Somerset County Council

County Council
– 21 February 2018

MEDIUM TERM FINANCIAL PLAN [MTFP]

Report on the Robustness of the 2018/19 Estimates and the Adequacy of Reserves and Balances

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1. Summary

1.1 The core function of the MTFP is to forecast the Council's finances in detail and ensure that the Council's priorities can be delivered. This involves the Council considering its future financial position to develop a strategy that will deliver financial stability in the medium to long term.

1.2 The level of government grants has reduced which, when combined with cost pressures such as demography and inflation, means that finances are very challenging for the Council.

1.3 The purpose of this report is to provide an opinion under Section 25 (1) of the Local Government Act 2003 which requires the Section 151 Officer to report to Council on the "robustness of the estimates" and the "adequacy of the reserves and balances".

2. Recommendations

2.1 The County Council is recommended to note that, in my opinion as the Section 151 Officer:

a) "The estimates used in the production of the budget proposal for 2018/19 are adequately robust."

The County Council is also recommended to note the following statement, made on the basis of the assessments contained in this report:

b) "Based on the assessment of the reserves, contingencies and balances, the key financial risks identified, and the thorough process used for developing the Medium Term Financial Plan, I have determined that the level of reserves, contingencies and balances for the 2018/19 financial year is adequate".

3. Background

3.1 The MTFP Process

3.1.1 The preparation for the 2018/19 budget cycle commenced in outline over 3 years ago as part of the rolling programme that is a fundamental part of the MTFP. Since then, further detailed work has been carried out to review and update the information.

3.1.2 The financial review process has been supported by an extensive exercise to identify the impacts and the key risks within the budget for next year. This enables me to be confident that the process undertaken by the Authority provides a sound basis for the statements in this report and supports my view on the overall robustness of the budget and sufficiency of reserves and balances.

3.1.3 All estimates by their nature have a degree of uncertainty attached to them. They are however produced with the support of professional finance staff in the relevant service areas before being reviewed by the Financial Planning Team to ensure consistency of treatment. The accuracy of these estimates is a vital part of ensuring that the budget is robust.

3.2 Absorption of Pressures

3.2.1 For 2018/19 a number of budgetary pressures exist for the Council. The potential financial impact has been considered and amendments to the MTFP included where necessary. For example, in previous years services were expected to manage their pay inflation as the pay award has been at low levels, typically 1%. For next year the pay award is likely to be higher than 2% and this has been budgeted for and included in our balanced budget. Absorbing two years of 2% pay awards would be unreasonable on top of delivering savings across service budget. The budget is therefore more robust than in previous years because this has been factored into service budgets. In addition, the inflation required for the SCC contribution to the Waste Partnership has been specifically included.

3.2.2 The themed approach to the MTFP continues to target efficiencies through the use of technology and service redesign which will help absorb other demographic and contractual inflationary pressures.

3.2.3 The biggest pressures are faced by Adult Social Care, Learning Disabilities and Children's Social Care Services. There are a number of factors causing this pressure but many are created by the lack of sufficiency in the market in certain high cost areas. The recognised improvement in Children's Services needs to continue and this needs to be a fully costed, considered plan. The Director of Children's Services is leading a piece of work prioritising the sufficiency of placements. This will identify a comprehensive set of actions with estimated costs to ascertain the correct level of funding required and work towards this priority for the Council. Many times it has been stated that good services cost less. We will ensure that our staffing costs and our expected care provision costs are forecast as accurately as possible.

3.3 Delivery on Savings

3.3.1 Over the last couple of years, the financial value delivered via approved savings proposals has reduced, reflecting the growing difficulty to achieve savings due in part to the cumulative impact of austerity. In many cases the savings that were not delivered will still be delivered but they took longer to realise. We have reviewed those that did not deliver and have assessed which savings are no longer viable savings options. This has been reflected in the budget gap we had to close.

3.3.2 The value of savings planned for 2018/19 is much lower than that needed in the previous year. These savings have to be delivered in full so that there is no ongoing impact on our budget or any one-off impact on our reserves.

3.4 Capital Investment Programme

3.4.1 The key risk traditionally in the Capital Investment Programme is that the actual costs are higher than estimated. The programme is well managed and we have not had any significant variations to approvals in the last few years. The current school building programme is extremely well run and we are confident of this continuing to be the case.

3.4.2 Services indicate their 'total scheme costs' when a scheme is approved. This improves accountability and provides a clear link between the initial estimate and the actual costs that arise. Actual costs are monitored on a monthly basis and any overspends would be identified. Overspends arise through unexpected additional works or inflationary costs arising from differences between estimates and tenders.

3.4.3 Many capital projects are financed from a range of sources including contributions from third parties. In the event of a default of a contributor or an overspend which cannot be negotiated between the parties, the Council could find itself funding the balance. Whilst the value of these risks is not considered to be particularly high, there could be a potential impact on the need for capital resources.

3.4.4 The level of borrowing for the forward programme is estimated and confirmation of funding from government for capital schemes is very difficult to predict. Much of the government's funding for infrastructure tends to be subject to bidding evaluation and can vary enormously from year to year.

3.4.5 To meet any unbudgeted capital costs within the proposed Capital Investment Programme that cannot be met through modifying the scope of the scheme or by redirecting resources from other projects, funding can be provided through the monies held within the Capital Fund. The Capital Fund is not as buoyant as it has been and will need to be replenished over time. During this period, it is particularly important to raise the level of capital receipts to manage any capital overspend and thereby limit any calls on the Capital Fund to those instances referred to in the paragraph above.

3.5 Conclusions

3.5.1 In terms of the Robustness of the Estimates, the key measurable risks contained within service budgets can be supported by the Contingency Budget. The Contingency Budget, including redundancy provision, is £9.8m.

3.5.2 **As Section 151 Officer, I am satisfied that the process carried out and the resulting content of the budget as described above has been sufficiently thorough to enable me to give Council the necessary assurance that the estimates are robust. This statement must however be read in conjunction with the remainder of this report on the levels of Reserves and Balances that supplement and support the assumptions made in the Budget.**

4. Adequacy of Reserves and Balances

4.1 Background

4.1.1 Under Section 25 (1) (b) of the Local Government Act 2003, a report is required from the Chief Financial Officer to advise on the adequacy of reserves. The Council is obliged to take account of these issues when setting the Council Tax and Budget for 2017/18.

4.1.2 Balances and reserves should be set at a level that recognises the financial risks facing the Authority. The greater the level of uncertainty and risk, the greater the likelihood of reserves being required at the end of the financial year. It is important that members understand the risks to approved budgets, maintaining sufficient reserves, balances and contingencies as well as managing a range of mitigations to limit as much as possible impacts on core services along with delivery of the priorities in the new County Plan.

4.1.3 In coming to a view on the adequacy of the reserves, it is necessary to take into account the following:

- The purpose of holding reserves and balances;
- The risks and uncertainties that may have financial consequences, their potential impact and likelihood of arising;
- The opportunity cost of holding reserves and balances.

4.1.4 The purpose of the General Reserve however is not to provide 100% cover for all possible eventualities, this would result in significant resources tied up against events that might not happen.

4.1.5 It is important to note that next year's budget includes £2m to top up reserves and so too do the years ahead.

4.2 The Purpose of Holding Reserves and Balances

4.2.1 The Council's financial environment is constantly changing, as are the demands on services and the needs of the County's population and environment. Reserves are therefore required to ensure that the risks that the Authority faces do not destabilise the services that it provides during the year. Reserves are an important part of the Council's financial strategy. They help to achieve long-term budgetary stability and allow the Council to manage change and short term fluctuations without undue impact on the Council Tax.

4.2.2 The Council holds revenue reserves in order to mitigate future risks over and above those managed through the Contingency Budget, such as:

- Excessive increases in demand and / or costs above the budgeted position arising from delays or failure to realise planned savings;
- Variations in forecast revenue income from Council Tax, National Non-Domestic Rates and other revenue streams;
- Uncertain future liabilities such as unforeseen insurance liabilities;
- Exceptional events identified through the Corporate Strategic Risk Register such as civil emergencies.

4.3 Risks and uncertainties

The Financial Climate

4.3.1 The Government's deficit recovery programme has significantly reduced the levels of funding in Local Government. The Council faces on-going challenges both within the current financial year, setting and delivering a balanced budget for 2018/19 and in agreeing the Medium Term Financial Plan.

4.3.2 The financial climate for local authorities is particularly uncertain both in relation to the totality of resources available for the sector and the distribution of those resources. Whilst we know what revenue support grant we can expect for the next three years to 2020/21, allocations of capital funding are only known with regard to highways. There is no consistent information on projected capital grants for future years. As funds have got tighter nationally, more bidding rounds for funding have been created with less certainty for all councils.

4.3.3 The Council continues to lobby for fairer funding for Somerset. Council tax increases alone will not sustain the budget increases required to meet demand in those services under most pressure. Children's Services budgets are under considerable pressure with market sufficiency and escalating costs as key concerns. This is local, regional and national issue that has not been recognised in the same way Adult Social Care funding has been noted.

4.3.4 Other External Risks with Potential Financial Implications

The Council is also vulnerable to financial risks arising from a range of other external factors, many of which have been identified through the Corporate Risk Register.

4.3.5 Civil Emergencies and Natural Disasters

Somerset has experienced adverse weather conditions in recent years such as major flooding incidents which could exceed budget allocations for operational services. Examples of the potential impact of events such as this include structural failure of bridges and landslips affecting the road network. In the short term, the additional resources required to make assets safe / operational would have to be met from General Reserves.

The Council continues to work with strategic partners to establish a viable Somerset Rivers Authority (SRA) to manage the risks. This includes the future proposal for the SRA to become a precepting authority and be able to raise its own council tax to support its planned work. For 2018/19, the local authorities in Somerset have been given dispensation to raise a precept equivalent to 1.25% for SRA related work.

4.3.6 Commissioning / Working with Partners / Supply Chain Failure

The Council commissions many of its services from third parties and increasingly works in collaboration with other organisations to commission outcomes. The process of commissioning helps ensure that the Council plans the multi-year transformation that will be necessary to support delivery of the County's priorities. The reduced level of public sector expenditure overall, along with the current economic wider climate is creating pressure within the supply chain as well as the Council's own operations. There have been a small number of high profile company failures in the social care sector and infrastructure industry, and in the local transport sector. The result is that the Council could incur additional costs from the need to re-procure and integrate a new supplier. If one of the Council's major contractors were to be affected in the future, there would be costs associated with implementing temporary arrangements and procuring replacement services.

4.3.7 Insurance Claims and legal challenge.

We have recently reviewed our insurance arrangements to minimise exposure for the Council and at the same time we have reduced costs. Although the maximum impact of any single legal claim against the Authority for negligence, for example, is currently limited to our £1m insurance excess, there remains a potential risk the Authority could face more than one claim in any one year which would exceed the capacity of the Insurance Fund and therefore impact on reserves.

4.3.8 School Places

The provision of new schools is predicated upon the timing and location of new residential developments. We are planning to meet the extensive need through borrowing and this is budgeted for within the forward MTFP.

4.4 The Opportunity Cost of Holding Reserves

4.4.1 A few years ago there was considerable criticism by DCLG around councils holding too much in reserves and external auditors (and armchair auditors) were encouraged to challenge why councils kept so much. Somerset's reserves have never been so high that this has been an issue but councils are encouraged to consider the balance between holding too much and too little money in reserves. If reserves are too small, this increases the Council's exposure to risk and endangers its capacity to deliver priorities in a planned and prudent fashion. If reserves are too large, money is unnecessarily tied up that could be supporting service delivery. However, it is important to remember that cash is not idle. The money the Council has in reserves is invested to earn interest and support our running costs.

4.4.2 It is acknowledged that SCC's reserves are now lower than they ought to be and next year's budget plans to increase reserves by £2m and to continue to do so by £2m per year until they are replenished sufficiently.

4.5 Key Reserves

4.6.1 The Council holds three main reserves for budgetary risk management – the General Revenue Reserve (GRR) to cover revenue risk and the Capital Fund (CF) to cover capital programme risk. There are also earmarked reserves which are used by the Council to mitigate some specific risks. Whilst many of these reserves have commitments against them or restrictions on their use, due to their shared nature with partners, there remains a small uncommitted element that could be reviewed in the event that the General Reserves were insufficient or needed to be protected.

4.6.2 The predicted reserves position at the end of March 2018 has been updated since the quarter 3 report that was presented to Cabinet on the 12th February. The update is shown in the table below:

	Value £m
Balance brought forward 2017/18	10.441
In year Transfers	(0.301)
Collection Fund Surplus 2017/18	4.871
Current Balance	**15.011**
Estimated in year overspend to be written off	(6.381)
Balance at March 2018	**8.630**
Base Budget contribution 2018/19	2.000
Estimated Collection Fund Surplus 2018/19	2.000
Balance at 31 March 2019	**12.630**

For the past few years, we have tried to keep a minimum of £15m in the General Revenue Reserve. We will be below that this year and will seek to replenish reserves accordingly.

5. Conclusion: Statement on the Adequacy of Reserves – Section 151 Officer

5.1 **“Based on the assessment of the reserves, contingencies and balances, the key financial risks identified, and the thorough process used for developing the Medium Term Financial Plan, I have determined that the level of reserves, contingencies and balances for the 2018/19 financial year is adequate”.**

6. Implications

6.1 The financial and risk implications are contained within the report.
The MTFP report includes a strategic overview of the impacts of the savings targets developed using the themed approach.

7. Background Papers

7.1 Cabinet 12 February 2018 – Medium Term Financial Plan

Note: For sight of individual background papers please contact the report author