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

Introduction

2.1. 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.

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

2.3. The Chief Finance Officer for the County Council is Sheila Little (in the post of Chief Finance Officer and Deputy Director for Change & Efficiency Directorate).

2.4. 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.

2.5. 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 (MTFP) (2012-17) and which continues as a core principle as the council moves forward to the next 5 year MTFP (2013-18).

2.6. Although the Council has successfully delivered significant efficiency savings & service reductions in each of the last two financial years (2010/11 £68m, 2011/12 £61m, and is forecast to deliver further savings for 2012/13 of £66m, the budget assumptions for the next MTFP (2013-18), includes significant further savings of £240m, making a total of around £435m over the eight year period. The level of savings delivered so far 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 (2013-18).

2.7. Further significant risk exists due to the following.

- The continuing unprecedented level of economic uncertainty: austerity seems likely to continue for at least the next 5 years.
- The introduction of the revised basis of local government funding. The changes to council tax benefit localisation support and the local retention of business rates increases the uncertainty around the level of actual funding the Council will receive in the future.

2.8. The Council is correctly focused on long term financial resilience and is proactively planning to apply one-off general reserves & balances totaling £18m to achieve a balanced budget in 2013/14 (as set out in paragraphs A86 to A91) plus a further £5m from balances to increase the risk contingency for 2013/14. The Council recognises that existing long term strategies are required to address this additional shortfall from 2014/15 and the plans to review the revenue and capital programme after the first quarter of 2013/14 will cover this.

2.9. 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 the first time, it is expected that around £5m of the £8m risk contingency will be required in 2012/13 indicating, as anticipated, that it is getting harder to deliver and sustain this year on year high level of new efficiencies. To mitigate against these risks, the Council proposes to increase the risk contingency to £13m for 2013/14 using balances.

2.10. The above risks apply where the Council continues with its long term MTFP strategy of annual council tax increases of 2.5% annually (except for 2011/12 where the Council accepted the first council tax freeze grant offer and 2012/13 where the Council increased council tax by 2.99%). However, accepting the Government's offer of a grant to compensate councils for not increasing council tax in 2013/14 with a grant equal to 1% council tax increase for each of two years (making a total grant over two years of £11.6m) for this Council, would mean it would be unable to sustain its MTFP plans without either:

- imposing significant council tax increases in 2014/15 and subsequent years; and/or
- developing alternative long term strategies to address reducing government grant funding and limited increases in council tax; and/or
- making additional reductions to front line services.

2.11. The forward assumption of increasing council tax by 2.5% for each of the subsequent MTFP years beyond 2013/14, is potentially optimistic in view of government's stated strategy to maintain zero council tax increases for the remainder of the current parliament and the prescriptive guidance set out in the Localism Act 2011 on how an authority must conduct a referendum if triggered. Together with the high level of service reductions & efficiencies required in the remaining four years of the MTFP beyond 2013/14, the Chief Finance Officer recommends that the Cabinet review the plans to deliver these efficiencies early in 2013/14 to be assured that these plans are sustainable and will not lead to the erosion of the Council's financial resilience.

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Financial management arrangements

2.12. In 2012 the Council was an award winner in the transparency category for its quarterly close process: a rarity within the public sector. This positions the Council well to achieve a smooth annual audit. An unqualified opinion on the 2011/12 financial statements and an unqualified conclusion on the council's arrangements for securing value for money was achieved in 2011/12. The 2012/13 external audit will be the first under the newly appointed auditor, Grant Thornton. The Chief Finance Officer is working closely with the new auditors to ensure a smooth transition.

2.13. 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.

2.14. The system for monitoring the progress on the implementation of efficiency savings has been enhanced during 2012/13 in recognition of the increased risk due to the continued high efficiency targets year on year: increased focus on efficiencies by the chief executive and senior officers before onward reporting and scrutiny by the Leader and Cabinet as well as Overview Scrutiny Committee. This will continue during 2013/14 alongside the on-going monitoring of the delivery of the efficiencies identified as part of the Public Value Review (PVR) programme, completed during 2012.

2.15. Throughout 2012/13 the Council Overview Scrutiny Committee, comprising the Chairmen of all other Select Committees, continued to scrutinise all Cabinet budget monitoring reports following presentation to Cabinet. The capital monitoring was enhanced during 2012/13, with more focused review by the chief executive and senior officers each month, in advance of formal reporting to Cabinet.

2.16. The above approaches will be continued into 2013/14 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 2013/14.

Budget process

2.17. The budget planning process, established in 2011, following a 'lean' process review, was developed further for this MTFP (2013-18) process. The main enhancements were:

- introduction of an earlier 'scene setting' phase ahead of scenario planning
- additional face to face engagement with the business & voluntary sector communities, and trade unions
- additional all Member briefings at each phase

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- enhancement of resident engagement - through Simalto survey
- further embedding of procurement efficiencies into the process.

2.18. 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 2012 and into January 2013, guided by advice from the Chief Executive, Strategic Directors and Chief Finance Officer

MTFP (2013-18) Budget assumptions

2.19. Table 2.1 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.

Table 2.1 Main budget assumptions 2013/14 to 2017/18

	Assumption	**Comments**
Pay inflation	2013/14 *1.5%* 2014-18 *2.0%*	These proposals follow a three year pay freeze.
General price inflation	2013-15 2.1% 2015-18 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 has been central to developing the MTFP 2013-18. Consultation with government has been extensive throughout 2012 and a range of likely outcomes modeled in the Council's scenario planning.
Interest rates	Minimal changes in base rates during 2012/13	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 0.7% Sector, our treasury management advisers, forecast minimal changes in rates until at least mid 2014 and then gradual, low increases.

	Assumption	Comments
Capital receipts	£50m (to fund programme over 5 years 2013-18)	The list of proposed disposals includes only assets that do not fit with the capital strategy of investing in the Council's 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	Demand pressures in Children, Schools & Families and Adults Social Care	Both Children, Schools & Families and Adults Social Care are experiencing increasing demand on services over the MTFP period reflecting: • increases in Surrey's population aged +80, dementia care in particular; • increases in Surrey's school age population; • legislative changes affecting vulnerable adults' entitlement and eligibility for support from the council; • increases in the number of looked after children and in particular those with a care protection plan. There is an increasing risk that these demand pressures may be understated, leading directly to the need to sustain an increased risk contingency of £13m in 2013/14.
Efficiency and other service savings	£240m	Efficiency & service reductions 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 going to be very challenging to implement. In addition there is a further £79m in savings and reductions to be identified and implemented by 2017/18.

2.20. 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. To mitigate this risk, the contingency sum built into the revenue budget has been increased from £8m to £13m for 2013/14.

2.21. 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 2013/14. As in 2012/13, 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

2.22. The final accounts for 2011/12 show available general balances at 31 March 2012 of £28.8m: a deliberate increase from previous years in anticipation of smoothing spending over the MTFP period. The latest budget monitoring position for 2012/13, as at the December 2012, forecasts that this level will remain at this level at 31 March 2013 and as detailed above, £12m of these general balances and £11m of carry forward reserves will be applied to the budget as one-off funding for 2013/14. Other adjustments to earmarked reserves, as set out in Annex 1A – Appendix A7, are recommended to preserve the Council's future long term financial resilience. This is particularly critical as government grants are expected to continue to reduce at the same time as local government funding becomes increasingly uncertain and service demand levels become increasingly volatile.

Financial Standing

2.23. 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 (2013-18) 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.

2.24. The Council had £18.6m placed on deposit with two Icelandic banks, which has been at risk following the administration of these banks in October 2008. The Audit & Governance Committee has received regular updates on the progress in, and prospects of, recovery of the deposits that are at risk. The Council has now received repayment of £13.4m (84% for Glitnir and 50% for Landsbanki bank) and legal rulings have concluded that the remaining funds will be received in due course. The Chief Finance Officer therefore advises that it is acceptable to close the Financial Investments Reserve of £9.5m set up to mitigate against possible losses.

2.25. The County Council maintains a number of other earmarked reserves. This includes existing funds to smooth the cost of replacing vehicles and IT equipment, to provide a source of funds for internal investment, to protect against interest rate changes and the impact of an economic downturn, together with a new reserve to facilitate long term investment aimed at maximising long term financial resilience. There are sufficient funds in these reserves to meet expenditure likely to fall on them during 2013/14 and are available for other uses in case of emergency.

Risk Assessment

2.26. The Council has recently been shortlisted for a national award for its corporate governance arrangements, which recognises improvements made.

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 2012/13 and will continue into 2013/14. 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 2013/14.

2.27. The specific risks 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;
- delivery of the waste infrastructure; and
- changes to health commissioning.

2.28. The Chief Finance Officer is satisfied that the proposed budget, including increased risk contingency, general balances and reserves sufficiently address these risks Additional resilience has been assured over the long term through the creation of new earmarked reserve for long term investment and infrastructure initiatives.

Future years

2.29. 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 2013/14 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.

2.30. 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 round will introduce further government grant cuts, meaning any changes to services over the MTFP (2013-18) period must be sustainable in the long term.

Conclusion

2.31. 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:

- the achievement of efficiencies & service reductions year on year;
- the transfer of uncertainty regarding the level of funding to local authority as result of the local government funding changes introduced from April 2013;
- the volatility implicit in the level of service demands; and
- the current economic situation and expected long term austerity faced by the country.

2.32. The above means a review of the MTFP (2013-18) is recommended after quarter one 2013/14 to validate assumptions and timescales.