Section 25 Report from Chief Financial Officer

Section 25 of the Local Government Act 2003 requires the Chief Financial Officer (the Director of Corporate Resources) to report to the County Council when setting its council tax on:

- the robustness of the estimates included in the budget, and
- the adequacy of the financial reserves in the budget.

The County Council is required to have regard to this report in approving the budget and council tax. It is appropriate for this report to go first to Cabinet and then be made available to the County Council in making its final decision.

Section 25 concentrates primarily on the risk, uncertainty and robustness of the budget for the next financial year rather than the greater uncertainties in future years. Given the significance of the Revenue Support Grant reductions announced to the end of the decade, this report considers not only the short term position but also the position to 2019/20 in the context of the County Council's current Medium Term Financial Strategy (MTFS) and the Transformation to 2019 (Tt2019) Programme.

Robustness of Estimates in the Budget

The budget setting process within the County Council has been operating effectively for many years and is based on setting cash limits for departments each year allowing for pay and price inflation and other marginal base changes in levels of service whether these be the increasing cost of social care or the requirement to make savings to balance the budget.

Individual departments are then required to produce detailed estimates for services that come within the cash limits that have been set. More recently, the requirement to make savings has dominated the budget setting process and major transformation programmes have been put in place to effectively and corporately manage the delivery of savings within the required timescales.

Appropriate provisions for pay and price inflation are assessed centrally with departmental input and are allocated to departmental cash limits. Specific inflationary pressures within the financial year are expected to be managed within a department's bottom line budget but contingencies are still held centrally in the event that inflationary pressures have a severe impact in any one area (e.g. energy costs).

Separate work is also undertaken to assess the demand led areas of service provision, which mainly relate to:

- Adults' Social Care
- Children's Social Care
- Waste Disposal

Any requirement to increase budgets in these areas is considered corporately and may require additional savings to be made across the board to meet the increased demand. This is seen as a more effective way of managing cost pressures and enables strategic decisions to be made about allocation of resources and the impact on service provision rather than all of those decisions potentially being made in isolation by each department.

Budget management within the County Council remains strong as demonstrated by the outturn position each year since austerity began and as reflected in the annual opinion of the External Auditors who has given an unqualified opinion on the annual accounts and in securing value for money / financial resilience.

A further £98m of savings were removed from the budget in 2017/18 and current monitoring indicates that most Departments are working effectively within the reduced resource envelopes including adult services where £13m of savings were approved to be deferred with the department required to meet the shortfall from reserves in the intervening period.

Of most significance is the continued increase in the number and cost of children looked after which shows a further pressure of £7.6m at the end of the year despite a £9.5m cash injection at the beginning of the year. This issue is explored in more detail later in this report.

Budget 2018/19

The budget for 2018/19 has been produced in line with the process outlined in the section above and therefore I am content that a robust, Council wide process has been properly followed and driven through our Finance Business Partners working with the Operational Finance Team. Further oversight is then provided by the Head of Finance and myself in presenting the final budget and council tax setting report to Cabinet and County Council.

The budget relies on a net draw from the Grant Equalisation Reserve (GER) of some £29.1m. Whilst significant this is entirely in line with the MTFS that has been put in place during this period of austerity and which provides the time and capacity to properly deliver major savings programmes every two years, with deficits in the intervening years being met from the GER. The lack of any requirement for savings targets for 2018/19 also adds further confidence to the budget setting process.

Once again, the robustness of the budget is underpinned by adequate contingencies for volatile areas such as social care as well as by the existence of departmental cost of change reserves, which can be used to meet unforeseen costs during the year as well as providing funding for investment to achieve transformational savings, for 2018/19 this will include funding generated by the early delivery of Tt2019 savings.

Risks in the Budget 2018/19

In some respects the significant changes to local government finance since 2010 have changed the profile of risk faced by most authorities. In reality the biggest financial risks now relate purely to reductions in government funding, changes in government policy and social care demand and cost pressures. These items together with other traditional risks are outlined below:

a) **Government Funding and Policy** – The MTFS includes the announced reductions in government grant over the current spending review period and plans are in place to deliver a balanced budget by 2019/20 based on the Tt2019 Programme . The four year settlement announced following the spending review had a massive impact on those projections, but these have been incorporated in the MTFS and the Tt2019 Programme takes this into account.

Following acceptance by the Department for Communities and Local Government (DCLG) of the County Council's Efficiency Plan for the period to 2019/20, the expectation was for minimal change for 2018/19 when the Provisional Local Government Finance Settlement was announced in December; which was the case. Other significant changes to funding or policy during the year would have to be covered by contingencies or general balances, but generally once grant levels have been set in the final settlement due in January they do not change, although there have been in year changes implemented previously, for example reductions to the Public Health grant.

b) **Social Care Demand Pressures** – Up to the end of 2014 there was a significant and sustained increase in the number of Children Looked After (CLA) across the County, mainly as a result of increases in referrals from other agencies. This was reflected in a £12.5m base budget increase for Children's Services in the 2015/16 budget. Since January 2015 positive management action underpinned by innovation grant monies from the DfE has changed the trajectory and generated a reduction in the numbers of children in care.

This has enabled the Department to meet its Transformation to 2017 (Tt2017) Programme savings target in respect of reduced placement costs, however over the Summer 2016, numbers began to rise again, partly due to Unaccompanied Asylum Seeking Children (UASC) and partly due to the courts placing more children at home (which still counts as a CLA). Inevitably with the overall increase in numbers of CLA cases, we are also dealing with higher numbers of care leavers who have greater expectations following legislative changes.

A further base budget increase of £9.5m was added to the budget for 2017/18 which took into account annual growth of around 5% in CLA numbers and a provision of around £3m a year was made in the MTFS. Continued higher growth in the current year coupled with increasing costs due to demand outstripping supply across the country has led to a predicted £7.6m pressure in the current year which will inevitably have an impact on the funding required for future years. At this stage, I am comfortable that the 2018/19 budget contains sufficient contingencies and flexibility to deal with the increased level of CLA costs, but a further review of this area will be undertaken in order to inform the next update of the MTFS over the summer.

In a similar process to Adults' Services, regular monthly meetings are now held with the Director of Children's Services to consider pressures and financial planning for the Department and this group will continue to look in detail at the CLA position as the year progresses.

Adults' social care is traditionally a far more volatile picture given the significant numbers involved and the significant ongoing changes to the client base. A major piece of work was undertaken as part of the 2016/17 budget setting process using detailed activity data to predict future activity and average costs. A long term strategy for managing social care finances alongside the delivery of savings and changes to the operating model was also approved at this time.

Additional funding has been made available to Adults' Services to reflect the increasing costs of care and adequate contingency provision has been provided centrally to cope with unexpected fluctuations in demand during the year. However past experience has shown that Adults' Services have been effective in managing demand against budget to achieve a balanced position by year end and enhanced monitoring in this area will continue to inform that process and highlight any early warning signs that may then need to be corrected.

This will include potential risks associated with the delivery of Tt2019 savings, early delivery of which is currently planned to provide resources in advance of need to help fund transformational change to generate the next round of savings and help to cash flow delivery of the Department's savings. Due to the nature of adult's social care in particular, it is not always possible to distinguish whether or not cost pressures arise due to further increased demand or the potential failure to have delivered a savings proposals and therefore it is necessary to manage the total budget against total activity and demand within the system, which is already in place and should highlight issues irrespective of how they have arisen.

c) **Council Tax** – The government have granted additional flexibilities in relation to council tax that allow local authorities with responsibility for adult social care to raise the social care precept by up to 3% on top of the 3% general increase in 2018/19 and 2019/20 (increased from 2%) without the need to hold a referendum. The Cabinet is recommended to take up the offer of the extra flexibility for the social care precept as agreed within the MTFS and in addition to agree a general increase of 2.99% which will generate an additional sum of £5.7m.

d) **Pay and Price Risk** – Pay inflation has been capped for some time and the MTFS contained provision for a general pay award of 1% and also allowance for the impact of the National Living Wage (NLW) in line with government policy. Subsequently there has been a two year pay offer for local government workers, which includes a 'core' increase of 2% and changes to the lower pay scales to reflect the impact of the NLW. The overall increase in the pay bill could be in the region of 6% over the two years, and is above the allowances made within the MTFS. Depending on the final pay award that is agreed this could mean additional recurring costs of circa £5m will need to be met by 2019/20.

Until the pay deal is concluded it is not possible to quantify the final impact but the budget includes provision within contingencies for an overall increase in the pay bill of 3% (a 'core' increase of 2% and changes to the lower pay scales to reflect the impact of the NLW) and the provision for future years will be reviewed when the MTFS is updated next year.

Increases in employer pension rates are also a factor that can impact on the budget and the results of the 2016 pension fund valuation and the increases have been built into the financial forecasts moving forward.

Similarly the impact of price inflation has been taken into account in setting the budget and it would take a major departure from the Council's assumptions to create a financial problem that we could not deal with. One exception to this is the impact of the NLW on the costs of social care services in the private sector. It is difficult to predict at this stage what the eventual impact will be given the number of different variables involved and whilst some additional provision has been made for this in the budget this may be an area that affects the price of social care services in the market place during the year and would need to be managed alongside other social care pressures outlined above. To date the provision made has been sufficient.

e) **Treasury Risk** – The County Council has limited exposure to interest rate risk as most long term borrowing is undertaken on a fixed rate. At the present time we are not undertaking any new or replacement long term borrowing due to the significant 'cost of carry' involved and our ability to internally borrow given our high level of reserves and cash balances. However, we do need to be mindful of the fact that we do not want to store up a large value of external borrowing that needs to be taken out in less favourable circumstances as our reserves reduce. Given current predictions on base rate levels and the fact that long term borrowing rates are based on the price of gilts rather than the underlying base rate, this is still considered low risk at this stage.

   On the investments side, the absolute value of estimated income is circa £8m per annum, which is minimal against the County Council's overall budget, however, the change in investment strategy which moved part of the portfolio to medium term investments has increased the risk in the portfolio overall. This has been mitigated by the creation of an Investment Risk Reserve which will deal with any changes in valuations of investment and provide a buffer against any significant drop in returns. Contributions to this reserve are regularly reviewed to ensure adequate provision is made.

The Adequacy of Reserves

The County Council's policy on general balances is to hold a minimum prudent level which on the basis of the previous risk assessment is around 2.5% of net expenditure. The projected level of general fund balances will be 3.0% of net expenditure at the beginning of 2018/19. This in part reflects the declining level of spend, rather than an increase in the level of balances held. However, the level of general fund balances has been reviewed as part of the wider strategy to manage the budget in the medium term whilst the Tt2019 Programme is implemented and in 2018/19 a one-off draw of £1m is planned. After this, general fund balances will be around 2.5% of net expenditure at the beginning of 2019/20.

Overall the level of earmarked reserves and balances that the County Council holds stood at £524.2m (including schools and the Enterprise M3 LEP reserve) at the end of March 2017 and these reserves, the majority of which are held for specific purposes as set out in the Reserves Strategy in Appendix 6, underpin the overall MTFS and capital programme.

Those reserves that are available to support the revenue position are used sensibly to manage change and provide the time and capacity to properly implement savings plans that seek to minimise the impact on service users.

The GER currently stands at over £57m, but this reflects the fact that a net contribution of more than £29m is required to balance the budget in 2018/19 and the fact that a further significant contribution will be required to cash flow the safe delivery of the Tt2019 Programme.

In addition, in order to continue the County Council's strategy of delivering savings over a two year cycle a further significant contribution will be required in 2020/21. As a consequence, where possible, the County Council will continue to direct spare one off funding into this reserve as part of its overall longer term risk mitigation strategy, which has served it very well to date.

Budget 2018/19 – Conclusion

Given the details outlined above, provided that the County Council considers the above factors and accepts the budget recommendations, including the level of earmarked reserves and balances, a positive opinion can be given under Section 25 on the robustness of the estimates and level of reserves for 2018/19.

The Position to 2019/20 and Beyond

Looking ahead to 2019/20, the County Council needs to address a budget gap of £140m by 2019/20. Bridging a gap of £140m after already removing £340m of expenditure is a massive undertaking particularly as each successive savings programme is becoming harder to deliver and many areas cannot be re-visited due to the nature of the revised service models or contractual arrangements that will have been put in place.

As in previous years, the County Council has responded positively to the transformation challenge and savings proposals to meet the £140m deficit were signed off by County Council in November last year subject to any further Stage 2 consultations that need to take place for some proposals.

What is different to previous years however is the fact that the profile of delivery for the savings programme is back loaded with some savings not being delivered at all until well after the 2019/20 financial year. Whilst sufficient resources have been set aside to cover this delayed implementation, it does increase the overall risk in the budget going forward as there will potentially be overlapping savings programmes.

Beyond 2020 the financial landscape will be significantly different and the County Council will no doubt face the biggest ever challenge to its overall financial sustainability which will be impacted one way or another by Government policy on fair funding, business rate retention and the future for adult social care and the growing pressure nationally on children's services.

At this stage however, the County Council must focus on delivery of savings towards 2019/20 and I believe it is well placed to do that at the same time as having realistic expectations around what can be achieved.

Carolyn Williamson

Director of Corporate Resources

17 January 2018