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 (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 chief finance officer is mindful of other associated statutory safeguards designed to prevent the authority from over-committing itself financially:

   - 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 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 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. Throughout the budget build process there have been regular meetings with and updates provided to the council's executive, and in particular the executive member for finance.

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 living increase set under the local pay agreement. 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 is to budget at the 100% level in-year. Then, any vacancy savings will be identified during the budget monitoring process and any underspend would contribute to the level of General Fund balances at year end and may be used to support the revenue budgets in later years.

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 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 level of local authority benefit errors has caused a loss in subsidy in recent years which has so far been reimbursed by the financial services contractor. The risk of any cost falling on the council is mitigated by close contract management.

13. 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 bed and breakfast costs). Experience of demand in 2009/10 and so far in 2010/11 has been used to inform the 2011/12 budget.

14. 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.

15. As part of the budget setting process consideration has been given to new income streams to the council proposed by the government. These include:

- Council tax freeze grant;
- New Homes Bonus;
- Planning fees – full cost recovery

Whilst details regarding the council tax freeze grant have been clarified and, as such, funding from this income stream has been included in the budget, the situation on New Homes Bonus and planning fees is less clear as formal guidance has not been forthcoming. As a consequence, whilst it is possible to estimate income from New Homes Bonus, it has been considered prudent not to include this in either the budget for 2011/12 or the MTFP at this time. A prudent assumption has been made regarding additional planning fee income under the proposed freedom to recover costs. This means that there is some exposure to risk to the 2011/12 budget or medium term financial plan viability should the government alter its proposals – however this is considered acceptable in the light of known factors.

16. A number of revenue income streams are sensitive to changes in market conditions and therefore there will always be a risk that budgeted 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 made significant adjustments to reflect lower income projections due to the economic downturn. Further adjustments have been made for 2011/12 refining budgets in light of actual patterns.

17. 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

18. The council has a substantial investment portfolio which it relies upon to support the revenue cost of services. Therefore the council is extremely sensitive to changes in investment income. The continuing impact of the low interest rates, and the anticipated future slow rise, has been factored in to the MTFP reported as part of the budget setting report.

19. Investments have been diversified in accordance with the treasury management strategy, and the earnings assumptions in the budget are set prudently. This investment income is budgeted for and committed in the year it is earned. There is therefore some level of uncertainty about the amount available when the budgets are set, and consequently a prudent estimate has been made of future earnings.

REVENUE CONTINGENCY SUM & OVERALL REVENUE BUDGET

20. The base budget presented to scrutiny committee in January included a contingency sum of £224,720. This is considered a prudent amount to cover the inevitable uncertainty within the budget.

21. 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 then the council has adequate revenue reserves in the short term to cover such additional costs. Longer term pressures would mean the MTFP would have to be reviewed.

22. The revenue financial projections for future years included in the MTFP that forms part of the report to the executive 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 – 2015/16 in the absence of anything more than a two year settlement. 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. Furthermore, fit for the future savings and other invest-to-save schemes will help to combat reduced funding, but the council may still need to temporarily draw on its revenue balances to cover any funding deficit.

CAPITAL PROGRAMME

23. 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

24. 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.

25. In the capital programme recommended to the executive, 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.

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

27. The council has a sufficient reserve to meet any potential capital programme overspends, although the programme shows the level of capital reserves temporarily dipping below the £5 million threshold. 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

28. In addition to the 2011/12 budget proposals, we have included a MTFP within the budget report. The plan sets out provisional revenue spending plans and the estimated use of reserves through to 2015/16.

BUDGET MONITORING

29. The council has a budget monitoring process for both its revenue budget and capital programme. System reports are produced monthly and considered by heads of service, the head of finance, management team and the executive member for finance. Formal reports are considered by executive quarterly.

30. The prudential code has also introduced a rigorous system of prudential indicators, which explicitly require 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.

RISK MANAGEMENT & INSURANCE

31. 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 2010/11 and will review their risk management plans before finalising their 2011/12 service plans. In 2006 we worked with Garrison Security to prepare business continuity plans, which are now in place.

32. In addition to the various measures outlined above, certain financial risks are mitigated by the council's insurance arrangements which have just been reviewed as part of re-letting a contract for insurance services from April 2011.

Adequacy of Reserves

33. 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.

34. The council held £1,762,050 in its general fund as at 1 April 2010 and, over the term of the MTFP intends to maintain this at a level that is no less than approximately 5% of the annual budget requirement; 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.

35. Finally the council has unspent capital receipts of £9.78 million at 1 April 2010 which form the capital reserve

Conclusion

36. 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.

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

Steve Bishop (Strategic director and chief finance officer) 9 February 2011