



SCRUTINY COMMISSION – 15 NOVEMBER 2017

REVIEW OF EARMARKED FUNDS AND BALANCES

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

Purpose of Report

1. To report the findings of a detailed review of revenue earmarked funds and balances.

Policy Framework and Previous Decisions

2. The earmarked funds strategy was approved by the County Council at its budget meeting on 22 February 2017 as part of the Medium Term Financial Strategy (MTFS). The earmarked funds are reviewed three times during the financial year.

Background

3. The review covered all revenue earmarked funds and balances, excluding schools earmarked balances. The review also excluded capital funds (capital receipts and capital grants and contributions unapplied) which are earmarked for capital projects and are reviewed as part of the MTFS capital programme.
4. The main elements of the review were to:
 - a) determine if earmarked funds were required and the appropriate level;
 - b) revise the spending and contribution profiles for the main earmarked funds over the next four years;
 - c) review the appropriate level of the General Fund;
 - d) consolidate funds for capital projects to the capital financing reserve;
 - e) reallocate balances to fund the shortfall in future developments (mainly capital).

Earmarked Funds

5. Earmarked funds are held in accordance with the County Council's Earmarked Funds Policy that is approved annually by the County Council as part of the MTFS – copy attached as Appendix A.
6. The level of earmarked funds held for revenue purposes as at 31 March 2017 was £57.9m, excluding the ring-fenced Dedicated Schools Grant earmarked fund and

monies held on behalf of other partnerships. Earmarked funds for capital purposes totalled £45.5m as at 31 March 2017. The list of earmarked funds is shown on Appendix B.

7. A detailed review of all balances of earmarked funds has been carried out with the focus of releasing funds that are not required for their original purpose. These amendments are shown as transfers in Appendix B. The main transfers are to the future capital developments earmarked fund (+£16.1m in total), explained below, and the capital financing fund (+£1.2m) which was due to the consolidation of the waste developments earmarked fund that was already committed to funding the 2017-21 capital programme.

Transfers to the Future Capital Developments Fund (+£16.1m)

8. Insurance earmarked funds £6.1m. Public and employers liability £3.9m released, justified by the claims experience maintaining the positive position anticipated by the fund audit. The fund is increased annually for inflation and kept under continual review. Further transfers from the fund may be possible in the future. In addition £2.2m can be released from the uninsured losses fund. This follows a review of the latest position of the failed insurer Municipal Mutual Insurance (MMI), which has stopped declining; mainly as a result a levy on scheme creditors in 2016 (the County Council paid £1.6m).
9. Adults and Communities Developments £6.5m. Funding set aside for development projects has been consolidated into the future developments fund from where they can be prioritised in future. The County Council is also reviewing the implications of the Better Care Fund (BCF)/ Improved Better Care funding received during 2017/18 for similar transfers to the future developments fund for Adults and Communities improvement projects.
10. Adults and Communities Extra Care £0.6m. No schemes under development, hence funding transferred to the future developments fund pending detailed plans for future project(s).
11. Public Health £1.4m – funding originally earmarked for projects is no longer required as recent underspends have been utilised. Planned projects can be progressed using existing resources. .
12. Chief Executive – Economic Development £0.8m. Projects totalling £0.7m are committed to leaving a balance of £0.8m that can be released. Successes of the fund include Funding Circle; investment in local businesses, with funding now being repaid. If new projects arise these will be submitted to the capital future developments programme for funding.

Future Capital Developments

13. There is a long list of projects requiring funding over the next 4 years. Since the MTFS was approved £29.6m (net of funding already in the capital programme for asset acquisitions) has been allocated to projects at Anstey Frith House,

Lutterworth East, Loughborough University Science and Enterprise Park, Leaders Farm and Lichfield South. The latest list of the other projects requiring funding totals £50m.

14. These include investment in infrastructure for schools and roads arising from increases in population, investment in community speed enforcement depending on the outcome of the pilot, a new records office and collection hub, major IT system replacements (mainly Oracle which the Council has had in place since the early 1990s) and additional investment in the Corporate Asset Investment Fund (CAIF) and energy efficiency programme to generate ongoing revenue savings and additional income.
15. The balance of funding available for new projects is £36.2m which leaves a shortfall of £13.8m.
16. The CAIF has a notional target of growing to £200m over the next 5-10 years. Existing holdings plus identified commitments will value the CAIF at circa £120m, leaving a funding requirement of £80m. By its nature the CAIF will generate returns that could cover the repayment of debt and associated interest. Additional investment in the CAIF, beyond the current commitments, will result in returns in excess of the £2m benefit included in the draft MTFS.
17. Closing the funding gap by taking on new loans is not the preferred option, as the additional financing costs would increase the requirement for future savings; for instance the long term costs of borrowing £10m would be approximately £0.5m per annum (5%). The Council's Capital Strategy is for no or limited prudential borrowing. Since 2012/13 the Council has voluntarily set aside £47.8m to repay debt (Minimum Revenue Provision) to save c£3m per annum. It is still anticipated that new borrowing can be avoided as over the course of the MTFS one or more of the following opportunities will arise:
 - a. Underspends on the County Council revenue budget.
 - b. Unexpected grants are received to replace previously earmarked County Council resources.
 - c. Temporarily use the cash supporting earmarked funds in advance of it being required, rather than making short term cash investments.
 - d. Utilise the annual provision (MRP) made for the repayment of debt that is not required until the 2040s. This is expected to be £6.5 million per annum.
 - e. Delay some of the expenditure until resources are available.
18. The list of Future Developments is continually refreshed and it is likely that the current requirement will increase. If this increase is material it will need to be managed through prioritisation and identification of alternative funding sources. For example a contribution for the Melton Mowbray distributor road may need to be included in the capital programme. Financial modelling is being completed and all potential income streams are being considered including contributions from Section 106 agreements and partners. An update on the programme will be reported as part of the new MTFS.

Forecast Earmarked Fund Balances

19. Following the review of earmarked funds, the updated list of earmarked funds and forecast of balances for the next four years are detailed in Appendix C.
20. The following paragraphs consider each earmarked fund in detail (including the estimated position at 31st March 2018).

Renewals of Equipment and Vehicles (£4.0m)

21. Departments hold earmarked funds to provide funds for the future replacement of equipment and vehicles.
22. The earmarked funds held, and forecast balances at 31 March 2018, are;
 - Children and Family Services (£1.7m). This earmarked fund is held to respond to the need to develop, improve and where necessary replace departmental management information systems such as Capita One and Frameworki.
 - Adults and Communities (£0.1m). This fund provides funding for the future replacement of departmental equipment and vehicles.
 - Environment and Transport (£0.7m). These funds will be used to supplement the resources made available within the capital programme for vehicle replacement. They will predominantly be used over the next 2 years with vehicle replacement from that point onwards being funded solely from the capital programme. However, some of the funding will also be used to support ICT procurements.
 - Corporate Resources (£1.5m). Funding set aside for planned ICT infrastructure renewals.

Trading Accounts (£1.0m)

23. Surpluses from the Industrial Properties trading account are transferred to an earmarked fund to provide funds for future capital investment, large maintenance items and to smooth volatility in revenue performance.

Insurance (£15.3m)

24. Earmarked funds of £9.9m are held to meet the estimated cost of the insurance policy excesses that the Council is liable for. This is for historic incidents that have not yet been reported to the Council and an amount to allow excesses of large property claims to be met. This enables the Council to meet excesses regardless of the timing of claims, which can be erratic. The levels are assessed periodically through an Actuarial Review. Excesses include:

- Property damage (including fire) £500,000
 - Public / Employers' liability £250,000
 - Professional indemnity £25,000
 - Fidelity guarantee £100,000
 - Money – completely self-insured
25. The uninsured loss fund of £5m is required mainly to meet potential liabilities arising from Municipal Mutual Insurance Ltd (MMI) that is subject to a run-off of claims following liquidation in 1992. The fund also covers the period before the Council purchased insurance cover and the period (1993-97) that the Council was insured with Independent Insurance, who has been liquidated.
26. While MMI's current position has improved, mentioned earlier in this report, there are other potential new liabilities, including a recent Supreme Court case that has widened the liability for abuse claims and a significant reduction in the discount rate used to measure investment income of awards over an average life expectancy. The position of MMI and other failed insurers is kept under regular review and if required additional contributions to the earmarked fund will be made in the future.

Committed Balances (£0.7m)

27. Two earmarked funds are used as a mechanism to carry forward resources where expenditure has been committed to schemes but the expenditure has not been incurred in that financial year. The two earmarked funds are the Central Maintenance Fund (CMF), £0.4m and the earmarked fund for community grants, £0.3m.

Children and Family Services

28. As a result of the recent Ofsted review and forecast budget overspend, the department is in the process of completing a detailed review of priorities for all Children and Family Services earmarked funds. The review will be completed in December and included in the draft MTFs 2018-22.
29. Children and Family Services Developments (£2.6m). General fund held for departmental improvement, transformation and responding to Ofsted and legislation changes, subject to review.
30. Supporting Leicestershire Families (£1.0m). This earmarked fund is used to fund the Supporting Leicestershire's Families service which is providing early help and intervention services for vulnerable families across Leicestershire.
31. Youth Offending Service (£0.4m). This earmarked fund is used to fund the Youth Offending Service particularly to address fluctuations in grants from Central Government.
32. Special Educational Needs Disability (SEND) (£0.2m). Local authorities have received grant for the implementation of a national redesign of services for children

with special educational needs and disabilities. Changes in national expectations and recruitment difficulties have resulted in some elements of implementation being re profiled.

33. School Based Planning (£0.6m). Funding set aside to fund the development of a school place planning strategy to support increased capital funding.

Adults and Communities

34. Adults and Communities Developments (£0.3m). This earmarked fund is mainly held to assist the department in achieving improvements and transformation. In addition to this fund the Department also has access to the Improved BCF grant funding awarded for 2017/18.

35. Communities and Wellbeing Developments (£0.3m). This earmarked fund is held to fund projects costs of replacement departmental ICT systems, smart libraries, school art and the collections hub.

Public Health

36. Public Health (£0.4m). The NHS grant for Public Health was above the level of historic expenditure, recognising the historic underfunding in Leicestershire. The balance is held for preventative and other Public Health beneficial activities.

Environment and Transport

37. Commuted sums (£2.5m). This is used to cover future revenue costs arising from developer schemes, where the specifications are over and above standard developments (e.g. block paving, bollards or trees adjacent to the highway). These liabilities can arise many years after the funding is received and therefore the balance on this earmarked fund has built up over time. The intention is to use these balances over the next few years (£0.4m per year) to help mitigate against the impact of the overall reductions in resources available for highways maintenance, along with any additional resources received in year (on average £0.2m to £0.3m per year although it does vary).
38. Civil Parking Enforcement (£0.1m). This is a small earmarked fund that is held on behalf of the District and County Partnership which is responsible for the enforcement of on and off street parking in Leicestershire. It will be utilised for equipment and technology replacement in future years.
39. Waste Developments (£0.6m). This will be utilised to fund specific one off pieces of work developing strategies and providing support to specific projects including those required to contribute to future MTFs savings.
40. Section 38 Income (£0.5m). This is income received from Housing Developers paid in advance and used to cover County Council costs for design checking, on site inspection of works during construction and administration of the process to ensure newly built estate roads are to the required standard for adoption. The signing of

the final certificate to agree new roads are at the required level should be carried out within a 4-year period. Section 38 income is paid into the earmarked fund and brought into the accounts to offset the costs in the year in which they are incurred. The majority of the current fund balance will be utilised over the next four years. However, it should be noted that additional funding may become due and be received over this period which would increase the balance on this fund.

41. Section 106 Income (£0.5m). Funding received to meet developer-related revenue expenditure (such as subsidised bus services and travel packs linked to new developments) and where there are no specific conditions for the funding to be repaid. The majority of the current fund balance will be utilised over the next four years. However, it should be noted that additional funding may become due and be received over this period which would increase the balance on this fund.
42. Leicester and Leicestershire Integrated Transport Model (LLITM) (£1.5m). This earmarked fund is for money generated from charging other local authorities for using the model. Surplus income is added into the fund and will be used to finance activity to refresh the model when required in around 3 years' time. Updating the LLITM is important to ensure it accurately predicts the impact of future prospective developments and supports potential bids for future major schemes.
43. Environment and Transport Developments/ advanced design (£1.2m). Part of this funding is required to fund feasibility studies and advance design works to enable bids to be made for major capital schemes to improve the transport infrastructure supporting expected growth in Leicestershire. Also part is required to manage the transition to increased service provision being covered from the Road Safety Partnership.
44. Other earmarked funds (£0.1m). These funds will be used for partnership transport projects.

Chief Executive's

45. Economic Development (£0.3m). This earmarked fund is held to provide funding for committed economic development initiatives.
46. Legal (£0.1m). This earmarked fund is held to provide funding for temporary solicitor posts to cope with current and transformation demand.
47. Signposting and Community Support Service (£0.2m). This fund is held to mitigate the impact of the withdrawal of Government funding for the Leicestershire Welfare Provision. The funding was provided from underspends in the scheme's two years of operation (2013/14 and 2014/15) and is used to temporarily support signposting and community support for vulnerable people, with the aim of minimising the on-going costs of this service over the next four years.
48. Chief Executive Department Developments (£0.4m). This earmarked fund holds funding towards a variety of projects and contingencies. The projects are phased

over several years and include: efficiency projects, planning control work, and funding received from (and ring fenced to) crime fighting and prevention.

Corporate Resources

49. Corporate Resources Developments (£0.4m). The main purpose of this earmarked fund is to provide funding to efficiency projects and one off initiatives in Corporate Resources. Examples of activities funded are investigating asset management changes/improvements and ICT development work.
50. Leicestershire Schools Music Service (£0.2m). This earmarked fund is under review and will be updated as part of the new MTFS.

Corporate

51. Transformation (£15.7m). The fund is used to invest in transformation projects to achieve efficiency savings and also to fund severance costs. To achieve the level of savings required within the MTFS the Council needs to change significantly and this requires major investment including in some of the core 'building blocks' of transformation such as improvements to data quality and improvements to digital services enabling more self-service.
52. East Midlands Shared Services (£0.4m). County Council funding set aside for investment in Oracle development projects to support the shared service.
53. Elections (£0.2m). The average cost of County Council elections is estimated to be £0.8m every four years, unless there are other elections on the same date that can share the cost. The earmarked fund is built between elections using budgeted annual contributions of £0.2m.
54. Broadband (£3.5m). This fund was established to allow the development of super-fast broadband within Leicestershire. A contract has been entered into with BT for phase 2 of the programme. There is a significant time lag in spending County Council funds due to grant conditions that required Central Government and other funding contributions to be spent within a set period. The funding is expected to be spent in the period 2017/18 to 2019/20.
55. Business Rates Retention (£1.4m). This fund was established following the introduction of the Business Rates Retention system in 2013 and is held as a contingency to fund potential shortfalls in business rates income impacting in later years, especially the risk of large appeals and fluctuations in Business Rates income.
56. Inquiry and other costs (£1.2m). This fund is held to provide funding for inquiry and other costs associated with historical child sexual exploitation.
57. Local Authority Mortgage Scheme (LAMS) (£-3.0m). The County Council invested £8.4m in the Local Authority Mortgage Scheme to make it easier for first time house buyers to obtain mortgages and thus stimulate the local housing market and

benefit the wider local economy. Investment of £3m in 2013/14 and £5.4m in 2012/13 has been advanced to Lloyds bank, temporarily funded from the overall balance of earmarked funds. The funding will be returned to the County Council, 5 years after the date it was advanced. The first tranche of funding is being returned in 2017/18 with the balance of £3m due back in 2018/19.

58. Pooled Property Fund(s) (-£20m). The Cabinet on 11 September 2015 and 11 October 2016 approved the investment of £15m and £10m respectively of the Council's earmarked funds into pooled property funds. To date £20m has been invested with the timing of the final investment of £5m uncertain at this stage. These investments will raise interest receivable by a significant amount, in effect replacing £20m earning 0.25% with £20m earning around 4%, albeit recognising that there is a higher level of risk with this type of investment. The investment is funded from the overall balance of earmarked funds and can be realised in the future when required.

Capital

59. Capital Financing (£19.3m). This fund is used to hold MTFS revenue contributions to fund capital expenditure in the approved 2017-21 MTFS.
60. Future Developments (£50.5m). Additional funding to support future capital programme developments, including the Corporate Asset Investment Fund. This is the forecast year end (at 31 March 2018) position and is not directly comparable to the balance of funding available on the overall fund of £36.2m explained earlier in the report. The difference mainly relates to spending commitments of approved schemes being in later years. The overall fund also includes anticipated funding in later years which are not included in the forecast balance at the end of 31 March 2018.

Schools / Partnerships Earmarked Funds

61. Dedicated Schools Grant (£1.7m). DSG is ring fenced and can only be applied to meet expenditure properly included in the Schools Budget, as defined in the School and Early Years Finance (England) Regulations. Any underspend on services funded by DSG must be carried forward and ring fenced to those services. This fund is notionally earmarked to fund any deficit budget that reverts back to the local authority as maintained schools move into sponsored academy arrangements and also to meet the revenue costs of commissioning places in new schools. A forecast overspend on the Schools revenue budget in the current year is reflected in the reduction as at 31st March 2018.
62. Health and Social Care (£0.9m). This earmarked fund is used to fund projects that improve health and social care outcomes in Leicestershire, including the prevention of admission and readmission into hospital as well as the prevention of other costly health and social care provision. Funding for these projects has been aligned with the strategic objectives of the BCF and has been agreed between the County Council and partners from the NHS.

63. Leicestershire and Rutland Sport (£0.8m). The earmarked fund's main purpose is to hold partner contributions until expenditure on the agreed activities has been incurred. A significant part of the services funding from external agencies is uncertain in nature, so the earmarked fund also allows management of funding variations and a redundancy provision.
64. Centre of Excellence (£0.2m). The Centre of Excellence for Information Sharing is a local-national collaboration, funded by multiple government departments. It is hosted by Leicestershire County Council, and has a team of people from across national and local organisations. The organisation's vision is for users of public services to achieve better outcomes as a direct result of improved information sharing between agencies and local places. The earmarked fund is held on behalf of the Centre of Excellence to fund ongoing work.
65. Leicestershire Social Care Development Group (LSCDG) (£0.3m). This earmarked fund is held on behalf of the LSCDG, a partnership with Leicester City Council. Funds are held on behalf of the partnership to meet the Director of Adults and Communities responsibility for workforce development in social care regardless of the sector. The monies are solely for the independent and voluntary sector across Leicester and Leicestershire.
66. East Midlands Shared Services – Other (£0.3m). This relates to the County Council's share of previous underspends on the joint committee (EMSS). The fund is held for investment in future EMSS developments and will be directed by the joint committee.

Other Issues

67. There are real advantages to the County Council of having a strong balance sheet in a period of economic crisis. These are obvious, such as a greater ability to weather financial shocks, but there are also advantages such as the ability to use this strength to implement policy decisions such as LAMS that offset, to an extent, the impact of the failure of banks to provide finance.
68. The overall level of earmarked funds includes balances for capital financing (£69.8m forecast at the end of 2017/18) which are required to fund the County Council's Capital Strategy. These resources have been set aside from revenue underspends, surplus earmarked funds and the current MTFs, to avoid the need to undertake external borrowing.
69. Members requested details regarding earmarked funds where the latest projections varied significantly from the previous forecast. Appendix D gives details of earmarked funds where forecasts as at 31st March 2018 have varied by more than £0.5m.

Schools Earmarked Balances

70. Schools and colleges are allowed to retain their accumulated balances in relation to delegated budgets. Schools balances have decreased from £11.9m in 2015/16

to £9.7m at the end of 2016/17. The largest balances held are to smooth out cost increases and particularly staffing costs, for land and building works and ICT investments.

General County Fund

71. The General County Fund is held to meet any unexpected risks. The uncommitted balance on the General County Fund was £14.8m as at 31st March 2017 and is expected to remain at £14.8m in 2017/18.
72. The policy on the General County Fund has been to maintain balances in line with the inherent risks faced by the County Council. The required level of earmarked funds is kept under review during the year and a more formal assessment is undertaken at the time the Medium Term Financial Strategy (MTFS) is rolled forward. The policy will be to continue to maintain a level of the General County Fund consistent with the overall financial environment. The level of the General County Fund is currently within the target range of 4 to 5% of net expenditure (excluding schools), the balance of £14.8m represents 4.3% of net expenditure for 2017/18.

Risk Assessment

73. As part of the earmarked funds review, the risk assessment was revisited given the rapidly changing financial environment. This shows that the risks faced by the County Council are increasing. The key risks are set out below;
 - Public finances continue to deteriorate with the prospect of further cuts in funding into the next decade, which will increase the County Council's savings requirement.
 - The localisation of business rates and changes to Council Tax Benefit mean that the income of the Council will be less predictable and potentially subject to in year shocks.
 - Environment including extreme weather.
 - Service pressures resulting in overspends. Although overall the Council is underspending, pressures within Adults and Children's social care are increasing. National funding changes could exacerbate these pressures.
 - Potential cuts to grant funding for Public Health.
 - Funding the additional costs of the National Living Wage.
 - Potential additional pay costs if the 1% public sector pay cap is removed.
 - Increase in demand for SEN transport.
 - Potential steep rises in general inflation and in specific areas such as energy.
74. The current MTFS includes a contingency in the budget of £8m over the four years of the MTFS. This needs to be considered alongside the General County Fund in relation to the risks faced by the County Council.

External Audit Review

75. KPMG, the County Council's external auditors, has reviewed the level of reserves as part of their Value for Money review of the 2017-21 MTFS and reported that given the uncertainties and service pressures that lie ahead the overall level of earmarked funds held are appropriate for the size of the organisation.

Management and Monitoring of Earmarked Funds

76. Information on earmarked funds is provided in the following reports;

- February – MTFS reports to the Cabinet and County Council. These reports contain the earmarked funds policy, forecast levels of funds and statement on the robustness of estimates, risks and funds.
- May/June – MTFS Provisional Outturn report to the Cabinet and Scrutiny Commission. These reports contain the key movements and the actual year end balances.
- July – Statement of Accounts report to Constitution Committee. This report sets out the earmarked funds in detail and includes a commentary and a statement showing all the transfers to and from the earmarked funds.
- October/ November - Autumn review of earmarked funds to the Cabinet and Scrutiny Commission.

Conclusion

77. The review of earmarked funds has identified that the level of earmarked funds by the end of 2017/18 for revenue purposes (excluding Dedicated Schools Grant and partnerships) is expected to be around £34.5m and that earmarked funds for capital purposes will be around £69.8m.

Background Papers

None.

Circulation under Local Issues Alert Procedure

None.

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List of Appendices

Appendix A – Earmarked Funds Policy

Appendix B – Earmarked Funds Restated

Appendix C – Earmarked Funds Projection

Appendix D – Earmarked Funds where balance projected at 31/3/18 has varied by more than £0.5m

Equality and Human Rights Implications

There are no direct implications arising from this report.

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