Annex 9

The Chief Financial Officer's report to the Council on the robustness of the estimates for the purposes of the Council's 2015/16 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 2015/16. 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 2015/16 and determine the planned level of the Council's balances.

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

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

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

The Robustness of the Recommended Budget

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

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

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

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

6. With a Cabinet system the onus is on Portfolio Holders to work closely with Directors to deliver acceptable and accurate budgets. This role has been taken seriously and has helped enhance the detailed knowledge of the Cabinet. There is an established process that allows the Finance Scrutiny Panel to challenge and debate the detailed budgets with the Finance Cabinet Committee.

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

8. **The conclusion is that the estimates as presented to the Council are sufficiently robust for the purposes of the Council's overall budget for 2015/16.**

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

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

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

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

Factor Assessment

a. Inflationary pressures

11. Every year base budget estimates are produced and then different inflation factors are applied to the resultant figures to take budgets to out-turn prices. It is inevitable that there will be either over or under provision for the full cost of inflation, as prices will vary against the estimates made. Efforts have been made to predict the level of inflation in the coming year, although the difficulty in making these predictions is highlighted by inflation remaining low and below the target for, and predictions of, the Monetary Policy Committee. The most recent figures for the year to December 2014, released on 13 January, have shown inflation at 0.5% which is the lowest level since recording in this form began in 1996. The last time inflation was at the target level of 2% was December 2013 and it has been below that level on a generally declining path since. As it is now more than 1% below the target the Governor of the Bank of England will be required to write a letter of explanation to the Chancellor of the Exchequer. This ongoing low inflation makes any increase in the rate of interest unlikely in the near future.

12. Even though inflation has been low increases in pay have been lower and people have seen the real value of their earnings fall. Pay rates had been frozen for several years prior to the 1% increase for 2013/14 and now 1.1% increases have been agreed for both 2014/15 and 2015/16. The Medium Term Financial Strategy (MTFS) includes an allowance of 1.5% for pay awards for 2016/17 and 2017/18. In the budgets the centrally held vacancy allowance has been maintained at 1.5%. This reflects the deletion of posts during the organisational restructure and the consequent reduction in the levels of salary under spends.

b. Estimates on the level and timing of capital receipts

13. The Council has always adopted a prudent view on the level and timing of capital receipts. Capital receipts are not recognised for budgetary purposes unless they have been received or their receipt is contractually confirmed prior to the budget being ratified. Currently, no significant disposals are anticipated in 2015/16.

14. The exception to this relates to receipts from council house sales. In this instance because sales occur throughout the year assumptions are made about their generation. Following the increase in Right to Buy discounts the number of sales has increased significantly. During 2012/13 there were 13 sales but 2013/14 saw the number increase to 53 and the first 9 months of 2014/15 have seen 28 sales. This indicates that the various Government initiatives to encourage lending have been effective and that it has become easier to obtain a mortgage.

15. Even with the Authority's substantial capital programme, which exceeds £116m over five years, it is anticipated that the balance of usable capital receipts at 31 March 2019 will be just under £1.8m. 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 previous demand led pressures on the benefits and homelessness services have been easing with the slow improvement in the economy. Locally the housing market is improving, with increases in key income streams like planning and land charges. The income from both these areas will be greater in 2014/15 than 2013/14.

17. The net savings for the budget have been achieved from three main areas. Firstly, the new waste management contract has generated CSB savings of £144,000 in 2014/15 and £88,000 in 2015/16. Secondly, increases in income in the Governance Directorate with Development Control contributing £120,000 and additional property rental income yielding another £130,000 over the two years. The third significant item is changing pay and display parking fees, which should provide £68,000. A number of other smaller savings have also been identified and together these provide a sound base for the 2015/16 budget. However, there is still a need for further savings in 2016/17 and 2017/18 and work is ongoing on a number of ideas to reduce net costs.

d. Risks inherent in partnership arrangements etc

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

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

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

20. A major threat to the Authority's financial standing is further substantial reductions in central government funding. The period from 2011/12 to 2015/16 will see grant funding reduced by approximately 60%. The period beyond 2015/16 will be the subject of the next Comprehensive Spending Review and whoever is in the next government will need to do more to reduce the deficit. A change of government could also see the New Homes Bonus scrapped and other structural changes to local authority finances. This means predicting beyond 2015/16 is hazardous although it is likely that there will be further reductions in revenue support grant and an increasing reliance on retained business rates.

21. I have previously expressed concern at the transfer of large financial risks to local authorities at a time of economic uncertainty. These risks were the localisation of Council Tax Benefit and the local retention of non-domestic rates. The implementation of Local Council Tax Support has been a success and the scheme has been managed within budget. In view of the success so far and the reducing caseload it has been possible to leave the scheme largely unchanged again for 2015/16.

22. Local retention of non-domestic rates has been more problematic and still represents a considerable financial risk. The major concern here arises from the treatment of appeals and refunds. Even though DCLG have already had the benefit of non-domestic rates paid in respect of periods prior to 1 April 2013, all appeals regardless of start date are accounted for within the new system. This means billing authorities are refunding money that they have not benefited from in the first place. There are still several hundred appeals outstanding, including one against the largest item on our rating list, and it is difficult to robustly predict what the combined outcomes will be.

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

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

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

25. The quarterly budget monitoring reports on key budgets to both the Finance and Performance Management Cabinet Committee and Scrutiny Panel will continue throughout 2015/16. The production of these reports during the year is essential in identifying emerging problems at the earliest opportunity. This allows maximum benefit to be accrued from any corrective action taken.

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

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

h. The adequacy of insurance arrangements

27. The Council is now in the final year of a five year agreement that was entered into following a collaborative procurement exercise with twelve other authorities. This exercise was somewhat disappointing and there was little benefit from it as insurance is something that is assessed on a risk by risk basis and not a uniform commodity that can be procured in baulk. Because of the value of the tender and the complexity of the insurance market, an external broker has been appointed to assist with the procurement. The Authority still maintains an insurance fund, which as at 31 March 2014 had a balance of £1.05m.

i. Pension liabilities

28. The latest triennial valuation as at 31 March 2013 showed an increase in the funding level of the scheme to 77% (the value of the scheme's assets only cover 77% of the liabilities). This has allowed the actuaries to reduce both the deficit payments and the projected recovery period. However, ongoing contributions have increased from 13% to 15.9% and this left the combined payment figure for 2014/15 and the two subsequent years similar to pre-valuation level. It is not anticipated that any applications will be made to DCLG for capitalisation directions and the full amounts of the deficit payments have been included in the CSB.

Statement on the adequacy of the reserves and balances

29. The Use of Resources assessment previously conducted by the external auditors moved on from the formulaic approach of CPA to achieve the 'good' ranking for reserves. The old formula had suggested that the Council should maintain a General Fund balance of at least £0.89m but no more than £17.86m. The Council's current best estimate of the General Fund balance at 31 March 2016 is £9.36m as shown in the Annex 8 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.

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

Item of risk	Estimated value of financial risk £000	Level of risk %	Adjusted level of risk £000
Basic 5% of Net Operating Expenditure			900
Grant reduction being 15% instead of 10% beyond 2015/16	600	50	300
Loss of New Homes Bonus in a new funding system	8,000	25	2,000
Pay award being settled 1% in excess of estimate for 16/17 and future years	800	25	200
Inflationary pressures between 1-4% higher than budget	600	20	120
Loss of North Weald Market Income	2,800	40	1,120
Unintended consequences of HRA reform impacting on General Fund	2,000	10	200
Localisation of Council Tax Benefit - Increase in caseload not covered by funding	1,000	20	200
Retention of non-domestic rates – losses on appeals	1,000	40	400
Renegotiating External contracts and partnership arrangements	4,000	25	1,000
Emergency Contingency	800	20	160
Total	21,600		6,600

31. The estimates for income generated from the market at North Weald airfield have been reduced but this remains a key source of income. Uncertainties surrounding the future of the airfield create a risk to the Authority that needs to be recognised and quantified hence its inclusion in the list above.

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

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 old CPA formula there is an expectation that an authority should carry a level of balance that equates to at least 5% of the net operating expenditure (NOE) of the Authority. During the period of the four-year plan NOE is expected to average out at £13.5m, which suggests a figure of £675,000.

35. The Council has always been conscious of its balances position as can be demonstrated by budget reports over many years. Fortunately for the Authority the question had not been whether it had a sufficient level of balance but rather that it had too much. Balances increased by £213,000 in 2013/14 to leave a balance of £9.88m at 31 March 2014.

36. Policies have been determined previously to bring about reductions and the current policy reflects that deficit budgets are necessary to support the structured reduction in spending. The current policy allows for balances to fall to no lower than 25% of Net Budget Requirement (NBR). This is slightly different from the NOE stated above, the average NBR figure for the next four years is expected to be £12.8m therefore 25% of that figure equates to £3.2m. The current four-year forecast shows balances still at £8.5m at the end of 2018/19.

37. 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 2019 balances will represent 68% of NBR, which is more than adequate. However, Members are aware that this situation can only be achieved with CSB savings and have stated a clear target of reducing expenditure throughout the period of the medium term financial strategy.

38. It has already been stated that the capital fund is expected to remain in a surplus position beyond 2018/19 and the capital programme is fully funded.

40. The main earmarked reserve is the District Development Fund (DDF) which is used to keep one off items of income and expenditure separate from the base budget. At 31 March 2014 the balance on the DDF was £3.8m, which was an increase of £0.2m in the year. The DDF is predicted to have a balance of £0.8m at the end of 2018/19, although this is likely to be reduced by the Local Plan and any further organisational changes. The only other earmarked reserve with a significant balance is the Insurance Reserve, which stood at £1.05m at the end of 2013/14. There were no significant movements in the year on this fund.

41. The HRA revenue balance of £2.97m at 31 March 2014 is expected to decrease, by £1m in 2014/15 and then increase by £52,000 in 2015/16 to remain above £2m. The balance on the Housing Repairs Fund is expected to reduce over the next year, from £2.75m to £1.74m. Similarly the Housing Major Repairs Reserve is predicted to decrease from £11.36m to £10.13m. The 30 year business plan has demonstrated that under self-financing the overall financial standing of the HRA will improve significantly and its reserves going into 2015/16 remain healthy.

42. The conclusion is that the reserves of the Council are adequate to cope with the financial risks the Council faces in 2015/16 but that savings will be needed in subsequent years to bring the budget back into balance in the medium term. Given the imminent general election there are particular concerns about New Homes Bonus and potential changes to the funding structure for local authorities.