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

Introduction

1. Section 25 of the Local Government Finance Act 2003 requires that when a local authority is agreeing its annual budget and council tax 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. The Council is required to have due regard to this report when making decisions on the budget.

3. In expressing my opinion I have considered the financial management arrangements and control frameworks that are in place, the level of total reserves, the budget assumptions, the adequacy of the Service & Resource Planning process and the financial risks facing the Council.

4. The report is the culmination of the Service & Resource Planning process which commenced in June 2014 in which detailed work has taken place with Councillors, the County Council Management Team (CCMT) and Deputy Directors.

5. Section 25 concentrates primarily on the uncertainty within the budget year rather than the greater uncertainties in future years. However, future uncertainties, particularly around the continuing reductions in funding after 2015/16 and the increasing pressures in demand driven services also inform the need for reserves and balances in the medium term.

Financial management arrangements and control frameworks

6. The Council received an unqualified opinion on both the accounts for the Authority and the Pension Fund for 2013/14. In respect of securing value for money, the conclusions are based on whether the organisation has proper arrangements in place for securing financial resilience and for challenging how it secures economy efficiency and effectiveness. The Council received an unqualified value for money conclusion for 2013/14.

7. The Council has strong governance arrangements in place and a robust assurance process that requires a statement at the year end from the ‘corporate lead officer’ for various key control areas. The Chief Finance Officer has responsibility for ensuring that an effective system of internal control is maintained; to provide an assessment of the current position across

the whole council and identifying areas for improvement where appropriate. Areas for improvement are reported to Audit & Governance Committee and monitored in year through the Corporate Governance Assurance Group.

8. All Officers and Members are required to work within an embedded framework of pre-existing financial management arrangements and structures. The Council has a robust system of budget monitoring and control and the Council's track record for budget management over recent years has been good. Mandatory refresher training for all cost centre managers on financial management roles and responsibilities took place last summer to reinforce key messages and ensure we maintain high levels of awareness.

Level of Total Reserves

9. As well as holding a contingency budget to enable those more volatile budgets to be managed, general balances are also held for unexpected events or emergencies. In reaching a decision on the level of balances I feel are appropriate to be held for 2015/16, I have considered the strategic, operational and financial risks facing the authority including the ability to deliver planned savings, as well as external risks such as the impact of flooding. The recommended level of balances for 2015/16, based on the risk assessment included in Section 3.8.1 of this report, is £17.4m.

10. A further consideration in setting a prudent level of balances and setting a robust budget is the underlying trend of under/over spending against the budget each year. As budgets are reduced more and more, the flexibility to manage pressures arising in one area against underspends elsewhere becomes increasingly more difficult. Although there was an overall underspend of £1.3m in 2013/14, contained within that were underlying overspends in children's social care and adult social care met by supplementary estimates and one-off fortuitous income.

11. The Financial Monitoring report for Cabinet in February 2015 sets out a forecast overspend, based on nine months of actual expenditure of £4.2m, after a virement of £2.8m from contingency to help meet some of the predicted overspend in children's social care and £1.5m use of reserves in adult social care . The underlying overspend therefore is £8.5m. This has reduced from a high back in July of £12.2m as a result of management action. It is expected that further action, including the impact of the vacancy freeze from December 2014 will reduce the forecast overspend further by the end of the 2014/15 financial year. However, it will not mitigate the position in full and use of reserves as well as requests for supplementary estimates will be necessary to meet the remaining pressures in both children's' and adults' social care.

12. Not managing to budgets is of course a concern in terms of financial management and could be seen as a sign of weakness in financial control. However, the reasons for the overspends in both children's and adults is due to rising demand. The increase can be clearly seen, with numbers of looked after children increasing by 47 during 2013/14 to 463 at the end of March 2014. At the end of October 2014 this had risen to 513 and stood at 509 at the end of December 2014. In relation to adult social care, client numbers increased by 10% from 2012/13 to 2013/14. In the current financial year the number of adults with a learning disability in receipt of services has increased from 1,778 in April 2014 to 1,854 by December 2014, an increase of 101 clients.

13. Earmarked reserves are also held for specific planned purposes. They fall into several categories; those retained for departmental or service use; reserves for unspent grants; insurance and capital reserves and schools balances.

14. In assessing the appropriate level of reserves a review is undertaken annually to determine if they are both adequate and necessary. With significant funding reductions and decreasing base budgets, resources have been set aside to help manage change projects which operate over more than one financial year. These include reserves such as those for the Thriving Families programme and for the costs of supporting schools converting to academies. At the end of 2013/14 earmarked reserves were £105m (excluding school reserves). By the end of 2014/15 they are estimated to reduce significantly to £73m; to £43m by the end of 2015/16; and to be around the £31m level thereafter. The expected level of reserves remaining by 2017/18 is adequate for the purposes intended although there is little funding set aside to manage some of the significant change programmes required to meet the savings over the medium term.

15. School reserves are also expected to be significantly lower at the end of 2014/15 than they were at the end of 2013/14. At the point of conversion from a maintained school to an academy, any balances also transfer reducing further the amount held by the council. Schools balances are projected to fall from £25m at the end of 2013/14 to £15m by the end of 2014/15.

16. The Budget Reserve enables cash flow movements to be managed over the medium term and ensure the Council can set a balanced budget each year. This need arises as the pressures and savings profile is different over the medium term. Following the review of earmarked reserves, in 2015/16 the Council will put £4.8m into the reserve from other earmarked reserves returning the Budget Reserve to a positive position from the £3.0m deficit assume in the MTFP. The existing MTFP had assumed that the reserve would also be in deficit of £12.7m in 2016/17. As set out Section 3.5 of this report, the expected shortfall in the Budget Reserve in 2016/17 is now only expected

to be £6.0m. Whilst this a much improved position compared to the existing MTFP, the council cannot hold a deficit reserve. My report to Cabinet in January 2015 set out that based on the current forecast, the temporary use of other reserves or balances such as developer contributions would still be required in 2016/17 to bring the budget reserve into balance. Any temporary use of other reserves or other balances would need to be replaced in a subsequent year. This position will need to be monitored closely and reviewed as part of the next Service & Resource Planning process to ensure the position is manageable.

Budget Assumptions

17. The formation of the 2015/16 budget and indicative budgets for the following two years to 2017/18 have allowed for best estimates of the total financial envelope over the medium term taking into account anticipated unavoidable pressures and the savings then required to match the funding available. In forming the estimates various assumptions have been made. The main assumptions together with an assessment of their risk are set out below:

a) <u>Government grant</u> – revenue support grant is forecast to reduce in line with the decreases seen over the last four years. The MTFP assumes a reduction of 51% by 2017/18 compared to the grant figure for 2014/15. This is in line with the recent statements by the Chancellor and with the figures set out in the Autumn Statement 2014. Top-up grant is assumed to increase in line with the Retail Price Index (RPI).

b) <u>Council Tax</u> – an increase in Council Tax of 1.99% is proposed for 2015/16 within the referendum limit confirmed by the Local Government Minister as part of the Final Local Government Finance Settlement announced in January 2015, and in line with the assumption in the current MTFP. From 2016/17, the MTFP assumes Council Tax increases of 3.0% each year. Whilst this is higher than the current referendum limit, it is beyond the next general election and the next government may have a different view on annual council tax increases. The position will need to be reviewed and potentially addressed as part of the Service & Resource Planning process next year in light of the latest information.

c) <u>Non Domestic Rates</u> – Business rates income for 2015/16 is based on the forecasts provided by the District Councils, with future years assuming growth in line with RPI. This is a cautious assumption given the expected growth in the economy. The 2015/16 budget takes account of the £0.9m deficit on collection for 2014/15, the second year of the operation of the business rates retention scheme. No assumptions have been made about surpluses/deficits on collection for future years as these are difficult to predict, particularly with the uncertainty of the impact of appeals. However, as part of the budget proposals for 2015/16, a new reserve of £0.5m is being created to cushion the impact of future year deficits.

d) Council Tax base & surpluses/deficit on collection – the proposed MTFP assumes increases in the taxbase of 1.0% each year, increased from 0.75% in the existing MTFP. The increase reflects the growth in house building being seen and planned across the county. Whilst the actual increase for 2015/16 is 1.76%, the impact on the future taxbase of the Council Tax Support scheme and Universal Credit remains uncertain. Therefore it is prudent to assume increases of only 1.0% in future. The position is similar with surpluses/deficits on Council Tax collection, where the budgeted sum is proposed to be increased to £3.0m from £2.0m in the existing MTFP, even though the actual figure for 2015/16 is £7.5m.

e) Inflation – pay inflation has been agreed locally for 2014/15 and 2015/16 to match the national position. For 2015/16 the increase is 1%, which after the 1% increase agreed in 2014/15 is in line with the national pay award for 15 months to March 2016 at 2.2%. Increases of 2.5% are assumed beyond then. Contract inflation is provided for up to a maximum of 3% across the MTFP, dependent on the index applied to the contract. Inflation on income from fees and charges is assumed at 2% in each year of the MTFP. General inflation on non-pay budgets has been assumed as zero in each year of the MTFP continuing with the approach introduced in 2013/14. Inflation has been falling over the last few months, with RPI and CPI standing at 1.6% and 0.5% respectively in December 2014. CPI inflation is not expected to hit the government's target of 2% until early 2017.Given this forecast, there is limited risk of inflationary pressures in the 2015/16 budget.

f) Interest Rates – all existing debt is under fixed interest rates so is not subject to interest rate variation and the MTFP assumes an extension of the strategy to borrow internally for prudential borrowing schemes. Prudent returns above the Bank Rate are assumed for 2016/17 beyond which no return above bank rate is assumed. This reflects the consequence that as longer term deposits with higher rates mature, the average rate of return will reduce. With the expectation of a slow increase in the Bank Rate from some time later in 2015, new deposits will be for a shorter duration. There is also some risk around the impact of the EU banking directives on the Council's ability to secure higher rated returns.

g) Capital Programme – the four year capital programme has been developed on the basis of estimates of future capital funding allocations from government grants in addition to use of reserves, capital receipts and S106 funding, with the assumption that the new capital proposals could be met from flexible capital resources available to allocate. Last year there was a late and unexpected significant reduction in the basic need allocations for 2015/16 and

2016/17. A firm programme for 2014/15 was agreed with the expectation that the shortfall would be reviewed and addressed as part of the capital budget setting process this year. The Service & Resource Planning report to Cabinet in January set out how the shortfall in 2015/16 and 2016/17 would be addressed. A shortfall remains in 2017/18 as the basic need funding allocations have not been announced beyond 2016/17.

Service & Resource Planning Process

18. The Service & Resource planning process is well established. The formation of the 2015/16 budget and MTFP has been carried out in conjunction with a refresh of the Directorate Business Strategies to 2017/18. Due to the uncertainties over future levels of government funding following the General Election in May 2015, no government departmental expenditure limits set beyond 2015/16 and a date for the next spending review unknown, it was agreed as part of the Service & Resource Planning process this year not to extend the medium term planning period beyond 2017/18. This timeframe also reflects the period of the current administration. The proposal was to make limited adjustments to the existing MTFP to reflect any changes to spending assumptions, particularly in light of increased demand in children's and adults; social care. In line with the approach taken for Service & Resource Planning, a light touch review of the Corporate Plan to 2017/18 has also been undertaken.

19. There were a number of enhancements to the process which were introduced last year in the formulation of budget proposals. These increased the level of challenge, providing a reasonable assurance of their robustness, and as such have remained in place this year. The key enhancements included scene setting with Cabinet and CCMT in the summer of 2014; wider and earlier cross party councillor engagement; and a new process for Scrutiny Committee

20. Examination of the budget proposals through the Service & Resource Planning process has led to a number of refinements and provides assurance about the robustness of the estimates. Scrutiny of the budget savings has also been considered from an equalities perspective.

Financial Risks

21. Given the reductions in government grant funding, the limitation on the level of Council Tax increases, the growing unavoidable pressures and the scale of savings required, the budget will inevitably contain a degree of risk. The key risks include:

a) <u>Achievement of savings plan</u> – the Council has a good track record of successfully delivering significant savings, having achieved £170m savings by the end of 2013/14 and further savings of £34m planned to be delivered in

2014/15 taking the total savings achieved to £204m. However with further savings of £61m already in the MTFP to be achieved over the next three years to 2017/18, along with an additional £27m now proposed, these further savings of £88m will be more difficult to deliver. Unlike previous years' there is only a very limited amount of money in the Efficiency Reserve to pay for redundancies and for the costs of transformation. There is a risk, if these costs cannot be met from within existing budgets that they will need to be the first call against the savings, pushing back the timing of achieving the savings. In addition, as set out in paragraph 16 above, there is a cash flow shortfall based on timing of the savings plans. It will be important to monitor the delivery of the savings carefully during the year and to review the cash flow position as part of the Service & Resource Planning process next year.

b) <u>Demand led pressures</u> – There are some budgets where client numbers for statutory services are notoriously difficult to control and where a degree of judgment has to be applied to estimate the level of risk to the budget. As set out in paragraphs 11 and 12 above, we have seen a significant increase in demand in both children's and adults' social care over the last year. The financial plans for 2014/15 assumed that the peak in demand would tail off. For children's social care this has not happened and the plans for 2015/16 assume a further increase in demand beyond the current levels. The budget assumes an additional £2.6m beyond the expected overspend at December 2014, around a further 50 looked after children. Even so, there is a risk that the demand will still exceed the budget. The introduction of the Care Act could give rise to significant numbers of clients coming forward for assessment and eligible for care and this will need to be kept under review. To mitigate these high risks, a contingency budget of £3.6m is built into the MTFP. However, this may not be sufficient to meet all requirements and the demand trends will need to be carefully monitored.

c) <u>Financial position of Oxfordshire Clinical Commissioning Group (OCCG)</u> – The Better Care Fund plan was approved by the Health & Wellbeing Board and submitted to NHS England in January. The £38m plan is expected to be approved. The agreement of the plan secures the £8m contribution to the council's budget in line with the assumptions in the existing MTFP and £1.9m for the implementation of the Care Act. Although OCCG are currently forecasting a breakeven position for 2015/16, contract negotiations with the NHS providers have not yet been completed nor has the contribution to the older people's pooled budget and the risk share arrangements been agreed. Cabinet will agree the Section 75 agreement in March 2015 which will confirm both the OCCG contribution to the pool for 2015/16 and the risk share agreements. However, this gives rise to a risk for the council in relation to the older peoples' pooled budget especially in light of the risk of rising demand for social care.

d) Capacity to deliver – over the past few years, the number of staff has been reduced by 30% and the number of senior managers by 40%. Delivering the savings required will be difficult in terms of capacity particularly as the plans are more complex and ambitious. There is also a risk around capacity to delivery of the capital programme with significant targeted government grant through both the City Deal and Local Growth Deals bringing £55m and £119m of grant funding into Oxfordshire respectively.

e) Market Failure –with an increasing amount of work being undertaken either in partnership or through contracts, the financial resilience of providers becomes increasingly important as does business continuity planning. The economic uncertainty in Europe and the low inflation outlook in the UK could put increasing pressure on companies remaining viable.

f) General Election – irrespective of who wins the election in May 2015, it is clear that all parties are committed to the austerity programme. There is a possibility that there will be an emergency budget after the election as there was in 2010, which could further reduce budgets in 2015/16 or cancel investment programmes which have already commenced. There is also a risk that there is no majority government and a coalition or minority government is formed that is unsustainable and leads to another general election within a short time.

g) Borrowing undertaken on behalf of Oxfordshire Local Enterprise Partnership (OxLEP) – part of the City Deal agreement with central government is to deliver £36.5m of infrastructure schemes using growth in business rate yield from the Science Vale Enterprise Zone. As the accountable body for OxLEP, the council will borrow from the PWLB[1] in 2015/16 and 2016/17 when the capital expenditure is incurred and repay the loan (principal and interest) from annual business rate income[2]. As part of the Local Growth Deal 2, OxLEP has secured £20m of the borrowing from PWLB at the Project Rate, which is 40 basis points lower than the standard market rate and therefore a lower overall cost. However, there is a risk that income from business rate growth is not sufficient to meet the cost of the loan repayments and if this happens the council will need to bear the cost until such time as business rate income is sufficient to meet the cost of the repayments.

Robustness of the Budget

22. The proposed budget and Medium Term Financial Plan addresses the demand pressures that are expected to continue into the medium term. It includes estimated reductions in funding to 2017/18 and sets out a plan to ensure that the Council can deliver budgets within estimated available

[1] Public Works Loan Board (or its replacement body)
[2] above the baseline at the date of creation of the enterprise zone in 2011

resources. The savings in the budget build on those approved last year. However, there is limited funding set aside to manage some of the significant change programmes required to meet the savings over the medium term and this could delay the achievement of some savings. The savings plan will therefore require close monitoring to ensure it is delivered on time. Overall, the budget and MTFP set a clear direction for the future and places the Council in a sensible position to meet the challenges ahead.

23. There are risks in the budget largely in relation to certain demand led budgets such as children's social care, which is under significant pressure in the current financial year. There is also a range of pressures and uncertainties in adult social care, particularly in relation to clients with learning disabilities and the impact of the care act. To help mitigate these risks, a contingency budget of £3.6m has been built into 2015/16 which will provide some degree of a safety-net. With ever tightening resources there is more risk in the budget for 2016/17 and beyond and this will need to be reviewed as part of the next Service & Resource Planning process.

24. The level of the Council's total reserves is sufficient to provide both general balances to manage the impact of unexpected events in line with the risk assessment; and the setting aside of earmarked reserves to meet known or anticipated liabilities.

25. Therefore, I am satisfied that the budget proposals recommended by the Cabinet are robust.

LORNA BAXTER
Chief Finance Officer

5 February 2015