

**Section 25 report, Local Government Act 2003**

- 1 Section 25 of the Act requires the Chief Financial Officer (the County Treasurer) to report to the County Council when setting its council tax on:
  - the robustness of the estimates included in the budget
  - the adequacy of the financial reserves in the budget.
- 2 The County Council is required to have regard to this report in approving the budget and council tax. It is appropriate for this report to go first to Cabinet and then made available to the County Council in making its final decision.
- 3 The CIPFA guidance on reserves and balances provides the general framework for considering the adequacy of reserves. A risk assessment has been made of the cost and demand pressures on budgets, insurance liabilities, achievement of budget savings and adverse winter conditions which support the proposed level of balances of approximately £18m. This assessment is set out as an Annex to the Appendix.
- 4 Similarly the level of reserves is scrutinised each year and the protocol on the purpose, use, control and review of each reserve has been agreed. Details of the protocol and the expected movements in each reserve are set out in Appendix 5. Schools have one of the largest reserves at a projected £36.8m supporting their delegated budgets funded by ring-fenced specific grant. The most important reserves for other services in terms of the medium term view are the grant equalisation reserve (used to help match grant loss), the equal pay reserve, corporate efficiency reserve and the insurance reserve.
- 5 Section 25 concentrates primarily on the uncertainty within the budget year rather than the greater uncertainties in future years. However future uncertainties, particularly for the County Council as a 'floor' authority also inform the need for reserves and balances in the medium term. The current financial position involving significant savings targets increases the risk of overspending, together with demand led spending pressures during a recession and potentially higher inflation.
- 6 The budget report is the conclusion of a detailed process of prior consultation and consideration through out the current year by Cabinet.
- 7 The County Council's policy on balances is to hold a minimum prudent level which on the basis of 2011/12's risk assessment is 2.5% of net expenditure. This is a level which is comparable with the last three years, and remains relatively low compared with other equivalent local authorities. The risks associated with being a floor authority and thus receiving the biggest reduction in government grant and of needing to achieve significant savings in service expenditure to balance the budget continue to justify this level of reserves. The risks associated with the achievement of budgeted savings have increased significantly

this year, though partly offset by reduced risk of recessionary impacts on the County Council

- 8 The level of uncertainty for the budget year is narrowed down as the budget strategy is developed during the year and defined in the performance and risk management and earmarked reserves paragraphs in the budget report.
- 9 In setting the budget the County Council should have regard to the strategic, operational and financial risks facing the County Council. The County Council has an overall risk management framework which covers these issues. The forward budget plan and reserves take into account the main risks and uncertainties, including:
  - Inflation
    - a pay freeze has operated in 2010/11 and the budget assumes a continuing pay freeze in 2011/12 and 2012/13 on the basis set out by the Chancellor of the Exchequer in the Emergency Budget in June 2010.
    - price inflation has been set at 2.5%. Given the sharp increase in both the retail and consumer price indices during the last year, containing price increases at an average 2.5% may prove challenging, depending upon market factors.
    - short-term interest rates have been budgeted to average 1.3% in 2011/12, 0.8% above the current base rate, as an upward movement in base rate is expected to begin during 2011/12.
  - Pay drift
    - increments are not budgeted for and services will need to secure efficiency savings to offset these. Past trends suggest that this can be managed.
    - there is a substantial potential liability from equal pay claims arising from the pay and benefits review. None of the claims has yet been considered by the employment tribunal and an equal pay reserve estimated at £47.1m at 31 March 2011 has been built up for non-school claims. School balances will assist in meeting claims in respect of school-based staff. An application for a capitalisation direction will be made in 2011/12 to protect against the risk of successful claims exceeding the capacity to fund them from the relevant reserves. A settlement in excess of this figure will require a capitalisation direction to enable the revenue impact to be phased over more than one financial year in order to avoid compensating job or service cuts, though there is no guarantee that the Government will provide an adequate capitalisation direction. The Government has also taken steps to assist local authorities to spread these costs by

introducing regulations which allow the effect of accruals for equal pay liabilities to be disregarded for council tax setting purposes.

- Employer contributions to the Hampshire Local Government Pension will remain at their current level for the three year period, 2011/12 to 2013/14, equivalent to 19.1% of pensionable pay, following the actuarial review at 31 March 2010.
- Savings and redeployments built in to the budget
  - The savings required in 2011/12 are on a significantly larger scale than in recent years. These will be subject to rigorous review by Executive Members and by the Cabinet, and savings plans will need to be approved and monitored during the course of the year.
- Efficiency savings and other savings
  - The 2011/12 and 2012/13 provisional budgets approved by the County Council in February 2010 included a corporate efficiency target of £15m per annum. Advance savings were achieved in 2010/11 and are budgeted to be achieved in 2011/12, enabling £7.4m to be transferred to the corporate efficiency reserve in 2011/12.
- Income
  - there is an annual review to maximise income and increase income at least in line with costs which is referred to in paragraph 5 of the report and reported in greater detail to executive members
- Achievement of budget plan
  - There is a well established and sound history of very close achievement of outturn to budgets, and though Children's Services are predicting an overspending in 2010/11, this is the result of the scale of in year grants made by the Department for Education.
- \* Strength of financial information and reporting arrangements
  - budget monitoring and control is well established, particularly in reporting and taking action over the second half of the financial year. Corporate co-ordination of budget monitoring focuses on demand led budgets, overall employee budgets and the achievement of planned savings.
  - other action plans have been put in place to consolidate and improve financial controls.
- Capital programme

- capital strategy, asset management plans and the local transport plan have all previously been accredited with the highest scores in the former comprehensive performance assessment.
- the slow down of the property market produced a temporary shortfall of capital financing resources in 2008/09 and 2009/10. Additional revenue contributions to capital were made in both in 2008/09 and 2009/10 and allowance has been made in the budget for additional temporary unsupported borrowing to cover the delay in achieving planned disposals.
- the Government's decision to provide support for capital schemes from 2011/12 solely by means of capital grant removes the problem of support through the formula grant system for borrowing allocations being ineffective, because of the damping of formula grant.
- Level of borrowing and outstanding debt
  - the issues are fully covered in the treasury management strategy and prudential indicators appendix to the budget report.
  - the current policy on temporary unsupported borrowing for specific projects results in the financing costs being contained within the forward budget plan cash limits without an additional impact on the council tax payer.
  - despite much lower capital receipts than originally planned since 2008/09, it has been possible to avoid the need for temporary unsupported borrowing to cover a general shortfall in capital financing resources.
- \* Contingent Liabilities
  - the County Council self-insures, so it finances all its own liability claims. The liabilities are uncertain but to cover these a provision is maintained for known liability claims and a reserve is maintained to deal with fluctuations in liabilities and in the level of fire damage reinstatement, which now stands at £11.9m.
- Annual Governance Statement
  - the Treasurer has the responsibility for ensuring that an effective system of internal financial control is maintained and operated in connection with the resources concerned.
  - the review of the effectiveness of the system of internal financial control is informed by the work of the managers within the County Council, by internal audit and the Audit

Commission in its annual governance report and other reports.

- the Audit Committee receives and reviews the annual governance statement and the external audit governance report.

- Audit Commission

- gave an unqualified opinion on the 2009/10 accounts, and an unqualified opinion on the County Council's arrangements to secure economy, efficiency and effectiveness in its use of resources in 2009/10.

- Other risks

- there are potential legal claims outstanding and other possible risks which past trends suggest can be met from balances if required. There is no known significant risk or liability which requires a provision, contingency or reserve not already allowed for in the budget report.
- changes in function and funding arrangements. The main risk relates to the arrangements for transferring funding from the County Council in respect of central services to schools, as schools opt for Academy status. The loss has been allowed for in the 2011/12 budget without assuming any offsetting savings will necessarily arise in 2011/12.
- though government grants have been confirmed for the next two years, the County Council's formula grant calculated from the formula is still £19.3m (10.4%) below the grant floor in 2011/12. The policy on the use of the grant equalisation reserve has provided mitigation against grant loss in previous years, but the contribution reaches its peak in 2011/12 and 2012/13.

- 10 Provided that the County Council considers the above factors and accepts the budget recommendations, including the level of earmarked reserves and balances, a positive opinion can be given under Section 25 on the robustness of the estimates and level of reserves.

Carolyn Williamson

County Treasurer

1 February 2011

**2011/12 – Risk assessment of General Balances**

	£m	%	£m	Comments
Inflation pay	332.7	-	-	Low risk of pay freeze assumption not holding in 2011/12
Non-pay	623.1	1.0	6.2	Allowance for higher non pay inflation, but with potential for absorption within the cash limit
Income	-196.4	-1.25	2.4	Risk of resistance to income generation assumption
Interest rates	28.8	2.0	0.6	Short-term interest rates may increase in 2011/12 above current levels, but the majority of interest costs relate to long term fixed rate borrowing and are mitigated by contingency provision
Demand led budget	306.3	6.0	18.4	Allows for potential for absorption within cash limit
Insurance liabilities	4.8	25.0	1.2	
Achievement of cashable savings	62.9	10.0	6.3	Risk increased by scale of savings targeted but mitigated by risk contingency within budget
Winter maintenance	4.1	25.0	1.0	Risk of higher spending than the four year average borne from balances
			36.1	
Less likelihood of worst cases coinciding		50.0	-18.1	
Proposed target balances			18.0	