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

Summary

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 in view of the on-going 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 and February 2017, the Director of Finance indicated that the although the level of risk remained significant and the position in each year was very serious, it was her view that the budget proposals recommended by the Cabinet for 2016/17 and 2017/18 would each produce a balanced budget that was deliverable, although extremely challenging. However, these reports also made it clear that the longer term sustainability of the council was dependent upon the development and implementation of robust transformation activities that deliver base budget reduction in costs. Whilst considerable changes have been made and efficiencies and cost reductions delivered (£542m since 2010, including an estimated £79m in the current financial year), the scale of transformation needed to deliver a sustainable longer term financial position remains to be developed.

1.5. Therefore, this report goes further. Although it is the view of the Director of Finance that the budget proposals recommended by the Cabinet for 2018/19 will produce a balanced budget, this has required an unprecedented level of one-off funding in the form of:

- use of capital receipts flexibility of up to £15m to fund transformation initiatives;
- estimated growth gain of £20m from participation in the Government's 100% Business Rate Retention pilot during 2018/19, and;
- use of up to £24m of council reserves.

1.6. Together the above one-off funding contributes to the short term financial stability of the council and are aimed at supporting the council to progress towards a sustainable position. However, this level of one-off funding (up to £59m) to balance the budget in 2018/19 is not repeatable in 2019/20.

1.7. In last year's equivalent report, the Director of Finance stated that the level of reserves at around £66m were at the minimum safe level. To enable a stable and balanced budget for 2018/19, the council will need to use a further £24m reserves, bringing the level to an estimated £42m. Although this is now below the minimum level the Director of Finance considers appropriate in the context of the risks and uncertainty facing the council in terms of funding beyond 2019/20 and service pressures, it will help ensure a balanced budget for 2018/19 while the council invests in becoming sustainable for the longer term. The need to replenish these reserves will be considered very closely during 2018/19 and ahead of setting the budget for 2019/20.

1.8. The continuing demand pressures and reducing grant funding from central government have required the council to make savings of over £540m since 2010. A further £66m will be required to be delivered in 2018/19 to ensure there is no further call upon reserves in year. Although this level is around the average level of savings the council has been achieving in most years, the Director of Finance recognises and is concerned that repeating this level of savings yet again is becoming even more challenging. The Director of Finance therefore requires that the action plans to achieve these savings are monitored regularly by leadership of the council throughout the year.

1.9. The experience of the forecast overspending in 2017/18 is due to a mix of savings not being achievable, and demand and cost pressures being greater than forecast in the budget. Managing these demand pressures within the budgets for 2018/19 is essential to sustain a balanced budget. Therefore the Director of Finance requires that the pressures assumed in the budget are closely monitored by the council's leadership along with the savings.

1.10. Looking ahead to 2019/20, the current estimated shortfall in funding compared to spending plans is £86m and at this stage the Director of Finance has no realistic expectation that funding levels assumed for 2019/20 will alter sufficiently to change her view that significant service transformation is needed by the council to set a balanced budget in that year. To illustrate this point, even if the council did secure acceptance into the 100% business rates retention pilot programme for a second year in 2019/20 (where the growth gain might be expected to be around £20m), and if the Government did not implement their current stated intent to apply negative RSG to the value of £17m for the county council in 2019/20, the funding shortfall would remain serious and would exceed £40m.

1.11. There is therefore an increasingly urgent need for the development and implementation of a robust wide ranging transformation programme if the council is to set a balanced budget in 2019/20. This programme must be established and underpinned by sound governance and caution against optimism bias well ahead of setting the 2019/20 budget.

Introduction

1.12. 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 as set out in the following sections.

Economic and financial position

1.13. 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.

1.14. The Government again announced the Provisional Financial Settlement relatively late, 19 December 2017. There was some improvement from the level of funding that was anticipated, specifically:

- the increased flexibility to raise core council tax by an additional 1% over assumptions without triggering a referendum (this is equivalent to around £7m in the base budget); and;
- the success of the county's application to be a 100% business rates retention pilot and thereby retain an estimated £20m business rate growth as a one off.

1.15. However, the council is still dependent upon significant other one-off funding to produce a balanced budget and another (eighth) year of significant service reductions and efficiencies (£66m).

1.16. The Provisional Settlement reflected the Government's assumed take up by councils of the increased core council tax flexibility which means that the Core Spending Power calculation now reflects an even greater reliance on locally raised funding from council tax and business rates, as distinct from Government grant. It is important to be aware that this increases the uncertainty of future funding as the council receives the actual levels of council tax and business rates collected, which can be variable. The impact is that there is less certainty over a significant proportion of the council's budget than in the past.

1.17. Other than the above, the immediate implications of the announcements in the Provisional Settlement were relatively minor in the short term, and do not impact materially on the council's financial positon for 2018/19. However, looking ahead the Provisional Settlement did indicate that several consultations will take place during 2018/19 that could have significant impact from 2020/21 and it is therefore important that the council actively contributes to these consultations, including:

- 'Fair and affordable' consultation on negative RSG;

- Green Paper on Adult Social Care, and;
- Fair Funding Review formal consultation and technical papers.

1.18. At the same time as funding levels reduce and become increasingly uncertain, 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.

1.19. Since September 2017 the Council has been forecasting a significant in year over spend on the revenue budget, £19m as at the end of November if no actions to contain expenditure were implemented. Since then the Acting Chief Executive and Directors have reinforced a series of measures initially put in place last financial year to stop or delay expenditure. However, at this relatively late stage in the year the current year's budget remains forecasting a significant overspend. The underlying pressure in this year's budget has been reflected in the pressure assumptions in setting 2018/19 budget to ensure this is as robust and realistic as possible.

1.20. Although the Council has made over £540m of savings and service reductions since 2010, 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 shortfall in delivery against savings target of £104m in the current year (estimated to deliver £79m in 2017/18) demonstrates the challenges and emphasises the need to caution against optimism bias.

Financial Resilience Review

1.21. The core conclusions of the Financial Resilience Review carried out the Chartered Institute of Public Finance and Accountancy (CIPFA) in 2016 at the request of the Director of Finance, supported by the Chief Executive and Leader, were that:

- 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; and
- that the Council could not manage until 2019/20 through reliance wholly on reserves, which are already somewhat depleted.

1.22. These have been considered in setting the 2018/19 budget and will continue to be reflected upon in the development of the transformation programme in 2018.

Reserves and balances

1.23. The Council holds general balances that allow it to respond to unexpected emergencies and earmarked reserves set aside for specific purposes. Between 2009 and 2012 this council sensibly increased the level of reserves in anticipation of austerity impacting. Since 2013/14 the Council has applied £103m of reserves to support the Budget. As explained below, it is the view of the Director of Finance that the level of reserves are 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.

1.24. The final accounts for 2016/17 show available general balances at 31 March 2017 of £21.3m. The latest budget monitoring position for 2017/18 forecasts that this level will be maintained at £21.3m by 31 March 2018. 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. £17m to £21m. Although the current expected level is at the high end 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 six years.

1.25. Details of all the Council's earmarked reserves are set out in Appendix 9. These are funds set aside for specific purposes and agreed by the Cabinet. The forecast total balance for all earmarked reserves at 1 April 2018 is £42m, down from £65m on 1 April 2017.

Risks and mitigating actions

1.26. 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 2017/18 and will continue into 2018/19. 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 2018/19.

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

- Further reductions in funding, due to constraints in the ability to raise local funding and/or distribution of funding, results in significant adverse long term consequences for sustainability and service reductions leading to significant implications for residents.
- Failure to achieve the MTFP, which could be a result of:
  - not achieving savings

- additional service demand and/or
- over optimistic funding levels

and as a consequence, lowers the council's financial resilience and could lead to adverse long term consequences for services if Members fail to take necessary decisions.

1.28. After eight years the risk of non-delivery of efficiencies and service reductions has increased and to recognise the risks inherent in the budget assumptions set out above, a number of mechanisms continue to be 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);
- ongoing member development programme to ensure that all members have the skills and information they need to understand the challenges facing the council;
- significant focus on income generating activities through an enlarged property investment programme and optimising use of the council's existing property assets;
- 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.

Capital Strategy

1.29. The recently revised Prudential Code requires the Director of Finance to report explicitly on the affordability and risk associated with the capital strategy.

1.30. The Council continues to invest in its infrastructure and local economy and this is reflected in the continued high levels of capital expenditure plans. The Council has restricted the types of capital scheme that it is prepared to borrow to fund to those schemes that are focused on avoiding a future revenue cost or that will generate a revenue saving, as a means of minimizing the ongoing revenue impact of borrowing decisions.

1.31. However, borrowing levels and the cost of borrowing are planned to rise due to the Council's investment strategy. The purpose of the investment strategy is to increase the Council's longer term financial resilience by generating a reliable income stream to support the Council's budget. Therefore, the increase in borrowing and the costs associated with borrowing, are partly mitigated by revenue savings and additional income generation.

1.32. The Council has well established processes for the governance and approval of capital expenditure included in the capital programme. These have proved effective in recent years in ensuring the delivery of the Council's capital programme. The Investment Board and the Shareholder Board (both established in 2013/14 to ensure the effective management of the Council's investment strategy, ensuring all commercial investment activities are entered into in accordance with the Council's governance framework, having due regard to risk and proportionality.

1.33. Central government has recently consulted upon changes to the reporting and accounting arrangements for local authorities' investment in commercial properties and economic development. The Government has yet to announce its proposals following this consultation and the Director of Finance believes the council should not change or amend policies on the basis of a consultation. However, this may become necessary and will be monitored.

1.34. Linked to the Council's capital expenditure plans, is the Council's approach to treasury management activities; its borrowing and investment strategies. The treasury management strategy proposed for 2018/19 is consistent with that applied in previous years and ensures that the Council adheres to the statutory requirement to give priority to security and liquidity over yield for its treasury management investment activities.

1.35. These inter-related controls and policies demonstrate that the Council's capital expenditure and investment decisions properly take account of stewardship, value for money, prudence, sustainability and affordability, by setting out the long term context in which capital expenditure and investment decisions are made, and by giving due consideration to both risk and reward and impact on the achievement of priority outcomes.

Conclusion

1.36. It is the Director of Finance's view that the combination of the need to deliver, again, a significant level of in year savings and service reductions, manage down service demands whilst developing a robust, wide ranging and early transformation plan to change how services are delivered from 2019/20, represent a very serious capacity and financial challenge to the council in 2018/19. All of these are required for the council to be in a position to set a balanced budget in 2019/20 and move towards becoming sustainable in the longer term.

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