

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, 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 shared accountancy managers, the head of finance, and the council's strategic management board (SMB).
6. The 2015/16 budget briefing session held with members on 9 February 2015 provided an explanation of the factors taken into account in determining the budget.

REVENUE BUDGET

7. 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 98 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). 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 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, which became a local 'council tax reduction scheme' (CTRS) from April 2013. 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 2015/16 budget.
16. 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.

17. 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 2014/15 (two years) and 2015/16 have been included in the budget;
- New Homes Bonus (NHB). The council has had confirmation of the first five tranches of NHB; these figures are provided by the Department of Communities and Local Government (CLG) and they have been included in the budget. Future year estimates have been provided by council officers. In my opinion the methodology used produces a prudent estimate.
- The government's Comprehensive Spending Review (CSR) in 2010 indicated that later tranches of NHB would be funded from reductions in formula grant – the MTFP includes significant estimated reductions in formula grant in future years. There is a risk that a new government from 2015 may decide to change the NHB scheme or even stop it altogether. A maximum of £14.1 million would be at risk should the scheme stop soon after a new government is in place. Two schemes in the provisional capital programme (Orchard Centre works and Didcot town centre housing) are specifically identified as only going ahead when the 'at risk' NHB is received;

18. 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 2015/16 refining budgets in light of actual patterns.

19. 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

20. 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.

21. 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

22. Since 2014/15 a significant change to the way the council budgets for contingency has been introduced. 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 have now been centralised.

23. There is now the potential for a greater call on the council's contingency budget and so the risk of overspending on this budget and the revenue budget has increased. Should this occur the council has adequate revenue reserves to cover such additional costs.

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. On 18 December 2014, the provisional settlement provided a one-year funding figure for 2015/16. The 2015/16 settlement was finalised on 4 February 2015 with negligible changes. Future years have had to be based on prudent estimates for 2016/17 – 2019/20. 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 future savings initiatives will help to combat reduced funding, but the council may still need to draw heavily on its revenue balances (including NHB receipts) to cover any funding deficit.
25. From 2013/14, the government changed the National Non-Domestic Rates (NDR) system which previously made up the majority of our formula grant when it was redistributed by the government. These changes introduced a complicated system of baselines, top-ups, tariffs, levies and safety nets. The council is projected to be around the safety-net. Although growth is expected in future years it has felt prudent not to factor any increase in income into the MTFP due to the known volatile nature of this income stream.
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. As mentioned above the NHB scheme may not always remain in its current form. Should the scheme be stopped altogether the council will have to review the services and the service levels it provides.

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. The council has implemented a project management system that is used to manage capital schemes. These measures reduce the risks of both overspend and slippage in the programme.
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 including, in the case of leisure centres, those needed in order to maintain the facilities and retain customers.
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 (MTFP)

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 2019/20.

PRUDENTIAL INDICATORS

33. 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

34. The council has a budget monitoring process for both its revenue budget and capital programme. System reports are produced quarterly for heads of service, and the strategic management board (SMB). Formal quarterly reports are issued via In Focus.

RISK MANAGEMENT & INSURANCE

35. We adopted a risk management strategy in July 2005. SMB 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 2014/15 and will review their risk management plans before finalising their 2015/16 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. It is anticipated that costs arising from the fire at our offices in Crowmarsh will be covered by our insurance policies.
37. The main risks inherent in the council's MTFP are:
 - government grant funding being less than estimated;
 - NHB income being less than that shown in the MTFP;
 - substantial increases in council tax reduction scheme caseload and costs;

- 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 allow time to manage the financial consequence of any of the above costs arising over the medium term should the 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 2014 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 £50.3 million in revenue fund reserves as at 1 April 2014. Revenue fund reserves are estimated to fall to £21.8 million by 31 March 2020 after taking into account budgeted expenditure and future income. This includes £1.5 million of unallocated NHB and £1.6 million investment income that will not be committed until after 31 March 2020.

41. Unallocated capital receipts as at 31 March 2020 are estimated to fall to £2.5 million.

42. In addition to this the council will have a range of assets including a £15 million loan to SOHA, and corporate bonds and equities.

43. Part of the council's medium term financial strategy is to generate income from £50 million of its reserves and assets. As at 31 March 2020 the £50 million is projected to be made up of £12.9 million of the revenue reserve (of £21.8 million), £15 million loan to South Oxfordshire Housing Association, £14.6 million in corporate bonds and equities, £5 million invested in the proposed Didcot Leisure Centre and £2.5 million (i.e. all) of the unallocated capital receipt balance.

Conclusion

44. 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.

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

William Jacobs (Head of finance and chief finance officer)

13 February 2015