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 the chief financial officer has personal responsibility for such administration;

   - Sections 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 the 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 accountancy manager, the head of finance, the council’s strategic management board and cabinet members.

6. The 2014/15 budget briefing session presented to the members on 8 January 2014 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 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. 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, so SMB have assumed a level of expected vacancy savings and this year, the council has budgeted 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 demographic growth and 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 for 2012/13 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 became a local 'council tax reduction scheme' (CTRS) from April 2013. This change resulted in immediate extra cost pressures for the council which are 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 2014/15 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), 2013/14 (two years) and 2014/15 (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 four 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 – and consequently (like many other councils) the later years of the MTFP rely heavily on using NHB funds to support the revenue account; There is a risk that a new government from 2015 may decide to change the NHB scheme or even stop it altogether. The MTFP projects the council's usable balances at 31 March 2018 to be £14.2 million. A maximum of £13.3 million would be at risk should the scheme stop soon after a new government is in place. Should the scheme be stopped the council will have to fundamentally review the services and the service levels it provides.

    - 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 unlikely that it will be implemented in 2014/15.

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 2014/15 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 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 used in year to support the revenue budget, therefore there could be some uncertainty about the amount available when the budgets are set, but the estimates are considered prudent enough to reduce the risk of this to acceptable levels.

REVENUE CONTINGENCY SUM & OVERALL REVENUE BUDGET

22. For 2014/15 a significant change to the way the council budgets for contingency has been introduced. Previous years' 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 2013, the provisional settlement provided a two-year funding projection for 2014/15 and 2015/16. The 2014/15 settlement was finalised on 5 February 2014 with negligible changes – the 2015/16 settlement remains provisional. Future years have had to be based on prudent estimates for 2016/17 – 2018/19. 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 (NNDR) 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 caught by the safety-net due to the closure of Didcot A power station. The budget and MTFP has been set based on this scenario as we believe we will be below the safety net for a number of 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.

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. Over recent years the council has adopted a more rigorous approach to the preparation of its capital programme. 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. Whilst these measures can manage and mitigate risk some capital schemes, by their nature, 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 a sufficient capital contingency and capital reserves to meet any potential capital programme overspends. The programme shows the level of capital reserves temporarily dipping below the 'self-imposed' £5 million threshold, however capital receipts are due by the end of the MTFP which will restore balances to above this level. While the use of these reserves would reduce the interest income earned, the current low rates available mean the impact would not be significant.

MEDIUM TERM FINANCIAL PLAN

32. An updated MTFP has been included in the budget report. The plan sets out provisional revenue spending plans and the estimated use of reserves through to 2018/19.

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 monthly for heads of service, and the strategic management board (SMB). Formal reports are issued via the Vale Information Sheet.

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 2013/14 and will review their risk management plans before finalising their 2014/15 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;
    - NHB income being less than that shown in the MTFP;
    - substantial increases in council tax reduction scheme caseload and costs
    - further council tax freezes in the later years of the MTFP;
    - macro-economic deterioration, such as slower interest rate rises, higher inflationary pressures and slower housing growth.

    Currently, 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 has issued guidance on local authority reserves and balances in 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 £5.2 million in its general fund as at 1 April 2013 and, over the term of the MTFP intends to maintain this at a level that is no less than approximately 10 per cent of the annual budget requirement (when the Audit Commission previously recommended at least 5 per cent); this 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. Finally the council has unspent capital receipts of £6.36 million at 1 April 2013 which form the capital reserve.

Conclusion

41. 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.

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

43. The reserves 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.

William Jacobs (Head of finance and chief finance officer) 14 February 2014