CIPFA performance in public services

Financial Resilience Review

Surrey County Council

December 2016

FINAL

Contents

1. Executive Summary

1.1. This written report reflects the findings, conclusions and advice reported to the Leader, his cabinet and the Chief Officer leadership on the 7 December 2016 in the form of a power-point presentation. That form of report presentation was chosen so that the CIPFA team could feed back as requested promptly to a planned meeting of the Cabinet and Chief Officers considering the budget for 2017/18. It reflects the facts and circumstances at that time.

1.2. Surrey County Council is in a difficult financial position and without making some key decisions on how it can reduce the costs of its operations is in danger of rapidly depleting its reserves over the next two to three years and going well below the absolute minimum level of reserves required.

1.3. Surrey's services spend is high, compared to similar authorities, with spending proportionately £100m more than average. It does not have a unique financial challenge; indeed in terms of spending power reduction for 2017/18 its change is below average. However, the unexpected level of loss of revenue support grant in the transition to how spending power changes were implemented in 2016/17 was one of the most significant due to the scale/gearing of Surrey's council tax base relative to grant. Along with a number of other councils, Surrey received a degree of transitional relief for 2016/17 onwards. However in terms of base funding Government has not accepted the council's arguments about the implied disproportionate loss of learning disability funding, which on case load was relatively high for Surrey because of local circumstances, and which had been included in Revenue Support Grant in the past. The Council are concerned also that the methodology applied by Government takes into account it relative council tax base more than once in the calculations.

1.4. At the time of the CIPFA review the Council's political leadership were giving informal but serious consideration to a major council tax rise, necessitating a referendum, to avoid what it perceived to be difficult and damaging service cuts. The CIPFA team reflected to the Council's member and officer leadership in December 2016 it's view that the budget strategy for 2017/18 was based on an overly optimistic assumption on the success of a referendum and an absence of a credible cost reduction plan.

1.5. Reserves are set to decline rapidly, which is an indicator both of poor financial resilience and failing to plan for, and then deliver, savings in service provision to enable the council to live within its resources. In addition, notwithstanding the savings gaps for 2017/18, the council's current medium term financial plan shows very significant gaps in savings still to be found in 2018/19 onwards. Overall, the combination of rapidly declining reserves and significant levels of 'still to be found' future savings is an extremely worrying one.

1.6. In term of the size of the true financial gap for 2017/18 in particular, but also over the medium term, the calculations and assumptions made by the finance team are sound although could be presented in a clearer way. Presentations focused too much on a residual “gap” after assumed savings rather than identifying the overall financial challenge to the council and thus the on-going status of all the savings to be found.

1.7. In the opinion of the CIPFA team, the council needs to produce a budget strategy on the basis of not having, or losing a referendum. Even savings that are already proposed in both Adults and Children’s Social Care are already at risk of non-delivery so other areas of spend and/or income need to be examined critically.

1.8. This is not a unique financial context for a county council, indeed as mentioned, the spending power change for Surrey is below average. Nevertheless the context is challenging, especially given the pressures on social care. For many working in local government, including members, the inevitable requirements to cut services in response to austerity is an anathema to their original personal motivations in joining the sector. However, the bigger responsibility falling on all councils, and enshrined in law, is to live within available resources.

1.9. We would like to thank those we interviewed and the staff who supported us for their welcome, openness and cooperation in carrying out this work in such a short timeframe.

1.10. **Post script**. The local government grant settlement for 2017/18 announced after the CIPFA review, allowed the council to bring forward an extra 1% ‘social care precept’, making a total allowable council tax increase for 2017/18 of 4.99% before triggering a referendum. The Cabinet had recommended a council tax increase of 15%, which clearly would have triggered a referendum, but the Leader withdrew this on the day of the Council budget setting meeting in February 2017. The Council voted for a 4.99% increase. (Note: the maximum of 5% rounded was an increase on the 4% limit referred to in this report following additional short term flexibility introduced by government for 2017/18, after the CPFA review). The Director of Finance in her ‘section 25’ report to the Council set out clearly the Council’s financial position and in all significant terms it reflected the conclusions of this CIPFA review and in particular the significant gaps in its savings strategy with the inevitable recourse to further depleting reserves to cover delays in establishing base savings. In announcing the 2017/18 final settlement the government announced formally that Surrey, alongside other relevant councils, could apply to be a business rate ‘pilot’ for 2018/19. Its is difficult to assess the financial effect of this one year pilot for Surrey nor indeed the impact of the new national business rate retention scheme and fair funding review on Surrey’s financial position from 2019/20 onwards.

2. Methodology and Terms of Reference

2.1. The Director of Finance for the council with the support of the Leader and Chief Executive, commissioned CIPFA to undertake a Financial Resilience Review informed by the insights of two of experienced Finance Directors/Chief Financial Officers. The work was undertaken in late November and early December 2016.

2.2. The review was agreed to include:

- An extensive cost and income benchmarking exercise using CIPFA's access to sector comparative data.
- A verification of financial estimates and assumptions
- An assessment of spending pressures from key service areas
- An assessment of savings plans over both the short and medium term, including the capacity of reserves that can be used as a buffer

2.3. The team worked closely with the Chief Executive's Corporate Leadership Team and in particular the Director of Finance and her team in carrying out this review.

2.4. The report in some areas may appear critical, this is not intended, and there are a number of areas that represent good practice that have not been commented on in any detail, as is the nature of this piece of work. These include recent corporate transformation programmes and corporate commercial strategies.

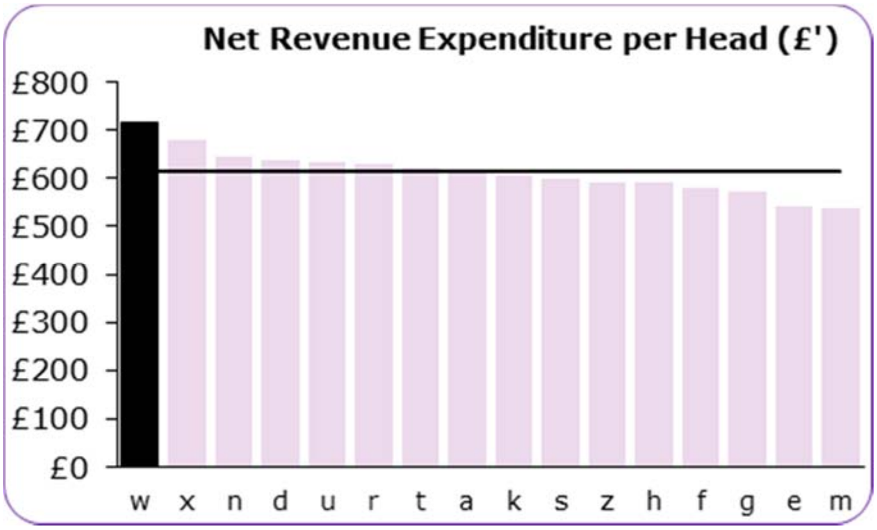
2.5. The on site work was preceded by extensive reading and analysis of key plans, policies and strategies as well as compiling and interpreting specific benchmarking data about the council. The on site review work was carried out over an intensive four day period by two experienced CFOs and the results and recommendations reported in the form of a power point presentation a week later to an informal meeting of cabinet and Chief Officers on 7th December considering next key steps in the budget for 201/18. This written report reflecting that presentation was subsequently produced for completeness.

2.6. While that timeframe does not allow an audit or comprehensive review of all documents, it does allow an intensive process relying especially on an extensive series of interviews with the leader, some cabinet members and senior officers, utilising the insights and experience of the CIPFA team. Given this, the report is felt to be a fair reflection of where the council is in terms of overall financial resilience at the time of the review and if it takes on board the recommendations will be in a better position to produce a more sustainable budget strategy.

3. CIPFA Diagnostic Headlines

- Net revenue spend per head of population highest in comparator group - £100m more than average
- High volume of Adults with Learning Difficulties leading to high spend
- Road maintenance high per head, £10m more than average
- Highways income lowest per head
- Street Lighting high per head, £5m more than average
- Bus subsidies highest per head, £4m more than average
- Library spend high per head, £4.6m more than average
- Adults income £8.4m lower than average
- On-Street Parking income £2m lower than average
- The above are based upon 2016/17 budget estimate returns.

Detailed analysis attached as appendices two - four



- Surrey is one of the 20% least deprived counties/unitaries and life expectancy for both men and women is higher than the England average.

- The health of people in Surrey is generally better than the England average

- Surrey's age profile is comparable with that of the whole of England

Comparator Group

(w)	Surrey	(k)	Essex
(h)	Buckinghamshire	(z)	Kent
(t)	Oxfordshire	(n)	Warwickshire
(r)	Hertfordshire	(a)	Dorset
(f)	Hampshire	(g)	Worcestershire
(u)	West Sussex	(x)	East Sussex
(m)	Cambridgeshire	(d)	Devon
(s)	Gloucestershire	(e)	Leicestershire

4. Headline Savings Challenge and Budget "gap" 2017/18

4.1. Headline Savings Challenges

The CIPFA team verified the assumptions and calculations in determining the headline savings challenge. The combination of inflation, demographic growth, net loss of government grant, transitional relief, increased income and council tax at the current referendum limits, results in estimated savings challenges of the following:

- Total savings required for 17/18 = £151m
- Total savings required for three years to 19/20 = £290m
- Total savings required for four years to 20/21 = £337m

The 2017/18 position is exacerbated by the one off use of reserves to balance the budget in 2016/17 and planned savings not being achieved in 2016/17.

4.2. Budget "gap" 2017/18

The budget "gap" i.e. unidentified residual savings still to be found, has been accurately reported although a number of significant savings are at risk of non-delivery. This can be mitigated by potentially using up to £13m provisions that may not now be required. However, these and the already planned use of £6m of reserves will add £19m to the budget challenge in 2018/19, even if the remaining savings of £36m are identified.

	£m
Savings	
Required for 17/18	151
Identified	(106)
Planned use of reserves	(6)
Reported Budget "gap"	**39**
- Use of "spare" provisions?	(13)
- Red Risk 17/18 non-delivery	10
Possible Remaining "gap"	**36**
One-off use of reserves/provisions carried forward to 2018/19	19

4.3. **Numbers will change**

The detail is consistent with presentations to members but there is always a degree of uncertainty in the assumptions used and the numbers will change at the margin as more information becomes available. These changes should be viewed in relation to the overall savings challenge and not just the residual gap at any one moment.

5. Referendum Impact

5.1. **Background**

At the time of the review and to help bridge the budget gap the Leader and his Cabinet were informally but seriously considering a significant increase in the council tax above the referendum limits thus triggering a referendum. This was to avoid what the leadership perceived as more difficult and damaging cuts. Surrey's council tax base is high, each additional 1% netting £6.2m for the council. Self-evidently this was intended to bridge at a minimum the residual reported budget gap of £39m for 2017/18 as at the time of the review and give the council greater on-going base budget income to cover some of the gaps in still to be found savings in 2018/19 onwards. (Note: the range or precise level of percentage tax increases being considered was not shared with the CIPFA team at the time).

The CIPFA team concluded that savings to bridge the residual gap for 2017/18 in the absence of a successful referendum were not being actively.

5.2. **In CIPFA's view, a referendum is highly likely to fail**.

5.2.1. During the course of their work on site the CIPFA team gained a much clearer understanding of why Surrey felt disadvantaged by the government's move to 'spending power' in 2016/17 onwards as a method of reducing Revenue

Support Grant for all councils, i.e., taking into account a council's relative council tax base. Surrey's sense of grievance primarily was because of three points. First, the scale of learning disability grant based on actual cases transferred into their RSG in the past, which was then significantly reduced as part of the government's focus on spending power. Second, the scale/gearing of surrey's council tax relative to RSG had amplified the unplanned for reduction in RSG very significantly. Third, Surrey had largely resisted calls to freeze council tax in previous years and instead had increased the council tax by the maximum permitted, typically 2% p.a., to protect service levels.

5.2.2. However, a significant perceived negative financial effect from the change to spending power was not unique to Surrey. A number of other upper tier councils with relatively strong council tax bases also suffered, for them, very significant unplanned reductions in RSG from 2016/17 onwards. More fundamentally the move to a spending power focus to RSG reduction for all councils (as opposed to the hitherto applied approach of a common % reduction in RSG) was introduced in response to a generally perceived unfairness in the previous approach. Councils with relatively high dependency on RSG and other grants, typically in metropolitan areas, saw very significant reductions in overall spending power by the application of the previous approach of applying common % percentage reductions in RSG; in comparison to shire areas with lower gearing and stronger local tax bases.

5.3. The spending power approach is not above criticism in itself. It raises the spectre of the council tax base being taken into account more than once in the calculations, it fails arguably to deal with the reality of current relative spending pressures in shire areas particularly for adult social care and some of the detailed elements government chose to include in the calculations were questionable when first introduced. However, in the opinion of the CIPFA team, in the round, the spending power approach is fairer overall when taking into account the effect of RSG reductions on the spending power of all councils.

5.4. In the context of a possible referendum debate, it would be very surprising if government did not deploy the key argument that Surrey's resultant spending power change is not above average, in fact the opposite, in comparison with other councils. For Surrey the issue is also complicated by the fact of its relatively high comparative service spend position compared to its most similar councils. This reflects in part completely legitimate choices taken in the past on service levels and council tax increases but would inevitably provoke questions to be dealt with around its relative efficiency and service levels

5.5. Regardless of the strengths and weaknesses of the case, the CIPFA team's view is that any proposed council tax rise above the referendum limit will very likely fail when put to a referendum. This is for two reasons, both to do with the actual legislative rules covering council tax referendums. Firstly, once a referendum has been formally triggered a council cannot actively argue for and promote a 'yes' result. It can only provide neutral explanatory information in the process. There is no similar restriction on government or any other agency positively campaigning for a 'no' vote. Secondly, and more significantly, the question put to the voters in the ballot box is simply and no more than "Do you agree to the council's proposed % council tax rise of 'X%' compared to the government's proposed rise of 4%?' No supporting commentary on savings avoided etc. is allowed on the ballot paper.

5.6. **The impact of referendum 'failure'**

The current budget strategy within current referendum limits for 2017/18 and future years contain significant residual gaps of 'still to be found' savings. For 2017/18 this is of the order of £39m but assuming the already identified saving are delivered. Triggering a referendum in February but subsequently failing to secure a yes result in May would mean meaningful decisions on how to bridge the residual gap not being taken until June at the earliest. Assuming the hiatus of part of the summer and necessary consultation, implementation of savings could be in late autumn reducing the impact of savings in year. Assuming just 25% of new savings being delivered in year to deal with the residual gap, i.e. £39m minus c£10m savings, means a further £29m from reserves needed to balance the budget in 2017/18. Coupled with the £6m use of reserves already assumed would result in reserves dropping by £35m or 41% by 31st March 2018. A truly worrying depletion in one year.

6. Ongoing Financial Resilience

6.1. **Overall Challenge**

As savings get harder to deliver going forward it is important to plan reductions in spend on at least a three-year time-frame to allow for adequate lead-in. i.e. for policy changes and delivery. It is of concern that even if the 2017/18 budget is delivered there are large unidentified budget gaps in future years. The table below shows the impact of not identifying further savings in future years and the potential very possible scenarios of some of those savings not being delivered or slipping.

	18/19	19/20	Total
	£m	**£m**	**£m**
Total Savings	82	57	139
Identified	(41)	(30)	(71)
Unidentified gap	**41**	**27**	**68**
Scenario one - impact of 50% slippage	21	13	44
Scenario two - impact of 25% slippage	11	7	18

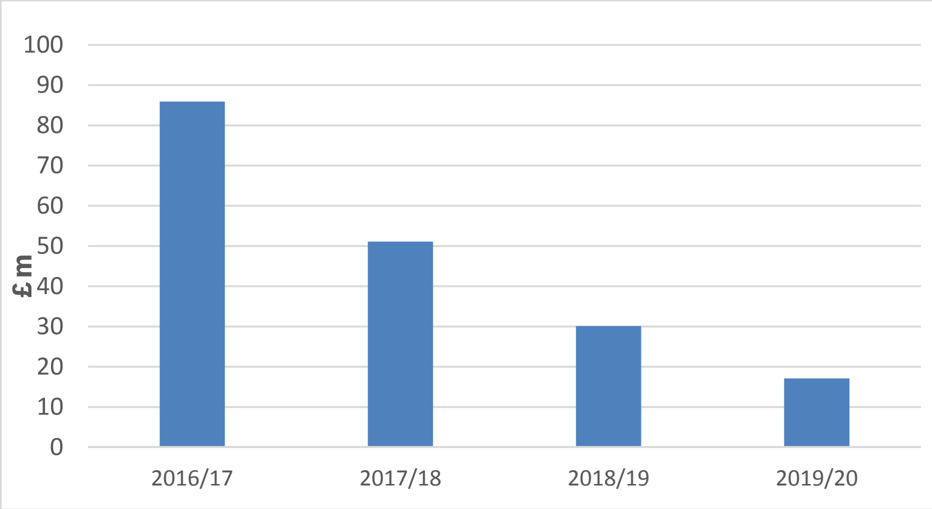
6.2. **Potential Scenarios if savings not identified**

If savings are not identified the only recourse to setting a legal budget is using reserves on a one-off basis. In CIPFA's view these should only be used on a contingency basis, as using reserves to balance the budget on an on-going basis is not sustainable. Rapidly reducing reserves is viewed as an indicator of poor financial resilience and not planning sustainable services within available resources.

6.3. **Overall Reserves**

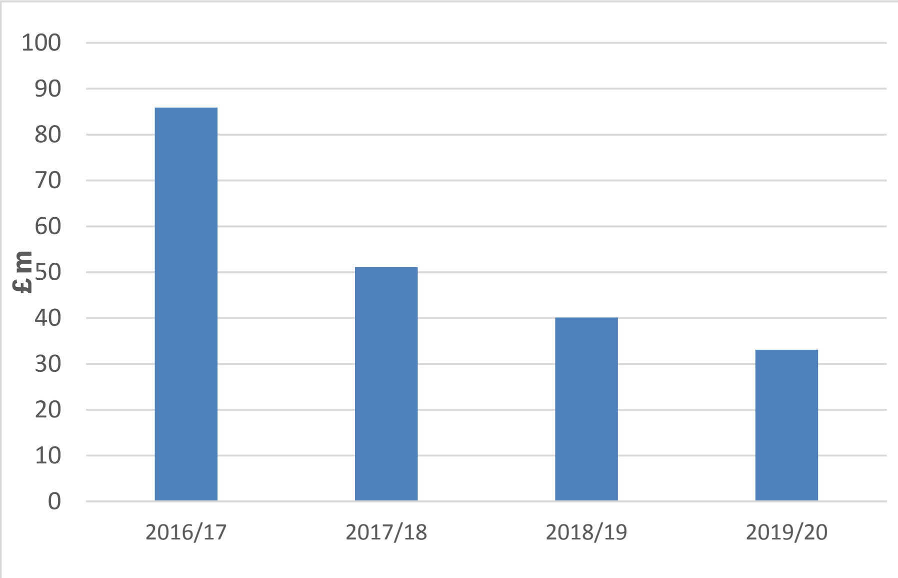
Up to now reserves appear to have been set aside and used prudently to allow for potential shocks and known risk or liabilities (e.g. insurances). These are estimated to be £86m at 31.03.17, excluding schools reserves that cannot be used to balance the council's budget. The majority are earmarked against certain events, e.g. capital spend, revolving infrastructure and economic downturn. These could be used to support the revenue budget but add risks to financial sustainability, as they are one-off. There is also a minimum balance as specified by the Council of £16m and an insurance reserve of £8m which is actuarially valued which can't be used, together making £24m. The scenarios below show the impact on reserves of not identifying additional savings and how close the council would be in not being able to maintain these reserves and therefore set a legal budget.

6.3.1. Reserves movement to 31.3.20: very possible scenario one – 50% slippage



Reserves reducing to approximately £17m by 31.3.20, below the minimum of £24m.

6.3.2. Reserves movement to 31.3.20: very possible scenario two – 25% slippage



Reserves reducing to approximately £33m by 31.3.20.

7. Other Observations

7.1. Adult's savings linked to health integration

Significant sums have already been assumed in the council's medium term savings plans arising from efficiencies linked to health integration. As well as overall integration savings being delivered there is an added risk of the council of having to fund a share of additional growth in local health service deficits once budgets are pooled. With a growing elderly population and a local health economy with its own pressures overall integration savings may be subsumed by this cost growth. The Council will wish to ensure it has this risk managed in its discussions with the local health system on future integration and confirm this risk does not undermine some of its planned savings from integration.

7.2. Adult Learning Difficulties growth of 5%

Based on the previous five years it has been assumed that learning difficulties numbers will increase annually by 5%. Having to identify savings to cover this level of growth from other services is understandably very difficult. Officers appear to have a number of good ideas about how a 0 - 25 year strategy could be implemented, recognising the criticality of a transitions plan in containing costs as children with learning difficulties become young adults. This work should be prioritised with a separate project resources and an owned transition plan. Consideration given to jointly managed teams.

7.3. Likelihood of unidentified gap coming from Children's and Adults is limited

Proportionately Adult Care and Children's services have to find a higher level of savings than other directorates, partly explained by the growth pressures in these areas. Particularly in Adults, efficiency savings at this level are becoming increasingly hard to deliver, as evidenced in the current financial year. The CIPFA review identified significant risk in some already proposed future savings in these service areas for 2017/18. All council operations have to contribute to financial balance but it is difficult to see these 'social care' areas can contributing significantly to the residual saving gap at least in the short term. It is recommended that options of service reductions or increased income be considered urgent in other areas to bridge the gap.

7.4. Presentation of information

The CIPFA team were able to verify the numbers used in determining the overall financial challenge, budget gap and assumptions used. However, this was only possible by working through background documents with the finance team. It was accepted by the Director of Finance that figures presented in the budget report could and would be made clearer in future, with more of a focus on the overall challenge, how this was calculated and the report an appendices explaining and justifying the assumptions used.

8. Conclusions and Recommendations on Financial Resilience

8.1. Conclusions

- The council is relatively high cost, proportionately £100m more than average compared to its comparator group
- It has a high council tax base and is less reliant on government grant and therefore reductions in grant than other councils. The change in how RSG was withdrawn from councils, by focusing more on evening the impact on spending power, had a significant impact on the Surrey's ' plans in 2016/17 onwards.
- The council's budget strategy is currently dependent on winning a referendum process and a significant gap, c £39m, is unresolved if the councils was limited to a 4% council tax increase.
- The calculations and assumptions made by the council's finance team in arriving at the total gap faced are sound although could be presented in a clearer way. Presentations focused on a residual "gap" after assumed savings rather than identifying the overall financial challenge to the council.
- There is a high level of un-identified savings in future years as well as 2017/18.
- The prognosis is rapidly declining reserves especially in 2017/18 but very likely into 2018/19 also. Indeed reasonable scenarios indicate the council will go well below minimum level in the next two to three years.
- The council's financial plans are not robust and it is at risk of becoming financially unsustainable unless it takes corrective action to adjust service levels and the cost of its operations to live within available resources based on maximum precept increases without recourse to referendum.
- Council tax referendum rules are in practice heavily weighted against securing a 'yes' result.

8.2. Recommendations

- A decision on a referendum should be taken with caution as the CIPFA team view is that it will fail but the process will distract from identifying and delivering the savings actually required to achieve a budget within available resources.

- A balanced budget strategy for 2017/18 and future years based on living within resources without recourse to a highly unlikely referendum result is urgently required. By definition this needs to be within referendum limits and show how the cost of operations and the services provided can be reduced to a financially sustainable position.

- Cost and Service reductions as well as additional efficiency savings, using comparator data should be identified and implemented as soon as possible, rather than relying on reserves to balance the budget in the short and medium term.
- The Council should focus more on understanding relative cost and service benchmarking in terms of necessary and additional saving strategies moving forward.
- As part of health integration discussions the council should agree a savings and risk share agreement to protect it now.
- Savings, particularly in Adults and Children's services should have greater rigour to reduce the risk of non-delivery
- Like all Councils, Surrey will need to model and plan for the impact of the Funding Review and the new national 100% business retention scheme from 2020.

Sean Nolan

Director of Local Government and Policing, CIPFA

March 2017

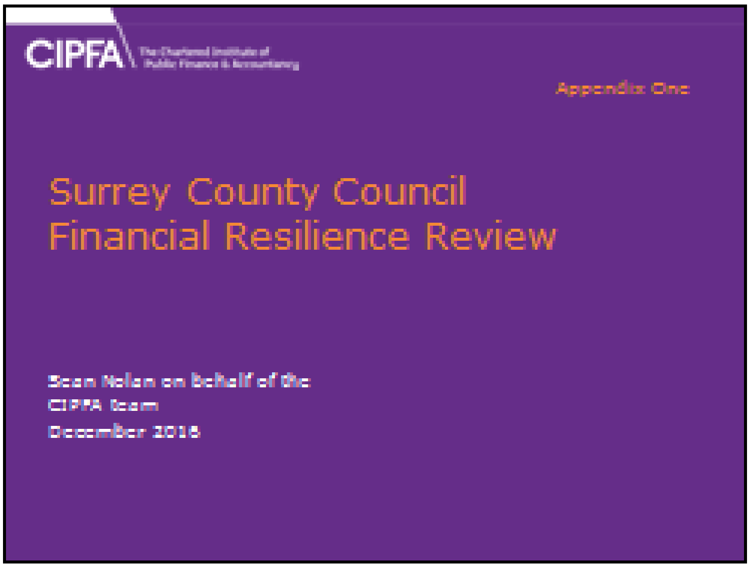
9. Meetings/Interviews Held

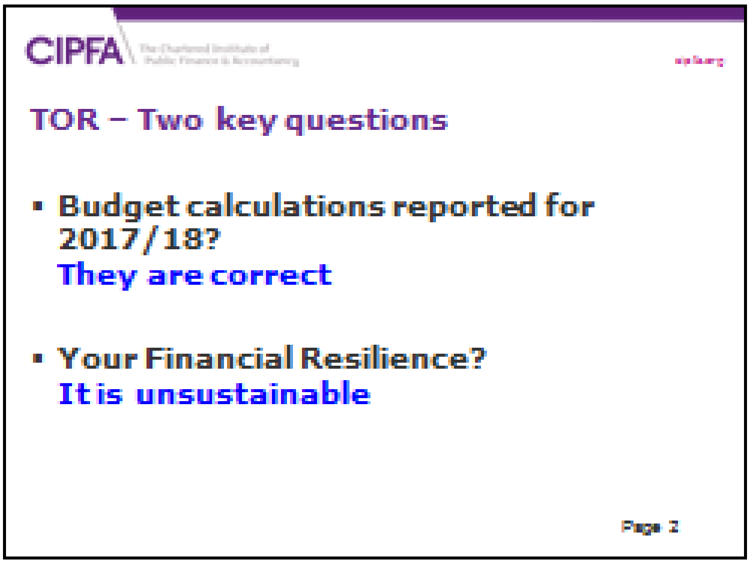
Officers

• David McNulty	Chief Executive
• Sheila Little	Director of Finance
• Kevin Kilburn	Deputy Chief Finance Officer
• Paula Chowdry	Strategic Finance Manager Children
• Helen Atkinson	Director of Adult Social Care and Public Health
• Wil House	Strategic Finance Manager Adult Social Care
• Julie Fisher	Director of Children's Schools and Families
• Susan Smyth	Strategic Finance Manager, Environment
• Sam Bushby	Assistant Director Children's Services
• Liz Uliaz	Deputy Director Adult Social Care

Members

• David Hodge	Leader of the Council
• Mel Few	Cabinet Member for Adult Social Care
• Clare Curran	Cabinet Member for Children and Families


CIPFA
Appendix One
Surrey County Council
Financial Resilience Review
Sean Nolan on behalf of the
CIPFA team
December 2016


CIPFA
TOR – Two key questions
▪ Budget calculations reported for 2017/18?
They are correct
▪ Your Financial Resilience?
It is unsustainable
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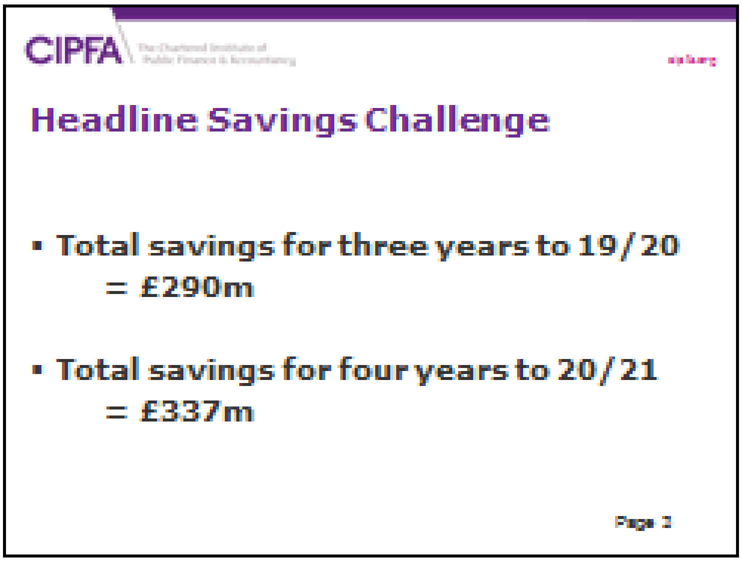
CIPFA
Headline Savings Challenge
▪ Total savings for three years to 19/20 = £290m
▪ Total savings for four years to 20/21 = £337m
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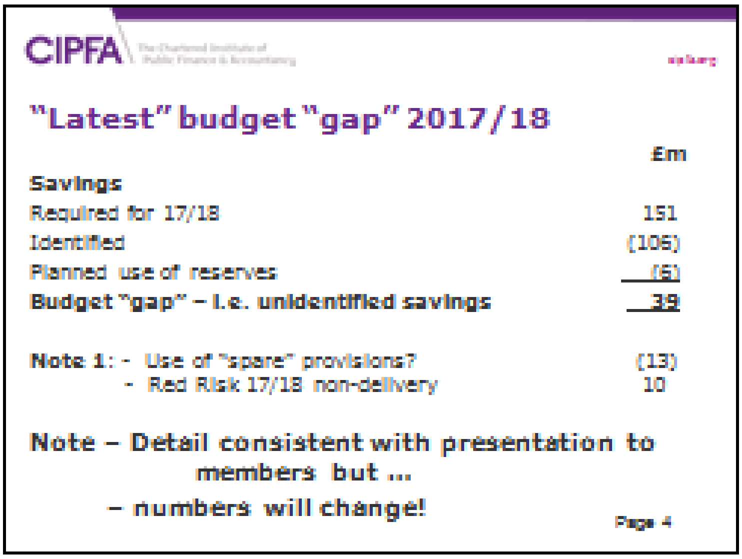
CIPFA
"Latest" budget "gap" 2017/18
£m
Savings
Required for 17/18 151
Identified (106)
Planned use of reserves (6)
Budget "gap" – i.e. unidentified savings 39
Note 1: - Use of "spare" provisions? (13)
- Red Risk 17/18 non-delivery 10
Note – Detail consistent with presentation to members but …
– numbers will change!
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TOWN HALL
ACADEMY
HOSPITAL
LIBRARY
POLICE
SCHOOL

2017/18 continued. Referendum Impact "if you lose"

- Stronger case than I realised!
- **However** highly likely to fail
- May result, June action earliest
- **Therefore** – with consultation etc. late Autumn, assume just 25% of new savings delivered in year
- i.e. £39m minus c£10m = £29m from reserves
- Resulting in reserves dropping by £35m or 41% by 31st March 2018

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Financial Resilience Thereafter

	18/19	19/20	Total
	£m	£m	£m
Total Savings	82	57	139
Identified	(41)	(30)	(71)
Unidentified gap	**41**	**27**	**68**
Impact of 50% slippage	21	13	44
Impact of 25% slippage	11	7	18

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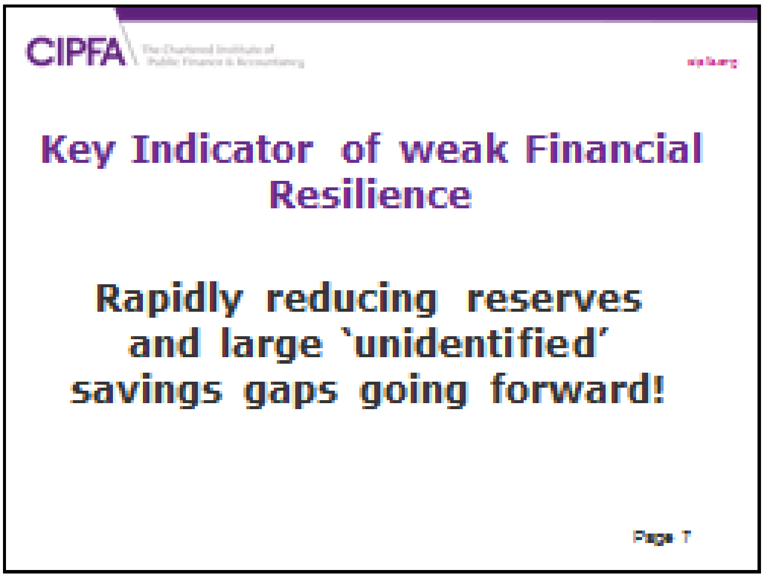
CIPFA
Key Indicator of weak Financial Resilience
Rapidly reducing reserves and large 'unidentified' savings gaps going forward!
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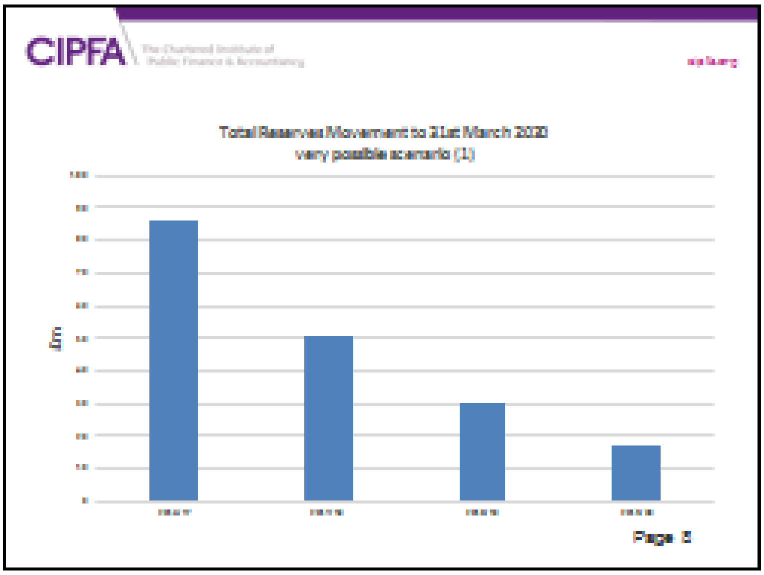
CIPFA
Total Reserves Movement to 31st March 2020
very possible scenario (1)
£m
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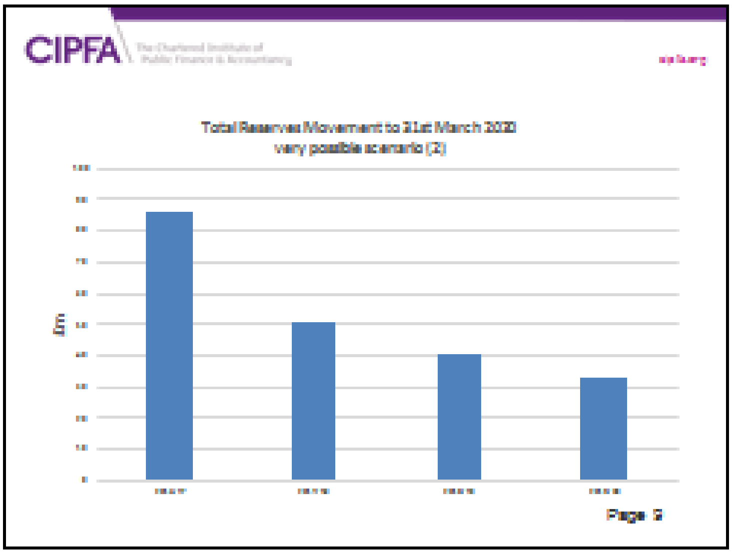

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Other Observations (1) – Diagnostics

- **Note: Mixture of volume/choices/unit costs**
- Net revenue spend per head of population highest in comparator group - £100m more than average
- High volume leading to high Adults LD spend
- Road maintenance high per head
- Highways income lowest per head
- Street Lighting high per head
- Bus subsidies highest per head
- Library spend high per head
- Adults income low
- On-Street Parking income low

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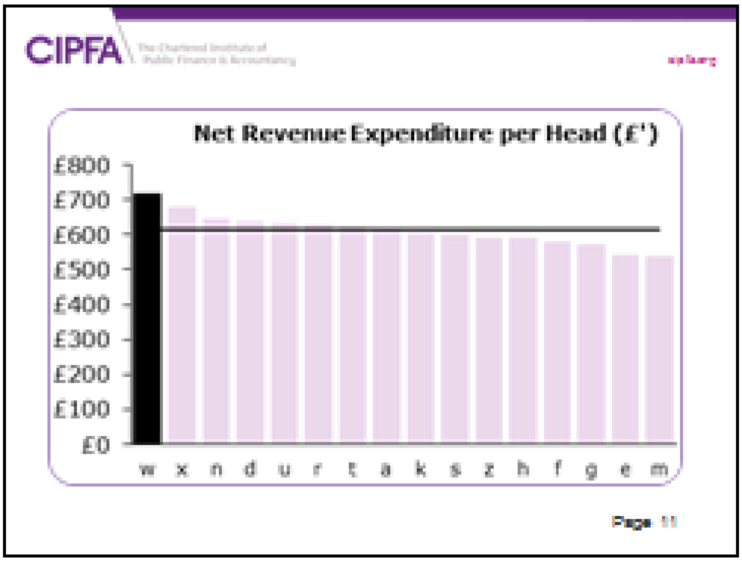

Comparative Statistics

(w)	Surrey	(k)	Essex
(h)	Buckinghamshire	(z)	Kent
(t)	Oxfordshire	(n)	Warwickshire
(r)	Hertfordshire	(a)	Dorset
(f)	Hampshire	(g)	Worcestershire
(u)	West Sussex	(x)	East Sussex
(m)	Cambridgeshire	(d)	Devon
(s)	Gloucestershire	(e)	Leicestershire

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Other Observations (2)

- Learning Disability and Spending Power
  - "Double Count Risk"
- c£45m identified Adults savings linked to health integration – but how is risk share dealt with?
- LD 5% annual growth risk – criticality of transitions plan
- Likelihood of unidentified gap coming from Children's and Adults is limited!

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Other Observations (3)

- **Presentation of information**
- **Interview Feedback**

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Overall Resilience Conclusion
▪ Dependent on winning a referendum process
▪ High levels of un-identified savings
▪ Rapidly declining reserves
Not a good Place!
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