

Meeting: FULL COUNCIL
Portfolio Area: Resources
Date: 25th February 2004

REVENUE BUDGET 2004/5 – REVIEW OF THE BUDGET AND LEVEL OF RESERVES AND BALANCES

(Resources - Opinion of the Chief Finance Officer)

KEY DECISION

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1 PURPOSE

1.1 Under Section 25 of the Local Government Act 2003, the Council's Chief Financial Officer is now required to report to the Council on:

- (a) The robustness of the estimates included within the budget
- (b) The adequacy of the Council's reserves and balances

1.2 Under the Act, Members must have regard to the contents of this report when making their recommendations on the budget.

2 RECOMMENDATIONS

That Members note the following statement of the Council's Chief Financial Officer.

"The main conclusion of the report is that in the light of the information provided during the budget process, it is my opinion that there is sufficient capacity in the proposed overall budget to cope with the financial risks the Council faces in 2004/05. The Summary and Conclusion of the report also sets out advice for managing the financial risks in the budget for 2004/05."

3 BACKGROUND

3.1 The Local Government Act 2003 received Royal Assent on 18th September 2003, and some of the powers contained within the Act relate to the setting of Councils 2004/5 budgets.

3.2 Section 25 of the Act includes a specific personal duty on the Chief Financial Officer ("CFO") to make a report to the authority when it is considering its budget and Council Tax.

3.3 Section 26 of the Act gives the Secretary of State power to set minimum level of reserves for which an authority must provide in setting its budget. The Secretary of State stated that "the provisions are a fallback against the circumstances in which an

authority does not act prudently, disregards the advice of its CFO and is heading for serious financial difficulty”.

3.4 The Local Government Finance Act 1992 also requires that authorities have regard to the **level of reserves** needed for meeting estimated future expenditure when calculating the next budget requirement.

3.5 There is also a range of safeguards to ensure authorities do not over-commit themselves financially. These include:

- The CFO Section 114 powers, which require a report to all Members of the authority if there is or is likely to be unlawful expenditure or an unbalanced budget
- The Prudential Code which will apply to capital financing from 2004/5.

3.6 These safeguards have been further reinforced by the introduction of the Audit Commission’s Comprehensive Performance Assessment (CPA) which includes a methodology to assess the financial performance and standing of the authority.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 Budget Process 2004/5

Details of the 2004/05 budget process is as follows;

(a) The budget setting process is prescribed by the Budget and Policy Framework Procedure Rules in the Council’s Constitution.

(b) See also ‘Changing Gear’ (Corporate Business Strategy 2002/03 – 2006/07 report number 11 Exec 12/11/03).

4.2 Risk Assessment

4.2.1 Local Government Act 2003

The Local government Act does not provide any specific guidance on how to evaluate the robustness of the estimates. The explanatory notes to the Act, do however, stress that decisions on the appropriate level of reserves should not be based on a rule of thumb, but on an assessment of all the circumstances considered likely to affect the authority. In addition reference is also made to the CIPFA guidance on reserves and balances.

4.2.2 CIPFA Guidance Note on Local Authority Reserves and Balances

The Chartered Institute of Public Finance and Accountancy (CIPFA) states that the following factors should be taken into account when the CFO considers the overall level of reserves and balances:

- Assumptions regarding inflation
- Estimates of the level and timing of capital receipts
- Treatment of demand led pensions
- Treatment of savings
- Risks inherent in any new partnerships etc

- Financial standing of the authority (level of borrowing, debt outstanding etc)
- The authority's track record in budget management (including the robustness of medium term plans)
- The authority's capacity to manage in-year budget pressures
- The authority's virement and year-end procedures in relation to under and over spends
- The adequacy of insurance arrangements

4.2.3 The above issues are also of relevance when evaluating the robustness of the budget. Comments on these issues are in 4.5 below.

4.3 CPA

Under the Comprehensive Performance Assessment (CPA) one aspect of financial standing that is assessed is the level of financial reserves and in order to achieve the 'good' ranking an authority would have to meet either of the following criteria:

The aggregate balance of

- General Balance
- Other earmarked revenue reserves
- Liabilities not recognised in the financial statements

should either be in surplus at the year end and the General Balance should be at least equal to 5% but not more than 100% of forecast net operating expenditure for the year, or

a formal financial risk management process should be operating, which the authority uses to justify a level of reserves and balances.

I can confirm that the Council meets the set criteria outlined above.

4.4 Reserves

4.4.1 The estimated level of General Fund balances available at 31 March 2005 is some £8m.

4.4.2 Reserves can be held for three main purposes:

- general reserves to meet the potential costs of emergencies or unexpected events, including a working balance to help cushion the impact of uneven cash flows and avoid unnecessary temporary borrowing. A minimum balance of £800,000 is held in addition to the available general Fund balances above.
- a contingency to meet the costs of events that are possible but whose occurrence is not certain – this also forms part of general reserves
- earmarked reserves to meet known or predicted liabilities over a period of time usually of more than one year. These earmarked reserves protect the Council against specific financial risks and this is a factor to be taken into account when assessing the adequacy of the totality of balances and reserves and the level of the General Balance. In view of the current level of balances no contingency provision has been made.

4.4.3 The Audit and Inspection Annual Letter 2002/3 which was reported to Executive on 14th January 2004 concluded that the level of General Fund and Housing Revenue Account balances were adequate.

4.5 Issues considered when evaluating the robustness of the estimates and the adequacy of the proposed financial reserves and balances

4.5.1 Inflationary pressures

Provision has been made for a nationally agreed pay award of 2.5% and this appears reasonable in the light of inflation forecasts. In line with recent practice the budget contains no general inflation provisions except for specific clearly identified cases eg utilities, contracts, business rates etc.

4.5.2 Estimates of the level and timing of capital receipts

Assumption about new capital receipts in 2004/05 are based on the current projected number of Council House sales under Right to Buy provisions and also reflecting the transitional arrangement for debt-free authorities under the new pooling of housing capital receipts procedures.

4.5.3 Treatment of demand led pressures and savings

Against a background of continuing financial pressures a limited number of revenue growth items is proposed. A savings exercise, has also been undertaken, which coupled with an increase in fees and charges has resulted in a reduction in the Councils net requirement of over £700,000.

4.5.4 Adequacy of reserves – Financial Standing

The authority has been debt-free since March 2001. Local collection rates for Council Tax and Non-Domestic Business Rates are in the top 10% in the country.

4.5.5 Record of budgeting and financial management

For many years, year-end out-turn has been well within approved budget levels. External auditors have commended the Council's record in financial management. This has also been reflected in the provisional Audit Commission CPA Audit Score Judgements which will feed into the overall CPA assessment.

4.5.6 Capacity to manage in-year budget pressures

The Authority has a record of maintaining good financial and budgetary discipline in the face of expenditure pressures, including virement procedures that allow funds to be moved to areas of pressure. Although underspends and overspends are not automatically carried forward, the Authority does have an approved carry forward scheme.

4.5.7 Strength of financial information and reporting arrangements and the robustness of the medium term plan

The Authority has a proven track record in financial management as borne out by the provisional CPA Audit Judgements and the annual Audit and Inspection Letters from the Audit Commission's Auditors. The current Financial Management System (FMS) has become outdated and the Authority has recently jointly procured a new system in partnership with Uttlesford District Council. This very advanced system should become operational during autumn 2004 and greatly enhance both financial reporting and preparing medium-term financial plans.

This process will also significantly improve through the new FMS. Chief Officer Board considers a monthly Key Budgeting Control Report and Members are updated on budgetary control matters throughout the year and staff budget holders receive regular information from their relevant Service accountant and/or regular FMS reports or through on-line access to the information.

4.5.8 Adequacy of insurance arrangements

The budget allows for the estimated outstanding claims under the 'excess' claims of the Council's insurance policies. The Authority has a low record of claims and inspections are regularly carried out. A surplus on the internal Insurance Fund has enabled a one off reduction in contributions in 2004/05.

4.5.9 Pension Liabilities

The Authority makes contributions to the Hertfordshire County Council's Pension Fund, which is invested in order to meet its liability to provide for the benefits to past employees and future benefits for existing employees. Employees contribute 6% of their salary. The Fund is valued every three years and the next valuation is due in April 2004. To achieve 100% funding of liabilities, increases in contributions are being phased in by annual steps. Since the previous valuation, the performance of equities (the major asset holding of the Fund) has fallen well short of the actuary's expectations at the time of the 2001 valuation. An interim valuation (as at 1 April 2003) indicated that the Authority's level of contributions would need to increase and this has been reflected in the 2004/05 budget.

4.5.10 Corporate Business Plan

The Council has adopted a Risk Management Strategy as part of its overall approach to Corporate Governance. This strategy involves the identification and management of the key external and internal risks the Council is exposed to at any one time. The Corporate Business Plan involves new initiatives. To reduce the risks created by the Plan it has been placed at the centre of the Council's policy and financial planning framework so that the service priorities and budget decisions are formed with the achievement of the Plan as the highest corporate priority.

4.5.11 Staff Vacancies

Staff costs represent a significant proportion of the Council's direct expenditure. The budget assumes an average transitional vacancy rate of 4.5%.

4.6 General Fund Services

4.6.1 Estimates in respect of General Fund services for the following expenditure types have been calculated centrally, based on all relevant factors: pay and related costs (allowing for a 2.5% pay award in 2004/05); rates, insurances, leasing charges, interest receivable. These estimates are considered robust for current service levels.

4.6.2 Estimates in respect of service controlled income and expenditure have been prepared by the relevant Service Departments in liaison with Finance in a well established procedure. Based on experience of past estimates prepared by a similar process these estimates are considered generally robust.

4.6.3 Some brief details of estimates which possibly could have a financial risk are as follows:

4.6.4 Resources Portfolio

Housing Benefit – From April 2004 Rent Rebates are to be accounted for in the General Fund (previously Housing Revenue Account). Due to a funding switch the level of specific grant for benefits has been increased from 2004/05, offset by a reduction in Revenue Support Grant. Estimates in respect of Council Tax Benefit, Rent Allowance and Rent Rebate payments, Government reimbursement of these payments and administrative subsidy entitlement have been calculated based on current take up of benefits, the latest levels of correctly paid benefits and Government notifications of reimbursements and subsidy levels. These estimates are therefore as robust and practicable as possible for an area of expenditure that is demand led.

4.6.5 Environment Services Portfolio

Parking Decriminalisation – Growth item included. Possibility of self financing scheme to be investigated.

4.6.6 Housing Portfolio

None identified.

4.6.7 Community Portfolio

None identified.

4.7 **Housing Revenue Account**

4.7.1 Repair Costs - to the extent that an element is demand led a period of extreme weather may lead to increased expenditure. The Council can mitigate the impact to a degree by investing in planned maintenance works which should over time reduce on demand repairs. Maintaining an adequate working balance will enable the HRA to absorb variations in repairs expenditure. The balance is expected to be in the order of £300k by the year end.

4.7.2 Voids and other unoccupied properties - prudent estimates of the impact of these items are made during the budget process.

4.8 **Summary and Conclusion**

4.8.1 When assessing the overall robustness of the budget and the adequacy of the reserves to meet potential financial risks, there are two main areas to consider in respect of 2004/05:

- (1) The key risks set out in paragraph 15 whilst not a complete identification of all the financial risks faced by the authority are felt to be those that could lead to pressures on budgets during the next financial year.
- (2) The drive for efficiency savings and redirected resources could make it more difficult for some services to meet unforeseen budget pressures.

- 4.8.2** In order to manage such financial risks it is obviously important that an increased emphasis is placed on sound financial reporting and monitoring of budgets. A General Fund Revenue Contingency Sum of £500,000 is proposed for 2004/05 within which the Executive can approve supplementary estimates where budget pressures cannot be accommodated through virement.
- 4.8.3** My conclusion is that the processes followed have been generally sound and similar to those that have produced robust estimates in the past. In the light of information made available during the budget process, there is sufficient capacity in the proposed overall budget to cope with the financial risks the Authority faces in 2004/05. It is also my opinion that the estimates and the processes used to produce them are considered to be generally sound and robust.
- 4.8.4** Finally advice on managing the financial risks in the budget for 2004/05 is as follows:-
- (1) Regular reporting on all budgets to budget-holders on a monthly basis and quarterly to the Resources & Management Scrutiny Panel. Attention should in particular be given to monitoring the riskier budgets including 'below the line' items such as Interest on Balances. Also key indicators should be monitored of activities which drive spending and give an early warning of potential pressures.
 - (2) Where the budget includes proposals for savings and efficiencies within their budgets, there must be plans in place both for their implementation and for monitoring such implementation.
 - (3) When during the year a net overspend for a budget is identified the monthly budget report must include an action plan setting out what steps are being taken to deal with the overspend.

5 IMPLICATIONS

5.1 Financial Implications

- 5.1.1** This report is financial in nature and implications are therefore contained within this report.

5.2 Legal Implications

This report complies with the requirements outlined in Section 25 of The Local Government Act 2003.

5.3 Policy Implications; Planning Implications; Environmental Implications; Staffing and Accommodation Implications; Human Rights Implications; Equal Opportunities Implications; Service Delivery Implications; Community Safety Implications; Information Technology Implications; Other Corporate Implications; Other Implications.

None identified at this time.

BACKGROUND DOCUMENTS

- Local Government Act 2003.

APPENDICES

- None.