



Report of the Director of Resources

Corporate Governance and Audit Committee

Date: 15 December 2009

Subject: The Changing Financial Landscape

Electoral Wards Affected:

Ward Members consulted
(referred to in report)

Specific Implications For:

Equality and Diversity

Community Cohesion

Narrowing the Gap

Executive Summary

This report has been prepared at the request of Members of the Committee and in the context of the changing financial landscape facing all local authorities. The Council has certainty as to its 2010/11 finance settlement from the Government. However, going beyond 2010/11, it is evident that the state of the public finances will have a significant impact upon future finances for all parts of the public sector, although at this time it is difficult to quantify the impact upon the City Council. The Council has adopted a medium term approach to financial planning, and the update of this financial plan in conjunction with the update of the Council's Business Plan during 2010 will be important in shaping the Council's response to its future financial challenges. At this time, the Council's financial planning arrangements are regarded as fit for purpose, but they will need to be kept under regular review to ensure that they remain so.

1.0 Purpose Of This Report

1.1 This report has been prepared in order to provide Members of the Committee with an understanding of, and an opportunity to review the Council's approach to medium term financial planning and management within the context and the financial challenges facing the public sector in general and specifically the City Council.

2.0 Background Information

2.1 Apart from Central Government itself, Local Government is the only part of the public sector within England and Wales which has its own tax raising powers. However, despite this, the spending of local authorities is subject to a significant

number of central government controls not least the simple fact that on average something like 75% of Local Authority spending is funded by various forms of central government grants. As such Local Government is not immune to factors affecting the national public finances.

- 2.2 The last decade has certainly seen a significant increase in Government spending with total government spending rising from £437.3 billion in 2000/01 (36.8% of GDP) to £582.7 billion in 2007/08 (41% of GDP). However it is clear that the credit crunch in 2007 and the resulting economic recession, which has now lasted for six consecutive quarters, has had a severe impact upon the health of the public finances.
- 2.3 The Chancellor's 2009 budget report in April revealed the sharp increase in public spending and a severe reduction in tax revenues. On the spending side this was significantly impacted by the Government's financial stability package to provide support to the finance and banking sectors. Government borrowing in the current year is forecast to be £175.6 billion, higher than any time since World War II and the public sector net debt for 2009/10 is forecast to represent 59% of GDP and expected to rise to 79% of GDP by 2013/14. Until the pre-budget report of 2008 the public sector net debt was limited by the Government's sustainable investment rule which stated that net debt should be maintained at below 40% of GDP in each and every year of the economic cycle. The 2009 budget proposes bringing current spending into balance by 2017/18 although the required policy decisions and projected recovery of the economy is only modeled to 2013/14. The recent Queen's speech included proposals for a Fiscal Responsibility Bill which will put into law a promise to halve the budget deficit within four years. The details of how this will be done will be included in the Pre-Budget Report in December. The Institute for Fiscal Studies have claimed that based upon the assumptions of the 2009 budget, a return to the 40% level for public sector net debt will not occur until February 2032. Regardless of the detail, it is clear that the Government's recovery plans depend upon a rapid economic bounce back with a forecast of 1.25% growth in 2010 rising to 3.5% in 2011.
- 2.4 In terms of public spending, the 2009 budget announced that public spending from 2011 would grow by just 0.7% per annum in real terms. However, how this will impact upon individual public services has not been spelt out although it is clear that it will not affect all services evenly and that some services will face very severe cut backs if other services are to be protected. The details of such spending proposals would normally be spelt out in the Government's Comprehensive Spending Review. Such reviews have been used by the Government to set out planned expenditure for the three forthcoming years. The timing of these reviews have varied over time but the original intention was that they would set out planned public expenditure for a three year period but would be undertaken every two years, thus year three of the previous review would become year one of the next. The planned spending review that was due in summer 2009 was postponed and it is now not clear when the next review will be announced.
- 2.5 2010/11 is in fact the third year of the previous Comprehensive Spending Review. The following table details the increases in Government formula grant nationally and for Leeds and also sets out the Leeds Council Tax in first 2 year covered by the current Comprehensive Spending Review.

Year	Increase in Government Formula Grant			Increase in LCC Council Tax %
	National %	Leeds %	Leeds £m	
2008/09	3.5	2.7	7.6	4.7
2009/10	2.8	2.1	6.2	2.9
2010/11	2.6	1.8	5.4	TBD

2.6 The above increases in formula grant were those that were announced in the Comprehensive Spending Review published in the summer of 2007, but they are subject to annual confirmation by the Government. On the 26th November 2009, the Parliamentary Under-Secretary of State (Mrs Barbara Follett) published the Government's formal proposals on the distribution of Formula Grant to English local authorities for 2010/11 which confirmed no changes to the allocation of formula grant to the figures previously published. The 1.8% increase for Leeds (2.1% increase in 2009/10) is less than the average for the Core Cities (2.1%), the West Yorkshire districts (2.7%) and the metropolitan districts (2.6%). The written statement says that the government expects to see the average council tax increase – which this year was 3.0% - fall to a 16 year low next year while authorities protect and improve front line services. Ministers have also confirmed that they are prepared to cap 'excessive increases', including requiring rebilling, as happened with two police authorities this year. The Government have announced that the increase in total "aggregate external finance" (all specific and general grants including business rates) will be 4% (4.2% in 2009/10). However, that figure includes an increase of 4.3% for specific grants many of which provide little or no flexible spending power for local authorities. The government will pay, through area based grant, £210m (£420m in a full year) for the implementation of free personal care at home for people with high personal needs from October 2010. There is an expectation that the overall cost will be £670m in a full year and that the £250m difference will be funded by local government efficiencies.

3.0 Main Issues

3.1 Based upon the above, it is clear that the public finances will face significant challenges over the next few years with some commentators predicting such pressures to continue for perhaps up to ten years. How these national pressures will impact upon local government and specifically the finances of the City Council is difficult at this time to quantify, although it seems highly unlikely that either local government overall or the City Council specifically, will be immune from the effects of a tightening of public finances.

3.2 This worsening of the national public finances, and its potential impact upon local government generally and the City Council specifically, also has to be seen and understood within the context of the financial challenges facing the City Council. These challenges include by way of example:-

- Demographic changes, in particularly the growth in the population over 85 years of age
- Increases in cost above inflation

- Child protection
- Declining levels of income
- Increasing cost of pensions
- Delivering the Councils ambitions and aspirations and national agendas
- The environmental agenda including carbon trading, Landfill tax and LATS

Many of these pressures are already impacting in the current year upon the Council's financial position and most certainly will continue to be pressures going forward.

- 3.3 For 2010/11, budget preparations are assuming the increase in the Council's formula grant as announced as part of our three year settlement that is 1.8%. The recent confirmation of this grant settlement is clearly helpful in planning terms. It may be noted that David Cameron in a speech to a recent CBI conference stated that a Conservative Government, if elected would introduce an emergency budget within 50 days of taking power, aimed at bringing down the Government deficit. Whether this would impact upon local government is uncertain at this time. Regardless of which party is in power after the next General Election, the general direction would appear to be clear, but going beyond 2010/11 we are working with a very significant degree of uncertainty as to the quantification of any impact upon local government generally and the City Council specifically. Some commentators are talking about a 10% reduction in public spending over the three year period from 2011/12, and the Conservative party has clearly stated that they would be aiming to reduce the Government deficit more speedily than a Labour Government. In order to provide some understanding of the potential impact of changes in the Government grant, each 1% increase or decrease in the Council's formula grant is worth £3M.
- 3.4 Whilst the focus tends to be upon formula grant, and its impact upon services and levels of Council Tax, it should not be forgotten that there are significant elements of Council provision funded by specific grant, most notably schools and the Housing Revenue Account. In addition, the Council receives significant sums through the Area Based Grant, which although not earmarked is directed at key priorities.
- 3.5 In terms of dealing with this new financial climate, and whilst there will continue to be a need to develop detailed annual budgets, it is clear that the Council has to be financially planning beyond simply the next financial year. The Council has in fact for a number of years adopted a medium term approach to financial planning. The Council's current financial strategy is included in the Council's Business Plan 2008 - 2011. The plan outlines the key issues and priorities over the planning period and in the light of forecast available resources sets out a basis for the allocation of resources in order to support the Council's strategic and business priorities. As such the purpose of the strategy is to underpin the delivery of the Council's priorities and to set out a framework for the preparation of the Council's annual revenue budget.
- 3.6 The current financial strategy marked a new approach for the Council in linking service and financial planning. A new approach to the allocation of resources was also adopted which used as its building blocks an assessment of relative needs, the delivery of efficiencies and local priorities and as such it marked a significant shift towards budget making in a policy led rather than a finance led corporate planning

framework. This new approach and resulting resource allocations for a five year period was detailed in a report agreed by Executive Board in December 2007 and incorporated into the Council's Business Plan that was published in the Summer of 2008.

- 3.7 Work will be commencing in the new year upon the next Council Business Plan which will cover the period 2011 to 2014. Assuming a new Comprehensive Spending Review sometime next year and a new three year financial settlement for local authorities, this will provide an opportunity for the Council to review its financial strategy to ensure that it can respond in a planned way to the changing financial landscape within the public sector.
- 3.8 The efficiency agenda is a significant economic driver. All public bodies are under pressure to make year-on-year efficiency savings in back-office and support service functions in order to maximise investment in front-line services. It is clear that the delivery of efficiencies will become even more important to the future of financial planning and management of the Council. The Government for 2010/11 has already increased the so called Gershon target from 3% to 4% and it is clear that these expectations will continue beyond 2010/11. The council has a good track record in delivering efficiencies. For the three year period 2005/06 to 2007/08 we delivered cashable efficiencies of over £56m and we exceeded the Government's so called Gershon target by 41.5%. For 2008/09 the Council delivered further efficiencies of £27m and the latest budget targets efficiencies of over £20m. Thus, over the 5 year period efficiencies of over £100m have been delivered. Efficiencies have been delivered across a number of areas, including energy, procurement, sickness management, administration and back office functions. However, it is clear that much more can be achieved and has to be achieved utilising the benefit of technology and changing the way that we work. The Council has embarked upon a transformation program as agreed by the Executive Board in December 2008. This report recognised that in order for the Council to deliver its Strategic and Business Plan outcomes (within challenging financial constraints), the delivery of a Transformation Program was imperative in order to bring about both significant change and facilitate a number of benefits (both cashable and non-cashable). The Business Transformation Program provides the basis for making significant efficiencies for the redirection of resources to front-line services which would otherwise not be achieved by the traditional incremental change approach.
- 3.9 In response to the changing financial landscape, the Council is also enhancing its arrangements to consider the efficiency of services. Central to these arrangements are plans to develop a Council wide approach to efficiency and value for money. Although plans are at an early stage, the enhanced approach is likely to include the following:
- Developing a corporate and systematic approach to value for money, including a clear and concise policy statement on vfm and a consistent approach to benchmarking
 - Developing governance arrangements for vfm including a review of existing terms of reference.
 - Considering the role and contribution of scrutiny boards and the Corporate Governance and Audit Committee to the vfm agenda
 - Developing and embedding a culture of vfm – the vision is that all Chief Officers will be accountable for driving down cost and delivering vfm
 - As part of the systematic approach to vfm it is intended to develop a 'dashboard' approach to reporting the current position on vfm across all services.

- Proposals for raising awareness of vfm and training/briefings on undertaking vfm reviews
- Review the Internal Audit plan and the Business Process Re-engineering team's work programme to refocus vfm reviews on corporate priorities
- Reviewing the procurement 'checklist' to determine whether market testing is an appropriate response for a particular service.

3.10 Accountability, and the in year monitoring of financial health, will also be crucial in terms of how the Council responds to current and future financial challenges as problems need to be identified as early as possible in order to take appropriate corrective action. Budget monitoring is undertaken at all levels of budget responsibility, with monthly reporting to corporate finance and senior management. This is supported by quarterly reporting to the Executive Board and to the Central and Corporate Scrutiny Board.

4.0 Implications For Council Policy And Governance

4.1 The Council's approach to its annual budget is set out within its budget and policy framework which detailed in Part 4 of the Council's constitution. This sets out a broad framework covering the preparation and scrutiny of budget proposals and arrangements for varying the budget in year. Whilst there are no proposals at this time for this framework to be amended, nevertheless it is important that this is kept under review so as to ensure that the Council is able to respond and deal with the financial climate it is facing.

5.0 Legal And Resource Implications

5.1 There are no legal or resource implications at this time.

6.0 Conclusions

6.1 It is clear that all public bodies will face significant financial challenges over the short and medium term, although at this stage quantifying how this will impact upon the Council's finances beyond 2010/11 is subject to a great deal of uncertainty. The City Council does have in place both medium term financial planning and monitoring arrangements and has a good track record of delivering its annual budget and required efficiencies.

6.2 The Council in the current year is facing a number of significant financial pressures, and it is clear that many of these, are by their nature structural. The preparation of the Council's 2010/11 budget is underway and the extent to which structural issues are dealt with will be critical in providing a basis for developing robust financial plans beyond 2011/12. Taking account of these and other developing financial pressures, it would be difficult to underestimate the potential impact that the changing landscape could have upon the Council's resources and its services. Both the on-going Business Transformation Program and the next Council Business Plan will be crucial in how the Council responds to these challenges.

6.3 Supporting the budget and policy framework, the Council has adopted a medium term approach to financial planning and has in place robust in-year monitoring arrangements. At this time it would appear that these are fit for purpose, although it is the case that these will need to be regularly monitored to ensure that they remain so. It is also undoubtedly the case that the real challenge going forward will not so

much be governance arrangements, but will be policy making, service prioritisation and the delivery of value for money within a tightly constrained financial environment. Nevertheless, in any likely scenario the Council will continue to control significant financial resources and will retain significant capacity to deliver services for the citizens of Leeds.

7.0 Recommendations

- 7.1 The Corporate Governance and Audit Committee is asked to note the contents of this report and are invited to comment on the extent to which the Council's financial planning arrangements are fit for purpose.

Background Documents Used

Developing the Councils approach to medium term financial planning - Executive Board December 2007

Council Business Plan 2008/2011

Chancellors Budget 2009

Business Transformation in Leeds City Council – Executive Board December 2008