Local Government Act 2003: Section 25 Report by the Director of Finance

Introduction

1.1. The Local Government Act 2003 (Section 25), requires that when a local authority is agreeing its annual budget and precept, the Section 151 Officer must report to it on the robustness of the estimates made for the purposes of the calculations and the adequacy of the proposed financial reserves.

1.2. The Council is required to set a balanced budget and in considering the budget, the Council must have due regard to the advice the Director of Finance includes in this report. This is particularly important this year in view of the serious financial challenges facing the council.

1.3. For Surrey County Council the Section 151 Officer is the Director of Finance, Sheila Little.

1.4. In the equivalent report in February 2016, the Director of Finance indicated that the although the level of risk remained significant and the position was very serious, it was her view that the budget proposals recommended by the Cabinet for 2016/17 would produce a balanced budget that was deliverable, and develop a longer term budget that was sustainable so long as several things happened, specifically:

- Government provided transitional relief in the Final Settlement 2016/17;
- all existing savings plans were delivered in full, and;
- that the Public Value Transformation (PVT) programme was adopted, managed and monitored to ensure it identified considerable base budget reductions in costs as soon as is manageable.

1.5. Since then although the Government did allocate transitional relief grant over two years to the council this fell short of covering the full extent of the ‘shock’ reduction in Government grant announced without consultation in the 2016/17 Financial Settlement; of the planned savings for 2016/17 of £83m, the current end of year forecast is for delivery of these planned savings is £63m, a shortfall of £20m. Within this £17m is covered through one-off actions showing even further just how difficult it is to sustain and increase year on year efficiencies in a climate of continuing rises in service demands and reducing Government grant. The Discovery phase of the PVT clarified that the savings already identified are the upper limit of what can be achieved through the transformation programme. Further, the council do not have transformational proposals in place that would meet the additional £50m required.

1.6. Although there has been progress in each of these areas none have been to the level needed meaning that **the financial challenges facing Surrey County Council as it sets the budget for 2017/18 are now even more serious.**

1.7. In expressing her opinion, the Director of Finance has considered the financial, governance and 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.

1.8. The council's proposed budget, which includes a council tax increase of 15%, is subject to a referendum, which means the council is required to also agree a substitute budget with a council tax increase of 5%, that would be put in place if the proposed budget is not supported.

1.9. In this context the remainder of this report provides a commentary on the robustness of the two budget proposals and the level of reserves in place to support the Council.

Economic and financial position

1.10. Strategically the financial and economic context facing the council remains similar to recent years, which is a continuation of austerity, significant reduction in central Government funding at the same time as increasing demographic pressures for core council services, adult and children's social care in particular.

1.11. The Government again announced the Provisional Financial Settlement in December, 15 December 2016. There was little change from the level of funding that was anticipated on the basis of the four year settlement announced the previous year. Although the overall core spending power (CSP) only very marginally changes over the four year period, the Provisional Settlement does confirm the very significant reduction of core central Government funding (-£88m over the period from 2016/17 to 2019/20), met by the very significant increase assumed in locally raised funding from council tax (£103m).

1.12. Although there was no new funding announced in the Provisional Settlement, there was some re-distribution of funding: allocating £241m from New Homes Bonus (NHB) to a new grant for one year only to support Adult Social Care, and permitting adult social care authorities to bring forward a 1% ASC precept for each of the next two years. The latter would allow councils to raise the social care precept by 6% over 2 years, i.e. 3% in 2017/18 and 2018/19 rather than the originally announced flexibility of 6% over three years i.e. 2% each year to 2019/20.

1.13. It is important to note that the net effect in the Surrey area of the other Provisional Settlement changes is a net outflow of resources from Surrey to elsewhere in the country of £2.2m (the County and Districts & Boroughs

receiving £6.2m less NHB and the County receiving £4m for the adult social care support grant).

1.14. Although the four year settlement offer made in the Final Settlement last year (covering 2016/17 to 2019/20) was intended to add certainty, it is worth noting that this covered only around half of the total gross funding of the council. Further, in October 2016 this council decided not to accept the Government's four year offer, one implication of which was to expose the council to the risk of further grant loss if Government needed to find more fiscal reductions in future years. Although Government haven't been required to do this for 2017/18, there remains a risk that this could occur in the remaining two years of the four year offer (2018/19 and 2019/20). This increases the level of uncertainty and the council may need to draw on reserves if the allocated amounts vary from those planned for.

1.15. The Government has confirmed the general council tax precept limit, i.e. ignoring the adult social care precept, at 2% without referendum as expected. As mentioned this can be augmented by the addition of the adult social care precept if adopted at up to 3% per year for the next two years or at up to 2% per year for the next three years. It is clear that this does not change the underlying base income after three years in either scenario. It is only a total of 6% either way and therefore adds no capacity over and above the pre-existing capacity announced last year and already assumed in the councils budget plans approved by the Council last year.

1.16. At the same time, the Council continues to face significant pressures from the care market as well as increasing year on year demographic demand for targeted services, in particular, but not exclusively, for social care. Public expectation about the level of service from universal service areas (e.g. Highways, Libraries) also continues to increase.

1.17. In September 2016 the Council forecast an in year over spend on the revenue budget of £22m if no actions to contain expenditure were implemented. Since then the Chief Executive and Directors have put in place a series of measures and actions to stop or delay expenditure. As a result the current year's budget is moving closer to being balanced at the yearend although as many actions are one-off or short term, there remains an underlying pressure moving into future years' budgets of £22m in 2017/18.

1.18. The Council has made over £450m of savings and service reductions since 2010 but its ability to continue to achieve this level of savings in the context of growing demand for its services and reductions in Government funding is increasingly difficult without leading to potential service failures. The Public Value Transformation review conducted this year to find additional changes confirmed this view.

Financial Resilience Review

1.19. In recognition of the seriousness of the financial challenges facing the Council the Director of Finance, supported by the Chief Executive and Leader, requested the Chartered Institute of Public Finance and Accountancy (CIPFA) to carry out a financial resilience review in November 2016. As well as looking at comparative spending and costs, the review focused on the accuracy of the council's budget planning assumptions and figures and the long term financial resilience of the Council. The key conclusions were:

- The budget planning assumptions and figures were sound
- The Council's financial resilience is not sustainable over the short or medium term unless it identifies and implements the Full scale of savings required as soon as possible to match its currently allowed income profile going forward.

1.20. CIPFA confirmed that the Council could not manage until 2019/20 through reliance wholly on reserves, which are already somewhat depleted. Furthermore they advised that any service reductions not yet planned would only have a part year impact in 2017/18 due to the need for public consultation and equality impact assessment ahead of implementation. They estimated only a quarter year effect of savings not already planned.

Reserves and balances

1.21. The Council holds general balances that allow the council to respond to unexpected emergencies and earmarked reserves set aside for specific purposes. Between 2009-12 this council sensibly increased the level of reserves in anticipation of austerity impacting. Since 2012/13 the Council has applied £110m of reserves to support the Budget. As explained below, it is the view of the Director of Finance that the level of reserves are now at a minimum safe level in light of the continuing and significant risks facing the council in terms of on-going increasing demands and limited local ability to manage the level of funding to keep pace with growing service demands.

1.22. The final accounts for 2015/16 show available general balances at 31 March 2016 of £21.3m. The latest budget monitoring position for 2016/17 forecasts that this level will be maintained at £21.3m by 31 March 2017. Appropriate levels of general balances are necessary to be maintained so that the Council can respond to unexpected emergencies. In recent years this balance has been set at between 2.0% and 2.5% of the sum of council tax and settlement funding, i.e. £16m to £20m. Although the current expected level is marginally in excess of this, the Director of Finance considers this prudent in view of the increasingly high level of service reductions and efficiencies required for the last 6 years (the average between 2010 and 2015 was around £66m, and this was consistently delivered), but this has increased to £83m for 2016/17 and as at 30 November 2016 only £63m of that is forecast to be delivered

1.23. Details of all the Council's earmarked reserves are set out in Appendix 7. These are funds set aside for specific purposes and agreed by the Cabinet.

The forecast total balance for all earmarked reserves carried forward at 1 April 2017 is £60m, down from £102m brought forward on 1 April 2016.

Risks and mitigating actions

1.24. In response to the significant challenges that the Council is facing and the associated emerging risks, an integrated risk framework is well established across the Council and will be maintained. The risk governance arrangements are well embedded and the close link between risk registers and business impact analyses and continuity plans has been sustained throughout 2016/17 and will continue into 2017/18. 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 and Audit and Governance Committee quarterly in 2017/18.

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

- constraints in the ability to raise local funding and/or distribution of funding;
- increased reliance on integrated working, partnership working and implementing new models of delivery to manage service delivery, optimise efficient service delivery and respond to the strategic infrastructure challenges facing the county;
- the on-going uncontrollable growth in demographic demands on services.

1.26. After seven years the risk of non-delivery of efficiencies and service reductions is increasing and to recognise the risks inherent in the budget assumptions set out above, a number of mechanisms are in place to help manage these risks, including:

- monthly reporting to Cabinet on budget monitoring forecasts within three weeks of the period end and including remedial management action where required;
- the operation of a robust risk management approach;
- the presence of the council's key internal control framework, including the financial regulations and Scheme of Delegation for Financial Management which provides the framework for delegated budget management;
- the sustaining of good working relations with the external auditor (Grant Thornton);
- the operation of the internal audit function and its role in assessing controls and processes to highlight any major weaknesses and advise on best practice, and;

- the continuation of robust arrangements to track and monitor demand growth, the delivery of new savings and determine any additional measures necessary.

Proposed and substitute budget

1.27. Despite determining a £170m savings programme for the next three years including £93m in 2017/18, the intensity of its pressures, desire to minimise service cuts and its loss of Government grant mean the Council does not balance its budget in 2017/18 or the subsequent years of the MTFP (£30m 2017/18, rising to £41m in 2018/19 and rising further to £73m by 2019/20). In setting council tax strategy, the council proposes to balance its 2017/18 budget and to achieve a long term sustainable financial position (up to the next decade), through a council tax rise of 14.99% (including 3% ASC precept), followed by a total of 4.99% in 2018/19 and 1.99% in 2019/20 in line with existing flexibilities.

1.28. This level of council tax increase proposed for 2017/18 breaches the limit set by the Secretary of State for the Department of Communities and Local Government (DCLG) (and will require a referendum on 4 May 2017. If not supported, the council tax increase will be 4.99%. Since the referendum must take place after the financial year has started, the substitute budget would have less than a full year in which to achieve the service reductions required to produce a balanced budget for 2017/18.

Prudential Indicators

1.29. 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, to which the council must adhere. In accordance with the current Treasury Strategy, which was updated and approved in July 2016, the Council has not entered into any additional long-term borrowing during 2016/17. Short-term borrowing from other local authorities has been used to manage cash-flow requirements.

1.30. Looking ahead in to 2017/18, it is planned to continue the strategy of maximising internal borrowing in order to minimise cash balances and borrowing costs.

Conclusion: Proposed budget

1.31. In agreeing the proposed budget the Council would effectively ‘re-set’ the level of baseline funding and **it is the Director of Finance view that this would mean the council’s finances become sustainable for the long term future so long as the substantial planned on-going service efficiencies and transformations totaling £93m are delivered.** This years’ experience of difficulty in delivering year on year service reductions requires that the current, already minimum safe level of reserves and balances are retained going into 2017/18.

Conclusion: Substitute budget

1.32. The substitute budget that the Council will be required to implement if the proposed budget is not supported through the referendum represents a very serious threat to the council’s financial sustainability. As well as **requiring significant additional savings** to be identified in detail (a further £30m for 2017/18 rising to £41m for 2018/19 and £73m for 2019/20), **the need to implement this budget part way through the year exacerbates the seriousness and means that the £30m would need to be found over only 10 months.** In reality probably even less time due to the inevitable consultation and other processes that would be required for actual implementation in the event of a failure to carry the proposed council tax increase.

1.33. **It is the view of the Director of Finance that the substitute budget includes significant risk of not balancing as additional and material service reductions, in addition to already stretching service reduction plans, are required to be delivered and have not at this stage been identified.** Although the Cabinet plan to require members to lead a process to confirm the additional service cuts to identify a balanced budget and make progress towards a sustainable budget in the event of the substitute budget being required, in reality some of these savings are likely to be one off or only capable of delivering part year savings in 2017/18, clearly one off savings in 2017/18 are of limited help in moving the Council towards a sustainable position. It is the view of the Director of Finance that the Council will be required to make a **significant unplanned use of earmarked reserves** in particular in 2017/18 in the possible range of £20m to £30m. This will take reserves **below the safe minimum levels advised by the Director of Finance unless they are replenished in the following year,** especially those earmarked for other purposes. To achieve that and the more underlying challenge of sustainable service spending and finances will require a fundamental review of the delivery of all council services.

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