



SCRUTINY COMMISSION – 31 OCTOBER 2018

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 21 February 2018 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;

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 2018 was £39.7m, excluding the ring-fenced Dedicated Schools Grant earmarked fund and monies held on behalf of other partnerships. Earmarked funds for capital purposes totalled £80.7m as at 31 March 2018.

Forecast Earmarked Fund Balances

7. 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 B.
8. The following paragraphs consider each earmarked fund in detail (including the estimated position at 31st March 2019).

Renewals of Equipment and Vehicles (£3.0m)

9. Departments hold earmarked funds to provide funds for the future replacement of equipment and vehicles, or IT development.
10. The earmarked funds held, and forecast balances at 31 March 2019, are;
 - Children and Family Services (£1.0m). 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 (£0.5m). 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 18 months 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 (£1.4m). Funding set aside for planned ICT infrastructure developments and renewals.

Trading Accounts (£1.0m)

11. 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 (£13.6m)

12. Earmarked funds of £7.6m 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 £375,000
 - Professional indemnity £25,000
 - Fidelity guarantee £100,000
 - Money – completely self-insured
13. The uninsured loss fund of £5.6m 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 have been liquidated.
14. While MMI's current position has improved, assets now cover estimated liabilities, 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 (£0.4m)

15. 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), £0.1m and the earmarked fund for community grants, £0.3m.

Children and Family Services

16. Supporting Leicestershire Families (£1.5m). 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. The funding is anticipated to be used in 2020/21 when Government grant funding is expected to end.
17. Children and Family Services Developments (£1.0m). General fund held for departmental improvement, transformation and responding to Ofsted and legislation changes, subject to review.
18. Youth Offending Service (£0.5m). This earmarked fund is used to fund the Youth Offending Service particularly to address fluctuations in grants from Central Government.
19. Special Educational Needs Disability (SEND) (£0.3m). 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.

20. School Based Planning (£0.4m). Funding set aside to fund the development of a school place planning strategy to support increased capital funding.
21. Innovation Fund – Practical Excellence (£0.2m). This earmarked fund is used to support the further development work of the ‘Signs of Safety’ approach within the department. ‘Signs of Safety’ is an innovative, strengths-based, safety-organised approach to child protection casework.

Adults and Communities

22. Adults and Communities Developments (£2.9m). 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 three years in 2016/17 in partnership with health partners.

Public Health

23. 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

24. Commuted sums (£2.3m). 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 (£0.3m 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).
25. Environment and Transport Developments/ advanced design (£0.8m). 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.
26. Civil Parking Enforcement (£0.2m). 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.
27. Waste Developments (£0.3m). 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.

28. Section 106 Income (£0.3m). 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 to support local bus services within Leicestershire.
29. Leicester and Leicestershire Integrated Transport Model (LLITM) (£2.2m). 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.
30. Other earmarked funds (£1.0m). These funds will be used to manage funding of schemes where grant awards and scheme expenditure relate to/occur in different financial years and also will fund plant renewal for highways services. It is expected that all of the existing funding will be utilised within the MTFs period, although additional funding will need to be allocated to fund plant renewal on an ongoing basis.

Chief Executive's

31. Economic Development (£0.5m). This earmarked fund is held to provide funding for committed economic development initiatives.
32. Legal (£0.2m). This earmarked fund is held to provide funding for temporary solicitor posts to cope with current and transformation demand.
33. Signposting and Community Support Service (£0.1m). This fund was set up 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 has been used to fund signposting and community support for vulnerable people. The fund will be fully spent in 2019/20 and a growth bid has been submitted to allow the service to continue.
34. Chief Executive Department Developments (£0.5m). 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

35. Corporate Resources Developments (£0.1m). 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 include supporting the Business Improvement Programme in Strategic Property / Asset Management.

36. Leicestershire Schools Music Service (£0.2m). This earmarked fund is used to grow and develop the service vision for the future to deliver the core and extension roles of the national plan for music education (NPME) including investing in sustainable projects and building capacity. Additionally, the service celebrates its 70th anniversary this year and funds are being utilised to support several schemes to promote this milestone, including a performance at the Royal Albert Hall.

Corporate

37. Transformation (£10.7m). 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.
38. East Midlands Shared Services (£0.4m). County Council funding set aside for investment in Oracle development projects to support the shared service.
39. Elections (£0.4m). 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.
40. Broadband (£2.0m). 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, which is due to complete in 2018/19. 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. Phase 3 which will be funded from the reserve and the capital programme is planned to commence in March 2019.
41. Business Rates Retention (£1.6m). 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. Part of the fund (£0.6m) also relates to the County Council's share of the Leicester and Leicestershire Business Rates Pool contingency, held for risks of significant appeals and/or businesses failing/ relocating.
42. Inquiry and other costs (£1.1m). This fund is held to provide funding for inquiry and other costs associated with historical child sexual exploitation.
43. Local Authority Mortgage Scheme (LAMS) (£0.0m). 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 was returned in 2017/18 with the balance of £3m due back in 2018/19.

44. Pooled Property Fund(s) (-£22.5m). 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 £22.5m has been invested with the timing of the final investment of £2.5m uncertain at this stage. These investments will raise interest receivable by a significant amount, in effect replacing £22.5m earning 0.75% with £22.5m 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

45. Capital Financing (£55.5m). This fund is used to hold MTFS revenue contributions to fund the phasing of capital expenditure in the approved 2018-22 MTFS.
46. Future Developments (£36.6m). Additional funding to support future capital programme developments. The overall fund includes anticipated funding in later years and an indicative spend profile of £10m p.a.
47. There is a long list of projects that will potentially require funding over the next 4 years. These include investment in infrastructure for schools and roads arising from increases in population, investment in Supported Living accommodation, investment in community speed enforcement (depending on the outcome of the pilot), a new records office and collections hub, major IT system replacements and a contribution and underwriting of section 106 developer contributions for the Melton Mowbray distributor road.
48. The current estimate of the funding required is £110m compared with funding currently available of £40m, which leaves a shortfall of £70m. A County Council funding likelihood high, medium, low assessment has been applied to the list of schemes, which reduces the estimated shortfall to £49m.
49. The list of Future Developments is continually refreshed and the current requirement exceeds the current funding available. This will need to be managed through prioritisation and identification of alternative funding sources, including contributions from partners.
50. Closing the gap by taking on new loans is not the preferred option, as this increases the requirement for future savings. It is still expected that this situation can be avoided as over the course of the MTFS one or more of the following opportunities will arise:
- Underspends on the County Council revenue budget.
 - Unexpected grants are received to replace previously earmarked County Council resources.

- Temporarily use of the cash supporting earmarked funds in advance of it being required, rather than making short term cash investments.
- Delay some of the expenditure until resources are available

Schools / Partnerships Earmarked Funds

51. Dedicated Schools Grant (-£1.3m). 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. The current 2018/19 DSG forecast is for an overspend of £3.5m, which would be part funded from the DSG earmarked fund which totals £2.2m, with the balance of £1.3m potentially carried forward to 2019/20 as a deficit on the DSG earmarked fund. A deficit on DSG can be carried forward with the permission of the Schools Forum and becomes the first call on the following years grant. Should approval not be granted, the local authority can seek adjudication from the Secretary of State. There is a risk that the balance may need to be met from the overall County Council budget and this is reflected by a contingency to use part of the overall net underspend to increase the County Council General Fund, as noted in paragraph 60 below. The position on the earmarked fund will be kept under review and may worsen in future years
52. Health and Social Care (£0.5m). 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 Better Care Fund (BCF) and has been agreed between the County Council and partners from the NHS.
53. Leicestershire and Rutland Sport (£1.0m). 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.
54. East Midlands Shared Services – Other (£0.1m). 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.
55. Emergency Management (£0.2m). This earmarked fund is for the County Council's share of previous underspends on the two Resilience Partnerships. Underspends from funds contributed by partner organisations are held separately as Receipts In Advance. The earmarked fund is held for future investments and as a redundancy provision.

Other Issues

56. 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.
57. The overall level of earmarked funds includes balances for capital financing (£91.1m forecast at the end of 2018/19) 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.
58. Members requested details regarding earmarked funds where the latest projections varied significantly from the previous forecast. Appendix C gives details of earmarked funds where forecasts as at 31st March 2019 have varied by more than £0.5m.

Schools Earmarked Balances

59. Schools and colleges are allowed to retain their accumulated balances in relation to delegated budgets. Schools balances have decreased from £9.7m in 2016/17 to £9.0m at the end of 2017/18. 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

60. The General County Fund is held to meet any unexpected risks. The uncommitted balance on the General County Fund was £14.8m as at 31 March 2018 and is expected to increase to £16.0m in 2018/19, to reflect the risk of a deficit on the DSG earmarked fund. The level of balance in 2019/20 and later years will be subject to review as part of the process of compiling the 2019-23 MTFS.
61. 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 4.1% of net expenditure for 2018/19 and the projected year-end balance of £16.0m represents 4.4%.

Risk Assessment

62. 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.
 - Potential cuts to grant funding.
 - Funding the additional costs of the National Living Wage.
 - Potential additional pay costs following the removal of the 1% public sector pay cap.
 - Increase in demand for SEN transport.
 - Potential steep rises in general inflation and in specific areas such as energy.
63. The current MTFS includes a contingency in the budget of £8m over the three later 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

64. KPMG, the County Council's external auditors have reviewed the level of reserves as part of their Value for Money review of the 2018-22 MTFS and reported: "The level of reserves are appropriate for the size of the organisation given the continued uncertainties and risk that lie ahead for the whole sector and the individual pressure and challenges the Authority faces in the short to medium term. The Authority will need to continue to keep the level of reserves under review on a periodic basis as its reserve requirements change."

Management and Monitoring of Earmarked Funds

65. 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

66. The review of earmarked funds has identified that the level of earmarked funds by the end of 2018/19 for revenue purposes (excluding Dedicated Schools Grant and partnerships) is expected to be around £27.3m and that earmarked funds for capital purposes will be around £92.1m.

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 Projection
Appendix C – Earmarked Funds where balance projected at 31/3/19 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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