

Committee: Full Council

Agenda Item

Date: 19 February 2009

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Title: Robustness of Estimates and Adequacy of Reserves

Author: Stephen Joyce, Chief Finance Officer

Item for decision

Summary

1. The attached report was received by the Finance & Administration Committee on 10 February 2009. The Committee approved the recommendations.
2. The Council is required to make the final determination.

Recommendations

3. The Council is recommended to:
 - a) Approve the minimum safe contingency level for 2009/10 at £1,084,543
 - b) Approve the risk assessment relating to the robustness of estimates as detailed in the attached report
 - c) Take account of the advice in the attached report when determining the 2009/10 General Fund budget and Council Tax.

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Summary

1. Section 25 of the Local Government Act 2003 requires each local authority, when setting its annual General Fund budget and level of Council Tax, to take account of a report from its Section 151 Officer on the robustness of estimates and adequacy of reserves. This document is the report made under Section 25 by the Chief Finance Officer, as UDC's Section 151 Officer, applicable to the setting of the General Fund budget and Council Tax for 2009/10.
2. The purpose of this requirement is to ensure that when deciding on its budget for a financial year, a local authority is formally made aware of any issues of risk and uncertainty by the CFO. The local authority is then expected to ensure that its budget provides for a prudent level of reserves to be maintained.
3. The CFO has assessed that the minimum safe contingency level is £1,084,543. The current forecasted level of the Working Balance is £1,096,000. There is no requirement to provide for reserves replenishment in the 2009/10 budget, although Members may wish to consider this if flexibility above a minimum safe contingency level is desired. No sum for reserves replenishment has been included in the budget.
4. This report also constitutes the formal risk assessment of the Council's budget necessary to satisfy the requirements of the Audit Commission Use of Resources inspection.
5. Section 26 of the Act empowers the Secretary of State to set a minimum level of reserves for which a local authority must provide in setting its budget. Section 26 would only be invoked as a fallback in circumstances in which a local authority does not act prudently, disregards the advice of its CFO, and is heading for financial difficulty.

Recommendations

6. Members are requested to recommend to Full Council on 19 February approval of the following:
 - d) the minimum safe contingency level for 2009/10 at £1,084,543
 - e) the risk assessment relating to the robustness of estimates as detailed in the report
 - f) to take account of the advice in the report when determining the 2009/10 General Fund budget and Council Tax.

Background Papers

7. The following papers were referred to by the author in the preparation of this report and are available for inspection from the author of the report.

Local Government Act 2003

Guidance Note on Local Authority Reserves and Balances – CIPFA 2003

Medium Term Financial Strategy

Budget reports and working papers

Impact

Communication/Consultation	No specific implications
Community Safety	No specific implications
Equalities	No specific implications
Finance	Detailed in the report
Human Rights	No specific implications
Legal implications	The report is prepared in order to comply with Sections 25 Local Government Act 2003
Sustainability	No specific implications
Ward-specific impacts	No specific implications
Workforce/Workplace	No specific implications

Basis of advice for the Section 25 report

8. In forming the advice for this report, the CFO has considered the following:
- The requirement established in the Council's Medium Term Financial Strategy to ensure that a safe level contingency is maintained.
 - The degree to which the Council's financial plans are aligned to the Council's statutory obligations, local priorities and policy objectives.
 - The adequacy of the information systems underpinning the Council's financial management processes.
 - Risks associated with the Council's activities, as identified within the risk register.
 - The level of earmarked and unearmarked reserves within the General Fund.
 - The degree to which uncertainties exist within the draft 2009/10 budget.

Robustness of Estimates

9. The following aspects increase confidence in the robustness of estimates:

- Detailed scrutiny, review and challenge of budgets by Heads of Division, finance officers and the Strategic Management Board. The aim has been to ensure that the budget is based upon realistic estimates of what resources are actually required to maintain existing service levels; for example, ensuring that contractual commitments are provided for, salary budgets reflect current staffing levels, and income budgets are based on an assessment of price and demand.
- Removal of unidentified savings targets so that the risk of being unable to deliver the savings is avoided.

10. No budget can ever be completely free from risk. Necessarily, assumptions are made which means that the budget will always have a certain amount of uncertainty. The following are the main areas of potential variability:

	Probability	Impact	Overall Risk
b) Pay award. At the time of preparing the budget and this report, neither the 2008/09 or 2009/10 pay awards have been settled. A payment equating to 2.45% has been made for 2008/09 in advance of a final settlement through arbitration. The budget assumed a pay award of 2.5%. If arbitration increases the settlement above 2.5%, this will place pressure on the Council's budget going in to 2009/10. 2.5% is the assumed pay award in the 2009/10 budget. The Government continues to adopt a policy of containing public sector rises, but if it is higher than 2.5%, this will place further pressure on the Council's finances. 1% of pay costs is equivalent to approximately £82,000.	Low	Low	Low
c) 2008/09 forecast outturn. The advice in this report takes into account the forecast outturn position and the estimated level of the Working Balance as at 31 March 2009. The actual outturn position will be determined at the end of May 2009. The actual position will affect the level of reserves and could possibly require replenishment above that which is budgeted.	Medium	Low	Low

	Probability	Impact	Overall Risk
d) Energy costs. Although there are indications of stabilization and price reductions in some parts of the energies industry, volatility continues to be experienced internationally. A level of inflation has been built in to the 2009/10 estimates, but there is potential to affect the Council if further price rises occur.	Medium	Low	Low
e) Car parking partnership. As with any new venture, there is risk that variations will arise from the business case on which the decision to proceed is predicated.	Medium	Low	Low
f) Investment income. The budgeted level of income has been substantially reduced, reflecting lower interest rates and the non-availability of the sum placed with Landsbanki. It is possible that interest rates could fall further. Volatility in the banking sector is such that increased reliance may have to be placed on the Government deposit account facility, which pays a very low rate of interest.	Medium	Medium	Medium
g) Recharges from General Fund to Housing Revenue Account. The budget assumes that the HRA will make a contribution towards the running costs of the Council. The basis of determining the level of contribution is due for review, to ensure that the statutory requirement to apportion costs fairly is met. The review will be carried out during 2009/10. The outcomes could affect the level of recharge.	Medium	Medium	Medium
h) Concessionary Fares. 2009/10 will be the second year of the extension to free bus travel. It is a demand-led budget but the scheme has not existed long enough to enable a reliable trend in demand to be established. Partner organizations in Essex are discussing the level of financial contributions to the scheme. These issues mean that there is a risk that variability from budget may occur in 2009/10.	Medium	Medium	Medium

	Probability	Impact	Overall Risk
i) Capital financing costs. These are influenced by variable factors such as cash flow, variations in the Capital Programme and availability of capital receipts. Complex regulations exist which contribute to the difficulty in producing reliable estimates	Medium	Medium	Medium
j) Instability of banking industry. The Council will adopt an investment strategy that aims to minimize the risk to funds placed on deposit. Accordingly reliance will be placed on UK Government-backed banks and the Government's deposit account facility. Under these arrangements it is a low risk that funds on deposit will be vulnerable but the possibility of a banking failure exists which could have a serious impact on the Council if it occurred.	Low	High	Medium
k) Demand for Services. The benefits service is beginning to see an increase in applications resulting from the current economic climate. The 2009/10 budget includes estimates of additional expenditure and Government subsidy, and some limited Government funding will be available. There is a need to ensure that the Benefits service is adequately resourced to meet the demands placed upon it. This could result in further pressure on the budget.	High	Medium	High
l) Benefits grant claim. During Autumn 2008, the external audit of the 2007/08 claim identified errors which may require some adjustment to the level of grant entitlement. This would be effected in 2008/09. It is likely that some of the issues identified will recur when the 2008/09 claim is audited, necessitating an adjustment in 2009/10.	High	Medium	High
m) Stansted Airport expansion. The budget includes provision to meet costs arising from the G2 public enquiry. This is a complex issue and as with all issues subject to legal proceedings it is possible that unbudgeted costs will arise.	High	High	High

	Probability	Impact	Overall Risk
<p>n) Fees & Charges Income. Attempts have been made to ensure that realistic estimates of income are included in the budget, but if economic conditions deteriorate further there may be unbudgeted loss of income. In general, there is an assumption that reductions in income will be managed by making compensating cost reductions, but this will not always be possible. Although the Council has yet to see a reduction in income levels relating to planning applications, it is possible that such a reduction could arise. Reductions have already been identified relating to land charges. There is a possibility that the Port Health service provided by the Council may cease. Car parking income could be adversely affected if the recession affects the number of people using car parks.</p>	High	High	High
<p>o) Refuse & recycling. Costs and income relating to waste are variable and there is always an inherent possibility of budget variances arising. The budget assumes that a contribution from Essex County Council will be made, subject to the UDC confirming its support for the Inter Authority Agreement. At time of preparing this report, this confirmation was not in place. Prices for recycling commodities are volatile, potentially affecting the Council's income.</p>	High	High	High
<p>p) Landsbanki. At time of preparing this report, there was no reliable information available regarding the prospects of recovering the outstanding sum. Any adjustment in the realizable value of the debt will have to be adjusted for in the Council's accounts. The Government has proposed a regulation which will defer the effect of any such adjustment until 2010/11. If the regulation is confirmed, there should be no effect on the 2009/10 budget. However, until the regulation is confirmed, there is a risk of an adjustment being required in 2009/10. As information emerges, the Council may decide in 2009/10 to make some form of provision against the possible future loss.</p>	High	High	High

11. Taking all of the above issues into consideration, the CFO's opinion is that the Council's estimates are not absolutely robust so he is unable to provide a full assurance that there will be no unforeseen adverse variances. This is an expected and acceptable situation for any organisation that has to deal with a large number of variables. Provided that the minimum safe level of balances is maintained (as detailed below), any variations arising as a result of any lack of robustness in the estimates should be manageable.

12. The risks identified above will be proactively monitored and mitigating action taken as soon as reliable trends emerge. Budget monitoring reports to Members during the financial year will set out the latest position and action being taken, where applicable.

Adequacy of reserves

13. There is no available guidance on the minimum level of reserves that should be maintained. In 2003 CIPFA stated that each authority should determine what is a prudent level of reserves based upon their own circumstances, risks and uncertainties.

14. The revised Medium Term Financial Strategy (MTFS) (elsewhere on the agenda) states that the Working Balance will be maintained at least at the minimum level necessary to provide a safe level of contingency.

15. The MTFS sets out the basis for determining the minimum level of unearmarked reserves:

- An amount necessary to cover a 2% overrun in gross expenditure
- An amount necessary to cover a 2% shortfall in expected gross income
- Additional amounts necessary to cover specific risk items.

16. Based on these criteria, the CFO assesses that the minimum level of unearmarked reserves necessary is **£1,084,543**.

17. The Working Balance is forecasted to be £1,096,000 as at 31 March 2009. This total is slightly above the minimum contingency level that is required. Accordingly there is no requirement for the 2009/10 budget to include a contribution to the Working Balance.

18. This advice may change if significant adverse variations in the identified risks occur before 19 February

Risk Analysis

19. The risk analysis is provided in paragraph 10 above. The mitigating action is proactive budgetary control as referred to in paragraph 12.