Committee: **Council Meeting**

Date: **10 February 2004**

Agenda Item No: **10**

Title: **UTTLESFORD DISTRICT COUNCIL'S REVENUE BUDGET 2004/5 – REVIEW OF THE BUDGET AND LEVEL OF RESERVES AND BALANCES**

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Summary

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

1) The robustness of the estimates included within the budget
2) the adequacy of the reserves and balances

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

3 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 2004/5. The Summary and Conclusion of the report also sets out advice for managing the financial risks in the budget for 2004/5.

Introduction and Context

4 The Local Government Act 2003 Section 25 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. Also 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".

5 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.

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

- The CFO S114 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.

7 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.

Budget Process 2004/5

Details of the 2004/5 budget process are outlined below:

8 The budget preparation process for 2004/5 began immediately after the 2003/4 budget was approved including Members agreeing an indicative budget position covering 2003/4 to 2005/6 at the Council meeting on 11 February 2003. The budget process continued after the election of the new administration on 1 May 2003 which included a Budget Strategy report being approved by Resources Committee in June 2003 and a series of budget prioritisation meetings during August between Officers the Leader of the Council and Committee Chairmen. The latter meetings included identifying areas considered to have the most significant pressure on budgets.

9 Also the Annual Council meeting in May 2003 agreed to recruit an Interim Director Strategic Development whose core brief was the translation of the Council's Community Strategy and a new four-year Quality of Life Corporate Plan into a phased delivery plan that would be linked with resources and have clear outcomes and timescales.

Risk Assessment

Local Government Act 2003

10 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.

CIPFA Guidance Note on Local Authority Reserves and Balances

11 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

The above issues are also of relevance when evaluating the robustness of the budget.

CPA

12 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, <u>or</u>

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

Reserves

13 The estimated level of reserves and balances as at 31 March 2005 are shown in Appendix 2 of the Budget Strategy – General Fund Summary report for 2004/5 which was submitted to the Extraordinary Resources Committee meeting on 3 February 2004.

14 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 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.

15 The Audit and Inspection Annual Letter 2002/3 which is submitted to the Council Meeting on 10 February 2004 concludes that the level of General Fund and Housing Revenue Account balances (£1.2m and £0.5m respectively) at around 9% of net expenditure are adequate. Although they are fixed by value, they will decrease in percentage terms as expenditure is forecast to increase.

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

(1) Inflationary pressures

Provision has been made for a nationally agreed pay award of 3% and this appears reasonable in the light of inflation forecasts. Budget holders have been advised to estimate at out-turn prices ie to take account of known or expected increases in the prices of goods and services. This is a tried and tested approach.

(2) Estimates of the level and timing of capital receipts

Assumption of new capital receipts in 2004/5 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.

(3) Treatment of demand led pressures and savings

The approach to the compilation of the budget was different to that in previous years. A key was the setting of expenditure guidelines, identifying priorities and budget items to be reviewed by relevant committees. This was done at an early stage of the process. Estimates have been based on the latest trend with adjustments where necessary to take account of known factors that might cause changes in demand. This is a tried and tested approach.

Adequacy of reserves – Financial Standing

(4) The authority has been debt-free since 1996. Local collection rates for Council Tax and Non-Domestic Business Rates are in the top 10% in the country.

Record of budgeting and financial management

(5) 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.

Capacity to manage in-year budget pressures

(6) The Authority has a record of maintaining good financial and budgetary discipline in the face of mid-year pressures, including reorganised and embedded 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.

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

(7) 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 has become outdated and the Authority has recently jointly procured a new system in partnership with Stevenage Borough Council. This very advanced system should become operational during the summer 2004 and greatly enhance both financial reporting and preparing medium-term financial plans.

(8) Members are regularly 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. This process will also significantly improve through the new FMS.

Adequacy of insurance arrangements

(9) The budget allows for the estimated outstanding claims under the 'excess' claims of the Council's insurance policies. The Authority has a very good low record of claims and inspections are regularly carried out. Insurance arrangements for staff leased cars has for several years been the responsibility of each individual and therefore the Authority has transferred any risk to the employee. An exceptional planning application cash settlement during the year was met from reserves.

Pension Liabilities

(10) The Authority makes contributions to the income of Essex 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. 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 contribution would need to increase threefold. To manage the situate in a sustainable manner, the council have agreed to make a capital lump sum payment in order to eliminate the deficiency payment over the four year period 2004/5 to

2007/8. Also an earmarked reserve has been created to assist in alleviating the situation after this period.

Quality of Life Corporate Plan

(11) 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 new Corporate Plan involves many new initiatives including the organisational restructure which are subject to individual risk assessment but without frustrating progress. 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.

PFI Leisure Centres

(12) The three Centres have been fully operational since August 2003. They are operated by an external contractor Leisure Connection under a 32 year agreement with Linteum Leisure who are the PFI facilitator. The major risk of market demand has been transferred to the PFI contractor but some financial risks still remain with the Authority such as the continuation of Business Rate Relief through their Industrial and Provident status.

Zero Based Budgeting

(13) The Resources Committee at its meeting in September 2003 approved the introduction of a zero-based budgeting approach for the 2005/6 estimates. Members agreed that although budget preparations based on previous expenditure provided stability, it re-enforces the status quo, meaning that overtime, service priorities and budgets can get out of line. The Quality of Life Corporate Plan will be central to zero-based budgeting.

Staff Vacancies

(14) Staff costs represent over 70% of the Council's direct expenditure. The new Administration were very keen that Heads of Service must consider all options before a vacancy was required to be filled. The Resources Committee in November 2003 therefore agreed that a new Recruitment to Vacancy Form be developed which takes account, for example, of Council priorities, future legislative change, Best Value review timetables, redistribution of tasks, opportunities to make use of new technologies and partnership working.

General Fund Services

16 Estimates in respect of General Fund services for the following expenditure types have been calculated by the Council's Financial Services, based on a full recalculation of all relevant factors: pay and related costs (allowing for a 3% pay award in 2004/5); rates, insurances, leasing charges, interest payable

and receivable. These estimates are considered robust for current service levels.

17 Estimates in respect of service controlled income and expenditure have been calculated jointly by Financial Services and Service Departments subject to final agreement and acceptance by budget-holders in Service Departments. This has been a sound process and based on experience of past estimates prepared by a similar process these estimates are considered generally robust. The reversal by Environment & Transport Committee of previously recommended increases in Car Parking charges has reduced the base and the whole issue of these charges will be reviewed in the next few months.

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

Resources Committee

Housing Benefit – Estimates in respect of Council Tax Benefit and Housing Benefit payment, Government reimbursement of these payments and payment of administrative subsidy have been calculated by Financial Services based on the latest information available about takeup 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 for an area of expenditure that is demand led, and dependent upon adequate and stable staffing and technology.

Procurement – Target savings of £31,800. Progress will be monitored throughout the year.

Audit/VFM Savings – Target savings of £21,000 including appointment of part time auditor for a fixed one year contract.

Administrative Review – Target savings of £20,000.

External legal fees – Extremely difficult to forecast but supported by a Risk Management Earmarked Reserve.

Environment & Transport Committee

Car Parking Income £33,000 - relating to parking at the Offices (Saffron Walden £22,000 and Dunmow £11,000) should be achieved but difficult to know real effects until introduced.

Industrial Estate - Uncertainty regarding future lettings. Occupancy of 10 out of 18 units assumed for budgeting purposes which is the current level.

Parking Decriminalisation - Budget prepared assuming no cost to the Council. Agency Agreement with County to be developed.

Development Control Committee

Planning Fees - Income increased by an additional £30,000 on top of the £50,000 already added in at the first round. As this is based on current demand, this could be a possible risk area.

Planning Staff Supplements - £49,000 has been built in to the budget for 2004/2005. These are to be funded from the one-off Planning Development Grant that we will be receiving in 2004/5.

Planning Consultancy Costs - A Risk Management Earmarked Reserve has been created to cover any overspends on a budget that is difficult to accurately forecast.

<u>Health & Housing Committee</u>

Pest Control income has been increased by £3,100. This is based on budgeted extra usage not a price increase.

The homelessness budget is demand-led and therefore difficult to accurately estimate. A Risk Management Earmarked Reserve has been created to mitigate the impact of significant variances.

<u>Community & Leisure Committee</u>

Grants to the CAB and other relevant groups are to be reviewed thoroughly by the Committee during 2004 with the intention of starting new three year agreements from 2005/6.

Partnership income estimates for Community Safety and Drugs Awareness of £11,000 and £10,000 respectively will be challenging.

Housing Revenue Account

19 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 £390k by the year end.

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

Summary and Conclusion

21 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 2004/5:

(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.

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. The Financial Management Reserve can be called upon in the first instance to address budget pressures which cannot initially be accommodated within budget-holder budgets through virement.

22 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 2004/5. It is also my opinion that the estimates and the processes used to produce them are considered to be generally sound and robust.

23 My advice on managing the financial risks in the budget for 2004/5 is as follows:-

(1) Regular reporting on all budgets to budget-holders on a monthly basis and to relevant Committees including Scrutiny Committees at each cycle. Attention should in particular be given to monitoring the riskier budgets including ‘below the line’ items such as Interest on Balances and Pension Costs. Also key indicators should be monitored of activities which drive spending and give an early warning of potential pressures.

(2) Where budget-holders have included 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-holder is identified the monthly budget report must include an action plan setting out what steps are being taken to deal with the overspend.

(4) The introduction of robust zero-based budget procedures commencing in March/April 2004 must be jointly undertaken by Accountants, budget-holders and relevant Members with reference to the Quality of Life Corporate Plan priorities. An initial report will be submitted to the Resources Committee in June 2004.