

Committee: Full Council

Agenda Item

Date: 18 February 2010

14

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 9 February 2010. 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 2010/11 at £1,181,000
 - 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 2010/11 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 2010/11.
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 £1,181,000. The current forecasted level of the Working Balance is £1,096,000, £85,000 below the minimum safe amount. The CFO's advice therefore is that the Working Balance should be increased by £85,000. The General Fund budget elsewhere on tonight's agenda includes provision to increase the Working Balance by £85,000.
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 18 February approval of the following:
 - d) the minimum safe contingency level for 2010/11 at £1,181,000.
 - 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 2010/11 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
Health and Safety	No specific implications
Human Rights	No specific implications
Legal implications	The report is prepared in order to comply with Section 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 2010/11 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.
- The budget no longer contains 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 an amount of uncertainty. The analysis below sets out the major risks applicable to 2010/11 and an indication of the possible impact.

11. It is not possible to give a precise estimate of the impact of each identified risk. As a general guide, the following broad definitions have been used:

Probability	Low	Possible, but unlikely
	Medium	Probable
	High	Almost certain
Impact	Low	Possible variance of up to £100,000
	Medium	Possible variance of £100,000 to £250,000
	High	Possible variance of over £250,000

	Probability	Impact	Overall Risk
b) Landsbanki. Although the situation is more encouraging than a year ago, the legal and political situation in Iceland remains volatile. The Council will be required to write off the impairment in value to the General Fund in 2010/11. CIPFA are currently revising their guidance on how to calculate the impairment charge. The Council has allocated £1,014,000 to a Contingency Fund. If the situation deteriorates, the impairment charge may be greater than this, requiring additional revenue provision. Conversely, an improved and confirmed position could result in a smaller impairment charge, enabling Contingency monies to be freed up for other purposes.	High	High (Adverse)	High

	Probability	Impact	Overall Risk
<p>c) Housing & Planning Delivery Grant. The budget assumes that the Council will receive £100,000 of HPDG, in the third and final year of the present scheme. Forecasting the amount due with confidence is not possible because of the many variables, the possibility that funding distribution methodology will change and/or the possibility that the scheme will be withdrawn. The maximum adverse variance is therefore £100,000. However, the possibility exists that the Council may receive a significantly higher sum, creating a substantial positive variance.</p>	High	High (favourable) Medium (adverse)	High
<p>d) Strategic Solutions. The budget includes no savings arising from implementing the "Strategic Solutions" programme, nor does it include any implementation costs. It is anticipated that most costs will be funded from the Council's Change Management earmarked reserve and/or support from Improvement East. However, there is a risk that additional funds will be required.</p>	High	Medium (adverse)	High
<p>e) Housing & Council Tax Benefits.</p> <p>The Benefits service has seen a growth in demand recently and estimates of continued growth have been built into the budget, with total expenditure estimated at around £17.5m.</p> <p>The budget assumes that 2010/11 benefits expenditure will attract an average grant subsidy of 98% i.e. grant income of £17.1m.</p> <p>This is subject to many variable factors including accuracy of processing, and the actual subsidy received may be lower or higher. With large sums involved, relatively small fluctuations can have a large financial impact.</p> <p>During 2010/11, the external audit of the 2009/10 grant claim will be carried out. If errors are identified that affect entitlement to grant, these will need to be adjusted for.</p>	Medium	Medium (Adverse)	Medium
<p>f) 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. There is a risk of favourable or adverse variances arising.</p>	Medium	Medium (adverse or favourable)	Medium

	Probability	Impact	Overall Risk
g) Refuse & recycling. Costs and income relating to waste are variable and there is always an inherent possibility of budget variances arising. Costs and savings arising from proposed partnership working have not been built into the budget. There are specific uncertainties relating to the costs of kitchen waste disposal, and the level of trade waste income.	Medium	Medium (adverse or favourable)	Medium
h) Recharges from General Fund to Housing Revenue Account. The level of recharge is based on many variable factors and is under constant review, to ensure that the statutory requirement to apportion costs fairly is met.	Medium	Low (adverse or favourable)	Medium
i) Pay award. At the time of preparing the budget and this report, the 2010/11 pay award was not known. The union side has claimed 2.5% or £500, whichever is greater, a total estimated cost of 2.8%. In return the Employer side has stated that no pay offer is to be made for 2010/11. The budget assumes a pay award of 1% plus provision for contractual entitlement to increments. If the actual pay settlement is above or below 1%, a budget variance will arise. 1% of pay costs is equivalent to approximately £82,000.	Medium	Low (adverse or favourable)	Medium
j) 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 and building control.	Medium	Low (adverse)	Medium
k) Fuel, Energy & Utilities costs. Although there are indications of stabilization and price reductions in some parts of the energies industry, volatility continues to be experienced internationally. A modest reduction has been built in to the 2010/11 estimates, but there is potential for price variations to occur.	Medium	Low (adverse or favourable)	Medium

	Probability	Impact	Overall Risk
<p>l) Concessionary Bus Travel. The Government has consulted upon a revised funding distribution which will see a cut to UDC's grant of £60,000. This has been adjusted for in the budget but the final grant determination may be different to that consulted upon. Responsibilities are transferring to Essex County Council and some of the financial issues are to be determined. In general, this is a demand-led activity with a risk of variation.</p>	Medium	Low (adverse or favourable)	Medium
<p>m) Instability of banking industry. The Council has an investment strategy that minimizes the risk to funds on deposit. Reliance is placed on UK Government-backed banks, securely rated Money Market Funds and the Government's deposit account facility. Nevertheless if a banking failure occurs, there could be a serious impact on the Council.</p>	Low	High (adverse)	Medium
<p>n) 2009/10 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 2010. The actual outturn position will be determined at the end of May 2010. The actual position will affect the level of reserves and could possibly require replenishment above that which is budgeted.</p>	Low	Low (adverse)	Low
<p>o) Stansted Airport expansion. The Planning Development Reserve has been built up to meet the costs arising from the G2 public enquiry, as well as other major planning-related expenditure. This is a complex issue and as with all issues subject to legal proceedings it is possible that unbudgeted costs will arise. The level of the Reserve should be sufficient but it is considered appropriate for such a strategic, significant and variable issue to be included in the risk analysis.</p>	Low	Low (adverse)	Low

12. 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.
13. 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

14. There is no available guidance on the minimum level of unearmarked 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.
15. 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.
16. 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.
17. Based on these criteria, the CFO assesses that the minimum level of unearmarked reserves necessary is **£1,181,000**.
18. The current forecasted level of the Working Balance is £1,096,000, £85,000 below the minimum safe amount. The CFO's advice therefore is that the Working Balance should be increased by £85,000. The General Fund budget elsewhere on tonight's agenda includes provision to increase the Working Balance by £85,000.
19. This advice may change if significant changes in the identified risks occur before 18 February.

Earmarked Reserves

20. Earmarked reserves are established for items of future expenditure that the Council knows it will be incurring, but no formal commitment exists and the precise amount and timing is not known.
21. The principal earmarked reserves held by the Council relate to the following:

Landsbanki Contingency – to absorb the reduction in the value of the deposit placed in the failed Icelandic bank, Landsbanki. At time of preparing this MTFS it is estimated that the amount to be written off in 2010/11 is £1.014m. The forecast balance on the reserve as at 31 March 2010 is £1.014m so is deemed to be adequate based on the current information available. If the situation in Iceland deteriorates during 2010, additional contingency provision may be required.

Planning Development – for costs associated with major planning issues such as the Stansted G2 inquiry. The reserve can also be used to bring about improvements in planning performance. The forecast balance on the reserve is £0.770m as at 31 March 2010. This is considered to be adequate for the intended purpose.

Change Management - to enable the Council to secure the capacity and expertise necessary to deliver strategic solutions. Implementation costs of the strategic solutions have not been quantified. The forecast balance on the reserve as at 31 March 2010 is £0.364m, of which £0.107m is budgeted to be used in 2010/11 leaving an uncommitted balance of £0.257m. It is considered unlikely that this will be sufficient to cover all of the implementation costs arising from the strategic solutions programme. The Council will need to identify opportunities to bolster this reserve.

Budget Equalization – to be drawn upon as part of balancing the budget while savings from the strategic solutions programme start to materialise. The balance on the reserve is forecasted to be £1.499m as at 31 March 2010. This is adequate to ensure a balanced budget until 2014/15, if the savings targets described in the Medium Term Financial Strategy are realised. In the event of any slippage in the savings programme, the Council will need to identify opportunities to bolster this reserve.

Risk Analysis

22. The risk analysis is provided above. The mitigating action is proactive budgetary control as referred to in paragraph 13.