South Oxfordshire District Council

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 head of finance) 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 head of finance 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 head of finance as chief finance 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 head of finance as chief finance officer to report to all the authority's councillors, in consultation with the monitoring officer and chief executive, 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 initial budget estimates were prepared jointly by the heads of service and appropriately qualified staff from Capita's accountancy team and have been finalised by the council's own accountancy team following the in-sourcing of the service on 10 December 2018. These have been reviewed and challenged by the council's strategic finance manager, the head of finance, the strategic management team and cabinet members.

6. The 2019/20 budget briefing session held with members on 5 February 2019 provided an explanation of the factors taken into account in determining the budget.

REVENUE BUDGET

7. Similar to most district councils the most significant costs within the revenue budget are:

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

9. The risk of overspending on staff costs is therefore considered negligible. The risk of under-spending on staff costs is high and this year the council's policy has been to budget at 96 per cent of the expected salary level.

10. The costs of the most significant council contracts are linked to increases in the various price indices, usually the Retail Prices Index (RPI) or the Consumer Price Index (CPI). 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 exists and 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 cost of housing benefit is largely met through government subsidy. The financial risk to the council should this cost increase significantly is small, because a very high percentage of the cost is met by the subsidy.

13. The level of local authority errors in the latest grant subsidy claim 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 government reformed council tax benefit from April 2013 when it became a local 'Council Tax Reduction Scheme' (CTRS). This change resulted in extra cost pressures for the council which have been factored into the proposed budget. The change also transfers the financial risk (and reward) from central government to the council for any significant changes in the numbers of residents claiming CTRS. We will closely monitor caseloads to assess any significant financial variation.

15. 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 2019/20 budget.

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:

    - New Homes Bonus ((NHB). On 24 July 2018 the Ministry of Housing, Communities and Local Government (MHCLG) signalled its intention to replace the NHB scheme with a scheme that looks to ‘incentivise house growth most effectively’. MHCLG said it ‘will consult widely on any changes prior to implementation’. To date there has been no consultation and so as I do not know what will replace NHB I am unable to make any estimate of what funding the new scheme may generate for the council. In setting the budget I have assumed the remaining tranches of NHB will be honoured by MHCLG but I have assumed no income for any new scheme. I believe this is a balanced and prudent approach to setting the budget;

    - The business rate retention scheme. This scheme is due to change in a number of ways on 1 April 2020. The funding baseline is to be reset (informed by the fair funding review), the business rate baseline is to be reset to reflect the current business rates base and the proportion of income retained (prior to top ups and tariffs) is under review. All in all, it means it is impossible to say what income this scheme may generate from April 2020. Because of this I have budgeted at the level of the current safety net across the MTFP to minimise the risk of overbudgeting for income.

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 charges 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 2019/20 refining budgets in light of actual activity levels.

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 returns on the council investment portfolio are relied upon to support the cost of services. 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 are diversified in accordance with the treasury management strategy, and the earnings assumptions in the budget are set prudently. 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. In 2014/15 I introduced a change to the way the council budgets for contingency. Previously underspends were in part caused by pessimistic budgeting that assumed and budgeted for worse case scenarios. A review of service budgets identified that, in addition to the central contingency budget, there were also budgets within services that could also be considered contingency budgets. These budgets were centralised.

22. In itself this did not reduce the annual unspending by services and so this year we employed The Chartered Institute of Public Finance and Accountancy (CIPFA) to help challenge our budgets. The work has elicited significant budget reductions and I am confident that further budget challenge work will deliver more savings.

FUNDING FROM CENTRAL GOVERNMENT

23. On 13 December 2018 the government announced the provisional 2019/20 local government settlement. The final settlement was issued on 29 January 2019.

24. When calculating councils' spending power the Government assumes councils increase their council tax to the maximum level allowable before a referendum would need to take place.

25. The business rates retention scheme currently allows local government to keep fifty per cent of collectable income. From 2020 scheme will change as discussed above. It is not possible to estimate the financial impact of any new scheme.

26. There is a risk that the assumptions about government grant reductions 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.

CAPITAL PROGRAMME

27. The council has adopted a 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.

28. For major projects the council engages skilled advisors to assist it. Whilst these measures can manage and mitigate risks, by their nature some capital schemes will still contain significant financial risks. This is particularly the case with major redevelopments where the council may choose 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.

30. In estimating additional capital receipts a view has been taken of the income to be obtained from future asset disposals.

31. The council has sufficient capital contingency and capital 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 investment income is not committed until it has been earned.

MEDIUM TERM FINANCIAL PLAN

32. An updated version of the MTFP 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 2023/24.

33. Over the past decade, the council has been at the forefront of new savings initiatives, for example joint working with the Vale of White Horse District Council to generate significant staffing savings. As a consequence, the council has been able to reduce its costs as government funding has reduced. In my report to council three years ago, I highlighted that the council's revenue expenditure would soon exceed its revenue income. This has happened and the council now has to draw on its balances in order to balance its budget.

34. In recent years, the government has encouraged councils to use their surplus balances before making cuts to budgets and has encouraged councils not to raise council tax through the awarding of council tax freeze grant.

35. The council has strong balances and so can support the revenue account across the entire five years of the MTFP. However, beyond that the council will need to eliminate this gap.

36. As we go through 2019/20 more information on the revision to the business rates retention scheme and the replacement for NHB will become available. Later in the year the government's spending review will reveal how the quantum of local government fund will change in future years and the MHCLG will determine what this means on an individual council level. With this information we will better understand the size of the budget challenge ahead of us and we can better prepare ourselves to meet it.

37. It is highly probable that this will result in a need to substantially reduce expenditure or substantially reduce income, or both, across the period of the MTFP.

PRUDENTIAL INDICATORS

38. The prudential code requires the calculation of a number of prudential indicators, which measure the sustainability of the council's MTFP, 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

39. At the end of September and November heads of service complete budget monitoring returns forecasting their year-end positions. We will move to more frequent budget monitoring in 2019/20.

RISK MANAGEMENT & INSURANCE

40. The risk management arrangements are managed by the council's risk and insurance officer.

41. The risk and insurance officer has recent led a thorough review of the council's insurance arrangements. This fed into the annual insurance renewal process resulting in greater assurance that the council has comprehensive cover in place.

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

- government grant funding is less than estimated, specifically;
    i. NHB income is less than that shown in the MTFP
    ii. The scheme that replaces NHB is less rewarding that the current NHB scheme
    iii. The revised business rate retention scheme does not favour the council financially.
- substantial increases in council tax reduction scheme caseload and costs
- macro-economic changes, such as slower interest rate rises, higher inflationary pressures and slower housing growth
- Unforeseen growth in essential expenditure.

Adequacy of reserves

43. 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.

44. The council's Medium Term Financial Strategy (MTFS) states that the council will hold £50 million of investments of which £35 million can be invested in capital schemes that will produce a return of certainty. The remaining £15 million can be invested in treasury investments. Whilst the treasury investments are capable of being realised, investment in capital schemes is not capable of being realised.

45. Excluding the £50 million investment, the council is projected to hold £4.0 million of general revenue balances and £9.9 million earmarked revenue reserves as at 31 March 2024. Of the earmarked reserves £1.5 million represents NHB ring-fenced for affordable homes.

Conclusion

46. 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.

47. Overall, the level of reserves is adequate in relation to the proposed revenue budget and capital programme. However, the council's MTFP shows that it faces a significant budget challenge over the next five years and beyond as it draws more from its reserves to support its revenue budget. The scale of the challenge will be determined by how generous or not the government's future funding schemes prove to be for our council.

William Jacobs (Head of finance and chief finance officer) 6 February 2019