items	127	151	-35	0	0
0	Net saving	0	-1,000	-1,500	-500	-400
18,077	Total C.S.B	18,160	17,661	16,362	16,120	15,937
1,879	One - off Expenditure	2,389	909	194	-13	0
19,956	Total Net Operating Expenditure	20,549	18,570	16,556	16,107	15,937
-24	Contribution to/from (-) Insurance Res	-24	0	0	0	0
-1,879	Contribution to/from (-) DDF Balances	-2,389	-909	-194	13	0
-549	Contribution to/from (-) Balances	-632	-1,005	-391	-577	-187
17,504	Net Budget Requirement	17,504	16,656	15,971	15,543	15,750
	FINANCING					
			-9%	-8%	-8%	
9,379	Government Support (NNDR+RSG)	9,379	8,568	7,882	7,252	7,252
36	RSG Floor Gains/(-Losses)	36	0	0	0	0
9,415	Total External Funding	9,415	8,568	7,882	7,252	7,252
8,089	District Precept	8,089	8,089	8,089	8,291	8,498
0	Collection Fund Adjustment	0	0	0	0	0
17,504	To be met from Government Grants and Local Tax Payers	17,504	16,656	15,971	15,543	15,750
	Band D Council Tax	148.77	148.77	148.77	152.49	156.30
	Percentage Increase %		0.0	0.0	2.5	2.5

GENERAL FUND MEDIUM TERM FINANCIAL STRATEGY 2010/11 - 2014/15

	REVISED FORECAST 2010/11	FORECAST 2011/12	FORECAST 2012/13	FORECAST 2013/14	FORECAST 2014/15
REVENUE BALANCES	£'000	£'000	£'000	£'000	£'000
Balance B/forward	8,300	7,668	6,663	6,272	5,695
Surplus/Deficit(-) for year	-632	-1,005	-391	-577	-187
Balance C/Forward	7,668	6,663	6,272	5,695	5,508
DISTRICT DEVELOPMENT FUND					
Balance B/forward	4,041	1,652	743	549	562
Transfer Out	-2,389	-909	-194	13	0
Balance C/Forward	1,652	743	549	562	562
CAPITAL FUND (inc Cap Receipts)					
Balance B/forward	21,091	13,753	11,427	10,339	9,773
New Usable Receipts	201	235	295	295	295
CR Used to Fund Capital Expenditure					
- Transistional Relief Receipts	0	0	0	0	0
- Other Capital Receipts	-7,539	-2,561	-1,383	-861	-830
Balance C/Forward	13,753	11,427	10,339	9,773	9,238
TOTAL BALANCES	23,073	18,833	17,160	16,030	15,308