REPORT OF CABINET

27 February 2006

Cabinet Members:

Cabinet Members:

*Cllr Brian Salinger (Chairman)

Councillors:

* Fiona Bulmer	Mike Freer	* John Marshall
Melvin Cohen, LL B	* Christopher Harris BA BSc MPhil	* Matthew Offord
* Anthony Finn BSc Econ FCA	* Lynne Hillan	

* denotes member present

$ denotes member absent on council business

1. COUNCIL BUDGET AND COUNCIL TAX 2005/06 (Report of the Leader of the Council and the Cabinet Member for Resources – agenda item 4):

The Cabinet Members submitted, in the following terms, their proposed recommendations to Council on the 2005/6 budget and council tax (the Cabinet Member for Resources being absent, Cllr Lynne Hillan spoke on his behalf in presenting the report).

The Council's budget was a financial expression of its services and levels of provision but also a conditioner of them. It linked the priorities and objectives of the Council as expressed in the Corporate Plan having regard to resources available and taxation consequences of spending decisions. This had been reinforced by the officers' Budget Board Policy-Led review of services and budgets at the start of the 2006/07 budget process.

The Council was required by law to set its budget having considered its estimates of expenditure and income, and for its call on the collection fund to be sufficient to meet its budget needs. This had to be done before 11 March 2006, and a meeting of the Council had been arranged for 7 March 2006 to achieve this.

Financial risks were addressed in the advice on reserves and balances from the Chief Finance Officer attached as Appendix A to the Cabinet Members' report, and which is attached as part of this report to Council. A significant emerging risk, however, was the capitalisation of redundancies for 2005/06 and 2006/07, which was currently estimated at close to £3m and would impact directly on balances if not achieved.

For the HRA, further slippage in the regeneration scheme programmes increased the risk of escalating repairs costs. The HRA Business Plan assumed a minimal level of repairs for those estates, based on a programme of demolition which has already slipped.

In Appendix A to the Cabinet Members' report, the Chief Finance Officer recommended that Cabinet consider his report on reserves and balances and determine an appropriate level of balances and a strategy for achieving that level in 2006/07 and subsequent years. It was noted, however, that balances were currently not forecast to be by 31.3.06 or 31.3.07 at a level recommended by the Chief Finance Officer.

The Council's Constitution required Cabinet to take account of recommendations from the external auditor on matters such as the level of reserves and provisions. Relevant comments from the External Auditor were included in Appendix A (section 10).

Staffing implications arising from the budget proposals had been reported to the General Functions Committee on 19 January 2006.

ICT and property implications were included in the Forward Plan statements at Appendix C to the Cabinet Members' report.

It was a requirement of the Local Government Act 2003 that the Council should have regard to the Chief Finance Officer's report on the adequacy of balances when making the budget calculations. Any decision by Council on the level of reserves that differed from that of the Chief Finance Officer would need to be recorded in the decision to demonstrate the Council had fulfilled this statutory requirement**.**

The Local Government Act 2003 required the Chief Finance Officer to report to Council as part of the budget process on the robustness of the estimates and the adequacy of the proposed financial reserves, although the final decision on the level and utilisation of reserves rested with the Council, and this was set out in the Chief Finance Officer's report at Appendix A.

Financial Regulations (Part 1, Section 2) within the Council's Constitution stated the following:-

(i) Cabinet will finalise its recommendations to Council on the budget, council tax and rent levels taking account of the results of budget consultation. This will normally be in February, following announcement of the Final Local Government Finance Settlement.

(ii) Cabinet's recommendations to Council must be made in time for Council to set the budget and council tax before 11 March of the preceding financial year to the financial year to which the recommended budget and council tax relate.

(iii) The budget that Cabinet recommends to Council must be based on reasonable estimates of expenditure and income, and take account of:-

- outturn forecasts for the current year;

- guidance from the Chief Finance Officer on the appropriate level of reserves, balances and contingencies;

- financial risks associated with proposed budget developments, reductions and ongoing projects;

- affordability of prudential borrowing over the period of the council's financial forward plan;

- recommendations from the external auditor on matters such as the level of reserves and provisions.

(iv) The budget recommended by Cabinet to Council will incorporate the latest projection of income from fees and charges. During the year Cabinet Resources Committee may approve changes to fees and charges, including the introduction of new charges.

COUNCIL BUDGET & COUNCIL TAX 2006/7

The Budget Process

A preliminary assessment of the 2006/07 budget was set out in the Financial Forward Plan which had been approved by Council in March 2005, and which forecast a council tax increase of 10.9% based on information available at the time on Government grants and local spending requirements.

Arrangements for consulting residents on the budget had been reported to the Resources, Performance & Partnerships Scrutiny Committee on 13 February 2006. Consultation with business ratepayers had taken place on 22 February 2006.

Scrutiny Committees had reviewed the draft budget and the Key Priority Plans. There were no recommendations requiring to be reported to Cabinet.

The National Framework & 2006/7 Settlement

The Local Government Minister had announced the Provisional Local Government Finance Settlement on 5 December 2006. Consultation on this had closed on 11 January 2006. The Final Settlement had been debated in Parliament on 6 February 2006, although the Minister had released the details on 31 January 2006.

The Government had announced additional funding above the 2004 Spending Review amounting to £305m (2006/07) and £508m (2007/08). The Government had claimed to have provided further relief of spending pressures over and above these amounts although no tangible benefits were expected. This followed pressure by local government for additional funding to meet increasing costs.

A new Formula Grant allocation system had been introduced providing grant figures for 2007/08 in addition to 2006/07. Formula Spending Shares

(FSS) were no longer used and Government assumptions on the national level of council tax that had previously been built into the system had been dropped. The Settlement now only set out final Aggregate External Finance (AEF) for 2006/07 and provisional figures for 2007/08.

Error! Not a valid link. Note: RSG and Specific Grant figures reflect several transfers in 2006/07, including £25bn in respect of the new Dedicated Schools Grant.

Overall, Formula Grant had increased by 3.0% in 2006/07 and 3.8% in 2007/08. For London, this was lower at 2.7% and 3.4% respectively.

The Settlement continued the system of 'floors' without ceilings. All authorities above the floor contributed a fixed proportion of their excess above their floor to finance the floor authorities. The minimum grant increases for education and social services authorities were :–

2006/07	2.0%
2007/08	2.7%

Barnet was at the floor in both 2006/07 and 2007/08.

The new allocation system was called the Four Block Model with grant allocated in the following ways: –

(i) Relative Needs Formula (RNF) which was related to Formula Spending Shares (FSS) in that it tried to reflect differences in cost due to deprivation etc. Notional spending was still used to calculate RNF for each authority but figures were presented as proportions of a national total. On their own, these proportions were meaningless and prevented any comparison of local spending with Government assumptions.

(ii) Relative Resources (RR), which was a reduction based on each authority's relative ability to raise council tax.

(iii) a central allocation based on a standard amount per head.

(iv) a damping factor to provide a minimum increase or floor as set out above. Authorities above the floor had their grant reduced to pay for the cost of the floor protection.

Appendix B to the Cabinet Members' report provided a copy of the Government's guide to the settlement and explanation of the new system, including a summary of Barnet's NRF proportions which demonstrated the complexity, difficulty in explaining and interpreting the new method. The increased complexity could enable Ministers to make greater judgemental changes to allocations without consultation and was a reason why local government had generally opposed this change during consultation.

There had also been significant alterations in funding responsibility and calculation of RNF. The key changes were as follows:-

- funding of schools via the new ring-fenced Dedicated Schools Grant (DSG) which had been financed by deducting the 2005/06 schools budget from authorities' formula grant. Barnet had spent £2.4m in excess of its 2005/06 school's FSS so the deduction resulted in a loss of £2.4m Formula Grant in 2006/07. The grant loss was built into Barnet's base grant upon which the 2% floor was calculated.

- transfer of all Residential Allowances and part of Preserved Rights special grants into Formula Grant.
- additional grant arose from the introduction of a free Concessionary Fares scheme nationally, which benefited Barnet by almost £1.7m.
- Resource Equalisation whereby RNF was increased to reflect actual spending on Social Services. As Barnet was deemed to be a relatively wealthy authority, this adjustment resulted in a loss of grant to the council.
- a new Children & Younger Adults Social Services formula allocations methodology. The resulting distribution changes were so great that the Government had been forced to damp the changes by introducing minimum increases in formula allocations for these blocks (2.0% in 2006/07 and 2.7% in 2007/08). This was paid for by scaling back increases of authorities above the floor at a level of 85% which was unsustainable and could force changes to the grant regime when the 3-year settlements were introduced in 2008/09..
- the interest receipts element had been removed, but insufficient data was provided under the new system to isolate the impact on Barnet.

For business properties, there were two multipliers

(i) the small business non-domestic rating multiplier for small business qualifying for a new small business relief scheme (i.e. those with a rateable value in London of less than £21,500); and

(ii) the non-domestic rating multiplier which included a supplement to pay for the new scheme.

The non-domestic rating multiplier to be applied in 2006/07 was 43.3p, which was reduced to 42.6p for small businesses.

The Settlement for Barnet

The Local Government Finance Settlement for Barnet was set out in the following table. The figures are fairly meaningless in terms of identifying the cause of grant changes to Barnet as they bore no clear relationship to the cost of services provided.

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Comparative figures for 2005/06 were only available for Dedicated Schools Grant and Formula Grant, which included significant adjustments in respect of additional grant for concessionary fares (£1.686m) and Preserved Rights moving from specific to formula grant (£1.658m).

The Settlement provided an adjusted formula grant increase of £1.7m, which was the minimum 2% guaranteed by the Government. However, London already operated a free concessionary fares scheme so there was no additional cost in this respect and the £1.686m could be treated as new money providing a real grant increase of £3.385m (4%). This increase had to meet the cost of inflation, full year effects, service demands and funding transfers for all non-school services. The indicative grant increase for 2007/08 was only £1.646m which was the grant floor of 2.7% after adjustments (the actual cash increase was only 1.7%).

The new Dedicated Schools Grant provided cash increases of £11.864m (7.3%) for 2006/07 and £12.270m (7.0%) for 2007/08. The Council had no choice but to passport these increases to the Schools Budget. The grant increases for schools were in stark contrast to those for other local services where council tax increases were likely to be capped at around 5%.

Government revisions in population and other data incorporated in earlier grant settlements were being made by a series of grant amending reports and changes to authorities' adjusted base when calculating grant floor protection. The first amending report (re 2003/04), had been issued last year and, although Barnet's notional figures had increased, it was not sufficient to exceed that year's floor protection. New amending reports for 2004/05 and 2005/06 had been issued and would be paid in 2006/07. Barnet would receive a total of £568,000. This grant was separate from the figures in 8.14.

Overall, the changes had resulted in Barnet receiving the minimum grant increases for 2006/07 and 2007/08. This was below national average increase in each year and failed to compensate for grant losses in previous years. A robust response to the settlement consultation had been made, but to no avail.

<u>Capping</u>

A statement on the provisional settlement by Phil Woolas, the Minister of State for Local Government, had included the following warning on capping :-

'…. we expect to see average council tax increases in each of the next two years of less than 5%. There is, following today's announcement, no excuse for excessive increases. Local government should be under no illusions; if there is excessive increase, we will take capping action – as we have done over the last two years'.

The Minister had subsequently added that authorities should not use previous capping principles as a guide for 2006/07 or 2007/08, which makes it unnecessarily difficult for local authorities to determine whether their council tax increases for 2006/07 would be capped.

To support their position on capping, the Government had issued Alternative Notional Amounts (ANAs) to enable a like for like comparison with the budget requirements in 2005/06. The only adjustment within the ANA for Barnet was the introduction of the Dedicated Schools Grant, which when deducted from the 2005/06 budget, produced an ANA for Barnet of £208,178,000 after rounding up.

Whilst introducing some uncertainty around how capping might be implemented in 2006/07, the capping legislation itself required the Secretary of State to determine whether the budget requirement (not the level of council tax) for a financial year was excessive, and this had to be done by reference to criteria specified and published by the Secretary of State. The criteria had to be decided in accordance with a set of principles, which had to include comparison with a previous year – the earliest year for this purpose being 1998/9. Different principles could be used for different classes of authority (e.g. London Boroughs, Districts, and Counties), and in previous years when some councils were formally warned the criteria used had been a combination of change in budget requirement and council tax over a 1-year and 3-year period. The legislation allowed the Secretary of State to designate councils for "in-year" capping, or to nominate a maximum budget requirement for the following year.

Authorities that were either designated or nominated might make representations to the Secretary of State. There was also the option to challenge in the courts; but from previous experience councils had found that the House of Lords had viewed the question of whether a budget requirement was excessive to be a matter of political judgement for the Secretary of State, who was not bound by a council's view of expenditure needs.

A copy of the capping regime was set out in Appendix D(ii) to the Cabinet Members' report.

If Barnet were challenged to explain its budget and tax increase there were a range of issues the council might want to highlight, including:-

- the disastrous 2003/04 settlement, which had also been referred to in the Annual Audit Letter and had not been redressed by subsequent settlements;

- the 2004/05 settlement which had left Barnet 3rd from bottom in London in respect to grant headroom after allowing for education passporting: a position which had not improved much in 2005/06 with Barnet being 13th from bottom in London in respect to grant headroom;

- Barnet being at the grant floor in both 2006/07 and 2007/08

- that Barnet had already budgeted for £48m reductions in the base budget over the last four years;

- the continued need to rebuild balances following the Section 11 Notice issued in 2003/04 by the external auditor, which although removed in 2004/05 was still crucial to current budget considerations.

<u>Revised Requirements for 2005/06</u>

The latest revenue monitoring position being reported to the Cabinet Resources Committee on 16 February 2006 would advise that balances were forecast to be £7.410m at 31 March 2006. After this report had been finalised, the council was notified that it would rewarded with £1.865m of LABGI[1].

There were no significant budget variations to the Housing Revenue Account. Any variations were to be met from the accumulated HRA balance.

Budget 2006/07

The introduction of the Dedicated Schools Grant in 2006/07 was a major change to local authority funding. School expenditure was now shown as a net nil budget whilst Formula Grant reduced by a similar amount so that council tax overall remained unchanged. This accounted for the significant change between the 2005/06 and 2006/07 gross budget figures.

Following an assessment of the Provisional Local Government Finance Settlement, Cabinet's draft budget proposals, including efficiencies of £6.248m, had been announced to Council on 20 December 2005, and would have resulted in a council tax increase of 3.29%

The budget to be recommended to Council on 7 March 2006 was set out in detail in Appendix C to the Cabinet Members' report. A net reduction of £2.03m in the budget was proposed over the draft discussed at Council in December. Proposals for 2006/07 along with any major variations were explained in Key Priority Plans attached as Appendx E to the Cabinet Members' report.

The Prudential Code enabled councils to borrow without Government approval, subject to certain controls and reserve powers – basically, the cost of borrowing had to be affordable over a period of years. Provision for prudential borrowing to fund the capital programme and the additional cost of this borrowing were explained further on in the Cabinet Members' report.

Barnet Local Strategic Partnership (LSP) had been awarded £1m Neighbourhood Renewal (NRF) funding in both 2006/07 and 2007/08. The grant was to tackle deprivation and social exclusion in the most deprived areas. The LSP was responsible for allocating NRF monies and performance managing the use of this funding, although the Council acted a secretary and treasurer to the LSP. Projects were being considered by the LSP on the basis that there was no on-going cost that would fall to the Council in later years.

General Fund Balances & Reserves

The Chief Finance Officer's report in Appendix A set out the position on General Fund balances, which were summarised as follows:–

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This position might worsen due to slippage on 2006/07 budget savings, in-year budget problems and the realisation of some contingent liabilities etc.

[1] LABGI – Local Authority Business Growth Incentive

Whilst a comprehensive risk assessment was set out in Appendix A, it was stressed that the greatest risk at present was getting Directions for 2005/06 and 2006/07 from the Secretary of State to capitalise redundancy costs. Setting aside these risks, the draft budget currently left balances £0.7m below the minimum of £10m recommended by the Chief Finance Officer. Proposals for achieving and maintaining this level of balances were set out in the Financial Forward Plan at Appendix G.

In addition to General Fund balances, the Council might set aside specific reserves to fund projects or provide funding for future potential costs. The only reserves in the accounts were as follows:-

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Greater London Authority

The Greater London Authority (GLA) precept incorporated the following budget requirements:-

- Mayor, GLA Assembly and corporate administration
- Transport for London;
- London Development Agency;
- Metropolitan Police Authority;
- London Fire & Emergency Planning Authority.

The Mayor had commenced consultation on the budget and precept requirements on 19 December 2005, proposing a precept increase of 16.59% including the Band D surcharge for the Olympics of £20 – before adjustment of London wide council tax bases.

The Mayor's revised 13.35% tax increase would be presented to the London Assembly on 15 February 2006. The component parts were as set out below, including the ongoing contribution to the 2012 Olympics at £20 a year on Band D:-

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Collection Fund

On 15 January 2006 (a date determined by Regulations) a forecast was made of the collection of previous years' council tax as at 31 March 2006. This calculation identified a deficit on the fund of £1.849m, which had been allocated between Barnet and the GLA, with the cost to Barnet being £1,471,050. The deficit had arisen as a result fewer new property completions than expected and a higher level of council tax exemptions. Based on current performance the estimated collection rate for 2006/07 had been retained at 98.5%, which took into account the effect on debt recovery that will result from changing over to a new local taxation system.

Council Taxbase

There were two measures of the taxable capacity of the Authority. The first was the Inland Revenue Valuation Office list, which was adjusted for discounts and exemptions on the council tax system and was used by the Government in Formula Grant calculations. The second was used for tax setting purposes and was a calculation made by the Chief Finance Officer, representing the estimated taxable capacity for the year ahead and incorporating the estimated collection rate.

Under delegated powers, the Chief Finance Officer had calculated the 2006/07 taxbase as 135,103 Band D Equivalents.

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Council Tax

The calculation of the council tax for Barnet was as set out below:-

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The GLA precept was £38,992,077 making the total demand on the collection fund £175,556,677.

The Council was required to set levels of council tax for each category of dwelling. As there were no special items within Barnet's or the Greater London Authority's budgets affecting parts of the borough, there are only eight amounts of tax to set, as set out below:-

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Individual Council Tax bills would reflect occupancy status with discounts for low occupancy (one or no adults) and exemptions for specific circumstances. In addition, residents would be eligible for Council Tax Benefit. In 2005/06, approximately 20% of council tax payers claimed a full or partial council tax rebate.

Financial Forward Plan and Medium Term Financial Strategy

It was now a requirement under the Prudential Framework that decisions on the budget must be taken in the context of the Forward Plan, with particular attention being paid to the affordability of prudential borrowing over a period of at least 3 years.

An update on the Forward Plan previously presented to Council in March 2005 was attached at Appendix G to the Cabinet Members' report, based on the following key assumptions:-

- most of the forecast budget increases related to estimated pay awards and inflation, London-wide levies, employer's pensions contributions, prudential borrowing costs and investment income and other known full year effects of previous decisions;

- resources for 2007/08 were based on the provisional settlement announced by the Government. Later years assumed a 2.0% floor settlement. Indications of increases in grant were unlikely until the Government completed its 2007 Spending Review including a decision on whether the additional grant announced for 2006/7 and 2007/08 would continue

- future contributions to balances to achieve and maintain the target minimum £10m balances.

As indicated above, the Financial Forward Plan did not currently recognise any budget pressures or risks beyond 2006/07 as there was insufficient information upon which to base costs accurately, the one exception being unsupported (prudential) borrowing where the full year effect of the capital programme was reflected.

The Government was expected to introduce 3-year grant settlements starting in 2008/09, as part of the 2007 Spending Review. This should provide a more stable environment within which to undertake effective financial forward planning as there should be far greater certainty over future grant levels. Changes in responsibility for local authorities would also be less likely to take place at short notice. However, there was currently a risk that population growth centred around Barnet's regeneration schemes would not be recognised in Government forecasts, which would result in a shortfall in grant increases to match demand.

The Chief Finance Officer had identified key issues within the 2006/07 budget (Appendix A). A number of these would be ongoing, and would be added to over the coming 3-4 years by the following risks and opportunities:-

- Lyons Inquiry
- Council tax revaluation (postponed until after the Lyons Inquiry)
- Spending Review 2007
- AEF grant floor has not been announced beyond 2007/08
- Levies
- LPSA Reward Grant
- Local Authority Business Growth Initiative beyond 2006/07
- Redundancy capitalisation
- Licensing Act
- Civil Contingencies Act
- Election Bill
- Modernising Core Systems (ongoing efficiency savings)
- Children Act
- Government's 10-Year Childcare Strategy
- ICT Infrastructure & technology refresh
- Housing Benefit reform
- Planning fees and Planning Delivery Grant
- Primary Schools Capital Investment Strategy
- Highways street lighting PFI
- Office accommodation strategy
- Health White Paper
- Review of responsibilities of the Mayor for London.

The Government's efficiency initiative (Gershon) required local authorities to achieve 2.5% annual efficiency saving targets. Barnet had produced significant efficiency savings in recent years. The addition of the 2006/07 savings to the £13m already identified might mean that the combined cashable / non-cashable target annual savings of £19.32m would be achieved by March 2007; one year before the deadline. Furthermore, the focus of the Council's efforts so far had been in identifying cashable savings, and work to identify non-cashable efficiencies would result in the target being exceeded.

A summary of the Council's draft medium term financial strategy was shown at Appendix H to the Cabinet members' report. This was the first time a summary had been published showing the framework to support the financial forward plan. It would be developed further over the coming months with a report to Cabinet early in the new municipal year, incorporating a combined Financial Forward Plan and Strategy on budget options for later years.

HOUSING REVENUE ACCOUNT

The HRA was a statutory ring-fenced account of the Council, covering all revenue expenditure and income relating to the housing stock. The Council was required to construct a budget to ensure that the account for the year did not show a debit balance.

The summary HRA wa shown in Appendix A to the Cabinet Members' report. This included a number of development proposals, which were shown in detail in the Performance Management Plan.

Rent Restructuring

The Government had introduced rent restructuring and convergence for local authority and registered social landlords (RSLs) over a 10-year period starting in April 2002. All rents would be calculated on the same basis, with 70% based on average earnings for the region (adjusted for numbers of bedrooms) and 30% based on the valuation as at January 1999.

The Government had undertaken consultation during the summer of 2005 on the three-year review of rent restructuring. The proposals therein had not been introduced for 2005/06 but were to be implemented for 2006/07. They involved a recalculation of base formula rents in line with those used for housing association properties, together with higher weightings for properties with three or more bedrooms. The result was that rent increases for local authority tenants would be higher than under the previous formula.

Rents would still move towards a target figure for each property. Following the formula, rents in Barnet would increase by an average of 5.56% in 2006/07 – however the Government had capped the increase at an average of 5%. It had promised that local authorities would be compensated in full for this, although full details as to how were awaited. The increase to any individual property was limited to inflation (deemed to be 2.7%) plus 0.5% plus £2 per week (on a 52 week basis).

Housing Subsidy

The trend of shifting resources away from London has been continued in this year's subsidy settlement. For Barnet the management allowance has been set at £634.72 (an increase of 6.1%) while the maintenance allowance is set at £1,099.30 per dwelling (an increase of 7.6%). The above inflation increases were meant to offset the effect of subsidy withdrawn through the guideline rent: as a result of the changes to the rent restructuring calculations described above this had risen by 8.1%. The net result was that Barnet had suffered a loss of £1.5m on these elements, before the effect of the compensation referred to above was considered.

The Major Repairs Allowance had also been paid as part of housing subsidy. Barnet's allocation had reduced by 0.5% per dwelling to £712.22 despite the level of inflation affecting the building industry. The total for 2006/07 was £7.939m, a reduction of £173,000 from 2005/06.

Service Charges

Service charges for tenants had been introduced in 2003/4 for specific services (mainly caretaking), and it was proposed that these be increased in line with the overall rent increase cap of 3.2%. Charges for these services would not generally recover the full cost of their provision.

HRA Summary & Working Balance

Total expenditure for 2006/7 was estimated at £49.118m, including payment of £8.999m to the Government in respect of housing subsidy. The proposed average rent increase of 5% and increase in tenant service charges was estimated to raise £1.992m before the effect of sales was taken into account.

Energy prices had continued to rise far in excess of inflation and it was necessary to pass these charges on in respect of space and water heating. It was proposed to increase these charges by 25%

It was proposed that rents for the Council's shared ownership schemes and hostels be increased in accordance with the general rent increase. It was also recommended that rents on garages be increased by 5%.

2006/7 would be the third year of Barnet Homes' management of the housing stock Further adjustments remained necessary in respect of service level agreements, both in respect of Barnet Homes and of the 'retained' HRA.

The HRA working balance stood at £5.8m on 31 March 2005. It was now anticipated that the HRA would break even in 2005/06 but for 2006/07 the estimates provided for a contribution from the balance of £785,000 resulting in a reduction to £5.1m at 31 March 2007. A balance of £4.3m was still required to be held against possible underwriting calls on regeneration schemes.

HRA Minimum Revenue Provision (MRP)

Until 2004/05 there had been a statutory requirement for the HRA to be charged with the MRP, which was approximately 2% of the HRA debt. This had had the effect of reducing outstanding housing debt by that sum. The housing subsidy mechanism provided compensation for this to an approximately equal amount. The Government's removal of the legal requirement and the subsidy resulted in there being no equivalent reduction in debt unless a voluntary charge were made; without subsidy this had to found from within HRA resources. Whilst the policy of not making a charge was entirely robust from a legal and accounting perspective, the merits of making a charge were being considered; some housing authorities had chosen to do so and investigations were taking place to explore the extent of this.

CAPITAL PROGRAMME

Introduction

The capital programme set out the plans for investment in buildings, roads, equipment, other assets and capital grants over 2005/6 to 2008/9 and beyond.

Decisions on the level of capital expenditure depended on the availability of the following sources of funding which were listed in the order they would normally be applied:-

- Private Finance Initiative (PFI) credits
- grants to meet capital expenditure
- the Major Repairs Allowance (MRA) within the HRA
- Section 106 agreements
- capital receipts (proceeds from the sale of land and buildings)
- direct revenue contributions
- Special Parking Account
- contributions from school balances
- Other public-private partnerships.
- borrowing and revenue resources available to meet financing costs

The recommended capital programme, including total spend of £70.681m in 2006/07 was set out later in the Cabinet Members' report. It was based upon current forecast resources, details of which were discussed in the following paragraphs.

The self-regulatory Prudential Framework gave local authorities freedom to determine the amount of capital investment they could fund by borrowing based on affordability, prudence, sustainability and good practice. The Government supported some of this investment by the use of Supported Capital Expenditure (SCE) allocations - either revenue or capital, which were further classified as either a single capital pot or ring fenced:-

- SCE(R) – notional capital allocations that fed into either the Capital Financing Relative Needs Assessment or the Housing Subsidy and which were often called supported borrowing. Borrowing over and above these allocations would not attract Government grant support, and so would need to be financed from the council tax. It was also extremely questionable whether councils' grant floor actually benefited from SCE(R);

- SCE(C) – capital grants, which might be ring fenced to specific projects or form part of the single capital pot and be available for general use.

The latest SCE(R) announcements for Barnet were set out below:-

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Allocations relating to transport were provided by Transport for London grants.

From 2006/07 Government support for local authority housing capital investment programmes would not be provided through the Formula Grant system. Support for work on private housing and other activity would be in the form of capital grant to be announced later in 2006.

The full revenue cost of this borrowing was provided in the respective General Fund revenue accounts.

Barnet's street lighting PFI. A preferred bidder had been appointed and the final contract was being negotiated. This would be subject to final business case approval. The contract would commence in 2006/07.

Capital Programme

The full capital programme was set out by Head of Service in Appendix C to the Cabinet Members' report, summarised as follows:-

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Due to limited General Fund resources, the significant changes to the non-HRA Programme from last year were the inclusion of slippage from 2004/05 into later years and the procurement costs of the Primary Schools Strategy.

The HRA programme for the improvement of homes was managed by Barnet Homes. It has entered into partnering agreements with the major contractors who would deliver the bulk of the programme until 2010/2011. Funding is via the ALMO Decent Homes borrowing, the Major Repairs Allowance, capital receipts and contributions from leaseholders. As yet the decent homes borrowing approvals had not been confirmed for 2006/07 and 2007/08.

The General Fund Housing programme totals £10.330m in 2006/07. It included expenditure supporting housing association projects and Disabled Facilities Grant schemes. The programme included funding from S106 monies of £3m.

The overall programme was reliant on external grants and revenue support to fund capital borrowing. Capital receipts were not forecast to fund a significant part of the programme except the Primary Schools Strategy that was reliant on receipts from the disposal of surplus educational sites to fund primary school improvements.

The following table summarised the estimated funding of the programme. It was stressed that borrowing now accounted for at least half of annual funding, whilst in 2006/07 it represented 33% of resources. The revenue consequences of borrowing had been incorporated into the revenue budget.

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1. PRUDENTIAL CODE & BORROWING LIMITS

The prudential system gave freedom to local authorities to invest as long as their capital plans were affordable, prudent and sustainable. The CIPFA Prudential Code set out the indicators that local authorities must use and the factors that they must take into account to show that they had fulfilled these objectives.

The principal constraint on capital investment would be the financial impact on the council tax and rent levels of the housing revenue account, which would be reflected in the indicators of affordability. It would be for the Council to decide on an appropriate level of borrowing in relation to its net capital financing costs and the level of council tax and housing rents.

For 2006/7, the Government had provided local authorities with a mix of revenue support for capital financing costs based on notional capital allocations and capital grants via the single capital pot, but the Government had still to decide whether to continue with the current arrangements or change the balance between revenue support for borrowing and capital grants.

The financial indicators under the Prudential Code and the 2006/07 Treasury Management Strategy & Annual Plan requiring Council approval were set out in Appendix F to the Cabinet Members' report along with full details of their calculation and purpose.

For the reasons set out in the Cabinet Members' report, Cabinet

RESOLVED TO RECOMMEND

Balances

1. **That, having taken account of all matters set out in the Chief Finance Officer's report on reserves and balances as set out at Appendix A to the Cabinet Members' report:-**
   - **(a) the appropriate level of General Fund balances be determined at £10m;**
   - **(b) the strategy for achieving and maintaining this level of balances in 2006/07 or future years be as set out in appendix g to the cabinet members' report.**

Revenue Budget and Council Tax

2. **That the forecast revenue outturn for the year 2005/6 and the estimates of income and expenditure for 2006/6 be approved**
3. **That it be noted that the Chief Finance Officer under his delegated powers has calculated the amount of 135,103 (band D equivalents) as the Council Tax base for the year 2006/7 in accordance with Regulation 3 of the Local Authorities (Calculation of Council Tax Base) Regulations 1992 made under Section 33(5) of the Local Government Finance Act 1992.**

4. **That the following amounts be now calculated by the Council for the year 2006/7 in accordance with Sections 32 to 36 of the Local Government Finance Act 1992:-**

(a) £715,210,640 being the aggregate of the amounts which the Council estimates for the items set out in Section 32(2)(a) to (e) of the Act;

(b) £499,485,045 being the aggregate of the amounts which the Council estimates for the items set out in Section 32(3)(a) to (c) of the Act;

(c) £215,725,595 being the amount by which the aggregate at 4(a) above exceeds the aggregate at 4(b) above, calculated by the Council, in accordance with Section 32(4) of the Act, as its budget requirement for the year;

(d) £79,160,995 being the aggregate of the sums which the Council estimates will be payable for the year into its general fund in respect of redistributed non-domestic rates, revenue support grant or additional grant increased or reduced (as appropriate) by the amount of the sums which the Council estimates will be transferred in the year from:-

(i) its collection fund to its general fund and;

(ii) its general fund to its collection fund in accordance with Sections 97(3) and (4) and 98 (4) and (5) respectively of the Local Government Finance Act 1988;

(e) £1,010.82 being the amount at 4(c) above less the amount at 4(d) above, all divided by the amount at 3 above, calculated by the Council, in accordance with Section 33(1) of the Act, as the basic amount of its Council Tax for the year 2006/2007;

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being the amounts given by multiplying the amount at 4(e) above by the number which, in the proportion set out in Section 5(1) of the Act, is applicable to dwellings listed in a particular valuation band divided by the number which is in that proportion is applicable to dwellings listed in valuation band D, calculated by the Council, in accordance with Section 36(1) of the Act, as the amounts to be taken into account for the year in respect of categories of dwellings listed in different valuation bands.

5. That it be noted that for the year 2006/7 the Greater London Authority has stated the following amounts in precepts issued to the Council, in accordance with Section 40 of the Local Government Finance Act 1992, for each of the categories of the dwellings shown below:-

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6. That, having calculated the aggregate in each case of the amounts at 4(e) and 5 above, the Council, in accordance with Section 30(2) of the Local Government Finance Act 1992, hereby sets the following amounts as the amounts of Council Tax for the year 2006/7 for each of the categories of dwellings shown below: -

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7. That in accordance with Section 38(2) of the Act the Chief Executive be instructed to place a notice in the local press of the amounts set under recommendation 6 above pursuant to Section 30 of the Local Government Finance Act 1992 within a period of 21 days following the Council's decision.

Housing Revenue Account and Rents

8. That the Housing Revenue Account estimates for 2006/7 be approved.

9. That, with effect from Monday 3 April 2006:-

(a) The rent of all Council dwellings, with the exception of those included under Recommendation 10, be changed in line with the Government's proposals on rent restructuring outlined in this report, producing an average increase of 5.0%

(b) That the rents of all properties relet for whatever reason be moved upwards to the formula rent. Where formula rent is below actual rent no reduction will be made.

(c) That service charges for all tenants of all flats and maisonettes based on the services they receive be increased to the following charges (per week, 48 week basis):-

Caretaking	**£4.74**
Caretaking Plus	**£6.13**
Block Lighting	**£0.76**
Grounds Maintenance	**£0.49**
Quarterly caretaking.	**£0.62**

(d) That there shall be an increase of 25% on the charge for space and water heating

10. That, with effect from Monday 3 April 2006: -

(a) The basic rents of dwellings in the Council's equity sharing scheme at Moorlands Avenue, NW7 be increased as follows:-

- **Current basic rents of £2,097 to £2,202 per annum**
- **Current basic rents of £1,932 to £2,028 per annum.**

(b) The net rents of dwellings in the equity share scheme at Friern Hospital be increased by 5.0%.

11. That, with effect from Monday 3 April 2006, the rents of Council garages be increased by 5.0%.

12. That the Chief Executive be instructed to take the necessary action including the service of the appropriate Notices.

Key Priority Plans

13. That the Key Priority Plans be approved.

14. That the Chief Officers be authorised to implement the detailed proposals set out in the Key Priority Plans within the resource constraints identified, in consultation with Cabinet Members as appropriate.

New Prudential Code and Borrowing Limits

15. That the Prudential Indicators set out in Appendix F to the Cabinet Members' report be approved and that the Chief Finance Officer be authorised to raise loans, as required, up to such borrowing limits as the Council may from time to time determine and to finance capital expenditure from financing and operating leases subject to:

(i) the appropriate provision having been made in the estimates for 2006/07;

(ii) authorisation (where necessary) of the expenditure by the appropriate Government Department;

(iii) a decision of the committee concerned or under delegated/urgency powers to incur the capital expenditure and that the Cabinet Resources be instructed to approve new projects up to the value of surplus resources outlined in this report, having regard to the priorities identified.

Capital

16. That the capital programmes be approved, and that the Chief Officers be authorised to take all necessary action to implement them.

Note: the appendices to the Cabinet Members' report, as referred to above, are being circulated to all Members of the Council, with the exception of Appendix A which is attached as part of this report.

Appendix A

Reserves & Balances

Report of the Chief Finance Officer

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1 INTRODUCTION

1.1 The Local Government Act 2003 places a duty on the Chief Finance Officer to report to Council as part of the budget process on:-

a) the robustness of the estimates; and

b) the adequacy of the proposed financial reserves.

1.2 Professional guidance published in January 2003 by CIPFA recommends that in making this report to Council the following factors should be taken into account:-

- services' record in delivering budget developments and reductions;
- capacity to manage in-year budget pressures;
- key financial assumptions underpinning the budget (e.g. inflation provisions);
- robustness of forward plan estimates;
- general debt outstanding and tax collection rates;
- adequacy of insurance arrangements and budget provisions to cover major unforeseen risks;
- year end accounting arrangements (e.g. whether services are permitted to retain underspends);
- financial reporting arrangements.

1.3 The Council's Financial Regulations[1] were updated to reflect this guidance two years ago and state that *"the budget that the Executive recommends to Council must be based on reasonable estimates of expenditure and income, and take account of:-*

- *outturn forecasts for the current year;*
- *guidance from the Borough Treasurer on the appropriate level of reserves, balances and contingencies;*
- *financial risks associated with proposed budget developments, reductions and ongoing projects;*
- *affordability of prudential borrowing over the period of the council's financial forward plan;*
- *recommendations from the external auditor on matters such as the level of reserves and provisions."*

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[1] Financial Regulations, Part 1, Section 2.5

1.4 This report addresses each of these factors and sets out my recommendations (as Chief Finance Officer) for General Fund balances, and how this impacts on decisions that Council must make on the 2006/07 Budget.

2 SERVICES' RECORD IN DELIVERING BUDGET DEVELOPMENTS & REDUCTIONS

2.1 Barnet has been faced within challenging grant settlements in recent years. In 2003/04 Barnet was at the grant floor (3.5%) compared to a national average grant increase of 6%. The grant position was affected by the 2001 Census and the process of Resource Equalisation as the Government moved from the regime of Standard Spending Assessments to Formula Spending Shares. In 2003/04, the settlement did not provide sufficient grant to achieve the required level of "passporting" to the Schools Budget, which required an additional contribution to be made from council tax. In 2004/05, Barnet's grant increase (5%) was again below the national average (5.7%), but in 2005/06 (6.6%) was slightly above the average (5.4%).

2.2 Over the three year period 2003/04 to 2005/06, the Council budgeted to deliver efficiency savings, service reductions and increased income totalling £37m. Because the Schools Budget is ring-fenced, these budget reductions had to be delivered entirely from the non-schools budget, which for 2005/06 stands at £208m (55% of total net service expenditure).

2.3 Achieving base budget reductions of £37m in three years is a significant undertaking and some slippage in this is inevitable, and in respect to budget decisions for 2002/03 to 2004/05 a total of £4m has been added back to the base budget in subsequent years:-

- £0.5m in respect to the 2002/03 budget;
- £2.6m in respect to the 2003/04 budget;
- £0.9m in respect to the 2004/05 budget.

2.4 It should be borne in mind that these figures comprise a mixture of increased income not being achieved and savings not being delivered. In respect to the 2005/06 budget, £1m has so far been added back to the draft 2006/07 budget in respect to increased parking income not being achieved. In total, therefore, £5m has been added back to the base budget in respect to £42m of savings budgeted for over a four year period 2002-2006, which equates to 12%.

2.5 Delivering savings of the level budgeted for in recent years is a substantial executive and management undertaking, which is not helped by having to respond to annual Government grant settlements just 3-4 months prior to the start of the financial year. Given this context I do not consider that slippage of this order gives any real cause for concern, but slippage has nonetheless occurred and is, therefore, a factor that must be taken into account in making a recommendation to Council on the level of General Fund balances.

2.6 On the other side of the coin is the risk that the cost of budget developments has been underestimated. Given the grant settlements that Barnet has received in recent years the level of service developments (excluding base budget pressures and the cost of prudential borrowing to fund capital investment) has not been significant – £3.3m in 2003/04, £2.4m in 2004/05 and £0.2m in 2005/06.

2.7 Developments are also provided for within the capital programme, where the risk of overspending or failure to deliver planned external funding contributions can translate into revenue implications through increased prudential borrowing and/or reductions in interest earnings on unused capital receipts. Over the past three years there have been some overspends on capital projects, one of the more significant being Mill Hill School expansion project – the original tender for the project was £2.963m, and the projected outturn was £3.343m.

2.8 <u>At present there are no significant issues that cause me concern with the council's ability to deliver efficiencies and developments within budget, although experience of the past four years would suggest that £1m (12%) of the £9m budgeted for in 2006/07 might result in a call on balances.</u>

3 CAPACITY TO MANAGE IN-YEAR BUDGET PRESSURES

3.1 Following on from the Section 11 Notice in February 2004 the council's financial standing, in terms of the level of balances, has considerably improved. The council's gross budget in 2005/06 is £690m, but in terms of assessing financial risks it is more appropriate to combine this figure with income and specific grants, which produces a total just over £1.0bn. In commercial terms this represents a significant level of "turnover" and variances from budget are inevitable, particularly when a significant amount of expenditure (e.g. adult and childrens services) and income (e.g. local land charges) is demand-led. It should, however, be borne in mind that even just a 1% variance equates to £10m.

3.2 In considering the council's capacity to manage in-year budget pressures I have reviewed the budget volatility reported in budget monitoring during the current and previous two years. The position can be summarised as follows:-

2003/04	Overspends	£15.4m	£1.9m net
	Underspends	£13.5m	overspend
2004/05	Overspends	£15.4m	£1.1m net
	Underspends	£16.5m	underspend
2005/06 (Month 7)	Overspends	£9.6m	£0.9m net
	Underspends	£8.7m	overspend

These figures exclude the HRA and schools balances.

3.3 <u>As with the delivery of budget developments and reductions, I do not consider these in-year variances to be exceptional, especially when considering the net variances achieved which clearly demonstrates management action to minimise overspending has been effective. Nonetheless, variances have occurred and are, therefore, a factor that must be taken into account in making a recommendation to Council on the level of General Fund balances</u>.

4 KEY FINANCIAL ASSUMPTIONS UNDERPINNING THE BUDGET

4.1 Provision for non-teacher pay awards is in line with the 3-year settlement agreed from April 2004. The cost of additional employer's pension contributions has also been made based on the latest 3 year actuarial valuation assuming no change in pension fund conditions. Inflation has been provided for in line with Government forecasts, or where alternative inflation indices or market conditions prevail, e.g. a significant provision over current forecasts of RPI has been made for renewing energy contracts during 2006/07.

4.2 Prudent assumptions have been made on the level of interest earnings and the cost of borrowing to finance capital expenditure that is currently approved within the draft budget and capital programme for 2006/07.

4.3 <u>At this point in time there are no issues within the key financial assumptions underpinning the 2006/07 budget that give me cause for concern, and this is not an area that will feature greatly in my consideration of the level of balances</u>.

5 ROBUSTNESS OF FORWARD PLAN ESTIMATES

5.1 An officer Budget Board was established at the outset of the 2006/07 budget process. It is chaired by the Director of Resources and also comprises the Deputy Director of Resources & Chief Finance Officer, Head of Corporate Support, Chief Education Officer, Head of Adult Services and Head of Highways & Design.

5.2 The members of the Budget Board have all been given the opportunity to review the budget proposals from every service, and in particular assess the risk of non-delivery of efficiencies and service reductions.

5.3 The Budget Board has also been particularly concerned at minimising the incidence of "cost shunting" between services, i.e. one service making a saving that requires other services to pick up the cost of continuing to provide the activity in question.

5.4 The Budget Board has considered risks within the draft 2006/07 budget in three ways. The first two are risks within the base budget and the proposed budget reductions, both of which could result in a call on balances if variances occurred. The third area is contingent liability risks not incorporated in the draft budget, which would be direct call on balances if they occurred and could not be offset by management action to identify compensatory savings. The items considered to be the greatest risk within all three areas are set out below.

<u>Base Budget</u>

- Rents, fees & charges

  These come to around £60m in the revenue budget. Shortfalls that have arisen previously on parking income and local land charges demonstrate how achieving this income is not always within the council's control. In 2006/07 the council will also be re-introducing the pest control service on a self-financing basis, but there are obvious risks associated with providing a service in competition with other providers already in the market.

- Specific grants

  Despite provisional figures for 2006/07 and 2007/08 being provided for some of the specific grants, there are some where uncertainty remains (e.g. Planning Delivery Grant).

  A new grant the council, or rather the Local Strategic Partnership (LSP), will be receiving is £2m worth of Neighbourhood Renewal Funding (NRF). The allocation of this funding will be determined by the LSP, but there is a risk that the council will be left with a responsibility for ongoing costs in 2008/09 and beyond.

- Borrowing & interest earnings

  The council, like all others, is subject to market fluctuations in interest rates that affect both short and long term borrowing and the short term investment of surplus cash.

- Accommodation strategy

  This is more of an issue for future years in terms of creating a large fixed cost within the base budget, rather than being a potential overspending problem. The strategy approved by Cabinet Resources Committee in July 2005 relies heavily on the council continuing to lease the majority of its office accommodation requirement for a further 15 or more years. This creates a risk of not being able to reduce costs if a major downsizing of the staffing establishment occurs over this period and the council is unable to sub-let surplus space.

  In terms of the 2006/07 budget, the risk is being minimised by delaying the signing of the new leases until all costs have been fully validated and the sub-leases to Barnet Homes have been signed.

- Council Tax collection

  Around £180m in council tax will be collected in 2006/07 for the council and the GLA. Barnet has the largest taxbase in London by some margin, and has the 5th largest taxbase in the country. Non-collection of council tax measured in fractions of % points can have a significant impact on the budget. Similarly, over-estimation of the number of new properties and under estimation of exemptions and discounts in the council taxbase can have the same consequences.

- Housing benefit and temporary accommodation

  These items are highlighted as a risk simply because of their size and volatility – budgeted gross benefit payments of £119m, subsidy £117m and temporary accommodation income £8.2m.

- Placements – adults, looked after children, special educational needs

These items are also highlighted as a risk simply because of their size and volatility – budgeted adult placements £75m, looked after children £14.2m and special educational needs £6.5m.

Budget Reductions

- Looked After Children external placements (£750,000)

  Members will have long experience of this being a volatile budget due to the nature of the service. The strategy to develop a greater number of lower cost options and reduce the number of out of borough residential placements is in place, but there always remains the potential for significant budget fluctuations to arise as a result of a very small number of additional looked after children. The comments here apply to the base budget as much as they do to this budget reduction.

- Street Enforcement Service (£850,000)

  This involves a big restructuring of the service and is highlighted as a risk simply because of the size of the proposed saving.

- MCS efficiencies and benefits realisation (£1,438,000)

  This is an aggregation of savings across the council that can be attributed in some way to Modernising Core Systems (MCS). As with the above item, it is highlighted as a risk simply because of the size of the proposed saving.

Items Not Incorporated in the Budget

- Asylum Seekers prior years' grant claims £1.7m

  The grant instruction enabling the audit of the Asylum Seekers claim was withdrawn by Government before the audit of the 2002/03 accounts was undertaken. Similarly, claims in following years remain unaudited and the payments received from Government are less than the claims submitted, resulting in an increasing debtor in the Council's final accounts. The Home Office have now made arrangements to complete all outstanding audits across the country prior to April 2006. However, the delay exposes the Council to risk that when the audits are completed the amount finally paid may be less than the accumulated debtor.

- Prior year charges to PCT £1.6m

  A significant level of work was undertaken with Barnet PCT during 2004/05 to establish a final position on outstanding monies owed to the Council. The final position was a debt of £1.6m, for which detailed invoices and backing papers have been submitted to the PCT. However, it is proving difficult to elicit payment and as a consequence although this is a valid debt, there is a risk of non payment.

- Total of 50+ legal cases

This is the current total number of litigation cases the council is involved in or which could arise. These have been risk assessed at a potential cost of £0.6m, although this would not all come due in 2006/07.

- Capitalisation of redundancies

  The assumption is that redundancies arising from budget decisions and major restructurings will be capitalised, but the ability to do this always rests on a Ministerial decision to provide a Direction to capitalise. This Direction is not automatic and has to be applied for, so there is always a risk that the cost of redundancies could fall entirely on the revenue budget (i.e. balances). The cost is estimated to be around £4m in 2005/06 and 2006/7 based on actual and potential redundancies arising from proposed savings in the draft budget.

- Barnet Homes withdrawing from SLAs

  Barnet Homes has the right to withdraw at six months' notice from most SLAs where the council provides accommodation and support services.

5.5 It is also important to consider the robustness of capital programme assumptions, in terms of estimates of project costs, anticipated external income and grant, and levels of capital receipts assumed to be supporting expenditure in the year.

5.6 The only significant project being added to the capital programme is the Primary School Capital Investment Strategy, but works are not scheduled to start until 2007/08. The draft capital programme provides adequate budget to enable the Wave 1 programme (2007-2010) to be worked up in more detail, both in terms of costs and estimated capital receipts to be generated (including the timing thereof). Any variances from the outline estimates reported to Cabinet on 5 December 2005 will be incorporated into the 2007/08 Budget and Forward Plan process.

5.7 A prudent assumption has been made on the level of capital receipts being generated in 2006/07, based on past experience.

5.8 The major sources of external funding for the capital programme are DfES Schools Modernisation (grant and supported borrowing) and TfL (grant). Assumptions built into the capital programme funding model are in line with notifications received.

5.9 Turning to later years, the Council now has a firm indication of grant in 2007/08. Current indications are that it will be another tight year financially with the council once again at the grant floor, although the earlier grant announcement will enable the council to forward plan with greater certainty during 2006/07.

5.10 <u>Whilst I am of the opinion that expenditure and income estimates are as robust as can be expected based upon sound supporting evidence, there are some significant risks within and without the council budget that could seriously impact on the council's financial position if they arose</u>.

6 GENERAL DEBT OUTSTANDING AND TAX COLLECTION RATES

6.1 The debts owed to the council as set out on the balance sheet are covered in part by various bad debt provisions, which were increased by £1.75m in 2004/05 to cope with a major write-off exercise to be undertaken in 2005/06. To date, approximately £672,000 has been identified for writing off against this provision since 1 April 2005 and there will be further amounts to come.

6.2 I currently have no significant cause for concern over the level of bad debt provisions for the routine accounts raised across the council for services provided where a charge is made and the income is not received up front. There are, however, significant debts outstanding from other public bodies, which relate to services and grant in previous years. These would add to the pressure on balances if not paid in full by these two organisations.

7 ADEQUACY OF INSURANCE ARRANGEMENTS AND BUDGET PROVISIONS TO COVER MAJOR UNFORESEEN RISKS

7.1 The insurance provision is being increased in line with the planned contributions over a period of 3 years, as outlined in the response to the Section 11 Notice (March 2004) and the Financial Forward Plan approved by Council in March 2005. The requirement was to achieve an insurance provision of £7.2m.

7.2 Ongoing work to cleanse the claims database may slightly reduce this requirement, although there is also a £0.5m annual shortfall in the internal insurance recharges actioned in the accounts each year.

7.3 With the 2005/06 planned contribution to the insurance fund being made, the provision will be around £6.4m by 31 March 2006, barring any unforeseen calls being made on the fund. Allowing for some improvement in the claims database cleansing mentioned above, this puts us within around £1m of the required level of provision after allowing for the annual shortfall on internal recharges. The budgeted contribution of £1m in 2006/07 (originally £1.5m was provided for in the March Forward Plan) would address the remaining provision shortfall (estimated at £0.5m) and provide the base budget correction for internal recharges. The council budget in 2007/08 could then be reduced by £0.5m, leaving £0.5m in the base to correct the ongoing internal recharge shortfall.

7.4 There is no central contingency budget, so any unforeseen expenditure or loss of income would immediately become a call on balances, unless management was able to identify compensatory savings.

7.5 The draft 2006/07 budget headlines announced at Council on 20 December 2005 do not include the £3m planned contribution to balances set out in the Financial Forward Plan approved by Council in March 2005, which was in the response to the Section 11 Notice and an expectation that balances at 31 March 2006 would be around £8m. Given that balances at 31 March 2006 are currently forecast to be around £7m, this represents a change in the Council's response to the Section 11 Notice.

7.6 It is my view that the council should continue to make contributions to balances and this is dealt with more fully in section 12 of this report. No change to the planned contributions to the insurance provision should be made.

8 YEAR END ACCOUNTING ARRANGEMENTS

8.1 Some councils allow services to carry forward some underspends, with a lesser amount therefore being returned to central balances. Where services are allowed to accumulate surpluses for specific projects or to offset overspends in later years, this will clearly have an influence on the level of centrally managed balances.

8.2 Barnet does not operate the policy of allowing services to retain underspends, and indeed has required some services to achieve underspends in order to offset overspends in others. The one exception to this is schools, where they are allowed to retain underspends against the devolved budget shares they receive each year.

8.3 Although it did not eventually materialise, Members will recall some concern during 2003/04 that the Government settlement might cause aggregate school balances to be completely extinguished and thereby create a new pressure on centrally managed balances. This did not materialise, and aggregate schools balances were a relatively healthy £11m at 31 March 2005.

8.4 <u>There are no aspects of the council's current year end accounting arrangements that impact on my consideration of the level of balances</u>.

9 FINANCIAL REPORTING ARRANGEMENTS

9.1 Despite the significant reporting improvements that will flow from SAP, the External Auditor has commented on improvements made to budget monitoring reporting arrangements over the past couple of years.

9.2 In addition to the normal exception reporting arrangements, reports to Cabinet Resources Committee have included traffic light monitors on all the budget savings for two years now. Furthermore, Member Challenge on the detailed position on cost centre budgets takes place during the year.

9.3 The one area for improvement is in reporting on debt management. At attempt has been made to include reporting on debt over 90 days through the FirstStat arrangements, but this has proved problematic in that this can easily be distorted by large volumes of certain invoices being raised at specific points in the year. Enhancing this reporting will be an important improvement during 2006/07, and I will be keen to identify best practice from other councils.

9.4 Whilst SAP provides a platform from which to improve financial management reporting, it still requires commitment from budget holders across the council to fully understand the shift in responsibility that has also taken place, in that accountants are still there to support them in managing and monitoring their budgets but are no longer going to be doing it for them.

9.5 <u>Overall, there are no issues in respect to financial reporting arrangements that especially impact on my consideration of the level of balances</u>.

10 RELEVANT EXTERNAL AUDIT COMMENTS

2003/04 Annual Audit Letter

10.1 The Council was served with a Section 11 Notice by the External Auditor in February 2004, as part of the Annual Audit Letter for 2003/04. The response, approved by Council on 1 March 2004, included a planned ongoing contribution to balances in the Financial Forward Plan of £3m a year. Increasing the insurance provision to a level recommended by the external actuary was also agreed as part of the Council's response to the Section 11 Notice

10.2 The External Auditor took this ongoing commitment to increase balances into account when lifting the Section 11 Notice at the end of 2004/05, so any significant deviation from this and/or the planned level of balances in future years creates a risk of the External Auditor taking a different view about the council's financial standing. The following comments are taken from the 2003/04 Annual Audit Letter, which incorporated the Section 11 Notice:-

- *Financial Position*

  The Council appears to be on track to deliver the majority of its plan and by bringing 2005/06 savings online early anticipates that it will achieve balances of over £4m by 31 March 2005. The Council also intends to budget for a further £3m to be added to reserves for both 2005/06 and 2006/07 which if achieved will take the level of balances to a more comfortable figure in excess of £9m.

  We will continue to monitor the position closely but do not consider it necessary to issue a further Section 11 notice as part of this letter. We may however consider further public reporting if we are not satisfied that the Council is taking sufficient steps to maintain adequate levels of General Fund balances.

- *Action Needed by the Council*

  Ensure that adequate General Fund balances are maintained in 2004/05 and beyond. Current plans to achieve balances of £7m by 31 March 2006 should be maintained.

- *Financial Standing*

  The Council's financial position is improving although still very weak. Processes for the identification, monitoring and reporting of savings have significantly improved from previous years. Proposed increases to General Fund balances of £3m in both 2005/06 and 2006/07 need to be sustained.

  We support the Council's proposals to include £3m increases to balances in both 2005/06 and 2006/07. We will keep this position under close review and consider whether we need to take any public action using auditor powers as the position unfolds.

10.3 It is important to differentiate here between the External Auditor's observations and recommendations. References to balances being £4m by 31 March 2005 and £7m by 31 March 2006 are not recommendations, they are observations that if the council achieved it's (not the external auditor's) then forecast outturn for 2004/05 of £1m, then an ongoing contribution of £3m a year to balances would deliver £4m by the end of 2004/05 and £7m by the end of 2005/06, assuming the outturn was in line with the budget in both those years.

10.4 It is important to be clear that in respect to the position at 31 March 2006, the External Auditor was merely supporting the Council's action in seeking to achieve balances of £7m by the end of 2005/06. These comments were based on information the council had supplied, as indicated in 10.3 above, and should not be misinterpreted as a recommendation that balances at 31 March 2006 should be £7m, as opposed to any other figure at that date.

10.5 The External Auditor has not stated what level of balances the council should have, but has attempted to guide the Council into what he considers to be a reasonable level of balances, whilst recognising it is for the Council to ultimately make that decision. In February 2004, External Auditor said the ongoing £3m contribution in 2006/07 should be made, in the knowledge that by the end of 2005/06 the council (based on it's forecast 2003/04 outturn) was hoping to see balances around £7m, such that the further £3m would take balances by 31 March 2007 to "a more comfortable figure in excess of £9m".

10.6 This is the only specific view expressed by the External Auditor about the actual level of balances the council should consider having, i.e. something in excess of £9m.

2004 Use of Resources

10.7 In the External Auditor's initial feedback on the CPA Use of Resources 2005, reference has been made to good progress on incorporating risk management into the budget process, which essentially reflects the work done in establishing a central register on financial risks and uncertainties which is reviewed on a regular basis. Nevertheless, the External Auditor will rightly continue to expect continued progress on this issue.

2004/05 Annual Audit Letter

10.8 This was issued in January 2006 and is being considered in full by Cabinet at the sane meeting as the 2006/07 budget. It highlights one of the key actions required of the Council is to continue focusing on maintaining a sound financial position and building up the level of general fund reserves to at least £10m, as well as maintaining its established focus on delivering recurrent efficiencies that do not impact on the service outcomes for corporate priorities.

11 LEGAL REQUIREMENTS

1.1 It is a requirement of the Local Government Act 2003 that the Council should have regard to the Chief Finance Officer's report on the adequacy of balances when making the budget calculations. Any decision by Council on the level of reserves that differs from that of the Chief Finance Officer will need to be recorded in the decision to demonstrate the Council had fulfilled this statutory requirement.

11.2 LAAP[2] Bulletins are intended to provide guidance that represents good financial management and which should be followed as a matter of course. Compliance with such guidance is recommended in the CIPFA[3] 2003 Statement on the Role of the Finance Director in Local Government.

11.3 LAAP Bulletin 15 is a "Guidance Note on Local Authority Reserves & Balances". Section 7.2 of this guidance states the following:-

> *The level and utilisation of reserves will be determined formally by the Council, informed by the advice and judgement of the CFO. To enable the Council to reach its decision, the CFO should report the factors that influenced his/her judgement (in accordance with paragraph 6.2) and <u>ensure that the advice given is recorded formally</u>. <u>Where the CFO's advice is not accepted this should be recorded formally in the minutes of the council meeting</u>."*

> [Paragraph 6.2 sets out a range of issues similar to those summarised in section 1.2 of this report.]

12 SUMMARY & RECOMMENDATIONS

12.1 From the above sections, the key financial risks that could cause balances to be reduced are set out below:-

(i) <u>Services' record in delivering budget developments & reductions</u>

I have concluded in the report that slippage has occurred on budgeted savings in previous years, but that following management action any overspend has been within the level of current forecast General Fund balances. I have indicated that if previous results were any guide there could be a call of £1m on balances arising from savings not being delivered in full.

(ii) <u>Capacity to manage in-year budget pressures</u>

I have highlighted the scale of in-year budget variations in previous years, and that whilst these are not exceptional in an organisation the size of Barnet, they have nevertheless arisen and therefore need to be factored into my recommendation on balances.

(iii) <u>Robustness of forward plan estimates</u>

I have indicated in this report that whilst I am of the opinion that expenditure and income estimates are as robust as can be expected, there are some significant risks within and without the council budget that could seriously impact on the council's financial position if they arose.

12.2 I must have regard to comments made by the External Auditor, the most significant of which are set out in the 2003/04 Annual Audit Letter, extracts of which are included in this report. His comments are very clear, such that whilst not directing

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2 Local Authority Accounting Panel (LAAP)
3 Chartered Institute of Public Finance & Accountancy (CIPFA)

the council on the level of balances it should have (since he knows this to be inappropriate), he has expressed the view that a more comfortable position for the council would be to have balances in excess of £9m.

12.3 However the Council chooses to interpret the External Auditor's advice, it is required by the Local Government Act 2003 to take account of the advice and judgement of its Chief Finance Officer. If this advice is not accepted this should be recorded formally in the minutes of the council meeting. In guiding the Council to respond to the Section 11 Notice in February 2004 it was my belief that the council had to work over a relatively short period of time to achieve balances of at least £10m, and to maintain them at this level thereafter by continuing to forecast year end balances throughout the year and to include an appropriate contribution to balances in the draft budget for the following year as appropriate. **I am still of the view that the Council should be aiming to get balances to £10m**.

12.4 The Forward Plan agreed by Council in March 2004 and updated in March 2005 would have seen the £10m figure being finally achieved as part of the 2006/07 budget, by getting to £5m by 31 March 2005, £8m by 31 March 2006 and £11m by 31 March 2007.

12.5 The council signed a Local Public Service Agreement commencing April 2003, which set ambitious targets for service improvements over the three years ending 31 March 2006. Achievement of these targets in full or to a significant degree, will result in the payment of Reward Grant over a 2-year period (2006/07 and 2007/08), which is split 50:50 between revenue and capital. Based on performance assessments provided by Heads of Service, which have been reviewed by the Corporate Performance Office, the council could be in line to receive revenue sums of £0.66m in both 2006/07 and 2007/08. The expectation is that these sums would be taken into balances, less any amounts the Council decided should be given to partners contributing to the achievement of service improvement targets. If it were assumed that the Reward Grant is achieved and that the full amounts were retained by the Council, then balances at 31 March 2007 could reach £7.66m based on current budget forecasts.

12.6 The Local Authority Business Growth Incentive (LABGI) scheme starts in 2005/06. The Government will pay additional grant to authorities whose total business rateable value increases above a certain threshold, which is intended to provide an incentive to promote local business growth and return some of the benefit to the local authority. There are no restrictions on the use of the grant, which is not determined until after the Inland Revenue have updated valuations at the end of each calendar year. Payment of any grant due will be before the end of the financial year.

12.7 The following summarises the current forecast position in General Fund balances:-

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12.7 This position will be improved to the extent that Barnet receives LPSA Reward Grant, but could worsen due to slippage on 2006/07 budget savings, in year budget problems and the realisation of some contingent liabilities etc. Setting these risks aside, the draft budget would leave a shortfall of £0.7m against the minimum £10m balances I have recommended at paragraph 12.3.

12.8 **Firstly, the Council must decide what it considers to be the appropriate level of balances given all the factors set out in this report. Secondly, if it considers an appropriate level to be £10m, or some other figure higher than the current forecast of £9.3m by 31 March 2006, it must determine a strategy for bridging the gap in 2006/07 and/or subsequent years.**

12.9 Before making a recommendation on how the council might get to this level of balances in the coming years, it is important to first consider the likely grant settlement in future years, and the scope to manage the level of balances over a longer period of time.

12.10 In 2006/07, setting aside the grant changes in respect to concessionary fares and the one-off Benefit from the Amending Reports, Barnet is firmly at the foot of the table of London Boroughs receiving just the 2% grant floor increase, along with 7 other boroughs.

12.11 In 2007/08, Barnet will again be on the grant floor (2.7%) along with two-thirds of London Boroughs. The grant increase is reduced to 1.7% when an adjustment is made for the transfer of revenue funding of capital to capital grants, and the position becomes worse still when you take into account the added pressure on council tax from losing £0.57m one-off grant from the Amending Report.

12.12 In 2008/09, the Government is expected to introduce a 3-Year Settlement. Given the provisional settlements for 2006/07 and 2007/08 show a worsening position for Barnet and London as a whole, there must be an expectation that Barnet will continue to be at the grant floor until at least March 2011. The message I am seeking to convey to Council here is that if Members consider it difficult to increase balances in 2006/07, the ability to do so in the subsequent four years will not be any easier.

12.13 Based on the forecast outturn for 2005/06, contributing £1m to balances in 2006/07 would achieve my recommended target of £10m. To repeat an earlier comment, it is for Members to determine the level of balances, however, Council is required to take into account advice from the Chief Finance Officer and other parties, such as the External Auditor.

12.14 There is no precise formula for calculating the figure but it should be determined after taking into account the financial risks facing the council, which are set out in this report. The council can certainly be managed with less than £10m balances, it is obviously doing so at present, but it's also the case that every significant budget variation that arises means having to assess the impact on balances. Too great an emphasis like this on the financial standing of the council can also divert executive and management attention from all the other corporate priorities around service delivery.

12.15 The level of council balances also has a direct link to the council's score on various aspects of CPA – Use of Resources, Direction of Travel and the Corporate Assessment itself. Within that context, a low level of balances also reduces the council's ability to take risks and so reduces the opportunity to make innovative improvements to service delivery.

12.16 If the Council decides that the appropriate level of balances target for balances should be a minimum £10m or some other sum above the forecast £7m set out above, but is not willing to contribute £1m in 2006/07, it should set out a strategy for achieving the target. This strategy could encompass a comprehensive review of the base budget against corporate priorities early in 2006/07, taking advantage of the greater certainty provided by the early Government announcement of 2007/08 grant. This would be something for the new Cabinet to consider when it is formed after the 2006 Municipal Elections.

13 HOUSING REVENUE ACCOUNT

13.1 The Local Government & Housing Act 1989 required the Housing Revenue Account (HRA) to be maintained as a ring-fenced account and prescribed the debits and credits for it. Any surpluses generated from the HRA can be used to support the account when it fails to break even and for any one year a budget can be set such that there is a drawing on balances, but it is not permissible for an overall HRA budget deficit to be set. It is for the Council to determine what level of balances should be maintained. At 31 March 2005 the HRA balances were £5.8m, forecast to be £5.1m at 31 March 2007.

13.2 The following regeneration scheme underwriting agreements need to be considered alongside these balances, however, it is envisaged that one or more of the Principal Development Agreements will be signed before March 2007 and when they are signed the Underwriting Agreements fall away:-

West Hendon	£1.1m
Stonegrove	£1.3m
Grahame Park	£1.9m
Dollis Valley	£1.3m
Total	£5.6m

13.3 In the case of Stonegrove there is reasonable confidence that the liability could be met from land disposal rather than being a call on the HRA, and the West Hendon liability will be removed once the Principal Development Agreement is signed, which is likely to be in the spring of this year.

13.4 The principal items of expenditure within the HRA are management and maintenance costs, together with charges for capital expenditure (depreciation and interest). This is substantially met by rent and service charge income from dwellings, garages and commercial premises. However, the national housing subsidy system is a mechanism for redistributing resources between local housing authorities and for the year 2006/07 Barnet has to repay £8.5m to the pool – this figure is increasing annually. The subsidy settlement for 2006/07 (notified in December 2005) is far tougher than originally anticipated, as it was for all London Boroughs. As a result it may not be possible to make a contribution to balances in 2006/07 if the identification of further savings and efficiencies doesn’t take effect quickly enough.

13.5 Balances were over £6m from 2001/02 until 2004/05 and will, according to current projections, be restored to that level by the end of the current year. Gross expenditure plus gross income for the HRA will be approximately £96m in 2006/07, of which 20% is subsidy and capital charges and therefore fixed. For the remainder, the effect of budget pressures is similar to that for other Council expenditure and income. I would consider balances of between £5m and £6m to deal with a budget of this size to be adequate, however, the potential call to meet liabilities under the underwriting agreements is such that returning the HRA to surplus should be regarded as essential from 2007/08.

13.6 It has been the practice in earlier years to use some of the surpluses generated from the HRA to finance capital investment in the housing stock as capital resources are scarce. This can only be done in future if the level of balances is high enough to meet any contingencies that may arise. The immediate issue for the HRA is, therefore, to return to a position of budget surplus to maintain a healthy position and generate further resources for capital investment.

14 FOR DECISION BY COUNCIL

14.1 Council should, taking account of all matters set out in this report:-

(i) determine the appropriate level of General Fund and HRA balances;

(ii) determine a strategy for achieving this level of balances in 2006/07 and later years.

Clive Medlam
Deputy Director of Resources & Chief Finance Officer