

DRAFT REVENUE BUDGET 2006/07

PORTFOLIO RESPONSIBILITY: CORPORATE STRATEGY AND FINANCE

CABINET

23RD FEBRUARY, 2006

Wards Affected

County-wide

Purpose

To receive the Corporate Management Board's (CMB's) proposed revenue budget for 2006/07.

Key Decision

This is not a Key Decision. Council will take the final decision on Council Tax levels for 2006/07 on 10th March, 2006.

Recommendations

- THAT**
- (a) the views of the Strategic Monitoring Committee on the draft budget strategy for 2006/07 agreed on 26th January, 2006 be noted;
 - (b) the budget strategy as outlined in this report (paragraphs 1 – 3 refer) be confirmed;
 - (c) the Council's responsibilities under Sections 25 – 29 of the Local Government and Finance Act 2003 as outlined in this report (paragraphs 4 – 9 refer) be noted;
 - (d) the position on financial standing and risk as outlined in this report (paragraphs 10 – 13 refer) be endorsed;
 - (e) the financial context to the preparation of the budget strategy and detailed budget plans for 2006/07 (paragraphs 14 – 33 refer) be noted;
 - (f) the assumptions for funding the revenue budget outlined in this report (paragraphs 34 – 36 refer) be noted;
 - (g) the revenue budget proposals for 2006/07 outlined in this report be recommended to Council for Council Tax setting purposes on 10th March, 2006 (paragraphs 37 – 40 refer);
 - (h) the efficiency plans outlined in this report (paragraphs 41 – 43 refer) be approved;
 - (i) the need to develop a robust Service Improvement Programme and deliver the benefits as part of the medium-term financial strategy of using reserves flexibly to deliver a soft landing in planned spending (paragraphs 44 – 46 refer) be endorsed.

Reasons

Cabinet needs to make a recommendation on the detailed revenue budget for 2006/07 to Council on 10th March, 2006 when the Council Tax for next financial year will be set. Its recommendations to Council need to be made having taken into account the Council's current financial standing, resource availability and spending pressures for the future.

Considerations

Budget Strategy

1. The approach taken to formulating the Council's budget set out in this report is in accordance with the budget strategy approved by the Cabinet on 26th January, 2006. This strategy incorporated the views expressed by the Budget Panel. The Strategic Monitoring Committee's views also need to be taken into account by the Cabinet as it considers this report.
2. The key elements of the budget strategy approved by Cabinet on 26th January, 2006 are:
 - Minimising the impact of budget decisions on frontline services by using existing financial capacity to maintain current levels of service provision whilst a whole-Council approach to a Service Improvement Programme that will deliver budget savings is developed and implemented;
 - Setting affordable Council Tax increases for 2006/07 and 2007/08 of 4.7%;
 - Transferring unspent Invest to Save budgets in 2005/06 into 2006/07;
 - Maintaining a minimum of £3m in revenue reserves;
 - Writing off significant overspends from 2004/05;
 - Writing off significant overspends from 2005/06;
 - Adjusting ongoing base budget pressures;
 - Funding only the most essential items of growth;
 - Creating a contingency in the event of continued overspend on social care and homelessness services;
 - Carrying out detailed research to understand the exact nature and extent of the financial pressures likely to arise in the future as a result of Herefordshire's changing population structure;
 - Preparing detailed efficiency plans to realise the £1.65m cash savings needed for 2006/07 and 2007/08; and
 - Preparing detailed Invest to Save plans supporting the Service Improvement Programme.
3. The Cabinet also agreed the following principles for future financial management:
 - A 'one organisation' approach to managing cash and other corporate resources in line with the key priorities set out in the Corporate Plan;
 - A 'one organisation' approach to putting the cash and other resources needed to

respond to the recent CPA and JAR inspections in place for:

- Improving the Staying Safe judgment;
 - Improving performance management;
 - Reviewing business processes; and
 - Making progress with the accommodation strategy.
- Ring-fencing adjustments for ongoing base budget pressures for that purpose and returning unused cash to the corporate pot;
 - Managing budgets at Directorate level rather than at service or team level as is the practice in some areas – particularly important if underlying budget pressures have been addressed;
 - Allowing Children’s Services to meet the cost of their base budget pressures from virement within the Directorate; and
 - Developing a robust Service Improvement Programme that would prepare the way for a ‘soft landing’ in the budget given the anticipated reduction in reserves in 2005/06 and impact of the Spending Review 2007 (SR07) in 2008/09.

Budget Calculations – Statutory Duties under the Local Government Act 2003

4. Sections 25 to 29 of Part 2 of the Local Government Act 2003 impose duties on local authorities designed to ensure they make prudent allowance for risk and uncertainties in their budgets and that they regularly monitor their finances during the course of the year.
5. Section 25 of the Act deals with budget calculations and requires the statutory chief finance officer to report on the robustness of estimates and reserves. This duty was introduced because the Council decides on the Council Tax before the financial year begins and Council Tax cannot be increased during a financial year. It therefore needs to consider the risks and uncertainties that might force them to spend more than planned. The Council has a statutory duty to take the chief finance officer’s Section 25 report into account when it sets the Council Tax.
6. Whilst local authorities have discretion to make their own judgments on a prudent level of budget and reserves, Section 26 of the Act contains reserve powers for the government to set a minimum level of reserves. This means that the government has the right to intervene if it thinks a local authority is acting irresponsibly.
7. Section 27 of the Act requires the statutory chief finance officer to report to Council if reserves have dipped below the minimum agreed level when the next budget is set. That report must include suggestions on how to avoid it happening again.
8. Sections 28 and 29 of the Act deal with budget monitoring issues and make budget monitoring a statutory duty. If monitoring establishes that the budget position has deteriorated, authorities are required to take appropriate action. This might include reducing spending in the rest of the year, increasing income or funding the shortfall from reserves.
9. The Director of Resources will provide her statutory report to Council on 10th March, 2006 when it sets the Council Tax for 2006/07.

Financial Standing and Risk

10. Sound corporate governance includes consideration of the financial risks facing an organisation. A detailed assessment of the key financial risks affecting the Council's budget strategy and plans is attached at Appendix A.
11. The external auditors have assessed the Council's financial standing as good but they continue to highlight the need to keep a sufficient level of financial reserves to provide the flexibility needed to respond to adverse circumstances.
12. The external auditor has also rated the Council's effectiveness in the Use of Resources as good stating that the Council offers good value for money. The Council needs to protect this reputation and continue to develop it as the Audit Commission's tests in these areas get ever more challenging.
13. The key risks to the Council's future financial standing are as follows:
 - Increasing client numbers in essentially demand led services such as adult and children's social care and homelessness;
 - Increasing costs of waste disposal and recycling services;
 - Increasing costs of Concessionary Fares services due to enhanced statutory requirements;
 - Very high inflationary increases in gas, electricity, heating oil and vehicle fuel prices;
 - Maintaining and improving the overall CPA rating of 3 stars with low Government funding and a below average Council Tax;
 - Developing and implementing a Service Improvement Programme for the whole Council that will deliver more for less spending;
 - Delivering LPSA2 targets within the agreed funding allocation;
 - Delivering the Local Area Agreement;
 - Responding to a new Government funding regime that is less transparent (and even harder therefore to explain to the Council Tax payer) and more judgmental than its predecessor;
 - Making sure that Herefordshire's case is heard at national level as public spending plans and distribution formulae are revised for the future;
 - Reviewing the hidden subsidies provided by Herefordshire in the discretionary fees and charges made for services as a potential contribution toward reducing net expenditure as increases in Council Tax are effectively capped and Government support is fixed; and
 - The outcome of the Lyons Inquiry into the role and responsibility of local government and the review of the funding arrangements that will follow.

Financial Context – The National Local Government Finance Settlement

14. The Government announced the provisional local government financial settlements for 2006/07 and 2007/08 in early December 2005. The final figures were released on 31st January, 2006 – even later than we have grown accustomed to in recent years. The main points are as follows:

Government Support for Non Schools Services

- The Government has introduced a new approach to calculating Formula Grant (FG) allocations known as the 'Four Block Model' that deals in cash grant rather than assumptions about spending;
- The Government made it clear that it was expecting average increases in Council Tax of no more than 5% but capping criteria for 2006/07 will not be announced until after local authority budgets have been set;
- Formula Spending Shares (FSS) have been replaced by Relative Needs Formulae (RNF) in an effort to stop discussion on the notional level of support included in each authority's settlement for any given service;
- Assumed National Council Tax (ANCT) has been replaced by the Relative Resources Amount (RRA) to avoid local comparison to the notional figure for Council Tax used by the Government for grant distribution purposes;
- Formula Grant allocations have been provided for the next two financial years – 2006/07 and 2007/08;
- Population figures have been updated and are now based on 2001 Census information;
- New social services and resource equalisation formulae have been introduced;
- In contrast to the current methodology, the new system does not provide for additional cash outside of the damping process to support borrowing costs faced by local authorities in investing in infrastructure programmes such as the Local Transport Plan;
- Grant for schools expenditure has been transferred out of Formula Grant and is now a specific Dedicated Schools Grant (DSG);
- Additional funding above the amount indicated in the Spending Review 2004 has been provided at national level of £305m for 2006/07 and £508m for 2007/08;
- Formula Grant increases 3% in 2006/07 and 3.8% in 2007/08 at the national level;
- There is no maximum level of grant increase but a damping process involving grant floors has been used to ensure every authority receives a minimum increase in grant in 2006/07 and 2007/08; and
- The grant floors for 2006/07 were set at:
 - 2% for Education/Personal Social Services authorities;
 - 3.2% for Police authorities;
 - 1.5% for Fire authorities; and
 - 3% for shire districts.

Government Support for Schools

- Government support for schools is now provided through a ring-fenced or specific grant called the Dedicated Schools Grant (DSG);
- The overall increase in DSG for England is 6.4% in 2006/07 and 6% in 2007/08;
- The amount of DSG per pupil is guaranteed in 2006/07 and 2007/08; and
- Actual grant paid will be calculated on the basis of pupil numbers on 31st January before the start of each financial year so the cash amounts announced are provisional until pupil numbers have been confirmed.

Financial Context – Herefordshire’s Local Government Finance Settlement

15. The key points of the Local Government Financial Settlement for Herefordshire are as follows:

Overall Government Support

- The overall headline was better than anticipated as the Government put more money into the system than expected based on their public spending plans outlined in SR04;
- Herefordshire’s overall grant increase (FG plus DSG) for 2006/07 is 6.4% and for 2007/08 is 3.4%; and
- Herefordshire is 38th out of the 46 all purpose authorities in terms of overall Government funding per head of population – a situation that is unlikely to improve significantly whilst it receives floor increases in grant.

Government Support for Herefordshire’s Non Schools Services

- Herefordshire’s Formula Grant increase is 2.4% for 2006/07 and 2007/08;
- These increases barely keep pace with expected inflation and therefore represent a standstill position in real terms;
- The new distribution formulae produce a ‘raw’ Formula Grant for Herefordshire of £46.148m in 2006/07 before floor damping. This increases by £394k as a result of the damping process giving a ‘final actual’ Formula Grant for 2006/07 of £46.542m;
- The new distribution formulae produce a ‘raw’ Formula Grant for Herefordshire of £48.32m in 2007/08 before floor damping. This reduces by £670k as a result of the damping process giving a ‘final actual’ Formula Grant for 2007/08 of £47.65m;
- It is important to note that Herefordshire’s Formula Grant allocations are affected by the damping arrangements with an increase in 2006/07 and a reduction in 2007/08; and
- Herefordshire is 33rd out of the 46 all purpose authorities in terms of Formula Grant funding per head of population in 2006/07.

Government Support for Herefordshire’s Schools

- Herefordshire’s Dedicated Schools Grant increase for 2006/07 is 4.3% and for 2007/08 it is 4%;

- Compared to non schools services, the increase in funding for schools spending is good;
- The DSG per pupil for Herefordshire will be £3,296.83 in 2006/07 which is an increase of 7.1% over the 2005/06 figure of £3,078.40;
- Herefordshire's DSG per pupil in 2006/07 places it 147 out of 149 in the all Education authorities funding league table;
- Herefordshire's provisional DSG for 2006/07 is £78.679m and for 2007/08 it is £81.852m.

Financial Context – Prior Year Over Spends

16. Cabinet has already decided to write-off the 2004/05 over spend in social care services of £714k. Cabinet's budget strategy also indicates write-off of other significant over spends from 2004/05. The only other large one is £419k in Property Services.

Financial Context – Projected Financial Performance for 2005/06

17. This years net revenue budget was set at £184.889m. Councillors have received regular updates on the budget situation for the current financial year as part of the Integrated Performance Report (IPR) process. The latest IPR is included elsewhere on this agenda. An assessment of current year spending compared to budget is important in terms of setting future budget plans as it provides information on the likely level of reserves available to start the new financial year dependent on whether an over spend or under spend situation is forecast.
18. The latest assessment of financial performance in 2005/06 remains that significant overspends are anticipated in adult social care £1.5m, with the worst case scenario being an overspend of £1.75m and homelessness services £747k. The Integrated Performance Report elsewhere on this agenda provides more detailed information. There is a pattern of over spending in social care emerging that the budget strategy for 2006/07 is designed to address.
19. It is likely that the over spends in service budgets in 2005/06 will be masked by under spending on the Financing Transactions budget of some £1.6m due to out-performance of treasury management targets and delays in taking the funding needed to pay for capital spending and a further under spend on the Invest to Save budget £1.928m.
20. Cabinet has already stated its intention to use the Invest to Save under spend in this financial year in 2006/07. The boost to reserves this under spend represents at 2005/06 financial year-end is therefore only temporary if the budget is committed and spent next year and doesn't roll forward again.

Financial Context – Revenue Reserves

21. The following table summarises the anticipated change in revenue reserves in the current financial year and in 2006/07.

	£m		£m
Balance as 1st April 2005	13,005	Estimated balance at 1st April 2006	7,923
Less Commitments in 2005/06		Less Commitments in 2006/07	
Programme Area Carry Forwards from 2004/05	3,915	Invest to Save	1,928
Capital to Revenue Transfer	1,348		
Overspendings brought forward from 2004/05			
Social Care	714		
Property	419		
Projected Overspends in 2005/06			
Adult Services	1,500		
Homelessness	747		
Add estimated underspendings in 2005/06			
Financing Transactions	-1,600		
Invest to Save	-1,928		
Add estimated Corporate underspendings in 2005/06			
West Mercia Supplies Dividend	-262		
Corporate Insurance	-138		
Environment Contingency	-132		
Local Authority Business Growth Incentive	-564		
Amending Report changes to claw back Revenue Support Grant 2004/05 and 2005/06	165		
Other commitments (some estimated)			
HR Changes	50		
Children's Services			
Change Management	250		
CPA	50		
Land Charges	100		
JE	100		
Gideon House	200		
Funding of Unison post	25		
Office of ODPM	123		

Estimated Balance as at 31st March, 2006	7,923	Estimated Balance as at 31st March, 2007	5,995
	=====		=====

22. The above table links back to the latest forecast outturn for 2005/06 and assumes that the outturn for 2006/07 will come in on budget. If all goes according to plan and that happens, the projected level of balances at 31st March, 2007 is currently forecast at £6.0m. This is needed in the event that efficiency savings are not delivered and social care pressures cannot be contained within the contingency funding for this purpose.
23. The £3.0m in excess of the minimum of £3m revenue reserves needed also provides some additional flexibility to fund the Service Improvement Programme and supporting strands of ICT, accommodation and organisational development.

24. As at 31st March, 2005 schools held balances of £8.9m including devolved capital of £1.6m and the main locally managed balances of £7.2m. The latest schools plans suggest that balances will reduce by 10% during 2005/06 due to budget pressures resulting from workforce reform, falling rolls and job evaluation. Schools are entitled to carry their balances forward into the following year. The Schools Forum has approved proposals to claw back any excess balances with any amounts being recovered being spent on capital improvements in schools.
25. Appendix B summarises reserves, balances and provisions as at 31st March, 2005 and projected for 31st March, 2006 for information.

Financial Context – Future Spending Pressures

26. The budget meetings with Directors in November 2005 were used to identify and quantify future spending pressures within each Directorate. The initial long list of spending pressures totalled approximately £20m in 2006/07.
27. The long list of spending pressures has been examined a number of times with increasing rigour by CMB, the Budget Panel, Cabinet and the Strategic Monitoring Committee. This has been necessary to ensure that available cash resources are allocated on a consistent basis for all Directorates in line with corporate priorities and the agreed budget strategy.
28. The initial long list of spending pressures was relatively painlessly reduced by £7m as items that CMB felt could be managed without the need for additional resources were removed.
29. The remaining £13m of growth pressures were examined in detail using an iterative process to identify:
 - base budget pressures;
 - unavoidable growth items where additional resources are essential for delivery;
 - social care demand pressures;
 - growth items where additional resources were not essential for delivery; and
 - growth items that could be potential Invest to Save opportunities.
30. The list of base budget pressures that emerged as a result of this process totals £2.9m in 2006/07 (the total rolling forward into 2007/08 is lower than this figure by £335k). This list was included in the budget strategy report agreed by Cabinet on 26th January, 2006 and is reproduced in Appendix C.
31. The list of unavoidable growth items where additional resources are essential for delivery was whittled down to £1.1m in 2006/07 (£771k in 2007/08). This list was included in the budget strategy report agreed by Cabinet on 26th January, 2006 and is reproduced in Appendix D.
32. The list of social care demand pressures totalled £2.8m in 2006/07 and rises to £4.1m in 2007/08. This information was included in the budget strategy report agreed by Cabinet on 26th January, 2006 and is reproduced in Appendix E.
33. The list of growth items where additional resources were not essential for delivery totalled £4.7m in 2006/07 (£4.8m in 2007/08). The list of growth items with Invest to Save potential totalled £1.4m (£486k in 2007/08).

Funding the Budget

34. The Financial Resource Model is a key part of the Council's medium-term financial strategy. It sets out the key financial assumptions that affect resource availability into the future. A comprehensive assessment of the corporate financial risks for the revenue spending plan is provided in Appendix A. The key issues are highlighted here:
- **Pay inflation** – rates of pay have been agreed for next year and will rise by 2.9%. The pay settlement for 2007/08 had not yet been agreed. The assumption is that pay inflation in 2007/08 will be 3.0%. Excluding schools, the increase in pay rates including national insurance and superannuation is £1.8m in 2006/07 and a further £1.9m in 2007/08.
 - **Pension costs** – the employers' contribution rate to the Local Government Pension Scheme administered by Worcestershire County Council is 17.1% for Herefordshire. This will rise to 17.6% in 2006/07 and then to 18.2% in 2007/08 to help eliminate the actuarial deficit on the pension fund. The additional contribution will cost £0.210m in 2006/07 and £0.260m in 2007/08.
 - **Price inflation** – price increases in the general economy are moderate at between 2% and 3%. There are some significant exceptions such as utility and vehicle fuel costs.
 - **Council Tax** - an increase of 4.7% has been assumed for 2006/07 in line with the Cabinet's budget strategy. The same level of increase for 2007/08 has been assumed for indicative purposes. Herefordshire's Council Tax is currently just below the average for an all purpose authority.
 - **Formula Grant/Dedicated Schools Grant** – the final settlement figures for 2006/07 and indicative figures for 2007/08 provided by the Government have been used in the FRM.
 - **Efficiency savings** – the FRM assumes that the Gershon cashable savings target of £1.65m in 2006/07 and 2007/08 will be achieved.
 - **Treasury Management** – the revenue consequences of having to borrow to fund the capital programme are fully reflected in the budget projection. Interest rates are judged to be reasonably stable over the next 18 months.
35. The FRM is summarised in Appendix F. The FRM starts with the approved base budget for 2005/06 of £184.889m and adjusts for all the significant known changes and financial planning assumptions outlined above. This enables the capacity in the budget to absorb base budget adjustments and essential growth to be estimated.
36. The FRM indicates spare capacity of £5.308m for 2006/07. This is higher than initial estimates as financial assumptions have been fine-tuned during the course of the budget preparation exercise.

Funding Allocations to Directorates

37. Allocating the financial capacity for 2006/07 in line with the budget strategy means that the list of base budget pressures (£2.9m) and the list of growth items (£1.1m) can be accommodated leaving £1.3m for a social care contingency.
38. Appendix G summarises the budget calculations for each Directorate. Next year's budget book will show detailed budget calculations for the new Directorates with comparable figures for 2005/06.

39. The Cabinet will want to consider any comments made by the Strategic Monitoring Committee and may have a view on further adjustments to the proposed spending plan for next year. It is suggested that any additions are paid for by a corresponding reduction in the Social Care contingency.
40. In addition to the funding allocations made from the corporate pot, Directorates have access to a range of specific grants that make financial management easier in some areas than others. The specific grant resources expected for 2006/07 and 2007/08 are outlined in Appendix H.

Efficiency Savings Plans

41. The Gershon saving target for cashable savings is approximately £1.65m a year. It is necessary to identify the exact source of those savings for the Annual Efficiency Statement that has to be submitted in April and in order to maintain our current Use of Resources scores.
42. The following table outlines progress in identifying the target level of efficiency savings in 2006/07 as reported to Cabinet on 26th January, 2006.

Cash Efficiency Plan 2006/07 and 2007/08 (all figures in £000's)

Directorate	2006/07	2007/08
Adult and Community Services	404	624
Children's Services	299	299
Corporate and Customer Services (including HR)	135	130
Environment	145	245
Resources	29	39
TOTAL	1,112	1,337

43. The only further cashable efficiency saving that has been identified since the last budget report is in recruitment advertising (£44k in 2006/07 and £88k in 2007/08). This figure will need to be allocated to Directorates based on staff turnover statistics. The remainder needed to meet the £1.65m target is £494k in 2006/07 and £225k in 2007/08. The target for the next two financial years will be achieved from additional vacancy savings allocated to Directorates on the basis of total base budget for employees in 2005/06. It may be possible to update the efficiency plan for 2006/07 as a result of the Corporate Strategy Review currently underway.

Service Improvement Programme/Invest to Save

44. A Corporate Strategy Review is currently underway that will result in a Service Improvement Plan (SIP) for each Directorate and ultimately one for the whole Council that includes the priorities identified in each Directorate SIP that most closely match corporate priorities. As well as identifying the key projects that will be taken forward, the overarching SIP will also identify the supporting strands. These are likely to be ICT, accommodation and organisational development.

45. It is suggested that unused element of the 2005/06 Invest to Save budget that will be carried forward into 2006/07 is set aside to help fund the investment needed to deliver the SIP once it has been agreed by members. The service improvement planning process is rigorous and is being applied consistently across all Directorates. Particular attention has been paid to identifying the benefits of the SIP developed by each Directorate and determining whether they are cashable and will lead to a deliverable base budget reduction.
46. The process for developing Directorate level SIPs and the overall SIP for the Council avoids the need to create a separate procedure for assessing the worthiness of a myriad of Invest to Save bids. This approach ensures that the corporate resource available for Invest to Save initiatives – which is what the SIP and associated strands will be – is allocated in line with corporate service improvement priorities.

Strategic Monitoring Committee

47. The Strategic Monitoring Committee considered the Cabinet's budget strategy report of 26th January, 2006 at its meeting on 13th February, 2006. The Committee supported the proposal for a 4.7% increase in Council Tax for 2006/07 noting that this level of increase was likely to be close to the maximum acceptable to the Government. The Committee noted that the Cabinet and Council would need to continue to monitor the Government's advice on what would be regarded as excessive Council Tax increases as the final budget setting decisions were taken.
48. The Strategic Monitoring Committee noted the uncertainty over the pressures on adult social services budgets and sought confirmation that there would be adequate provision within the budget to deal with these issues. The Cabinet is proposing to establish a social care contingency which will be released on the basis of an independent piece of research to establish the financial implications of changes in demand for these services. The Committee also wanted confirmation that the Children's Services Directorate had sufficient resource to deliver the Joint Area Review improvement plan.
49. The Strategic Monitoring Committee considered the medium-term financial constraints within which Herefordshire will have to deliver improving services at less cost. The Committee supported the Cabinet's proposal to transfer the unspent Invest to Save budget in 2005/06 into 2006/07 in order to fund the emerging corporate service improvement plan.

Conclusions

50. This budget cycle has been a difficult one for the Council. Herefordshire faces huge challenges in meeting rising customer demand, statutory duties and rigorous inspection regimes whilst maintaining financial stability into the future.
51. Herefordshire schools are amongst the worst funded in England on a per pupil basis but the increase in Dedicated Schools Grant was comparatively good at 4.3%. In contrast, the 2.4% increase in non-schools funding will barely cover inflation.
52. The scope to make good the shortfall in Government funding is severely limited by the cap on Council Tax increases. Reviewing the scope to raise additional income sensitively through fees and charges may reveal opportunities for bridging the funding gap.
53. The budget outlined in this report represents a significant step towards addressing some of the structural issues within the Council's budget for the future. However, reserves will be significantly depleted in 2005/06 as prior year and current year over spends are written off to help establish a stable budget position going forward.

54. The creation of a Social Care contingency in the event demand continues to increase to the extent currently predicted is an important step towards managing the key financial risks Herefordshire is facing. It is essential that these demand led pressures are fully understood and the resource implications assessed as soon as possible.
55. There will be limited capacity to deal with the level of over spending in key service areas that occurred in 2004/05 and is happening in the current year. These service areas need to consider whether alternative service delivery models may achieve more with less.
56. The medium-term financial prognosis is not good with SR07 looming large. The pressure from the Government to deliver efficiencies whilst improving outcomes and outputs continues to increase. The limited capacity in Herefordshire's financial reserves to provide the flexibility needed to achieve a soft landing in the budget means there is a pressing need to develop a Council-wide Service Improvement Programme supported by implementation of appropriate ICT, accommodation and organisational development strategies. The pay back in terms of budget reductions resulting from the investment needs to be certain **and** delivered if Herefordshire is to maintain its current financial standing.

Alternative Options

The Cabinet considered alternative options prior to confirming its preferred budget strategy on 26th January, 2006. The alternative options were:

- to use all the available capacity in 2006/07 to address base budget pressures and essential growth in the year, cutting back as necessary for 2007/08; and
- to assume no financial capacity in 2006/07, cutting back further as necessary for 2007/08.

These options were discounted as they were likely to lead to immediate cuts in frontline services in favour of the 'soft landing' approach outlined in this report.

Risk Management

The financial risk issues are outlined in this report and Appendix A. The key risks are:

- failure to contain spending within budget approved budget for 2006/07 – formal monitoring arrangements are in place linked to the IPR process to mitigate this risk; and
- failure to deliver the financial benefits in terms of reduced cost of service provision as part of the Service Improvement Programme currently being developed – the SIP will need to identify the risks and action necessary to manage them.

The implications of failing to manage these risks are that the Herefordshire's reserves will fall below the minimum required of £3m, damaging the Council's reputation for being good at the Use of Resources.

Consultees

The public via the January 2006 Community Forum meetings, Budget Panel, Strategic Monitoring Committee and members via a budget seminar.

Background Papers

None identified.

FINANCIAL RISK ASSESSMENT OF THE REVENUE SPENDING PLAN FOR 2006/07 & 2007/08

Council Tax

The Financial Resources Model allows for an annual increase of 4.7% in Council Tax. This is the firm proposal for 2006/07 at this stage and an indicative figure for 2007/08 and beyond. A 4.7% increase in Council Tax for 2006/07 is within the 5% guideline suggested by the Government. Capping criteria for next financial year will not, however, be published until all councils have set their budget for the year.

The Financial Resources Model allows for a 1.6% growth in the Council Tax base for 2006/07 as determined by the Council and a 0.4% increase in 2007/08 as provisionally indicated by Government. The level of growth for 2007/08 may be more than indicated, but is a prudent indicator for current purposes. The Council Tax base included in the Financial Resources Model takes into account Herefordshire's policy on Council Tax discounts for second and long-term empty homes.

A neutral position on the Collection Fund is forecast in the Financial Resource Model. Changes in the Council Tax base are regularly monitored. There are many factors that could affect the outturn for each financial year. In practice, the actual position on the Collection Fund at each year-end is rarely neutral because there are so many variables that affect the outturn. A surplus is clearly more desirable than a deficit and the impact of a deficit in both financial and reputational terms depends on its size.

Formula Grant and Dedicated Schools Grant

The final figures announced by the Government on 31st January, 2006 are as follows:

	2006/07		2007/08	
	£m	%	£m	%
Formula Grant	46.542	2.4	47.650	2.4
Dedicated Schools Grant	78.679	4.3	81.852	4.0
TOTAL	125.221	6.4	129.502	3.4

These are firm figures for the next two financial years. It is difficult to forecast the level of increases for 2008/09 and beyond at this point in time. The Government will begin its triennial review of its public spending plans shortly – this will be known as Spending Review 2007 (SR07) and will impact on local authority spending plans for 2008/09 and the following two financial years. The prognosis for local government is not good given anticipated national priorities. We will continue to ensure local spending pressures are understood at regional and national levels. We will also continue to scan the financial horizon to ensure our spending plans for the future are sustainable.

Inflation

Pay inflation has been included at 2.95% in 2006/07 and at 3% thereafter for non-teaching staff. Pay inflation for teaching staff has been allowed at 3%.

Pensions inflation has been included at 0.5% in 2006/07 and at 0.6% thereafter. This represents the stepped increase in the employers contribution rate assessed at the last actuarial review of the pension fund.

The Financial Resource Model assumes a 2.5% increase in fees and charges income each year.

A 2.5% increase in other costs have been allowed. This will be a challenging target in some areas. The budget strategy for 2006/07 allows for excess inflation in some areas such as utility costs.

Investment Income and Financing Costs

The level of investment income received and debt financing costs paid clearly depends on economic conditions and overall spending plans for revenue and capital. Our projections on the Financial Transactions budget are based on estimated cash flow taking into account capital and revenue spending plans. Significant slippage in the capital programme in particular can lead to a better than budgeted position. Based on advice from our treasury management consultants, we anticipate that interest rates will remain low with no dramatic change either up or down.

Staffing Budgets

These budgets are not fully funded on the basis that savings arise each year as staff leave the Council. Directors will need to continue to exercise close control over vacancy management to ensure staffing costs are within budget and to generate efficiency savings wherever possible without detriment to service provision.

Partnership Working

Herefordshire will continue to explore the potential for partnership working and procurement on an active basis. The shared services agenda could potentially deliver cost and service improvements over the longer-term. No assumptions on the level of savings and when they are likely to occur are included in the Financial Resources Model at this stage.

Changes in the Base Budget

The Financial Resource Model has been prepared on the assumption that tight financial control at Directorate level will be maintained for the future. Growth items of significant size will clearly impact on the resource forecast. The Government has promised to ensure that new burdens will be properly resourced for the future. It is hoped this will ease pressure in the years to come.

Organisational Development

Herefordshire is going through a period of structural change. This needs to be achieved within the existing base budget although it is recognised that some one-off costs may be incurred as preparations for service improvements are made.

Concessionary Fares

Spending on the Concessionary Fares scheme is notoriously difficult to predict. Introduction of the new statutory scheme for 2006/07 means this budget could be volatile. This budget will need to be closely monitored.

Social Care

2005/06 saw significant levels of overspending particularly in adult services. The overspend from 2004/05 will be written off as will the 2005/06 overspend. The base budget has been adjusted for 2006/07 and a contingency established in the event of further overspend. Further measures are also being taken to manage this risk. An independent assessment of the cost drivers in this area of service provision is underway to help to help establish a realistic base budget.

Homelessness

This is another high risk budget that produced a significant overspend in 2005/06. The base budget for 2006/07 and 2007/08 reflecting the action plan that is in place to bring this budget back under control.

Waste Management

An earmarked reserve has been established to help pay for future costs arising from the Waste PFI project. The Financial Resource Model includes a further contribution of £825k to this reserve in 2006/07. A figure of £580k has been included for future years. This will need to be closely monitored in the event it proves insufficient and the resource assumption needs to be changed.

Unforeseen Contingencies

The recommended minimum level of revenue reserves and balances is £3m. The General Reserves balance is expected to be £6.0m at the end of 2006/07 if all goes according to plan. This is considered sufficient to deal with any other unforeseen events and is in line with Prudential Code requirements.

Changes in Taxation

The revenue spending plan assumes that the current national system of taxation remains the same. The Chancellor of the Exchequer could change employer National Insurance contribution rates, Climate Change levy and VAT rates and exemptions.

Changes in the Local Government Finance System

The balance of funding review is still underway – indeed Sir Michael Lyons' remit has been extended to include consideration of the respective role and responsibilities of central and local government. The Government is in the process of reorganising other elements of the public sector and a white paper on local government organisation in England is expected this summer. Meanwhile, an increasing number of funding streams are being allocated at regional level. All these factors could have significant implications for future service and financial planning.

Gershon Efficiency Targets

The Financial Resource Model assumes a target for cashable savings of £1.65m a year. This target needs to be reviewed as final spending figures for each year are available. The Annual Efficiency Statement for 2006/07 setting out how cashable and non-cashable efficiency savings will be delivered has to be prepared by mid-April.

Edgar Street Grid Project

Herefordshire's spending plans do not recognise the resource implications over time for the Council of this project. These will emerge in the next few weeks now that the Chief Executive of the Joint Venture Company – Jonathan Brotherton – is in post. Local Authority Business Growth Incentive Scheme grant may be an appropriate source of funding for this and other regeneration activity.

STATEMENT OF RESERVES, BALANCES AND PROVISIONS

Reserve, Balance or Provision	Purpose of the Reserve, Balance or Provision	Actual as at 31st March, 2005 £000	Forecast as at 31st March, 2006 £000	
General Revenue Reserve	General reserve retained to meet unforeseen costs. Includes £3m minimum provision.	13,005	7,923	See note 1 below
Schools Carry Forwards	Retained at the discretion of Schools Governing Bodies.	8,919	6,400	See note 2 below
Waste Disposal	Surpluses brought forward from the budget provision for the Waste PFI contract in previous years. Intended to be used to smooth out costs following renegotiation.	1,386	1,586	
Winter Maintenance	Amount retained to meet costs of very cold winter.	108	108	
IT Support Services	Balance carried forward to meet expenditure in future years.	758	758	
Support Services	Balance carried forward to meet expenditure in future years.	358	358	
Insurance	Set aside to meet future insurance excesses and uninsured losses (self insurance).	885	1,000	
Schools Balance of Risk	Internal insurance for schools.	335	335	
Bad Debts	Former Hereford and Worcester liabilities relating to insurance.	73	50	
Maintenance of Open Spaces	Committed lump sums utilised to meet additional maintenance liabilities.	87	100	
Initiatives Fund	Amount available to fund projects (repayable).	372	420	
Learning and Skills Council	Amount set aside for probable grant repayment.	108	--	
Industrial Estates	Amount set aside for maintenance at the Industrial Estate.	123	123	
SRB Scheme	Amount set aside for possible repayment of grant	96	96	

Legal Claim	Amount set aside to meet costs of a legal claims against the Council	47	--	
Various Small Reserves and Provisions		110	--	
TOTAL		26,770	19,257	

Note 1: The estimate as at 31st March, 2006 includes £1.928m Invest to Save budget that will be spent in 2006/07.

Note2: This estimate is based on the schools current budget plans, but normally the school balances will exceed this estimate.

PROPOSED BASE BUDGET ADJUSTMENTS

DIRECTORATE	BUDGET HEADING - explanation	BASE BUDGET ADDITION 2006/07 £000	CHANGE 2007/08 £000
Adult & Community Services	Learning Disabilities – ongoing deficit	758	0
Adult & Community Services	Homelessness – temporary accommodation costs (this figure excludes the £300k one-off virement in 2005/06)	686	-260
Adult & Community Services	Parks & Countryside – loss of contract income from Hereford City Council	85	0
Adult & Community Services	Cultural Services – unrealisable savings in the TIC service	124	0
Adult & Community Services	Older People – independent assessment of the financial implications for the future of Herefordshire's changing population structure on adult and children's social care spending	75	0
Adult & Community Services	Older People – catch up on contractual inflation for the SHAW contract	393	0
Adult & Community Services	Parks & Countryside – catch up on contractual inflation indices	41	0
Children's Services	Transport – catch up on contractual inflation indices	90	0
Corporate & Customer Services	Land Charges – ongoing budget deficit	80	0
Environment	Concessionary Fares – excess over the amount allowed for in the Financial Resources Model needed to implement the new statutory scheme	154	0
Environment	Waste Collection – catch up on contractual inflation indices	200	0
Environment	Street Cleansing – catch up on contractual inflation indices	50	0
Resources	Revenues & Benefits – support for Academy software not included in the budget	76	0
Resources	Property Services – excess inflation in utility costs	75	0
TOTAL		2,887	-335

APPENDIX D

ESSENTIAL GROWTH ITEMS

Directorate	Essential Item	2006/07	2007/08
		£000	£000
Adult and Community Services	Older people – maintaining services currently funded by Access and Systems Capacity Grant	137	137
Children's Services	Children with Disabilities – contribution to the Joint Agency Agreement from Social Care over and above the contribution from the Direct Schools Grant	279	250
	Children's Commissioning – replacement of one-off funding necessary to maintain current level of service provision	160	--
	Safeguarding children replace reduction in grant funding	149	--
	JAR/Children and Young People Action Plan	100	25
Corporate and Customer Services	Coroners Service – legal obligations to pay increased fees	30	30
Environment	Public Transport – withdrawal of subsidised bus service AMW funding	85	150
Resources	Senior Management restructure. Legal obligation. Commitment ends 2007/08	139	139
	Support for Adult and Community Services. Additional accounting support needs to continue	40	40
TOTAL		1,119	771

APPENDIX E

SOCIAL CARE DEMAND PRESSURES

Directorate	Budget Heading - explanation	2006/07 £000	2007/08 £000
Adult & Community Services	Older People – full year cost of growth placements in 2005/06	204	204
Adult & Community Services	Older People – current assessment of increasing demand for services	476	1,710
Adult & Community Services	Mental Health – full year cost of growth placements in 2005/06	226	226
Adult & Community Services	Mental Health – current assessment of increasing demand for services	115	231
Adult & Community Services	Learning Disabilities – full year cost of growth placements in 2005/06	337	337
Adult & Community Services	Learning Disabilities – current assessment of increasing demand for services	895	895
Children's Services	Secure Placements – anticipated increase in demand for service	250	200
Children's Services	Placements – anticipated increase in demand for service for children with learning disabilities	200	200
Children's Services	Children with Learning Disabilities – anticipated growth in demand for service	50	50
TOTAL		2,753	4,053

FINANCIAL RESOURCE MODEL FOR 2006/07 AND 2007/08

	2006/2007			2007/2008			2008/2009			2009/2010		
	Total	DSG	Other Services	Total	DSG	Other Services	Total	DSG	Other Services	Total	DSG	Other Services
	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Base Budget	184,889	73,963	110,926	196,964	78,679	118,285	204,850	81,852	122,998	214,736	85,126	129,610
Inflation	3,052	0	3,052	3,166	0	3,166	3,274	0	3,274	3,403	0	3,403
	187,941	73,963	113,978	200,130	78,679	121,451	208,124	81,852	126,272	218,139	85,126	133,013
Other Items												
- Waste management - PFI Contract - UNDER REVIEW	825		825	580		580	580		580	580		580
- Part transfer of Preserved Rights grant into FSS	104		104	0		0	1,891		1,891	0		0
- Incorporation of Residential Allowances into FSS	764		764	0		0	0		0	0		0
- Concessionary Fares (TBA)	360		360	0		0	0		0	0		0
- LPSA 1 Performance Reward Grant	(850)		(850)	0		0	0		0	0		0
- Pump Priming of LPSA 2	850		850	0		0	0		0	0		0
- Job Evaluation - UNDER REVIEW	300		300	0		0	0		0	0		0
- Emergency Planning	60		60	0		0	0		0	0		0
- Procurement - WMS Savings	(300)		(300)	0		0	0		0	0		0
- Unison	5		5	0		0	0		0	0		0
- Changes in Capital Financing Costs	(221)		(221)	875		875	603		603	796		796
- Repayment of LGR SCA	0		0	0		0	(453)		(453)	(334)		(334)
- Prudential Code - Capital Implications	732		732	849		849	573		573	628		628
- Whitecross School - PFI Contract	150		150	1		1	144		144	177		177
	2,779	0	2,779	2,305	0	2,305	3,338	0	3,338	1,847	0	1,847
Additional Funding/(Savings)												
P&FG - Support Services (Proposed Budget Reductions)	(59)		(59)	0		0	0		0	0		0
Strategic Housing (Proposed Budget Reductions)	(23)		(23)	(23)		(23)	0		0	0		0
ICT (Proposed Budget Reductions)	(194)		(194)	6		6	0		0	0		0
ICT (Service Development)	194		194	(6)		(6)	0		0	0		0
Invest to Save	(2,048)		(2,048)	0		0	0		0	0		0
Efficiency Savings	(1,650)		(1,650)	(1,650)		(1,650)	0		0	0		0
Capacity in budget	5,308		5,308	915		915	0		0	0		0
	1,528	0	1,528	(758)	0	(758)	0	0	0	0	0	0
	4,307	0	4,307	1,547	0	1,547	3,338	0	3,338	1,847	0	1,847
	192,248	73,963	118,285	201,677	78,679	122,998	211,462	81,852	129,610	219,986	85,126	134,860
Reinstate Schools at DSG	4,716	4,716	0	3,173	3,173	0	3,274	3,274	0	3,405	3,405	0
TOTAL STANDSTILL BUDGET	196,964	78,679	118,285	204,850	81,852	122,998	214,736	85,126	129,610	223,391	88,531	134,860
Council Tax at 'Standstill'	4.70%			4.70%			6.29%			4.11%		

FUNDING ALLOCATIONS TO DIRECTORATES

	Adult and Community Services	Children's Services	Corporate and Customer Services	Environment	Resources	Chief Executive	Human Resources	Total
	£000	£000	£000	£000	£000	£000	£000	£000
<u>Inflated 2005/06 Base Budget</u>	42,308	94,251	6,944	23,190	19,037	973	1,238	187,941
Less one-off Budget Allocation for 2005/06 (Invest to Save)					-2,048			-2,408
Budget Additions								
Growth Items etc (FRM)	868	150	5	1,185	511	60		2,779
Reinstate Schools at DSG		4,716						4,716
Less 2005/06 Budget Reductions full year effect	-23				-59			-82
Less Share of Efficiency Target	-580	-388	-180	-347	-101		-54	-1650
<u>New Base Budget for 2006/07</u>	42,573	98,729	6,769	24,028	17,340	1,033	1,184	191,656
Add Proposed Base Budget Adjustments	2,162	90	80	404	151			2,887
Add Essential Growth Items	137	688	30	85	179			1,119
Social Care Contingency					1,302			1,302
Proposed 2006/07 Budget	44,872	99,507	6,879	24,517	18,972	1,033	1,184	196,964

Note: Disaggregation of budgets into new Directorate groupings still subject to change as new organisational structure is implemented at the detailed level.

SPECIFIC GRANT RESOURCES

Funding Area	Grant	2006/07 £000	2007/08 £000
R Education	School Development Grant (Provisional Only)	5,406	-
R Education	Ethnic Minority Achievement	35	35
R Education	Targeted Primary Strategy	563	-
R Education	Targeted Secondary Strategy	260	-
R Education	Music Services (a)	230	220
R Education	Music Services (b)	9	73
R Education	School Travel Advisers	32	32
R Education	School Improvement Partners	22	-
R Education	Secondary Strategy: Behaviour and Attendance	68	68
R Education	Secondary Strategy: Central Coordination	-	136
R Education	Primary Strategy: Central Coordination	141	138
R Education	Extended Schools	287	287
R PSS	Youth Opportunity Fund	30	30
R PSS	Sure Start (including Sure Start Local Programmes)	2,439	2,425
PSS	Carers	592	605
PSS	National Training Strategy	304	309
PSS	Preserved Rights	1,722	1,606
PSS	Children's Services	376	466
PSS	HR Development Strategy	141	143
PSS	Access and Systems Capacity	1,971	2,059
R PSS	CAMHS	180	184
R PSS	Teenage Pregnancy	99	99
R PSS	Mental Health	363	368
PSS	Delayed Discharge	374	384
PSS	Preventative Technology	114	193
EPCS	Waste Performance and Efficiency Grant	349	366
EPCS	Planning Delivery Grant (Revised)	2	-
EPCS	Rural Bus Subsidy Grant	855	-
EPCS	Homelessness	28	28
R Unallocated	Supporting People	6,656	6,324
	Total Special and Specific Grants	23,648	16,578
R Education	Dedicated Schools Grant	78,679	81,852

R = Ringfenced