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

   - 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 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 cabinet members, and in particular the cabinet member with responsibility 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 previous years, although this has so far been reimbursed by the financial services contractor. The error rate has fallen recently thanks to active management and the level of local authority errors in the latest grant subsidy claim for 2010/11 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.

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, 2010/11 and so far in 2011/12 has been used to inform the 2012/13 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. Details regarding the s.31 council tax freeze grant for both 11/12 (four years) and 12/13 (one year only) have been clarified and, as such, funding from this income stream has been included in the budget.

    - New Homes Bonus (NHB) and general government funding. The council also has a high degree of certainty around the first two tranches of NHB, as these amounts have been confirmed by the government department for Communities and Local Government. Future year figures are based on the best estimates of council officers and therefore, whilst every care has been taken in preparing these estimates, they can only be considered provisional.

      The Government's Comprehensive Spending Review (CSR) in 2010 indicated that later tranches of NHB would be funded from reductions in general government grant – however, until more detailed guidance is released no further reductions in grant other than those already shown have been included.

      The government has also consulted on reforming general grant funding by shifting from the current needs-based formula grant approach to an incentivised localisation of business rates approach. Until more detailed guidance is released it is not possible to confirm whether the council is likely to be a net gainer or net loser relative to current grant funding.

      With so much fundamental reform in local government funding and so many unquantifiable variables, there is a significant risk that future government income forecasts may be over estimated. There is no immediate danger and the 2012/13 annual budget is unaffected. However, the medium term financial plan (MTFP) may need to be substantially amended next year after further government guidance is made available, which could necessitate further cost reductions and service cuts.

    - Planning fees – full cost recovery. The previous (11/12) MTFP had included an estimate for increased income as a result of the council being allowed to set its own planning fees in order to recover the costs of planning service (within certain limitations). The legislation was supposed to become statute in 2011/12; due to a lengthy consultation process, this is now not likely to happen before 1 April 2013. Therefore, no increase in planning fee income as a result of this proposal has been included in this MTFP.

    This means that the medium term financial plan viability has some exposure to risk, should the government alter its proposals – however this level of risk is considered acceptable in the light of known factors. The 2012/13 annual budget is not so exposed to risk as the government financial reforms will not be introduced until 2013/14 and the council's high level of revenue reserves cushions us from any immediate budgetary pressures.

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 2012/13 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. This prudent approach is also applied to any debts due and appropriate provisions are made for bad or doubtful debts.

INVESTMENT INCOME

18. The council has a substantial investment portfolio (both cash and investment property) 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 (with the anticipated future slow rise) and the effects of the property market downturn have 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 December included a contingency sum of £214,720. Some of this amount (£64,720) is for events that have been identified as ‘allocated’ contingencies for which there is still uncertainty around the likelihood and amount, and the balance (£150,000) is for purely unforeseen events. Past experience has proved that this is considered a prudent amount to cover the inevitable uncertainty within the budget.

21. Because of the prudent approach to budgeting outlined above, with the exception of future government grant funding which is highly uncertain at the current time, 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 additional costs. Longer term pressures would mean the MTFP would have to be reviewed.

CAPITAL PROGRAMME

22. 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

23. 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.

24. 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.

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

26. 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 'self-imposed' £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

27. In addition to the 2012/13 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 2016/17.

BUDGET MONITORING

28. 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 cabinet member with responsibility for finance. Formal reports are considered by the cabinet quarterly.

29. 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

30. 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 2011/12 and will review their risk management plans before finalising their 2012/13 service plans. In 2006 we worked with Garrison Security to prepare business continuity plans, which are now in place.

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

Adequacy of Reserves

32. 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.

33. The council held £3,325,792 in its general fund as at 1 April 2011 and, over the term of the MTFP intends to maintain this at a level that is no less than approximately 10% of the annual budget requirement (when the Audit Commission recommends at least 5%); 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.

34. Finally the council has unspent capital receipts of £9.78 million at 1 April 2011 which form the capital reserve.

Conclusion

35. 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.

36. Overall, I believe 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. There is greater risk than would ordinarily be considered acceptable around the government funding estimates but the council has time over the next 12 months to review these in light of further government guidance.

Steve Bishop (Strategic director and chief finance officer) 9 February 2012