Annex 16

The Chief Financial Officer's report to the Council on the robustness of the estimates for the purposes of the Council's 2009/10 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 2009/10. Where this advice is not accepted, this should be formally recorded within the minutes of the Council meeting. The Council will consider the recommendations of the Cabinet on the budget for 2009/10 and will 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 is also a range of safeguards, which are in place 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 next year is likely to see significant changes to the waste and leisure services. These changes and the "Credit Crunch" are still ongoing and represent significant risks to the Council's ability to assess properly all the financial pressures it faces.

5. However the Council's budget process, developed over a number of years, has many features that promote an assurance in its reliability:

   - The rolling four year forecast provides a yardstick against which annual budgets can be measured
   - The early commencement of the budget process and the clear annual timetable for both Members and officers including full integration with the business planning process promotes considered and reasoned decision making
   - The establishment of budget parameters in the summer is designed to create a clear focus before the budget process commences

- The analysis of the budget between the continuing services and one off District Development Fund items smoothes out peaks and troughs and enables CSB trends to be monitored
- The adoption of a prudent view on the recognition of revenue income and capital receipts
- The annual bid process whereby new or increased budgets should be reported to Cabinet before inclusion in the draft budget
- Clear and reasoned assumptions made about unknowns, uncertainties or anticipated or forecast changes

6. Changes to the process have also created the facility for far greater consultation, particularly with the development of the Overview and Scrutiny Panel which deals with finance and performance management issues. With a Cabinet system the onus is on Portfolio Holders to deliver acceptable and accurate budgets. This role has been taken seriously and has helped enhance the detailed knowledge of the Cabinet.

7. The budget is therefore based on strong and well-developed procedures and an integrated and systematic approach to the preparation of soundly based capital and revenue plans and accurate income and expenditure estimates. The risks or uncertainties inherent in the budget have been identified and managed, as far as is practicable, and assumptions about their impact have been made.

8. **The conclusion is that the estimates as presented to the Council are sufficiently robust for the purposes of the Council's overall budget for 2009/10.**

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

9. Guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA) states that the following factors should be taken into account when the CFO considers the overall level of reserves and balances:

   - Assumptions regarding inflation;
   - Estimates of the level and timing of capital receipts;
   - Treatment of demand led pressures;
   - Treatment of savings;
   - Risks inherent in any new partnerships etc;
   - Financial standing of the authority i.e. level of borrowing, debt outstanding etc;
   - The authority's track record in budget management;
   - The authority's capacity to manage in-year budget pressures;
   - The authority's virements and year-end procedures in relation to under and overspends;
   - The adequacy of insurance arrangements.

10. These issues have formed the basis for budget reports in the past and they remain relevant for the current budget.

Factor Assessment

a. Inflationary pressures

11. Every year base budget estimates are produced and then different inflation factors are applied to the resultant figures to take budgets to out-turn prices. It is inevitable that there will be either over or under provision for the full cost of inflation, as prices will inevitably vary against the estimates made. This is particularly relevant in the current unstable economic climate. Efforts have been made to predict the level of inflation in the coming year, but it should be noted that there are two specific items where there could be additional costs:

12. The Council procures energy through consortiums and has recently moved to the Office of Government Commerce (OGC) framework agreement, in accordance with advice from the Essex Procurement Hub. Substantial price increases have been seen for both electricity and gas, but the OGC view is that wholesale prices have reduced from their peak. On this basis the additional budgets for energy are split between CSB and DDF. However, there is a risk that this split may not prove correct.

13. Current and future pay awards are in doubt, as agreement has still not been reached on an increase for 2008/09. The divergence in views between the Unions and the Employers resulted in industrial action earlier in the year. This dispute is now in arbitration and it is hoped the 2008/09 award can be resolved before we enter 2009/10. The Medium term Financial Strategy (MTFS) includes an allowance of 2.475% in both 2008/09 and 2009/10, which is believed to be prudent. Recruitment and retention is less of a concern, but some difficulty is still being experienced in certain areas. In the budgets the centrally held vacancy allowance has been maintained at 2%. This reflects the ongoing underspends, which will again lead to a greater increase in reserves than had been originally estimated. It is unlikely that the Authority will have a full establishment throughout 2009/10 and so this allowance is reasonable.

b. Estimates on the level and timing of capital receipts

14. The Council has always adopted a prudent view on the level and timing of capital receipts, a position justified by past experience. Capital receipts are not recognised for budgetary purposes unless they have been received or their receipt is contractually confirmed prior to the budget being ratified. Cabinet has adopted a policy of not entering into further disposals until the property market has improved and so no significant disposals are likely in 2009/10.

15. 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. Sales completed in 2008/09 are likely to be less than the 28 in 2007/08, and the original estimate of 30 has now been reduced to 8. It is anticipated that sales will now stabilise at 10 for the following three years.

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

17. Even with the Authority's substantial capital programme, which exceeds £53m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2013 will be £11.3m. The Capital Strategy continues to emphasise that priority will be given to capital schemes that will create future revenue benefit, either through increased income or reduced costs. This has been the case with the recent decisions to invest in waste and leisure services.

c. Treatment of demand led pressures and savings

18. The largest demand led pressure facing the Council is for the green waste service. Members previously decided to boost recycling rates by removing the charge for sacks and providing an all year service. The public responded positively to the service and vast quantities of green waste are now being collected. However, the biodegradeable sacks currently used for this service are expensive and the numbers of sacks being put out for collection by residents has caused problems for the contractor. A revised service utilising a second wheeled bin will be introduced during 2009/10. This requires considerably investment in terms of CSB, DDF and capital. However, this is a key service and by moving forward in this way it has been possible to secure significant ongoing revenue support from Essex County Council and one-off capital assistance to help purchase the necessary equipment.

19. Demand has also increased dramatically for bus passes, following the introduction of the new national scheme. The number of passes in issue has increased by more than 50% and over 16,000 passes have been issued. Negotiations are ongoing with Essex County Council, as they are keen to take over responsibility for this service from district councils. This would greatly reduce the financial risk to the districts and the Department for Transport has already indicated that responsibility for the scheme is likely to change as part of the next Comprehensive Spending Review.

20. The "Credit Crunch" has seen new benefit claims increase by more than 25% and is also likely to increase demand for the Council's homelessness service. These will not be the only Council services to face extra demands in the current economic climate. Against this background, it is clear that in order to avoid breaching the guideline on reserves it will be necessary to seek savings in the last three years of the period covered by the medium term financial strategy. However, the current strength of reserves means that it should be possible to do this in a structured and progressive way.

d. Risks inherent in partnership arrangements etc

21. 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)

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

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

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

24. However, the discipline of Financial Regulations - not incurring spending without a clear budget - must be rigidly observed, and the monitoring of the riskier budgets, particularly income budgets, needs to be maintained. The quarterly budget monitoring reports on key budgets to both the Finance and Performance Management Cabinet Committee and the Finance and Performance Management Scrutiny Panel will continue throughout 2009/10. The production of these reports during the year is essential in identifying emerging problems at the earliest opportunity. This allows maximum benefit to be accrued from any corrective action taken.

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

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

h. The adequacy of insurance arrangements

26. The Council is now in the fourth year of a five-year agreement, which was subject to a competitive tendering process. As part of this exercise different levels of excess and policy cover were considered. The Council made a decision to undertake a greater degree of self-insurance and accept higher excess levels to reduce insurance premiums. Savings on premiums resulting from this exercise are likely to be in the order of £1m over the life of the agreement, and some of this saving is being paid into the Council's insurance fund. However, as part of the 2007/08 external audit the need for such a large insurance fund was questioned. Following a review of the annual transactions through the fund, the meeting of the Finance and Performance Management Cabinet Committee on 8 December decided to cap the fund at £500,000 and take the surplus of £460,000 to the DDF.

i. Pension liabilities

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

28. Despite taking the higher deficit payment option, the deficit payments to the fund will reduce from £1.822m in 2007/08 to £1.796m in 2008/09. Council agreed in December 2007, as part of approving the Capital Strategy, that the

policy of capitalising deficit payments would continue and a further £2.5m of capital receipts will be moved to the Pension Deficit Reserve to fund this.

29. An annual application is made to Department for Communities and Local Government (DCLG) for a capitalisation direction. Authority was given to capitalise the full additional deficit payment in 2005/06 although for 2006/07 the capitalisation was limited to 57.19% of the value of the application. This followed concerns at the Treasury about excessive capitalisations creating pressure on the Chancellor’s “Golden Rule”. Despite the overall level of applications being higher in 2007/08 concern about the “Golden Rule” appeared to have eased as full directions were obtained.

30. The regulations for issuing capitalisation directions were changed for 2006/07, with a “Two Gate” system being introduced. Applications must satisfy the previous criteria to clear Gate 1 but applications will not pass Gate 2 until the national economic impact has been considered in total. Confirmation of whether the applications have been successful or not will not be provided until the end of January. If capitalisation directions are not provided then the additional charges to revenue for 2008/09 will be £662,000 General Fund and £311,000 HRA. As the deficit payments have not changed significantly the amounts at risk in future years are broadly similar.

Statement on the adequacy of the reserves and balances

31. The Use of Resources assessment now conducted by the external auditors has moved on from the formulaic approach of CPA to achieve the ‘good’ ranking for reserves. The old formula had suggested that the Council should maintain a General Fund balance of at least £0.89m but no more than £17.86m. The Council’s current best estimate of the General Fund balance at 31 March 2010 is £7.9m as shown in the Annex 13.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.

32. The following table lists those developments and cost pressures within the four-year forecast that offer the greatest risk to financial stability.

Item of risk	Estimated level of financial risk £000	Level of risk %	Adjusted level of risk £000
Basic 5% of Net Operating Expenditure			1,100
Pay award being settled 1% in excess of 2.475% est. for 08/09 and future years	600	20	120
Inflationary pressures between 1-4% higher than budget	600+	20	120+
Loss of North Weald Market Income	4,000+	20	800+
General Income between 1-4% less than budget	600+	10	60+
Interest Rates 1% less than budget	500+	10	50+
Emergency Contingency	800+	20	160+
Capitalisation applications refused for 08/09 and 09/10	1,300	40	520
Renegotiating External contracts and partnership arrangements	Say 1,000+	10	100+
Total	9,400+		3,030+

33. The presentation in this table is not a scientific approach, but a crude attempt to put a broad order of scale on the main financial risks potentially facing the Council. It is meant to be thought provoking rather than definitive. It is certainly not a complete list of all the financial risks the Council faces but it shows the potential scale of some of the risks and uncertainties and the impact they may have on the Council's balances if they were to come to fruition.

34. Based on the CPA formula there is an expectation that an authority should carry a level of balance that equates to at least 5% of the net operating expenditure (NOE) of the Authority. During the period of the four-year plan NOE is expected to average out at £18.6m, which suggests a figure of £930,000.

35. The income generated from the market at North Weald airfield is significant to the ongoing financial well being of the Authority. Uncertainties surrounding the future of the airfield create a risk to the Authority that needs to be recognised and quantified hence its inclusion in the list above. A number of contracts have been granted to outside bodies for the provision of Council services. The failure of any of these contracts would inevitably lead to the Council incurring costs, which may not be reimbursed. Other than certain bond arrangements there is no specific provision made in the estimates for this type of expenditure, which therefore would have to be covered by revenue balances.

36. The Council has always been conscious of its balances position as can be demonstrated by budget reports over many years. Fortunately for the Authority the question had not been whether it had a sufficient level of balance but rather that it had too much. Balances have been increasing since 2003/04 and are predicted to peak at £7.99m as at 31 March 2010.

37. A number of policies have been determined previously to bring about reductions and the current policy reflects that deficit budgets are now necessary for the balances to fall. That is to say that the current policy allows for balances to fall to no lower than 25% of Net Budget Requirement (NBR). This is slightly different from the NOE stated above, the average NBR figure for the next four years is expected to be £17.70m therefore 25% of that figure equates to £4.43m. The current four-year forecast shows balances still at £6.475m at the end of 2012/13.

38. The risk assessment undertaken above suggests that 20-25% of NBR is about the range that this authority should be maintaining its balances within. By 31 March 2013 balances will represent 35% of NBR, which is perfectly adequate. However, Members are aware that this situation can only be achieved with CSB savings and have stated a clear target of reducing expenditure throughout the period of the medium term financial strategy.

39. It has already been stated that the capital fund is expected to remain in a surplus position beyond 2012/13 and the capital programme can be fully funded.

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

41. HRA revenue balances are expected to decrease slightly from £6.2m as at 31 March 2009 to £5.79m as at 31 March 2010. The balance on the Housing Repairs Fund is expected to reduce over the next year, from £3.83m to £3.48m. Similarly the Housing Major Repairs Reserve is predicted to reduce from £4.52m to £4m. Even though reductions in reserves are budgeted the overall financial standing of the HRA and its reserves going into 2009/10 remain healthy.

42. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2009/10 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term.