

Committee: Full Council
Date: 19 February 2008
Title Review of the level of Reserves and Balances
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Agenda Item

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Item for decision

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:
 - a) The robustness of the estimates included within the budget
 - b) 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 conclusions are that the processes followed have been generally sound and significantly more robustly challenging than in previous years. In the light of information made available during the budget process and the assumptions made, with the exception of the BAA G1 appeal for costs, there is limited but sufficient capacity in the proposed overall budget to cope with the financial risks the Authority faces in 2008/09.

Recommendation

It is recommended that Council approves this report.

It is also recommended that members consider the contents of this report in approving the Housing Revenue Account and General Fund budgets which are items 11 and 12 on the agenda.

Background Papers

Budget reports 2008/09, Financial Regulations, Statement of Accounts 2006/07, Local Government Acts 1992 and 2003, CIPFA guidance Note on Local Authority Reserves and Balances

Impact

Communication/Consultation	No specific implications
Community Safety	No specific implications
Equalities	No specific implications
Finance	This report concerns the Council's whole General Fund and Housing Revenue Account

	budgets
Human Rights	No specific implications
Legal implications	The Council's budget reflects the statutory need to spend
Ward-specific impacts	The Council's budgets have wide-ranging implications for all wards. No specific ward issues can be highlighted
Workforce/Workplace	No specific implications

Situation

- 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 applied to capital financing from 2004/5.

Budget Process 2008/09

- 7 The budget setting process for 2008/09 commenced in February 2007 with the publication of the Medium Term Financial Strategy (MTFS). This document predicted a significant deficit in 2008/09. At that time it was expected that 2007/08 would be a year of change that would enable the council to address the predicted 2008/09 shortfall. As Members will be aware significant problems were identified with the 2007/08 budget which meant that this did not happen.
- 8 In September 2007 despite an earlier round of savings aimed at both 2007/08 and 2008/09 the predicted deficit for 2008/09 stood at £1,426,000. On 1 October 2007 a new Finance Management team was put in place with the remit to resolve 2007/08 issues and set a legal 2008/09 budget.

- 9 Since October 2007 a vast amount of work has been undertaken to further examine, and where possible delete or reduce the cost of new spending pressures. This has been accompanied by a rigorous examination of existing budgets to identify all possible efficiencies. The investigation into all aspects of the budget setting process was detailed and challenging, both to existing Finance staff and budget holders.
- 10 On 11 December 2007 it was reported to Full Council that the investigations had identified a number of flaws in the existing predictions and the new deficit for 2008/09 was £1,822,000 this was despite three significant cost cutting exercises already undertaken, LABGI correction, October budget cutting and October voluntary redundancies (10 staff). The Chief Financial Officer recommended that £1,000,000 of staff costs had to be removed from the 2008/09 budget. There then followed the redundancy exercise which is still progressing.
- 11 All proposed changes and revised budget levels have now been reported to and accepted by the relevant Committees.

Risk Assessment

- 12 The Local Government Act 2003 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

- 13 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 budgets
 - 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.

Reserves

- 14 The estimated level of reserves at 31 March 2009 is shown in Appendix 1 to this report. The rationale for each of these reserves and the level required in each has been reviewed. Reserves have been merged where appropriate to reflect better classification or the fact that alternative budget provision exists. I believe that the remaining reserves are both necessary and at adequate levels.
- 15 In addition to the various reserves, the Council should have, as a minimum, a working balance of 5% of General Fund net operating expenditure which equates to Balances requirement of approximately £500,000. In addition there should also be a working balance of £500,000 on the Housing Revenue Account (HRA).
- 16 The challenges surrounding the 2007/08 financial year mean that the predicted level of Balances at 31 March 2008 is likely to be in the region of £100,000 which is below the recommended minimum. It is proposed to transfer £400,000 from the PFI Reserve to the General Fund Balance to meet the minimum criteria.
- 17 The HRA Balance at 31 March 2008 is likely to be £604,698. It is felt the level is sufficient for 2008/09.
- 18 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.
- 19 Issues considered when evaluating the robustness of the estimates and the adequacy of the proposed financial reserves and balances:
Inflationary pressures
- (1) Provision has been made for a nationally agreed pay award of 2.5%. Budget holders have been advised to estimate at out-turn prices i.e. 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
- Assumptions of new capital receipts in 2008/09 are based on the current projected number of council house sales under Right to Buy

provisions and also reflecting the transitional arrangement for authorities under the pooling of housing capital receipts procedures.

(3) Treatment of demand led pressures and savings

Particular care has been taken in compiling the key Council budgets which are often described as 'demand led' because their achievement is to some degree outside the Council's control. These types of budgets, including spending on housing benefits and receipt of income from planning applications, car parking charges and interest on the Council's cash and financial reserves are likely to contribute significantly to any overall variation of actual achievement against budgets.

Adequacy of reserves and balances – Financial Standing

- (4) The councils General Fund Balance has been severely depleted and can only meet the minimum criteria if £400,000 is transferred from the PFI Reserve. A financial plan is in place to enable the PFI Reserve to meet the required level by the deadline of 31 March 2020.

Record of budgeting and financial management

- (5) The council has for the last two years had poor financial management which has led to significant flaws in the base budget calculations. Budget holders in general are good at managing their budgets.

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 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 poor recent record in reporting financial information. The MTFS is a useful document, however a number of basic errors are contained within it. A revised MTFS will be brought before Members in the near future.

Adequacy of insurance arrangements

- (8) 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. Insurance arrangements for staff leased cars have for several years been the responsibility of each individual and therefore the Authority has transferred any risk to the employee.

Pension Liabilities

- (9) The Authority makes contributions to the Essex Pension Fund, which is invested in order to meet its liabilities to provide for the benefits to past employees and future benefits for existing employees. Changes to the scheme for 2008/09 mean that employee contributions are increased in line with salaries. The Fund is valued every three years and the next valuation is required for April 2010. The 2007 valuation showed that the Fund's investments were achieving performance levels short of the actuary's expectations at the time of the 2004 valuation. The Authority has made provision within its revenue budget for the annual deficit payments on the Fund until the next valuation.

Private Finance Initiative (PFI) Leisure Centres

- (10) 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 is 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.

Staff Vacancies

- (11) Staff costs represent over 80% of the Council's direct expenditure. An extremely challenging 5% staff turnover figure was initially built in to the 2008/09 budget. Whilst the actual target remains it is now identified as a whole of service savings target rather than just on salaries.

General Fund Services

- 20 Estimates in respect of General Fund services for the following expenditure and income types have been made based on a full recalculation of all relevant factors:

pay and related costs, rates, insurances, other premises, transport and supplies or services costs, leasing charges, interest payable and receivable, fees and charges receivable. These estimates are considered robust for current service levels.

Income from the Business Rates Retention Scheme is based on estimates and a government driven formula which may show some variation when finalised. The effect of any change is unlikely to be material as budgets are based on the cash received in 2006/07.

Interest on the Council's cash flow balances is based on projected cash flows and movements in interest rates and will be closely monitored during the year.

- 21 Members should note other assumptions made in the 2008/09 budget:

- No budget has been included for the Local Authority Business Growth Incentives (LABGI) Scheme. A possible new scheme may be introduced in 2009/10.
- An expenditure budget of £500,000 was originally included for the G2 airport costs. This has now been reduced to £250,000
- The Budget includes a provisional sum of £200,000 for the new Housing and Planning Delivery Grant which is due to start later in 2008.
- The 5% savings (vacancies) factor included in the Original Budget for 2007/08 has been retained and has been deducted from each service. For the Authority as a whole this amounts to around £500,000 and as the Council has just been through a very strict redundancy process, it is likely to be very difficult to achieve this level of savings in the next financial year. Reviews of all budgets will be carried out during 2008.
- The budget for Investment Interest Income has been forecast based on the views coming out of the City, and take into account the most recent Base Rate cut to 5.25%. A lower level of rates is expected later in 2008/09. However the Council does have some investments placed out up to a year at higher fixed rates, which will help offset the recent fall in the Base Rate.

22 Brief details of committee estimates which may have a financial risk are as follows:

Finance and Administration 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 based on the latest information available about 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.

Environment Committee

The Building Surveying function operates in a competitive environment. Fee income is subject to such competitive pressures and will be monitored during the year.

The income from car parking will be closely monitored, as it is demand led. Changes to tariffs should increase income, however the new ½ hour tariff makes actual income levels harder to predict.

Charging for collection of Bulky Items is new and whilst a prudent level of expected income has been included in the budget close monitoring will be required.

Development Control Committee

Planning fees are a major factor in the Council's budget and will be subject to detailed monitoring during the year.

BAA has asked for costs to be awarded against the Council in respect of the G1 appeal. A precise figure has yet to be determined however it would be reasonable to expect this to be in excess of £1,000,000. The council believes it can defend the request but should it be unsuccessful there are no Reserves to meet an award of this size.

Community Committee

Public Health income is high at the present time. Lower estimates for 2008/09 have been included but these will need to be closely monitored.

Housing Revenue Account

- 23 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 £438,588 at 31 March 2009.
- 24 Voids and other unoccupied properties - prudent estimates of the impact of these items are made during the budget process.

Conclusions

- 25 When assessing the overall robustness of the budget and the adequacy of the reserves to meet potential financial risks, the main areas to consider in respect of 2008/9 are set out in paragraphs 19-24 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.

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.

- 26 My conclusion is that the processes followed have been generally sound and significantly more robustly challenging than in previous years. In the light of information made available during the budget process and highlighted above, with the exception of the BAA G1 appeal for costs, there is limited but sufficient capacity in the proposed overall budget to cope with the financial risks the Authority faces in 2008/09.
- 27 A detailed financial reporting and control timetable is currently being drawn up and will be presented to Performance Select Committee at the next meeting. There are clearly the need for a number of things to be included, some of which are:

- Monthly reports, both capital and revenue, to all budget holders, cover sheet to be returned highlighting and explaining areas for concern, including a recovery process where necessary
- Monthly reports to Senior Management Board and Members
- Finance reports to each committee cycle outlining variances, with reasons provide by budget holders and again recovery plans where necessary
- Bearing in mind previous problems have arisen due mainly to over optimistic income assumptions, a number of key financial indicators to be reported monthly such as:
 - Planning fee income
 - Car park income
 - Bulky item collection income
 - Grant income

Risk Analysis

Risk	Likelihood	Impact	Mitigating actions
Failure to identify the major risks in the budget	2	4	<ul style="list-style-type: none"> • Budget holders have a better understanding of their areas • Internal Audit review • Bigger Finance team • Better reporting

APPENDIX 1					
ANALYSIS OF RESERVES					
Reserve	Estimated Balance 1 April 08	Estimated Receipts in 2008/09	Estimated to be applied in 2008/09	Estimated Balance 31 March 09	Purpose of Reserve
	£	£	£	£	
Financial Management Reserve	0.00			0.00	Absorbs variations in General Fund revenue expenditure and finances the costs of special and one-off projects. It can be used for both revenue and capital projects.
District Character Reserve	0.00			0.00	Useable resources set aside for specialist advice in relation to ensuring that the District's character is protected from the effects of airport and other major development pressures
PFI (Special Grant) Cashflow	701,517.42			701,517.42	An equalisation reserve established to eliminate the reducing sum received from Government towards the Council's PFI scheme. Note 1
District Election	0.00			0.00	Resources set aside to finance future district council elections
Housing Needs Survey	44,000.00		-44000	0.00	Useable resources set aside for regional Housing Market Assessments, a 5-yearly survey of the local housing market including affordable housing needs
Energy Efficiency Investment Reserve	15,000.00		-15000	0.00	Useable resources established to finance future investment in energy efficiency measures in non- HRA Council properties
Total	760,517.42	0	-59,000	701,517.42	

Note 1 Any additional Housing Planning Delivery Grant (HPDG) over £200,000 will be used to replenish this reserve