Annex 6

The Chief Financial Officer's report to the Council on the robustness of the estimates for the purposes of the Council's 2011/12 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 2011/12. If this advice is not accepted, the reasons must be formally recorded within the minutes of the Council meeting. Council will consider the recommendations of Cabinet on the budget for 2011/12 and determine the planned level of the Council's balances.

2. Sections 32 and 43 of the Local Government Finance Act 1992 also require billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the net budget requirement.

3. There are a range of safeguards, which exist to ensure local authorities do not over-commit themselves financially. These include:

    - The CFO's s.114 powers, which require a report to the Cabinet and to all members of the local authority if there is or is likely to be unlawful expenditure or an unbalanced budget
    - The Prudential Code, which applied to capital financing from 2004/05.

The Robustness of the Recommended Budget

4. A number of reports to the Cabinet in recent years have highlighted the difficulties inherent in setting budgets, not least because of significant changes in the level and complexity of Government funding and continuing pressure to protect and develop services. At the same time major changes have been introduced to the way the Council is structured and managed and the way services like waste and leisure are delivered. These changes and the "Credit Crunch" are still ongoing and represent significant risks to the Council's ability to assess properly all the financial pressures it faces.

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

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

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

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

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 2011/12.**

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

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

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

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

Factor Assessment

a. Inflationary pressures

11. Every year base budget estimates are produced and then different inflation factors are applied to the resultant figures to take budgets to out-turn prices. It is inevitable that there will be either over or under provision for the full cost of inflation, as prices will vary against the estimates made. Efforts have been made to predict the level of inflation in the coming year, although the difficulty in making these predictions is highlighted by inflation remaining stubbornly high and above the target for, and predictions of, the Monetary Policy Committee. Inflation, as measured by the annual rate of increase in the Retail Prices Index, rose from 4.7% for November to 4.8% for December. Over this period the Consumer Prices Index rose from 3.3% to 3.7% and so is rapidly approaching double the Government target of 2%. However, whilst recovery in the overall economy remains weak the Monetary Policy Committee are likely to continue their cautious stance and not strongly intervene with increases in interest rates to reduce inflation.

12. If inflation remains at the current level for long pressure for a pay award will increase. Pay rates have been frozen for 2010/11 and the Government has stressed the need for restraint in public sector pay over the length of the Comprehensive Spending Review. The Medium Term Financial Strategy (MTFS) includes an allowance of 1.5% for pay awards for 2013/14 and 2014/15, as it is felt that a pay freeze for the entre period is unlikely to be sustainable. 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 increased from 2% to 2.5%. This reflects the ongoing underspends, with total salaries at December 2010 being 3.8% underspent. It is unlikely that the Authority will have a full establishment throughout 2011/12 and so this allowance is reasonable.

b. Estimates on the level and timing of capital receipts

13. The Council has always adopted a prudent view on the level and timing of capital receipts. Capital receipts are not recognised for budgetary purposes unless they have been received or their receipt is contractually confirmed prior to the budget being ratified. Cabinet is unlikely to agree further disposals until the property market has improved and so no significant disposals are anticipated in 2011/12.

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

15. Even with the Authority's substantial capital programme, which exceeds £50m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2015 will be £6.5m. The Capital Strategy continues to emphasise that priority will be given to capital schemes that will create future revenue benefit, either through increased income or reduced costs.

c. Treatment of demand led pressures and savings

16. The main demand led pressures are still on the benefits and homelessness services as people continue to struggle with the difficult economic circumstances and rising unemployment. Stagnation in the housing market is an ongoing problem and the lack of activity in this area continues to impact on key income streams like planning and building control fees and land charges. One encouraging development in this area is the possible move away from prescribed planning fees, with Council's being able to seek full recovery of their costs. The outcome of the consultation on this proposal is eagerly awaited as any additional freedom over charging would be welcomed.

17. Savings have been achieved for the 2011/12 budget by focusing on areas that have historically underspent. There has been some history in recent years of the budget as a whole being underspent and an exercise was undertaken to limit budgets going forward to the average amount spent in the previous three years. This removed over £350,000 from the CSB and, together with the transfer of the commercial property from the Housing Revenue Account, provided a sound base for the 2011/12 budget. However, these were the "quick wins" and going forward a public consultation exercise will be necessary to inform decisions on future service provision.

d. Risks inherent in partnership arrangements etc

18. There are several partnership arrangements, some of which carry risks of varying degrees in monetary terms. The risks have not been specifically identified in the budget but are underwritten through the Authority's balances.

e. Financial standing of the authority (i.e. level of borrowing, debt outstanding etc)

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

20. The largest threat to the Authority's financial standing is the reform of the housing subsidy system. The reform of the housing subsidy system was proposed by the previous Government and the new Government is continuing with these reforms. It is likely that this Council will be required to take on approximately £200m of debt in order to avoid annual payments of £11m of subsidy. There are also concerns about how the reforms will be implemented and possible unintended negative consequences on the General Fund. These issues were raised in the Council's consultation response but it remains to be seen whether the Government will make appropriate allowances.

21. There is also a potential income stream that may significantly benefit the Authority but has not been allowed for. The New Homes Bonus provides an incentive for Councils to encourage residential development. Grant will be payable to Councils based on the year to year increase in their tax base, the amount of grant is likely to be payable for six years and should commence from 1 April 2011. However, the consultation on the calculation of the bonus and how it is to be shared between district and county levels only closed on 24 December and no firm date has been given by DCLG for confirming the details of the scheme. Whilst such uncertainty exists over the calculation and the amounts payable it is not prudent to build this income into the MTFS.

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

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

23. Most managers have received training on budget management. A course involving an external trainer the CFO and the Chief Internal Auditor has now been supplemented with additional detailed training on a directorate basis being provided by accountancy staff.

24. The quarterly budget monitoring reports on key budgets to both the Finance and Performance Management Cabinet Committee and Scrutiny Panel will continue throughout 2011/12. 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. Following a collaborative procurement exercise with twelve other authorities a new long term agreement has been entered into. As part of this process a number of options on excess levels and joint arrangements were considered. However, the most cost effective option proved to be keeping the portfolio of policies with Zurich on similar excesses. The Authority still maintains an insurance fund, which as at 31 March 2010 had a balance of £428,000.

i. Pension liabilities

27. The latest triennial valuation as at 31 March 2010 showed a reduction in the funding level of the scheme to 71% (the value of the scheme's assets only cover 71% of the liabilities). However, the actuaries have been able to keep the deficit payments at a similar level for the next three years by increasing the deficit recovery period from 20 to 27 years. Ongoing contributions have benefitted from a slight reduction from 13.1% to 13%.

28. Annual applications are made to Department for Communities and Local Government (DCLG) for capitalisation directions, as separate directions are required for the Housing Revenue Account and the General Fund. These applications have been made since 2005/06 and the only year when a full direction was not given was 2006/07 when the capitalisation was limited to 57.19% of the value of the application.

29. The regulations for issuing capitalisation directions were changed for 2006/07, with a “Two Gate” system being introduced. Applications must satisfy the previous criteria to clear Gate 1 but applications will not pass Gate 2 until the national economic impact has been considered in total. For 2010/11 the Government have limited capitalisation directions to 38% of the amounts applied for. This restriction has caused amounts of £176,000 to be charged to the District Development Fund and £82,000 to the HRA. As the deficit payments have not changed significantly the amounts at risk in future years are broadly similar.

Statement on the adequacy of the reserves and balances

30. The Use of Resources assessment previously 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 2012 is £7.7m as shown in the Annex 4 b. This is clearly within the range specified but as a benchmark is not particularly useful. Therefore a risk assessment related to the Authority’s individual circumstances is provided as a more meaningful benchmark against which the adequacy of the balances can be determined.

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

Item of risk	Estimated level of financial risk £000	Level of risk %	Adjusted level of risk £000
Basic 5% of Net Operating Expenditure			1,100
Grant reduction being 20% instead of 6% over in last 2 years of CSR	900	50	450
Pay award being settled 1% in excess of estimate for 11/12 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
Unintended consequences of HRA reform impacting on General Fund	2,000	50	1,000
Capitalisation applications refused for 11/12 and 12/13	1,300	40	520
Renegotiating External contracts and partnership arrangements	Say 1,000	10	100
Emergency Contingency	800	20	160
New Homes Bonus, income over MTFS at level implied in consultation	(2,800)	30	(840)
Total	9,000		3,590

32. The income generated from the market at North Weald airfield is significant to the ongoing financial well being of the Authority. Uncertainties surrounding the future of the airfield create a risk to the Authority that needs to be recognised and quantified hence its inclusion in the list above.

33. A number of contracts have been granted to outside bodies for the provision of Council services. The failure of any of these contracts would inevitably lead to the Council incurring costs, which may not be reimbursed. Other than certain bond arrangements there is no specific provision made in the estimates for this type of expenditure, which therefore would have to be covered by revenue balances.

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

35. Based on the old CPA formula there is an expectation that an authority should carry a level of balance that equates to at least 5% of the net operating expenditure (NOE) of the Authority. During the period of the four-year plan NOE is expected to average out at £16.1m, which suggests a figure of £800,000.

36. The Council has always been conscious of its balances position as can be demonstrated by budget reports over many years. Fortunately for the Authority the question had not been whether it had a sufficient level of balance but rather that it had too much. Balances had been increasing since 2003/04 but 2009/10 saw a reduction of £135,000 to leave a balance of £8.3m 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 necessary to support the structured reduction in spending. The current policy allows for balances to fall to no lower than 25% of Net Budget Requirement (NBR). This is slightly different from the NOE stated above, the average NBR figure for the next four years is expected to be £15m therefore 25% of that figure equates to £3.75m. The current four-year forecast shows balances still at £5.7m at the end of 2014/15.

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 2015 balances will represent 39% 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 2014/15 and the capital programme is fully funded.

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

41. The HRA revenue balance of £6.1m at 31 March 2010 is expected to decrease, by £99,000 in 2010/11 and £544,000 in 2011/12. The balance on the Housing Repairs Fund is expected to reduce over the next year, from £4.1m to £3.6m. In contrast, the Housing Major Repairs Reserve is predicted to increase slightly from £5.79m to £5.87m. Even though reductions in reserves are budgeted the overall financial standing of the HRA and its reserves going into 2011/12 remain healthy.

42. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2011/12 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term.