Report of the chief financial officer on the robustness of the budget estimates and the adequacy of the reserves

1. Section 25 of the Local Government Act 2003 places a duty on the chief finance officer (at this council the strategic director and chief finance officer) to make a report to the council on the robustness of the estimates and the adequacy of the reserves. This report fulfils this requirement and provides councillors with assurance that the budgets have been compiled appropriately and that the level of reserves is adequate. It is a statutory requirement that councillors must consider this report when considering and approving a budget.

2. In presenting this report the strategic director and chief finance officer is mindful of other associated statutory safeguards designed to prevent the authority from over-committing itself financially, namely:

   - Section 151 of the Local Government Act 1972 which requires the authority to make arrangements for the proper administration of its financial affairs and that the strategic director and chief financial officer has personal responsibility for such administration;

   - Section 32, 43 & 93 of the Local Government Finance Act 1992 which requires the authority to set a balanced budget;

   - The Prudential Code introduced as part of the Local Government Act 2003 sets out the framework within which the authority must manage its investments, including adequate planning and budget estimates;

   - the external auditor's duty to assess the adequacy of the authority's proper arrangements to secure economy, efficiency and effectiveness ('value for money').

3. To reinforce these obligations, section 114 of the Local Government Finance Act 1988 requires the strategic director and chief finance officer to report to all the authority's councillors, in consultation with the monitoring officer, if there is or is likely to be unlawful expenditure or an unbalanced budget.

Robustness of the budget estimates

PREPARATION, REVIEW & SCRUTINY

4. In accordance with best practice and using accruals accounting, the council provides for realistic estimates of costs and known liabilities.

5. The detailed budget estimates have been prepared jointly by the heads of service and appropriately qualified staff from the council's financial services team. These have been reviewed and challenged by the chief accountant, the head of finance, and the council's management team.

6. The 2012/13 budget update report presented to the scrutiny committee on 20 December 2011 provided a detailed explanation of the factors taken into account in determining the base budgets.

REVENUE BUDGET

7. The most significant costs within the revenue budget are:

    - staff salaries and related costs
    - payments under contracts for services
    - housing and council tax benefit payments.

8. The estimates of staff costs are prepared by calculating the cost of employing each member of staff for the full year. The budget also includes the costs of recruiting to posts that are currently vacant, unless it has been decided that the post will not be filled. The costs include incremental progression and an allowance for the cost of any locally agreed pay award. All of these are known when the budgets are set.

9. The risk of overspending on staff costs is therefore considered negligible. The risk of under-spending on staff costs is high, but rather than assume a level of expected vacancy savings, the council's policy has been to budget at the 100 per cent level in-year. Then, any vacancy savings will be set aside in an earmarked reserve and may be used to support the revenue budget in a later year.

10. The costs of the most significant council contracts are linked to increases in the various price indices, usually the Retail Prices Index (RPI). The applicable RPI is known when the budgets are set and the budget reflects any estimated contract inflation. Allowance has also been made within the budget for additional costs arising from increased demand for services (e.g. additional properties leading to increased waste collection costs).

11. The risk of overspending on contract costs is therefore considered small. There remains a financial risk from a contractor failing to deliver services in accordance with the contract. Such risks are managed through the council's contract monitoring and risk management procedures, but cannot be eliminated.

12. The costs of housing and council tax benefits are largely met through government subsidy. The financial risk to the council should these costs increase significantly is small, because a very high percentage of the cost is met by the subsidy. The government has indicated a major change in funding council tax benefit from April 2013 which could result in extra cost pressure for the council. This has not been factored into the budget.

13. The level of local authority benefit errors has caused a loss in subsidy which has so far been reimbursed by the financial services contractor. The error rate has fallen recently thanks to active management, and the level of local authority errors in the latest grant subsidy claim for 2010/11 is safely below the government's threshold. The risk of any cost falling on the council is therefore low and continues to be mitigated by close contract management.

14. The areas of expenditure where there is a greater level of risk are within the demand led budgets such as the costs of homelessness (including temporary accommodation). Experience of demand in the current and recent years has been used to inform the 2012/13 budget.

15. However, these form a relatively small part of the council's gross revenue expenditure and heads of service manage these risks through monitoring activity and the performance management and budget monitoring processes.

16. As part of the budget setting process consideration has been given to income streams which could change as a result of recent and pending legislation. These include:

    - council tax freeze grant. Details regarding the council tax freeze grant for both 2011/12 (four years) and 2012/13 (one year only) have been clarified and it has been included in the budget;

    - New Homes Bonus (NHB). The council has a high degree of certainty around the first two tranches of NHB, as these figures are provided by the Department of Communities and Local Government (CLG) and they have been included in the budget, although they have not been budgeted to be spent in 2012/13. Future year figures are based on the best estimates of council officers and therefore, whilst every care has been taken in preparing these figures, they can only be considered as estimates. The government's Comprehensive Spending Review (CSR) in 2010 indicated that later tranches of NHB would be funded from reductions in formula grant – however formula grant has not been adjusted to take account of this unknown;

    - planning fees – full cost recovery. Legislation allowing the council to set its own planning fees in order to recover the costs of the planning service (within certain limitations), has been delayed. This is not now likely to happen before 1 April 2013 at the earliest and may not happen at all. Therefore no significant increase in planning fee income has been included in the budget.

    This means that no significant optimism or estimation risk has been built into the 2012/13 budget. There is however greater risk for the Medium Term Financial Plan (MTFP) viability, should the government alter its proposals – however this level of risk is considered acceptable in the light of known factors.

17. A number of revenue income streams are sensitive to changes in market conditions and therefore there will always be a risk that budget targets are not met. These include planning fees, building control fees, and land charge fees which all respond directly to the fluctuating characteristics of the housing market. Car parking income can also be volatile and responds to the general economy and retail market. Previous budget-setting exercises have made adjustments to reflect prevailing market conditions. Further adjustments have been made for 2012/13 refining budgets in light of actual patterns.

18. In order to minimise the risk of budgeted income not being achieved, the council takes a prudent approach when calculating the revenue income budgets and debts due and makes appropriate provisions for bad debts.

INVESTMENT INCOME

19. The council has a substantial investment portfolio which it partially relies upon to support the cost of services. The council is very sensitive to changes in investment income. The continuing impact of the low interest rates, and the

predicted slow rise, have been factored in to the MTFP reported as part of the budget setting report.

20. Investments have been diversified in accordance with the treasury management strategy, and the earnings assumptions in the budget are set prudently. The majority of the investment income is not committed until the year after it is earned. There is therefore certainty about the amount available when the budgets are set.

REVENUE CONTINGENCY SUM & OVERALL REVENUE BUDGET

21. The 2012/13 budget includes a contingency sum of £382,500. This is considered a prudent amount to cover unforeseen circumstances and the inevitable uncertainty within the budget.

22. Because of the prudent approach to budgeting outlined above it is considered that the risk of overspending on the revenue budget is small. Should this occur the council has adequate revenue reserves to cover such additional costs. Longer term pressures would mean the MTFP would have to be reviewed.

23. The revenue financial projections for future years included in the MTFP that forms part of the report to cabinet shows budget pressures emerging across the next five years and beyond. This is as a result of the predicted reduction in central government funding, which has been estimated for 2013/14 – 2016/17. There is a risk that the assumptions are proven to be under-estimated, in which case the council's revenue reserves are considered adequate to compensate. Furthermore, savings from the council's Fit for the Future (FFTF) programme and other invest-to-save schemes will help to combat reduced funding, but the council may still need to draw heavily on its revenue balances to cover any funding deficit.

FUNDING FROM CENTRAL GOVERNMENT

24. The revenue financial projections for future years included in the MTFP show budget pressures emerging across the next five years and beyond. A major factor in this is the predicted reduction in central government funding. The 2010 CSR, provided a two-year settlement for 2011/12 and 2012/13. Future years have had to be based on officer estimates for 2013/14 – 2016/17 in the absence of anything more certain.

25. From 2013/14, the government has proposed changes to the National Non-Domestic Rates (NNDR) system which makes up the majority of our formula grant. Details around the actual process have not been released. Until more clarity around the scheme is available, it is impossible to assess whether or not the council will benefit from the revised scheme or not compared to the current needs-based funding regime. As such, no further adjustment has been made to the previous assumptions around formula grant reductions at this stage, although once the details around the scheme are known and the council's position assessed, members should be prepared to take decisions to ensure the long-term sustainability of the council.

26. There is a risk that the assumptions are proven to be under-estimated, in which case the council's revenue reserves are considered adequate to compensate until the MTFP can be reviewed. Additionally further FFTF savings and other invest-to-save schemes will help to offset reduced funding, but the council may still need to temporarily draw on its revenue balances to cover any funding deficit.

CAPITAL PROGRAMME

27. Over recent years the council has adopted a more rigorous approach to the preparation of its capital programme. The split into an approved programme and a provisional programme is made to give greater certainty of costs and timescales before a final commitment is made. This requires a detailed appraisal to be agreed by the relevant cabinet member before expenditure is committed. The council has implemented a project management system that is used to manage capital schemes. These measures reduce the risks of both overspends and slippage in the programme

28. For major projects the council engages skilled advisors to assist it. While these measures can reduce and manage risks, by their nature some capital schemes will still contain significant financial risks. This is particularly the case with major redevelopments where the council has chosen to be an active partner, sharing both risks and rewards.

29. In the capital programme recommended to the cabinet, allowance has been made for works considered necessary to the council's land and property assets including, in the case of leisure centres, those needed in order to maintain the facilities and retain customers. There is also provision for up to £15 million for a new leisure centre at Didcot. Whilst the council expects to attract external funding to reduce this cost, there is a risk that the net cost could exceed this amount.

30. No account has been taken of the income to be obtained from preserved right to buy sales, or from other future asset disposals.

31. The council has sufficient reserves to meet any potential capital overspends. While the use of these reserves would reduce the interest income earned, the impact would not be significant. The income is not committed until it has been earned.

MEDIUM TERM FINANCIAL PLAN

32. The 2012/13 budget update report presented to the scrutiny committee on 20 December 2011 included a draft MTFP. An updated version of this has been included in the budget report taking account of all budget changes since that date. The plan sets out provisional revenue spending plans and the estimated use of reserves through to 2016/17.

PRUDENTIAL INDICATORS

33. The prudential code requires the calculation of a number of prudential indicators, which measure the sustainability of the council's medium term financial strategy, explicitly with regard to affordability, prudence, value for money, stewardship, service objectives and practicality. This is backed up by a specific requirement to monitor performance against forward-looking indicators and report and act on significant deviations.

BUDGET MONITORING

34. The council has a budget monitoring process for both its revenue budget and capital programme. System reports are produced monthly for heads of service,

management team and the cabinet member for finance. Formal reports are considered by cabinet quarterly.

RISK MANAGEMENT & INSURANCE

35. We adopted a risk management strategy in July 2005. Management Team regularly revises the corporate risk register in light of changing conditions. Service teams have taken account of the risk management work in their service plans for 2011/12 and will review their risk management plans before finalising their 2012/13 service plans. In 2006 we worked with Garrison Security to prepare business continuity plans, which are now in place.

36. In addition to the various mitigation measures outlined above, certain financial risks are mitigated by the council's insurance arrangements which are reviewed annually.

37. The main risks inherent in the council's MTFP are:

    - government grant funding being less than estimated;
    - further reduction in council tax in 2013/14, or a council tax freeze after 2013/14;
    - macro-economic deterioration, such as slower interest rate rises, higher inflationary pressures and slower housing growth.

    There are sufficient usable revenue balances and New Homes Bonus income to compensate for costs arising over the medium term should the above risks materialise.

Adequacy of reserves

38. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued guidance on local authority reserves and balances in Local Authority Accounting Panel (LAAP) bulletin 55. It sets out the three main purposes for which reserves can be held:

    - a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing – which forms part of general reserves;
    - a contingency to cushion the impact of unexpected events or emergencies – also part of general reserves;
    - a means of building up funds often referred to as earmarked reserves, to meet known or predicted liabilities.

39. The council held £750,000 in a general surplus and deficiency reserve as at 1 April 2011 and intends to maintain this level. This is approximately six per cent of the annual budget requirement and is likely to be sufficient to cover uneven cash flow and all but the most serious emergency. In addition, the recommended revenue budget contains an adequate contingency sum to cover unanticipated costs.

40. The council held £31.157 million in revenue fund reserves as at 1 April 2011. This is estimated to fall to £24.732 million by 31 March 2017 after taking into account

committed expenditure and future income. At the end of 2016/17 it is estimated that the unallocated element of revenue reserve balances (£17.468 million as at 1 April 2011), also known as the enabling fund, will be £4.496 million and unallocated capital resources will be reduced to £nil. However, it is estimated that the council will receive £10.267 million in NHB by 2016/17, which is currently all being budgeted to be transferred to an earmarked reserve.

41. In additional there is a revenue reserve of £10.609 million which forms part of the Community Investment Fund (CIF).

42. Finally the council has unapplied capital receipts of £35.757 million at 1 April 2011 which form part of the CIF. The capital growth bid for the new leisure centre in Didcot, estimated to cost £15 million, is proposed to be funded from these receipts.

Conclusion

43. The budget estimates have been prepared following a properly controlled and professionally supported process. They have been subject to due consideration and the identifiable risks should be capable of management.

44. Overall, the level of reserves is adequate in relation to the proposed revenue budget and capital programme and the budgets are sustainable.

45. The reserves earmarked within the CIF are not reduced other than by the sums already earmarked. The income earned on these reserves is therefore a sustainable source of funds for the council.

Steve Bishop (Strategic director and chief finance officer) 13 February 2012

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