STATEMENT ON GENERAL FUND BUDGET STRATEGY
BY THE CHIEF FINANCIAL OFFICER
UNDER S.25 LOCAL GOVERNMENT ACT 2003

Section 151 of the Local Government Act 1972 requires local authorities to make arrangements for "the proper administration of their financial affairs' and appoint a CFO to have responsibility for those affairs. The CFO must exercise a professional responsibility to intervene in spending plans in order to maintain the balance of resources so that the authority remains in sound financial health.

Section 25 of the Local Government Act 2003 (LGA 2003) imposes a duty on the Chief Financial Officer (CFO) to report formally to Council on the following matters:-

- The robustness of the estimates made for the purpose of the calculations (to set the Council Tax).
- The adequacy of the proposed financial reserves.

These specific matters are dealt with below but it is important to set the whole of the 2016/17 budget process in the context of the financial circumstances in which local government finds itself.

This year marks the start of a new CSR period, bringing with it the opportunity to receive a 4 year settlement with indicative allocations already provided in the PLGFS. For the 2016/17 financial year the budget shortfall as published in this report was £33.7M. On the assumption that Full Council implements the balanced budget proposals for 2016/17 set out in the budget report, over the three year period of the Medium Term Financial Strategy 2017/18 – 2019/20 the remaining budget gap stands at £42.3M representing a significant and ongoing challenge to the Council.

Council Tax

There were provisions within the Autumn Statement and PLGFS to allow Council's to implement an additional 2% increase in Council Tax specifically to fund Social Care pressures (Social Care 'Precept'). This 2% increase could be in addition to any Council Tax rise planned within the current referendum framework which allows Council Tax to be increased by 1.99%. In total, this new provision would allow Council tax to be increased by up to 3.99% in Social Care Authorities.

My advice to the Executive has been that given the Council's overall financial position, the financial and demographic pressures faced by Social Care, and the fact that the Executive had already indicated that they were minded to increase Council Tax by the 1.99% referendum limit prior to the announcement of the power to take up an additional 2% Social Care precept, that the opportunity to raise additional income from Council Tax should be taken up, and that a rise of 3.99% would therefore be my recommendation.

However, I recognise that it is for the Executive to determine Council Tax policy and the level of Council Tax rise which it would wish to recommend and implement for 2016/17, and that the Executive's recommendation is for a 2% increase in Council Tax in total, specifically to contribute to funding Social Care pressures.

Budget Methodology

Given the continuing fragility of the economic environment and the scale of expenditure reductions required year on year, there will inevitably be significant risks involved in delivering a balanced budget. Whilst considerable pressure exists on the Council's budget because of the severely reduced level of resources available for local authorities in the future, further advanced forward planning to deliver the budget savings required in the medium term is in preparation and is absolutely essential.

Whilst therefore the basic methodology for putting the budget together at the Council has not changed in this financial year, it must be recognised that the scale of the changes and some of the measures being introduced do increase the risk built into the budget for 2016/17 and beyond. As part of the budget setting process for 2017/18 and onwards a fundamental review of the way in which the Council identifies savings is being undertaken with a potential move to outcomes based commissioning and outcomes based budgeting.

Use of One Off Funding

The level of one off funding already included in the 'base position' totals circa £13M to balance the budget position in 2016/17. As set out in previous years' statements the consistent use of large one off sums to balance the budget is clearly not a sustainable position. Assuming a draw of £3.9M from General Fund balances as a contribution to balancing the 2016/17 budget, the remaining General Fund balance of £8.9M will be close to the minimum level recommended by the Section 151 Officer of £5.5M, and given the ever tightening financial position, the increasing pressures on spend (in particular in social care) and the significant savings to be made in future years, it is difficult to foresee that significant sums of one-off funding will be available in future years to support the budget position.

Medium Term Position

There are significant budget shortfalls in future years as set out in the Medium Term Financial Strategy Report and members must not lose sight of the need to ensure that work is ongoing to redesign the Council in order to build a sustainable organisation going forward and a necessary part of this work will be to develop recurrent savings proposals for future years. As part of addressing the medium term budget shortfall, the MTFS sets out the Councils Efficiency Strategy. Members must be mindful of the need to carefully consider the extent to which one off funding is utilised in order to deliver a balanced budget in any one year.

Budget Risks

There are a number of specific major risks that could adversely impact on the Council's financial position. These are detailed in Appendix 12 – Key Financial Risks.

The 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 to be made available to the Council in making its final decision.

Notwithstanding the above, as required under Section 25 of the Local Government Act 2003 I would make the following formal comments on the Robustness of the Estimates and the Adequacy of Reserves:

A) ROBUSTNESS OF ESTIMATES

Budget setting is made up of several estimates some involving quite complex forecasting. By the very definition of the word, estimates are not factual and the degree of accuracy will not only vary but also take different periods of time to be proven to be correct or otherwise.

Savings Proposals

Over the course of 2015/16 the Executive, supported by CMT, have develop a series of detailed budget proposals the majority of which were published in November 2015. Whilst some figures have changed and proposals have been amended these have been validated by CMT prior to their inclusion in the final proposed budget. There is therefore a high degree of validation inherent within the final budget proposals for these savings.

Further savings proposals in the sum of £8.5M are put forward for consultation within this budget report, and the setting of a balanced budget is based on an assumption that these savings will be implemented in full following consultation. There is a risk that following consultation the final savings which can be delivered will be less than the £8.5M required. If this was to be the case, the budget report provides a delegation to the Section 151 Officer to draw from General Fund balances to balance the budget position.

Any further draw from General Fund balances would increase the level of one-off funding utilised in setting the budget, decrease General Fund balances further, and increase the recurrent budget shortfall in 2017/18 and the level of recurrent savings required to balance the budget.

The largest single budget saving still subject to consultation and further work is the Phase 2 Operating Model saving in the sum of £2.5M for 2016/17. It will be important that Cabinet and CMT progress this proposal and consultation in a timely fashion to ensure that this saving can be delivered in full in 2016/17, or if it is to change following consultation that the implications are reflected in the budget as soon as is practicable.

Budget Assumptions

Key elements within the budget are provisions for inflation on pay and prices, projected levels of income and achievability of savings. Details of these items are included in the reports and have already been through the validation process as set out above. However, there are a number of points to draw out:

i) Assumptions made in all of the forecasts are basically sound. The pay award has been incorporated into the budget for 2016/17 onwards at 1%. Employer contributions to the Hampshire Local Government Pension for current service costs will remain at their current level of 13.1% for the period, 2016/17 to 2019/20. These may need to be adjusted following the triennial actuarial review. The contribution for past service will increase by a known amount each year thereby giving certainty about this cost. Contributions from April 2017 will be reviewed as part of the next actuarial review and the impact will be built into future forecasts.

ii) The scale of the reductions in local government funding has meant that the Council has been forced to look at radical options for reducing expenditure across services. Proposals which involve significant change to current structures, systems and processes, or which have major implications for service design inherently involve higher levels of risk than those which broadly maintain current arrangements. At the most practical level those risks begin with the possibility of slippage and disruption in the transition from old to new arrangements.

The Executives recommendations for savings proposals now total £29.9M.

Individual savings items have been approved by the relevant Directors and Heads of Service and have been subject to scrutiny by CMT. Responsibility for actioning any changes in the budgets will fall to me as Section 151 officer, and all savings approved will be actively monitored throughout the year although responsibility for the delivery of these savings rests with the relevant Director.

iii) The Council's external auditor gave an unqualified opinion on the 2014/15 financial statements and an unqualified conclusion on the Council's arrangements for securing value for money.

The Council has maintained a robust system of budget monitoring and control evidenced by the small unplanned variances from budget on final outturn in recent years. Where over spends or under spends have arisen, potential variances have been identified early enough to enable corrective action to have effect.

The Section 151 Officer considers that the financial control arrangements remain sufficiently robust to maintain adequate and effective control of the budget in 2016/17.

iv) The current economic climate and national issues surrounding adult social care (aging population) and the safeguarding of children have impacted on the budget. Additional provision to cover all of these issues has been included within the final budget proposals and will be the subject of detailed monitoring throughout the year. Rising demand in both adults and children's social care together with reduced funding remains one of the most significant risks to the sustainability of the Council and its financial position. The Executive is recommending implementing the 2% Council Tax increase which the Government has made available to provide specific additional funding to support Social Care pressures.

v) A prudent but realistic view of interest rates has been taken in constructing estimates for interest charges in 2016/17 budget. Whilst these estimates are considered to be adequate at this point in time the considerable turbulence within the financial markets may lead to further consideration. Interest rate trends and capital financing operations will be monitored closely throughout the year to facilitate timely action designed to optimise the Authority's position.

B) ADEQUACY OF PROPOSED FINANCIAL RESERVES

Risk Mitigation – Mindful of the overall risks within the budget, some of which are specifically highlighted above, (of which some are not quantified nor have any specific offsetting financial provision within the budget), the Section 151 officer has reviewed the minimum level of the Council's General Fund reserves/balances.

The current recommended minimum General Fund (GF) Balance is £5.5M, as recommended and approved last year.

In reviewing the minimum level of General Fund Balance for 2016/17 the CFO has been cognisant of the risks and provisions together with the continuing reduction in Local Government funding and the consequent significant budget shortfalls the Council still faces in the medium term. Whilst given the financial risks the Council faces in the next few years there would be a sound argument for increasing the minimum GF balance level even further, conversely the ability to do so is constrained by the fact that the Council faces a significant budget shortfall which limits the Council's ability to set aside further sums to increase the minimum level of balances.

However, in light of the increased level of risk around the Medium Term Financial Strategy and the increased probability of resources being required to support the delivery of the MTFS, the Earmarked Medium Term Financial Risk Reserve has been maintained and strengthened with additional funding set aside to be added to this reserve. As this has the impact of increasing the overall level of balances and reserves, the Section 151 Officer is not recommending a further increase in the minimum level of GF Balance at this stage, but would recommend increasing the minimum level of this balance further in the future should the financial position allow.

The Medium Term Financial Strategy Report also includes a Reserves Policy going forward. This gives the Section 151 Officer and CMT the authority to set aside available funds into a prioritised list of earmarked reserves.

It is worth highlighting that the Council has an excellent track record of remaining within budget once it has been set, and has never been in the position of reporting an overall overspend on the General Fund despite some very difficult recent years in respect of reducing income and escalating social care costs in both children and adult services. It is noted however that the forecast outturn position for 2015/16 is relatively small overspend, and that this is indicative of the tightening financial position. It will be important to retain tight expenditure controls in 2016/17, and deliver the proposed savings, to ensure that the Council doesn't overspend in 2016/17 and aims to deliver a budget underspend to support the overall financial position for 2017/18 onwards.

Issues which it is appropriate to draw specifically to the attention of Cabinet and Council are detailed below:

i) The Council holds a number of specific provisions for issues like debt write off that are assessed on an ongoing basis against the specific issues to which they relate. Review of these provisions forms part of the budget preparations covered above.

ii) The General Fund balance is used to support revenue, capital and strategic pressures and to provide a working balance.

Details of the use of the General Fund Balance is included in the report. The level of GF Balance and the projected use is forecast for four years. The minimum level of GF Balance is recommended by the Section 151 Officer taking into account issues like the proposed draw, the level of risk contained within the budget, the strengthening of the Medium Term Financial Risk Reserve, and previous experience on potential levels of net overspend, but also takes account of the practicalities of being able to increase the minimum GF balance at a time when the Council is faced with having to find significant savings, far greater than at any other time, simply to balance the budget position.

Best practice guidance issued by CIPFA is followed in determining a level of GF Balance based on assessed risks, which are reviewed annually. Based on the current assessment of the overall financial position, the Section 151 officer has recommended that the minimum level of GF Balance should be maintained at £5.5M, albeit that should the Authority find itself in a position where it could realistically identify additional resources to fund an increase in the minimum level of GF Balance as well as the increase in earmarked reserves, then the Section 151 officer's advice is that it would be prudent to do so. There is no legal definition or Audit Commission recommendation on the absolute level of balances and reserves that any authority should hold but the risk based approach does provide a consistent, transparent methodology that can be updated periodically.

iii) Attention is drawn to the level and use of capital resources in the General Fund Capital Programme report. Whilst this identifies the overall Capital Programme is fully funded this is based on a revised estimate of capital receipts. The level of capital receipts is volatile and therefore while the funding deficit is now closed from the level reported previously this remains an area to monitor as the deficit is based on estimated forecast receipts rather than receipts received.

Slippage in capital receipts could change the forecast of temporary borrowing that is required unless accompanied by equivalent slippage in spend. Non-receipt of any planned income will require a permanent draw from balances, additional borrowing or for savings to be found in the capital programme. In drawing up the capital programme these risk factors are obviously taken into account but as a backstop position these potential shortfalls will continue to be reviewed over the longer term and where possible, be reduced by re-phasing schemes or bringing forward the use of prudential borrowing.

The Council also has key strategic property and land sites which it has been holding until market conditions improve. These have been reviewed to ensure that those held are truly strategic and as a result sites have been identified for sale which has in part served to reduce the forecast capital deficit. The categorisation and potential for sale of sites will continue to be actively monitored and sites held by the Council which are not operational provide a further source of contingency to reduce the risks outlined in the above paragraphs.

iv) Levels of borrowing and debt and associated treasury risks are fully covered in the Treasury Management Strategy and Prudential Indicators report which appears on the Council agenda. In recognition of the risk associated with the current strategy the Council is maintaining a Treasury Risk Reserve, and as part of setting the 2016/17 budget the S151 officer has recommended that the level of this reserve should be maintained at £2.1M, which the CFO considers to be the prudent minimum at this time based on the current borrowing strategy. The Reserve has been and will continue to be subject to ongoing review, not least of which will be to review the new risks which are now in the system as a result of the new banking regulations. This means that UK banks are less likely to receive government support in future should they find themselves in financial difficulties, and instead will have to resort to 'Bail In', whereby individual investors (be they individuals or institutions) would be expected to fund any shortfall via a 'hair cut' i.e. a reduction to the sums they hold on deposit for which there will be no protection for institutions. The Treasury Management Strategy has been developed with the Bail In risk in mind and a more diversified portfolio of investment has been developed and as a consequence the CFO was able to release £1M of the Reserve as part of setting the 2015/16 budget, to support the MTFS Reserve.

Future Budget Uncertainty

Section 25 of the LGA 2003 concentrates primarily on the uncertainty within the budget year rather than the greater uncertainties in future years. However future uncertainties also inform the need for reserves and balances in the medium term. The current financial position involving significant savings targets increases the risk of over spending, together with demand led spending pressures during a recession and potentially higher inflation than assumed. Funding beyond 2016/17 is more certain with the start of the new CSR period and the publication of indicative figures for the next four years. However these figures need do still need to be caveated as they are dependent on a number of assumptions including economic growth and interest rates, in order for the Chancellor to achieve the ambition of a surplus by 2019/20.

SUMMARY

This formal report is part of a continuum of professional advice and is the culmination of a budget process in which lots of detailed work has already taken place with Directors, Senior Managers and their teams and Members.

Whilst as set out in this report the budget does contain a number of underlying risks, the S151 officer considers that the budget proposals recommended by the Cabinet for 2016/17 are robust and deliverable for the one year planning horizon, but are underpinned by the significant use of one off resources, which is not sustainable in the medium term, and are dependent on £8.9M of savings which are still subject to consultation and which must be delivered in full to achieve a balanced budget and avoid a further draw from balances or reserves.

It is also recognised that there are significant demographic pressures in both Adult and Children's social care which need to managed. There are also risks associated with the achievement of efficiencies and service reductions and robust monitoring arrangements must continue to ensure savings are delivered within the required timescale. Overall whilst it is recognised that this budget has elements of risk, it is felt that sufficient mitigating actions are already in place to accept and to manage those risks in 2016/17.

However, the S151 officer remains concerned about the Authority's medium term position, with circa £42M of savings still to be found by 2019/20. This concern is heightened as general fund balances are close to the recommended minimum level, and a risk analysis of the position has recognised that earmarked reserves are low, meaning that short term options to shore up the budget through a draw on balances/reserves (even though not ideal), to buy time to put in place sustainable transformation and deliver sustainable savings alongside reduced service provision, are limited. In addition, the Council has used significant one off funding in balancing both the 2015/16 and the 2016/17 budgets, and the level of one off funding utilised are unlikely to be available in future. This will mean that there will be more pressure to deliver significant and sustainable budget savings to balance the budget for 2017/18 onwards.

Therefore, both Members and the Council's Management Team must not lose sight of the need to ensure that work is ongoing to develop sustainable savings proposals for future years (a key element moving forward will therefore be driving forward and implementing the Council's new Operating Model and Efficiency Strategy), mindful of the fact that available reserves to support the financial position are limited. That said, there is a balance to be struck, as Members must also be mindful of the need to carefully consider the extent to which one off funding is utilised in order to deliver a balanced budget in any one year, albeit that it may be prudent to do so if it buys time to bring sustainable savings and spending and service reductions on stream.

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