Local Government Act 2003: Section 25 Report by the Chief Finance Officer

Introduction

1.1. 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:

- the robustness of the estimates made for the purposes of the calculations
- the adequacy of the proposed financial reserves.

1.2. The Council must have due regard to the report when making decisions on the budget and precept.

1.3. The Chief Finance Officer for the County Council is Sheila Little (in the post of Chief Finance Officer and Deputy Director for Business Services Directorate).

1.4. 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.

1.5. 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 Medium Term Financial Plan (2013-18) and which continues as a core principle as the council moves forward to the next 5 year MTFP (2014-19).

1.6. Although the Council has successfully delivered significant efficiency savings & service reductions in each of the last three financial years (2010/11 £68m, 2011/12 £61m, 2012/13 £66m, and is forecast to deliver further savings for 2013/14 of £60m, including the budget assumptions for the next MTFP (2014-19) making a total of around £492m over the nine year period.

1.7. The Council sets out how it has increased value, reduced unit costs and provided better quality services to residents in its "More than 50 Ways Surrey County Council adds value" booklet, attached as Appendix 1 to the main report.

1.8. The level of savings delivered so far continue to retain a balance of approximately an 80:20 split between meeting the austerity agenda through a combination of service efficiencies and tax increases, similar to central Government's strategy for addressing the national fiscal deficit. However, continuing this level of further savings year on year is becoming harder for services to deliver, therefore increasing the risk in the MTFP (2014-19).

1.9. Further significant risk exists due to:

a. the continuing unprecedented level of economic uncertainty: austerity seems likely to continue for at least a decade.

b. the on-going revisions to the basis of local government funding. This current financial year, 2013/14, saw the start of council tax benefit localisation support and the local retention of business rates; looking ahead the expansion of the health and social care integration transformation, involving re-alignment of social care funding, the implications of the upcoming Care Bill, and on-going changes to local authorities responsibilities and funding for these, all increase the uncertainty around the level of actual funding the council will receive in the future.

c. The increasing tendency for late Government announcements of Financial Settlement details makes the challenge of effective financial planning more difficult, reducing the opportunity to consult effectively with stakeholders.

d. Funding issues related to top slicing of grants and allocations.

1.10. The Council remains correctly focused on long term financial resilience and is proactively planning to apply one-off general reserves & balances totaling £26m to achieve a balanced budget in 2014/15 (as set out in paragraphs 1.29 to 1.32). This will enable the Council to further pursue the medium term strategy focused on securing a fair share of Government funding for this Council for the services where demand is uncontrollable by the Council: adult social care and school places in particular.

1.11. Taken together, all of these risks will require careful consideration as to the prudent level of balances to be maintained and a review of the level of the risk contingency within the revenue budget. In recent years the Council has had a risk contingency within the revenue budget of £8m, principally to mitigate against non-delivery of service reductions & efficiencies and to facilitate smoothing of spend across financial years. For 2013/14 this contingency was increased to £13m as a one off reflecting that efficiencies are getting harder to deliver and sustain. However, the risk contingency has not been used in any past year and the expectation is not to have to use it again for 2013/14. Although there remains a high level of efficiencies to deliver in the up-dated MTFP(2014-19), the proposal to reduce (in 2014/15) and then remove (from 2015/16) the risk contingency is sensible; since including it only increases the efficiencies required to be delivered in any one year.

1.12. However, to recognise the risk of non-delivery of efficiencies going forwards the proposal to establish a mechanism to regularly track and monitor progress on the implementation of robust plans for achieving the efficiencies across the whole MTFP period, will ensure early action can be taken if it emerges that any plans are non-deliverable.

1.13. The above risks apply where the Council continues with its long term financial strategy of below inflation annual council tax up-lifts to secure the long term funding required to sustain service delivery. For the new MTFP (2014-19) the proposal to amend the council tax strategy from 2.5% annual up-lift, to be marginally below the level of intended council tax referendum threshold indicated in the Spending Round 2013, of 2% (for 2014/15 and 2015/16), represents a continuation of this long term strategy. Council tax up-lifts of 1.99% are used throughout this proposed MTFP period.

1.14. For the last two years this has meant declining the Governments council tax freeze grant offers and instead put in place sensible council tax up-lifts. For 2014/15 and 2015/16 the Provisional Financial Settlement has indicated further council tax freeze grants at 1% (for two years for 2014/15 and for 1% year for 2015/16). Although the Government have indicated that these grants will be added to the 'review' base for that period, there is no certainty beyond 2015/16, whereas the council tax up-lift is in the Councils long term base budget. 7

1.15. Accepting these grants would be inconsistent with the Council's long term strategy and would erode the Council's funding base: particularly important to this Council because of the high dependence upon council tax funding as a result of low central Government grant support and high service demand pressures.

1.16. It must be recognised that, at the date of writing this paper, the Government have yet to confirm the referendum threshold level for 2014/15 or 2015/16, although this Council has been consulting on budget proposals based on the Governments clearly stated intent to set the level at 2% for each year. This intent was stated several times in the Spending Round 2013 announcements published on 26 June 2013; deliberately issued in the summer to assist councils with their financial planning. If the Council has to amend its proposed council tax strategy (and lower the level of council tax up-lifts) once confirmation of the referendum threshold is known, then the council will have to:

- impose a more significant Council Tax up-lift in 2015/16 and subsequent years; and/or
- make significant cuts to front line services.

1.17. In the event that the referendum limit is announced after the Full Council agrees the budget, including council tax precept, for 2014/15, the Council will separately consider any appropriate action.

Financial management arrangements

1.18. For 2012/13 the Council received another unqualified opinion on the Council's financial statements and an unqualified conclusion on the Council's arrangements for securing value for money. Indeed, the Council was rated as 'good or better' in terms of its financial resilience, when the top rating achievable is usually good. Further, the Council is recognised in Grant Thornton's national report on all of its local authority clients (which present 40% of local authorities) for its high quality and robust long term financial planning.

1.19. This was the first year under the newly appointed auditor, Grant Thornton. The Chief Finance Officer worked closely with the new auditors to ensure a smooth transition and will continue this positive working in future years.

1.20. The Council has maintained a robust system of budget monitoring and control evidenced by the continuation of timely monthly reports to Cabinet. Where over-spends or under-spends have arisen, prompt management actions have been identified to minimise effect and to enable early corrective action to be put in place where relevant.

1.21. The system for monitoring the progress on the implementation of efficiency savings has been sustained during 2013/14: regular review of efficiencies by the Chief Executive and senior officers before onward reporting and scrutiny by the Leader and Cabinet as well as Council Overview Scrutiny Committee. This will continue during 2014/15 alongside the additional mechanism whereby the Chief Executive and Chief Finance Officer will regularly review the progress of plans to deliver efficiencies across the whole MTFP period (not just 2014/15) highlighting any significant issues to the Leader and Cabinet as appropriate.

1.22. Throughout 2013/14 the Council Overview Scrutiny Committee, comprising of the Chairmen of all other Select Committees, continued to scrutinise all Cabinet budget monitoring reports following presentation to Cabinet. The capital programme was monitored closely by the Chief Executive and senior officers each month, in advance of formal reporting to Cabinet.

1.23. The above approaches will be continued into 2014/15 and progress on the actions needed to achieve the required savings will be tracked. The Chief Finance Officer considers that the financial control arrangements remain sufficiently robust to maintain adequate and effective control of the budget in 2014/15.

Budget process

1.24. The budget planning process, established in 2011, following a 'lean' process review, was developed further for this MTFP (2014-19) process. The main enhancements were:

- broader representation and more discursive workshop style to the face to face engagement with the business & voluntary sector communities, and trade unions
- regular all Member briefings at each phase
- specific induction training programme to support in particular the newly elected Councilors following the May 2013 elections.

1.25. 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 assumptions, calculations and proposals in this budget are the result of challenge and scrutiny by the Leader of the Council, Members of the Cabinet and Select Committees throughout the summer and autumn of 2013 and into January 2014, guided by advice from the Chief Executive, Strategic Directors and Chief Finance Officer.

MTFP (2014-19) budget assumptions

1.26. 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: Surrey Pay	Up to 1.6% each year	These proposals follow a three year pay freeze for senior officers and increases as follows for other staff on Surrey pay: 2010/11 Pay freeze, but up to £300 if headroom allowed 2011/12 Flat rate £250, plus up to £250 if headroom allowed 2012/13 Flat rate £350, plus up to £250 if headroom allowed
Pay inflation: National pay	1% each year	
General price inflation	2014/15 2.1% 2015-19 2.2%	General inflation relates to non service specific 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.
Council tax benefit support localisation and business rate retention	N/a	The impact of the local government funding review was central to developing the MTFP (2013-18). Consultation with the Government and Surrey borough & district councils was extensive throughout 2012 and 2013. The Council modeled a range of likely outcomes in its scenario planning.
Interest rates	Minimal changes in base rates during 2014/15	All existing long term debt is fixed interest and so not subject to interest rate variation. MTFP allows for new borrowing at on average 5%, but rates may vary between 4.4% and 5.6% over the 5 year MTFP period. Interest on cash balances is assumed as 0.7% Sector, our treasury management advisers, forecast minimal changes in rates until at least mid 2014 and then gradual, low increases.
Demand led pressures	Demand pressures in: Children, Schools & Families and Adult Social Care directorates	Both directorates are experiencing increasing demand on services over the MTFP period reflecting: • increases in Surrey's population aged +80, dementia care; • increases in Surrey's school age population; • legislative changes affecting vulnerable adults' entitlement and eligibility for support from the council. There is an increasing risk that these demand pressures may be understated, leading directly to revenue budget overspends in 2014/15.
Efficiency and other service savings	£219m over 2014-19	Efficiency & service reductions identified by Strategic Directors and their proposed budget targets will be very challenging to implement, so the Chief Executive and Chief Finance Officer will add a mechanism to track delivery of these savings. Some degree of risk is recognised (see paragraphs 1.8 to 1.13)

1.27. The Chief Finance Officer's opinion is the general assumptions are realistic but the proposed efficiency and other service savings are ambitious and there is substantial risk they will not all be achieved within the required timescale. To mitigate this risk, the Chief Executive and Chief Finance Officer will establish a more robust mechanism regularly to monitor and report progress in planning delivery of savings.

1.28. In recognition of the need to invest to deliver some of the efficiencies & service reductions required, the invest to save fund created in 2010/11 against which services will be required to produce full business cases before any resources are actually released, will continue in 2014/15. As in 2013/14, 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 and balances

1.29. The final accounts for 2012/13 show available general balances at 31 March 2013 of £19.9m. The latest budget monitoring position for 2013/14, as at 31 December 2013, forecasts that this level will remain at £19.9m by 31 March 2014. Appropriate levels of general balances are necessary to be maintained so that the Council can respond to unexpected emergencies. The recent adverse weather and flooding may require use of some of these balances in the coming months.

1.30. Details of earmarked balances are set out in Appendix A7. To enable the Council's financial strategy to secure a fair share of Government support for uncontrollable service demands to be met, the budget proposal is to apply £26m of these earmarked reserves to the 2014/15 budget: importantly, £20.1m of this is from the Budget Equalisation Reserve which is the carry forward reserve set up to smooth spending across financial years. The remainder is sensible to use after reviewing the reasons for holding each balance, an annual process.

1.31. During the current financial year, the Cabinet has agreed to use the Severe Weather Reserve, £5m, to improve the condition of roads, reducing the longer term deterioration of road conditions and reducing future maintenance liability. At the end of this financial year, it is proposed to create a new reserve to mitigate against the potential liability for business rate appeals, £1.25m.

1.32. The Chief Finance Officer confirms that the level of reserves and balances represents a prudent and sensible level for the Council: ensuring funds are set aside for likely future commitments, particularly necessary in the current uncertain financial climate, whilst not holding excessive balances when services are facing increasing demands.

Financial standing

1.33. 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. During the current financial year, 2013/14, the Council has repaid a loan of £68m using cash balances as part of an active strategy of reducing cash balances while interest rates are low. However, the MTFP (2014-19) makes provision for the financing of all proposed borrowing and assumes an extension of the strategy to borrow internally unless external factors (i.e. interest rates and or capping limits) alter and make early borrowing appropriate.

Risk assessment

1.34. 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 is well established in the Council and will be maintained. This has seen several changes to the risk governance arrangements embedded in the council and the close link between risk registers and business impact analyses and continuity plans has been sustained throughout 2013/14 and will continue into 2014/15. Similarly the Leadership Risk Register remains in place and will continue to be monitored monthly by the Chief Executive and senior officers, and reviewed by Cabinet quarterly in 2014/15.

1.35. The specific risks relating to the financial environment and opportunities facing the Council and recorded in the Leadership Risk Register are:

- erosion of the council's main sources of funding (council tax and government grant)
- delivery of the major change programmes and associated efficiencies;
- increased reliance on partnership working to manage service delivery and maximise efficient service delivery, in particular integration of health and social care, and,
- the increasing uncertainty over future local government funding, exacerbated by late announcements.

1.36. The Chief Finance Officer is satisfied that the proposed budget, including risk contingency, general balances & reserves sufficiently addresses these risks, Additional resilience has been assured over the long term through sustaining the earmarked reserve for long term investment & infrastructure initiatives and creation of a reserve to mitigate against potential business rate appeal successes.

Future years

1.37. 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 close monitoring and, in view of the increased uncertainty around Government funding, council tax and business rates, as well as volatile service demands, it is likely that adjustments will be required during 2014/15 to take account of unforeseen events and changes in the underlying assumptions. However, it sets a clear direction for the future and places the Council in a sensible position to meet the challenges ahead.

7

1.38. Given the scale of the financial challenges facing the public sector, the Chief Finance Officer must emphasise the high likelihood that the next Comprehensive Spending Review (CSR) will introduce further government grant cuts, meaning any changes to services over the MTFP (2014-19) period must be sustainable in the long term. It ought to be recognized that the content of the next CSR will be particularly hard to forecast in view of it being a new Parliament.

Conclusion

1.39. 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 increased uncertainty in a number of areas:

a. the achievement of efficiencies & service reductions year on year;

b. the transfer of uncertainty regarding the level of funding to local authority as a result of the local government funding changes introduced from April 2013;

c. the volatility implicit in the level of service demands;

d. the current economic situation and long term austerity faced by the country.

1.40. The above means monitoring of the whole MTFP (2014-19) period is recommended throughout 2014/15 to validate assumptions and timescales.