

## Appendix H

### **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 shared accountancy managers, the head of finance, and the council's management team.
6. The 2013/14 budget update report presented to the scrutiny committee on 15 January 2013 provided a detailed explanation of the factors taken into account in determining the base budgets.

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### REVENUE BUDGET

7. The most significant costs within the revenue budget are:
  - staff salaries and related costs
  - payments under contracts for services
  - housing 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 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 benefit errors has caused a loss in subsidy which has so far been reimbursed by the financial services contractor. The error rate has in the level of local authority errors has fallen recently thanks to active management by officers of the council and the financial services contractor; the level of local authority errors in the latest grant subsidy claim for 2011/12 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 has reformed council tax benefit, which becomes a local 'council tax reduction scheme' (CTRS) from April 2013. This change has resulted in immediate extra cost pressures for the council which has been factored into the proposed budget. The change also transfer 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

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accommodation). Experience of demand in the current and recent years has been used to inform the 2013/14 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 both 2011/12 (four years), and 2013/14 (two years) (note that: 2012/13 was one year only) have been clarified and these have been included in the budget;
  - New Homes Bonus (NHB). The council has had confirmation of the first three tranches of NHB; these figures are provided by the Department of Communities and Local Government (CLG) and they have been included in the budget, and transferred to reserves in 2013/14. 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 – the MTFP includes significant estimated reductions in formula grant in future years;
  - 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 further delayed. It is possible that it will be implemented in 2013/14, but this is not certain. Therefore no significant increase in planning fee income has been included in the budget except for the 15 per cent national increase in planning fees which the government introduced in late 2012/13.

This means that no significant optimism or estimation risk has been built into the 2013/14 budget. There is however greater risk for the Medium Term Financial Plan (MTFP) viability, should any of the government grants alter significantly – however this level of risk is considered acceptable in the light of known factors.

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 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 2013/14 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.

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### INVESTMENT INCOME

20. 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.
21. Investments have been 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. The 2013/14 budget includes a general contingency sum of £300,000 as well as a contract bonus payment contingency of £82,500. This is considered a prudent amount to cover unforeseen circumstances and the inevitable uncertainty within the budget.
23. 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.

### 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 19 December 2012, the provisional settlement provided a two-year funding projection for 2013/14 and 2014/15. The 2013/14 settlement was finalised on 4 February 2013 with negligible changes – 2014/15 remains provisional. Future years have had to be based on prudent estimates for 2015/16 – 2017/18. 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 savings 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
25. From 2013/14, the government has changed the National Non-Domestic Rates (NNDR) system which previously made up the majority of our formula grant when it was redistributed by the government. These changes are based on the council's estimated levels of local business rates due, and then (in the case of this council) a tariff is paid to central government. The government sets a retention level that the council is allowed to keep. If the business rates due is higher than our retention level, any surpluses are distributed to central government, the county council and the district. If the amount due falls below our retention level 40 per cent of the deficit is borne by the council, however a safety net cuts in at 92.5 per cent and it is estimated that the council will be below this safety net for some years. As such the level of business rate funding in the MTFP is estimated to be at 92.5 per cent of the retention level set by government.

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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. Additionally further FFTF savings and other savings 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.
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 income is not committed until it has been earned.

**MEDIUM TERM FINANCIAL PLAN**

32. The 2013/14 budget update report presented to the scrutiny committee on 15 January 2013 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 2017/18.

**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**

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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. Reports are considered by cabinet briefing three times per year.

**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 2012/13 and will review their risk management plans before finalising their 2013/14 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 reductions in council tax in 2016/17 and 2017/18;
- 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 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 2012 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.

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40. The council held £42.4 million in revenue fund reserves as at 1 April 2012. In addition there is a revenue reserve of £10.6 million which forms part of the Community Investment Fund (CIF). Revenue fund reserves are estimated to fall to £26.3 million by 31 March 2018 after taking into account committed expenditure and future income, which includes unallocated new homes bonus receipts of £11 million.
41. At the end of 2017/18 it is estimated that the unallocated element of revenue reserve balances known as the enabling fund (£16.3 million as at 1 April 2012) will be £3.8 million and unallocated capital resources will be reduced to £0.2 million.
42. Finally the council has unapplied capital receipts of £35.8million at 1 April 2012 which form part of the CIF. The capital scheme 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)

8 February 2013

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