

**REPORT TO:** East Lothian Council

**MEETING DATE:** 28 August 2012

**BY:** Executive Director (Support Services)

**SUBJECT:** 2011/12 Year-end Financial Review

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## **1 PURPOSE**

- 1.1 To inform Council of the unaudited financial position for 2011/12 and to finalise arrangements for the carry-forward of funds into 2012/13.

## **2 RECOMMENDATIONS**

The Council is recommended to:

- 2.1 Note the financial results for 2011/12, their impact on reserves and the Council's financial strategy.
- 2.2 Approve the addition of brought forward DSM surpluses to and deduction of brought forward DSM deficits from the 2012/13 individual schools budgets.
- 2.3 Approve the cessation of the Older Peoples Care Homes Service and Domiciliary Care Service as Trading Activities with effect from 01 April 2012.
- 2.4 Approve the final budget adjustments for the 2011/12 financial year (Section 3.30 - 3.32).

## **3 BACKGROUND**

### **Overall Summary**

- 3.1 The draft accounts for 2011/12 were submitted for audit on 26 June 2012 which is within the deadline set by the Accounts Commission. Audit work has commenced and will be completed by the end of September. The figures noted below and in the subsequent appendices, are unaudited and these could change as a result of discussions with our external auditors.

- 3.2 The draft accounts were presented to and discussed at the meeting of the Audit & Governance Committee on 17 July and a full copy of the draft accounts has been submitted to the Members Library.
- 3.3 Since 2010/11 the accounts of all local authorities must be prepared under International Financial Reporting Standards (IFRS). The presentation to the Audit & Governance Committee correctly focused upon the IFRS figures within the financial statements. However, we typically monitor our accounts on a statutory basis which strips out a number of IFRS adjustments. This report therefore focuses upon on the statutory position of the Council at the end of the financial year.
- 3.4 The key highlights from the 2011/12 closure of accounts are as follows;
- Usable Reserves decreased by £7.5m comprising a HRA decrease of £3.4 million and a General Services decrease of £4.1 million.
  - Capital spending totalled £71.5 million – a significant increase (26%) when compared to the previous financial year.
  - To support this capital spending, external borrowing increased by £38.9 million (15%). The difference between capital spending and external borrowing has been funded either from capital grants and external contributions or from the Council's own cash resources.
  - Pension liabilities as measured by the actuary increased by £14.2 million (18%) to £94 million.
- 3.5 The results for the year have a number of implications for the Council's financial strategy. In particular;
- The 2011/12 financial year is a significant watershed as the Council has used reserves to bridge the gap between income and spending on services. Usable General Service reserves dropped by 22% during the year.
  - The Council enters the 2012/13 financial year with the reserves expected and required as part of setting the 2012-2015 budgets in February 2012. However, all the existing reserves are now fully committed.
  - As at 31st March 2012, the Council remains on track with its existing financial strategy. However, significant financial risks – not least the inability of certain services to constrain and reduce costs and over-spends on capital projects – are emerging and will require further close monitoring and review as part of my reporting on 2012/13 financial performance.

### **General Services Revenue**

- 3.6 The final results for the various General Services revenue budgets was generally in line with expectations and as reported in the quarterly reports made during the year. A summary of the financial position across

each of the Business Groups at the end of March 2012 is attached at Appendix 1a.

- 3.7 In overall terms there were under-spends across most Council revenue budgets – leading to a smaller use of reserves than originally planned when setting the 2011/12 budget in February 2011.
- 3.8 However, all the Groups rated as ‘High’ financial risk as part of the Quarter 3 report - which included Children & Families, Pupil Support, Community Partnerships and Transport & Waste overspent their approved budgets. The underlying pressures are unlikely to abate during the 2012/13 financial year. A key part of the Council’s financial strategy is based upon cost containment and any continued overspending across these areas would compromise delivery of the approved strategy.
- 3.9 The former Education & Children’s Services Department ended the year with an overall budget under-spend. However, this masked a number of significant variances. While the Primary Group was well under-spent – as a result of slower than expected increase in roll numbers - there were significant over-spends within the Children & Families and Pupil Support Groups. The situation within Children & Families has continued into the 2012/13 financial year and gives particular cause for concern.
- 3.10 The former Community Services Department (excluding the Housing Revenue Account) also ended the year with a budgetary under-spend – helped by an increased surplus within the Building Services Trading Activity. Adult Social Care ended the year broadly within budget. There were however over-spends within Community Partnerships as a result of additional grant payments to community groups and as a result of the increase in National Non Domestic Rate charges. These are also ongoing issues for the 2012/13 financial year.
- 3.11 When the planned use of reserves are taken into account, all corporate budgets (Finance, IT, Human Resources, Legal Services and the Chief Executive’s Office) were under-spent at the year-end. As had been anticipated during the year, Council tax income at the end of 2011/12 was slightly less than budgeted (0.7%) due to a reduction in the number of house completions that had been anticipated in setting the budget.
- 3.12 The former Environment Group ended the year with a small budget deficit of £52,000. There were overspends within the Roads Services Group – largely as a result of increased energy costs relating to Street Lighting, the cost of winter emergency work and responding to flooding emergencies. We are working with managers across this Group to ensure that greater cost control is exercised in this area over the coming year.

### **Reserves**

- 3.13 During 2011/12 the Council used £4.1 million of its usable General Services reserves. This represented 22% of the total available at the start of the year and although planned, reflects a significant shift in the way in

which services are funded. An analysis of the movement and the current balances on each of the different reserves is included at Appendix 1b.

- 3.14 The Roads Renewals Fund – set up two years ago to meet the costs of reinstating the roads network after the severe winter – has now been fully used.
- 3.15 The 2011/12 financial year also saw the first use of the Cost Reduction Fund. This has now decreased from £5 million to £3.7 million with most of the reduction arising from the additional one-off costs which can arise when staff numbers are reduced. The staff groupings involved were; Chief Officers, IT Services and Domiciliary Care Services and these will generate significant recurring annual savings across future years.
- 3.16 Appendix 1b highlights two elements of General Services reserves that have been earmarked to support particular purposes. The first is £573,000 which is earmarked as carry-forwards for the schools under the Devolved School Management scheme. The second is £82,000 for Mid & East Lothian Drugs & Alcohol Project (MELDAP). This is a project that has been funded by a range of partners over an extended period of time.
- 3.17 Under the DSM scheme, the old year surplus or deficit for each school is added to or deducted from the current year budget for that school, all of which is funded by this earmarked element of the General Services reserve.
- 3.18 At the end of 2011/12 the Council retains £14.7 million of usable General Services Reserves. The largest part of this (£6.4 million) has been set aside to bridge the gap between budgeted income and expenditure in 2012/13 and 2013/14. There are currently no 'spare' General Services reserves and this is fully illustrated in Appendix 1b.

### **Trading Activities**

- 3.19 East Lothian Council has set up five trading activities. Every trading operation has the statutory financial target of breaking even over a cumulative three period. This is seen as an important indicator of whether Best Value has been achieved in these services.
- 3.20 Each of the Council's trading activities produced a surplus during 2011/12. The results for the financial year for each are outlined below.

<b>Trading Activities – Revenue Budget Performance for 2011/12 financial year</b>		
<b>Name of Trading Activity</b>	<b>(Surplus)/Deficit for the period £000</b>	<b>Cumulative (Surplus)/Deficit over past three years</b>
Property Maintenance	(697)	(1,647)

Facility Services	(48)	(1,239)
Roads Services	(187)	(1,857)
Care Homes	(80)	(62)
Domiciliary Care Services	(248)	(74)

- 3.21 There is no definitive list of which service has to be a trading activity. The test of what is a Significant Trading Operation (STO) – to use the terms in the relevant legislation - is considered to be a matter for individual authorities and each Council is expected to structure the delivery of its services in order to achieve Best Value in their area.
- 3.22 In a number of cases, especially where there were services that were used to competing for work under the old Compulsory Competitive Tendering (CCT) regime, there was also a desire to retain a competitive edge to service delivery. This was true of the Property Maintenance, Facility Services and Roads Services trading operations.
- 3.23 The two Adult Social Care trading operations (Care Homes and Domiciliary Care Services) were different as they were initially set up three years ago at the time the National Care Home contract was being developed and during the establishment of new procurement/contracting arrangements.
- 3.24 These two trading activities have now been operating for three years and have met the required statutory targets over this period. It is my view, along with the Head of Adult Wellbeing, that the original purpose of these two trading operations has been met.
- 3.25 In these circumstances it would be appropriate to cease the trading activity arrangements with effect from 01 April 2012. The two services would continue to operate in their current way and clients or customers would see no change in the way in which services are provided.

### **Housing Revenue Account**

- 3.26 The financial results for the Housing Revenue Account were also very much in line with expectations. Although rental income was under-budget - due to the slower delivery of affordable homes - there were compensating variations in other lines in the budget.
- 3.27 During 2011/12 the reduction in usable reserves for the Housing Revenue Account totalled £3.4 million. This was planned as part of budget decisions made during the year and relates almost entirely to the purchase of homes under the Council's Open Market Acquisition scheme. An analysis of the movement in HRA reserves is included at Appendix 1b

- 3.28 Moving into 2012/13, the Housing Revenue Account remains healthy and has adequate reserves of £6.7 million. These will be used as part of the ongoing Modernisation and Affordable Homes capital programmes.
- 3.29 The HRA reserves of £6.7 million are split between general reserves of £2.8 million and a Capital Fund of £3.9 million. The latter can be used in the future to either finance capital expenditure or allow for the redemption of debt. The advantage of this reserve is that it can be used flexibly in the coming years to manage the effect of rising debt costs particularly those associated with the new build programme.

### **Budget Adjustments**

- 3.30 As part of the year-end 'closedown' we are required by relevant statute to process a number of accounting adjustments in order that the statements we submit are in the approved format. The most significant adjustments are as follows;
- Central Support reallocations – to ensure that we report the total cost of each service provision we are required to reallocate the costs and budgets for central support services such as Finance/IT/Human Resources to 'service' accounts such as Social Work & Education;
  - IAS19 Pension Adjustments/Credits – for the majority of staff the Council made under statutory arrangements an employer's pension contribution of 17.5% of salary plus an amount to fund the interest on previous years' deficits. In accounting terms this charge is too high since it covers the necessary charge for the financial year plus a charge for pension contributions relating to previous years. An accounting adjustment needs to be undertaken at the end of the financial year in this respect.
  - Depreciation – in order that the Council follows generally accepted accounting practice we are also required to allow for depreciation in our annual accounts preparation.
- 3.31 The requirement to carry out these adjustments results in the final year-end figures being on a different basis compared to the budget reports issued to management during the year. To minimise any difficulties that may arise from this where possible budgets are entered for depreciation and the majority of pension credits. We also adjust for central support costs and reserves transfers as appropriate.
- 3.32 In addition to the above the Secondary School Group budget was increased by £32,000 in total to reflect the receipt of additional Revenue Support Grant relating to probationer teachers.

### **Capital Investment and Borrowing**

- 3.33 During 2011/12 the amount spent on capital assets continued its upward trend. This is indicated in the Table below.

<b>Year</b>	<b>Gross Capital Spend (£m)</b>	<b>HRA Capital Spend (£m)</b>	<b>General Services Capital Spend (£m)</b>
2011/12	£71.5m	£33.2m	£38.3m
2010/11	£56.8m	£30.1m	£26.7m

3.34 The total capital spend in 2011/12 was £71.5 million - with the HRA accounting for £33.2 million of this total. The HRA capital spend can be split as follows;

- £14.2 million on new Affordable Homes;
- £8.0 million on Open Market Acquisition and the Mortgage to Rent scheme;
- £11.0 million on Modernisation.

3.35 Gross capital expenditure within General Services related specifically to the Capital Plan (£35.1 million) was less than planned (£39.9 million) mainly as it has taken longer than expected to initiate some major projects, particularly the new Musselburgh Care Home and the Gullane Day Centre.

3.36 However, 2011/12 has seen the emergence of significant overspends on specific capital projects. These include the following;

- Brunton Hall Refurbishment – the current final anticipated overspend is anticipated to be in the region of £350,000 in excess of the approved project cost of £3.7 million.
- Dunbar Community Facility – the final anticipated overspend is expected to be in the region of £200,000 in excess of the approved capital costs of £4.5 million.
- Ormiston Community Facility – the current costs on this project total £1.048 million against a budgeted project cost of £900,000.

3.37 A significant proportion of the additional costs of these projects has or will fall due in the 2012/13 financial year – again putting additional strain on the approved Capital Plan and to an extent, the Council's financial strategy.

3.38 I have requested further information on the background to these overspends and this will be considered in detail by the Corporate Asset Group (CAG). In conjunction with the CAG, I am also carrying out a review of the Capital Plan. This review includes extending the planning horizon for capital work, updating project timing and costs when appropriate, and assessing how the future capital spend will be afforded.

The results of this review will be reported back to Council/Cabinet for consideration and approval. As part of this review we will consider how the specific overspends noted above could be treated.

- 3.39 At its August 2010 meeting, the Council agreed to set up a £2 million Property Renewals Fund with the aim of meeting some of the costs of a £7M planned programme of priority works across the Council's property estate. During the 2011/12 financial year spending on these works totalled £1.8 million and has been partly funded by a transfer of £500,000 from the Property Renewals Fund with the remainder charged against the capital account. The balance on the Property Renewals Fund now stands at £932,000 and is presented alongside other reserves on Appendix 1b. The future funding of these works is also being considered as part of the review of the Council's Capital Plan referred to above.
- 3.40 Borrowing has increased in line with capital investment. During 2011/12 long-term and short term borrowing increased to £292.5 million, an increase from £253.6 million in 2010/11. This debt has to be repaid with interest from future revenue budgets.

#### **4 POLICY IMPLICATIONS**

None.

#### **5 EQUALITIES IMPACT ASSESSMENT**

This Report is not applicable to the wellbeing of equalities groups and an Equalities Impact Assessment is not required.

#### **6 RESOURCE IMPLICATIONS**

- 6.1 Financial – as described above.
- 6.2 Personnel – none.
- 6.3 Other – none.

#### **7 BACKGROUND PAPERS**

- 7.1 Council 8 February 2011– All
- 7.2 Council 29 March – Item 01 Increase in Revenue Support Grant Funding. Change in ELC Budget 2011-2012
- 7.3 Council 17 May 2011 – Item 6 Financial Strategy – Update



- 7.4 Council 23 August 2011 – Item 09 2010/2011 Financial Review.
- 7.5 Council 25 October 2011 – Item 12 Financial Strategy – Mid Year Review
- 7.6 Cabinet 8 November 2011 – Item 01 Mid Year Review – New Build Programme
- 7.7 Members Library February 2012 – Financial Review 2011/12 – Quarter 1
- 7.8 Council 14 February 2012 – All papers
- 7.9 Members Library July 2012 – Draft Statement of Accounts
- 7.10 Audit & Governance Committee 17 July 2012 – All papers

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## REVENUE BUDGET PERFORMANCE at 31 March 2012

	Budget for the year £000	Actual to 31/03/12 £000	Budget for the period £000	(Surplus) / Deficit for period £000	(Surplus) / Deficit %	Financial Risk Assessment	Change since last assessment
<b>Education &amp; Children's Services</b>							
Children & Families	12,642	13,111	12,642	469	3.7%	High	Increase
Pre-school Education & Childcare	6,349	6,195	6,349	(154)	(2.4%)	Low	No change
Pupil Support	7,840	8,196	7,840	356	4.5%	Medium	No change
Schools - Primary	129,363	128,180	129,363	(1,183)	(0.9%)	Low	No change
Schools - Secondary	127,468	127,683	127,468	215	0.2%	Medium	Increase
Schools Support Services	4,396	4,155	4,396	(241)	(5.5%)	Low	No change
	<b>288,058</b>	<b>287,520</b>	<b>288,058</b>	<b>(538)</b>	<b>(0.2%)</b>		
<b>Community Services</b>							
Adult Social Care	50,853	50,772	50,853	(81)	(0.2%)	Medium	No change
Community Housing	4,278	3,942	4,278	(336)	(7.9%)	Low	No change
Property Maintenance	3,637	3,055	3,637	(582)	(16.0%)	Low	No change
Housing Revenue Account	0	4,432	0	4,432	0.0%	Low	No change
Community Partnerships	1,096	1,596	1,096	500	45.6%	High	Increase
Culture	6,664	6,710	6,664	46	0.7%	High	Increase
Community Development	16,429	16,329	16,429	(100)	(0.6%)	Low	No change
Facility Support	1,449	1,458	1,449	9	0.6%	High	Increase
Healthy Living	16,112	16,212	16,112	100	0.6%	Low	No change
Landscape & Countryside Mgt	6,734	6,686	6,734	(48)	(0.7%)	Medium	No change
	<b>107,252</b>	<b>111,192</b>	<b>107,252</b>	<b>3,940</b>	<b>3.7%</b>		
<b>Chief Executive's Office</b>	<b>3,344</b>	<b>4,101</b>	<b>3,344</b>	<b>757</b>	<b>22.6%</b>	<b>Low</b>	<b>No change</b>
<b>Environment</b>							
Economic Development	1,114	974	1,114	(140)	(12.6%)	Low	No change
Planning & Environmental Services	3,427	2,881	3,427	(546)	(15.9%)	Low	No change
Transport & Waste Services	21,379	22,117	21,379	738	3.5%	High	Increase
	<b>25,920</b>	<b>25,972</b>	<b>25,920</b>	<b>52</b>	<b>0.2%</b>		
<b>Corporate Resources</b>							

Human Resources	0	0	0	0	0.0%	Low	No change
Financial Services	0	0	0	0	0.0%	Low	No change
Revenues & Benefits	1,410	1,173	1,410	(237)	(16.8%)	Low	No change
Customer Services	488	471	488	(17)	(3.5%)	Low	No change
Law & Licensing	26	(12)	26	(38)	(146.2%)	Low	No change
IT Services	0	0	0	0	0.0%	Low	No change
	<u>1,924</u>	<u>1,632</u>	<u>1,924</u>	<u>(292)</u>	<u>(15.2%)</u>		
<b>Total All Departments</b>	<u>426,498</u>	<u>430,417</u>	<u>426,498</u>	<u>3,919</u>	<u>0.9%</u>		
<b>Corporate Management</b>							
Revenue Support Grant (inc. NNDR)	(170,684)	(170,684)	(170,684)	0	0.0%	Low	No change
Asset Management	(215,524)	(215,254)	(215,524)	270	(0.1%)	Low	No change
Council Tax	(46,259)	(45,945)	(46,259)	314	(0.7%)	Low	No change
Joint Board Requisitions	10,482	10,181	10,482	(301)	(2.9%)	Low	No change
Other	994	223	994	(771)	(77.6%)	Low	No change
HRA Transfer	(247)	(247)	(247)	0	0.0%	Low	No change
Use of Reserves	(5,260)	0	(5,260)	5,260	0.0%	Low	No change
	<u>(426,498)</u>	<u>(421,726)</u>	<u>(426,498)</u>	<u>4,772</u>	<u>(1.1%)</u>		
<b>Total All Council</b>	<u>0</u>	<u>8,691</u>	<u>0</u>	<u>8,691</u>			

### Note

Budgets and Actuals are after the redistribution of central support and shared accommodation costs plus the impairment adjustments

**RESERVES ANALYSIS - 31 MARCH 2012****Change in Usable Reserves**

<b>Reserve</b>	<b>31 March 2011</b>	<b>Change/Use</b>	<b>31 March 2012</b>
	<b>Position</b>	<b>Position</b>	<b>Position</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>General Services Reserves</b>			
Required to Support Future Budgets	8.408	-2.051	6.357
Civil Emergency	2.000	0.000	2.000
Property Renewals	1.432	-0.500	0.932
Cost Reduction Fund	5.000	-1.267	3.733
Roads Renewals	0.600	-0.600	0.000
<b>Earmarked Reserves</b>			
• DSM (Devolved School Management)	0.265	0.308	0.573
• MELDAP/DAAT	0.144	-0.062	0.082
Insurance Fund	1.006	-0.033	0.973
Capital Receipts Reserve	0.000	0.095	0.095
<b>Sub-total General Services Reserves</b>	<b>18.855</b>	<b>-4.110</b>	<b>14.745</b>
<b>HRA Reserves</b>			
Capital Fund	5.399	-1.414	3.985
General Reserve	4.743	-1.995	2.748
<b>Sub-total HRA Reserves</b>	<b>10.142</b>	<b>-3.409</b>	<b>6.733</b>
<b>Total Reserves/Change</b>	<b>28.997</b>	<b>-7.519</b>	<b>21.478</b>

## CAPITAL BUDGET PERFORMANCE 2011/2012

## Funded By Capital Programme

Capital Project	Area	2011/12 Capital Budget (£'000s)	2011/12 Capital Spend (£'000s)	Notes
New Day Centre - Gullane	Adult Social Care	1,400	91	Spend delayed to 12/13
Fa'side Tranent - new residential home and Day Centre (ASC005)	Adult Social Care	128	97	
Musselburgh Care Home	Adult Social Care	1,000	0	Spend delayed to 12/13
Mobile Working	Community Housing	23	0	
PV installations in public buildings	Corporate	600	541	
Brunton Hall - Theatre and Main Hall refurbishment	Culture & Community	2,100	1,617	Overspend on whole project expected
Dunbar - new Community facility (HC046)	Culture & Community	3,650	3,725	Overspend on whole project expected
Dunbar Town House Museum	Culture & Community	598	580	
John Gray Centre Haddington (HC018)	Culture & Community	3,516	3,306	Awaiting final bill
Musselburgh Racecourse - new stables & community building (HC033)	Culture & Community	61	165	Overspend on whole project
Ormiston Community Centre (HC047)	Culture & Community	786	817	Overspend on whole project expected
Tranent Library	Culture & Community	971	849	
North Berwick Museum - refurbishment (HC021)	Culture & Community	100	16	
Campie Primary - Relocate Nursery within main school	Education	60	0	
Dunbar New Primary School (ECS030)	Education	3,080	2,972	
Dunbar Primary - relocate Comms Unit from Burgh	Education	400	406	
Haddington IS / St Mary's RCPS - New shared Campus	Education	5,333	3,966	
Sandersons Wynd PS - additional Classrooms (ECS042)	Education	20	0	
SEN Equipment - specialised equipment for pupils (ECS047)	Education	30	19	
Toilets East Beach Nth Berwick - Glen Golf Club	Facility Support	25	0	
Replacement Vehicles (ENV002)	Fleet	1,691	1,685	
East Lothian Legacy Project - 3 new All Weather	Healthy Living	1,823	1,966	Overspend will be recovered in 12/13
East Lothian Legacy Project - All Weather Running/Meadowmill	Healthy Living	934	791	
Pavilions - Longniddry, Middleshot Sq, Olivebank, Whittinghame Drive, Lewisvale Park	Healthy Living	40	77	
Sports Centres - refurbishment & Equipment	Healthy Living	375	375	
Schools IT	IT	1,222	1,227	
Corporate IT	IT	240	286	
Core Path Plan Implementation (HC028)	Landscape	129	111	
New Groundcare Depot - the Heugh, Nth Berwick (relocation from Lime Grove)	Landscape	21	96	Overspend on whole project
Polson Park restoration (HC038)	Landscape	50	137	
John Muir Country Park Play Area	Landscape	80	0	
Vehicle Management System	Landscape	40	0	
Cuthill Park	Landscape	100	0	
Amenity Services Machinery & Equipment - replacement	Landscape	323	283	
Project Fees	Corporate	1,161	1,746	Adjustment as part of 12/13 budgets
Cemeteries - Extensions (HC026)	Landscape	300	0	
Coastal Car Parks	Landscape	400	48	

Peppercraig Depot Haddington - extension for staff welfare required by H & S etc  
 New Investment Properties  
 Roads  
 Purchase of New Bins

Landscape	25	17
Property Maintenance	230	0
Roads	6,800	6,999
Waste Services	70	96

Underspend in 10/11

<b>39,935</b>	<b>35,107</b>
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**Funded From Other Sources**

Property Renewals (Mostly Primary Schools)  
 Revenue Resources/Donated Assets  
 Previous Under-spends on Projects

0	1,844
0	791
0	520

**Total Gross General Services Capital Spend**

<b>39,935</b>	<b>38,262</b>
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