LOCAL GOVERNMENT ACT 2003: SECTION 25

REPORT BY THE CHIEF FINANCE OFFICER

INTRODUCTION

1. The Local Government Act 2003 (Section 25) requires that when a local authority is agreeing its annual budget and precept, the Chief Finance Officer must report to it on the following matters:
   a) the robustness of the estimates made for the purposes of the calculations
   b) the adequacy of the proposed financial reserves.
2. The authority must have due regard to the report when making decisions on the budget and precept.
3. The Chief Finance Officer for the County Council is the Chief Finance Officer and Deputy Director for Change & Efficiency.
4. In expressing her opinion, the Chief Finance Officer has considered the financial management arrangements that are in place, the level of reserves, the budget assumptions, the overall financial and economic environment, the financial risks facing the County Council and its overall financial standing. Preserving the Council's financial resilience is a key long-term driver in the Council's financial strategy that has been reflected in the current MTFP (2011-15) and which continues as a core principle as the Council moves forward to the next 5 year MTFP (2012-2017).
5. Although the Council has successfully delivered significant savings in 2010/11 (£68m) and is forecast to deliver the further savings target for 2011/12 of £60m, the budget assumptions for the next MTFP (2012-17), includes significant further savings of £206m, making a total of around £334m over the seven year period. There is a significant level of risk in agreeing a MTFP with continuing high level of further savings required year on year and it may become harder for services to deliver each year's savings.
6. Further significant risk exists due to the unprecedented level of economic uncertainty and the proposals to fundamentally review the basis of local government funding with effect from 2013/14. Taken together, these risks will require a higher level of general balances to be maintained and the continued inclusion of a contingency sum, £8m, within the budget.
7. The above risks apply where the Council continues with its MTFP 2011-15 strategy of annual council tax increases of 2.5% annually (accept 2012/13 where the proposal is to increase council tax by 2.99%). However, accepting the Government's offer in October 2011 of a one-off grant to compensate Council's for not increasing council tax by 2.5%, equal to £14m for this Council, would mean the Council would be unable to sustain its medium term financial plans without either:
   - imposing significant Council Tax increases in 2013/14 and subsequent years; and/or
   - making additional reductions to front line services (since the one off grant should only be spent on one-off items).
8. There is a risk that these actions would not be sustainable and may lead to the erosion of the Council's financial resilience.

FINANCIAL MANAGEMENT ARRANGEMENTS

9. The Council's external auditor gave an unqualified opinion on the 2010/11 financial statements and an unqualified conclusion on the Council's arrangements for securing value for money. This follows a similar opinion in 2009/10, despite that the Council had to implement the accounting changes required under the International Financial Reporting Standards (IFRS) changes for the first time.
10. The Council has maintained a robust system of budget monitoring and control evidenced by the small unplanned variances from budget on final outturn in recent years. Where over-spends or under-spends have arisen, potential variances have been identified early enough to enable corrective action to have effect.
11. A robust system for monitoring the progress on the implementation of efficiency savings, linked with other elements of the change programme was established in 2010/11 and has been maintained during 2011/12. The Corporate Board, which includes the Strategic Directors, the Chief Finance Officer and the Head of HR, review progress in detail on a monthly basis before a budget monitoring report is presented to the Cabinet. These budget monitoring reports are presented within a month of the end of the monitoring period, which is about 2 weeks earlier than in previous years. The timeliness of this reporting means any variations from the budget are considered early and management action can be put in place promptly.
12. In addition the Public Value Review (PVR) programme, begun in 2009 continues to identify the actions necessary to deliver many of the proposed MTFP savings and monthly monitoring at the PVR Steering Board, Chaired by the Leader of the Council, ensures regular comparison of targeted savings to actual savings.
13. During 2011/12 the Overview Scrutiny Committee, comprising of the Chairs of the other Select Committees, was established and since July 2011 all Cabinet budget monitoring reports have been further scrutinised by this committee following presentation to Cabinet.
14. This approach will be extended to 2012/13 and progress on the actions needed to achieve the required savings will be tracked.
15. The Chief Finance Officer considers that the financial control arrangements remain sufficiently robust to maintain adequate and effective control of the budget in 2012/13.

BUDGET PROCESS

16. In September 2011 the budget planning process was reviewed to ensure it is a 'lean' process that fulfils its purpose. Whilst some of the proposals will require longer term changes to take place before they can be implemented, the main changes to the budget planning process has been:

    - a greater involvement in the development of assumptions underlying the scenario planning by Members;
    - a reduction in the number of iterations of the budget necessary at Cabinet;
    - a more direct link to strategic planning within services.

17. The budget has been constructed by looking at expected activity for the future years rather than the incremental approach. This applies a consistent approach to preparing budget proposals across all services. The proposals in this budget are the result of scrutiny by the Strategic Directors, Chief Finance Officer, Leader

of the Council, Members of the Cabinet and Select Committees throughout the autumn of 2011 and into January 2012. All assumptions and calculations have been subject to scrutiny by the Council's officers. Proposals have been scrutinised by staff in the service and endorsed by the relevant Strategic Director.

MTFP (2012-17) BUDGET ASSUMPTIONS

18. The table below shows the main budget assumptions together with an assessment of their robustness and the risk they pose to the Council's financial position and strategy.

	Assumption	**Comments**
Pay inflation	2012/13 *1%* 2013/14 *1.5%* 2014/15-2016/17 *2%*	These proposals follow a two year pay freeze.
General Price inflation	2012/13 *2.5%* 2013/14, 2014/15 *2.1%* 2015/16 & 2016/17 *2%*	General inflation relates to other budgets only. Specific inflation allowances have been included in individual services budgets reflecting the assessment of Strategic Directors and the Head of Procurement of the likely cost increases.
Local Government Resource Review (LGRR)	N/a	The impact of the LGRR on the level of funding for the council from 2013/14 will remain uncertain until autumn 2012. However, the draft proposals issued in Dec 2011 have confirmed the Council's scenario planning to be robust. Continued modelling of any further draft proposals during the summer / autumn will monitor the risks.
Interest rates	Minimal changes in base rates during 2011/12	All existing debt is fixed interest and so not subject to interest rate variation. MTFP allows for new borrowing at on average 5%, but rates between 4.4% and 5.6% over the 5 year MTFP period. Interest on cash balances is assumed as 1% Sector, our treasury management advisers, forecast minimal changes in rates until at least mid 2013/14 and then gradual, low increases.
Capital receipts	£69m (to fund programme over 5 years 2012-17)	The list of proposed disposals includes only assets that do not fit with the capital strategy of investing in our estate either to meet service needs or develop an income stream. Any shortfall on receipts would be funded from other available capital reserves.
Demand led pressures	Demographic pressures in Children, Schools & Families Directorate and Adult	Both Directorates are forecasting increasing demand on services over the MTFP period reflecting: • increases in Surrey's population aged +80; • increases in Surrey's school age population; • legislative changes affecting vulnerable adults'

	Social Care Directorate	entitlement and eligibility for support from the Council; • increases in the number of looked after children and those with a care protection plan. There is a risk that these pressures may be understated, leading directly to the need to sustain the risk contingency of £8m into 2012/13.
Efficiency and other Service Savings	£206m	Savings identified by Strategic Directors who confirm that actions have been identified to deliver savings and the targets included in budget proposals are realistic and achievable, albeit these are not easy to implement. Some degree of risk is recognised (see para 6)

19. It is the Chief Finance Officer's opinion that the general assumptions are realistic but that the proposed efficiency and other service savings are ambitious and there is substantial risk that they will not all be achieved within the required timescale. However, the contingency sum built into the budget together with the availability of general balances at the higher recommended level of £30m allows sufficient headroom provided robust monitoring processes are kept in place.

20. In recognition of the need to invest to deliver some of the efficiencies and service reductions required, an invest to save fund has been created from 2012/13, against which services will be required to produce full business cases before any resources are actually released. Unlike the former invest to save fund created in 2010/11 and 2011/12, this reserve will require services to 'repay' the investment released to them over an agreed period – thereby ensuring that this fund is replenished over time and available for future investment initiatives.

LEVEL OF RESERVES

21. The final accounts for 2010/11 show available general revenue balances at 31 March 2011 of £24.6m. The latest budget monitoring position for 2011/12, as at the December 2011, forecasts that this level will increase to £30m by 31 March 2012. Annex 6 contains the policy statement on reserves and balances.

FINANCIAL STANDING

22. The Council has complied fully with the requirements of the Prudential Code for Capital Finance in Local Authorities. The formal recommendation to the Council sets out the prudential indicators, which the Council must adhere to. The Chief Finance Officer is satisfied that the level of borrowing assumed in the indicators is affordable and sustainable. The MTFP makes provision for the financing of all proposed borrowing and assumes a continuation of the strategy to borrow internally unless external factors (i.e. interest rates and or capping limits) alter and make early borrowing appropriate.

23. The Council has £18.6m placed on deposit with two Icelandic banks, which has been at risk following the administration of these banks in Oct 2008. The Audit & Governance Committee has received regular updates on the progress in, and prospects of, recovery of the deposits that are at risk. Based on the information currently available the Chief Finance Officer advises that there is a reasonable expectation of recovery of some of the deposits, but that until the level of settlement is known, it would be prudent to maintain the financial Investments

reserve of £9.5m against possible losses. This will be kept under review, in year, as the legal cases proceed.

24. The County Council maintains a number of other earmarked reserves estimated to total £81.9m (including Iceland reserve) at 31 March 2012. This includes existing funds to smooth the cost of replacing vehicles and IT equipment, to provide a source of funds for internal investment, and new reserves set up specifically to protect against interest rate changes and the impact of an economic downturn. There are sufficient funds in these reserves to meet expenditure likely to fall on them during 2012/13 and are available for other uses in case of emergency.

RISK ASSESSMENT

25. In response to the significant challenges that the Council is facing and the associated emerging risks, an integrated risk framework comprising the separate disciplines of risk management has recently been established. This has brought several changes to the risk governance arrangements as set out in the main budget report, but centred around the set up of a Corporate Resilience Steering Group, chaired by the Assistant Chief Executive and with a focus on the operational side of risk and will develop the link between risk registers and business impact analyses and continuity plans. The Leadership Risk Register has been in place throughout 2011/12 and will continue into 2012/13. This is monitored monthly by the Corporate Board and reviewed regularly by Cabinet.

26. The specific risks and opportunities facing the Council and recorded in the Leadership Risk Register are:

    - delivery of the major change programmes;
    - 2012 Olympics;
    - delivery of the waste infrastructure; and
    - changes to health commissioning.

27. The Chief Finance Officer is satisfied that the proposed budget, general balance and reserves sufficiently addresses those risks identified in the Leadership Risk Register. Additional resilience has been assured through the creation of new earmarked reserves specifically to mitigate against specific serious risk:

    - Interest rate risk reserve
    - Economic Downturn Reserve

    Both are fully explained in the earmarked reserves Annex 7.

FUTURE YEARS

28. The proposed budget addresses the estimated reduction in funding over the next five years and sets out a plan to ensure that the Council can deliver budgets within estimated available resources. The plan will require monitoring and it is likely that adjustments will be required to take account of unforeseen events and changes in the underlying assumptions, but it sets a clear direction for the future and places the Council in a strong position to meet the challenges ahead.

29. Given the scale of the financial challenges facing the public sector, the Chief Finance Officer must emphasise the likelihood that the following spending round (CSR 2014-2017) continuing to reduce budgets so any changes to services over the MTFP period need to be sustainable in the long term.

CONCLUSION

30. The Chief Finance Officer considers that the budget proposals recommended by the Cabinet are robust and sustainable. However, there are considerable risks associated with the achievement of efficiencies and service reductions and clear planning, management and monitoring arrangements are needed to ensure savings are delivered within the required timescale. Additionally, there is added risk due to the economic situation and the Government's policy of tackling the national deficit and implications on the level of local government funding – a particular issue for this MTFP period as the new funding arrangements will come into effect. The level of reserves together with the contingency sum is sufficient to meet the known risks within the budget, taking account of the Councils robust financial management framework.