C

ESPO MANAGEMENT COMMITTEE – 25 MARCH 2011

AGENDA ITEM NO. 5

FORECAST OUTTURN 2010-11 AND BUDGET 2011-12

REPORT OF THE INTERIM DIRECTOR AND CONSORTIUM TREASURER

Purpose of Report

1. This report sets out the Forecast Outturn for 2010-11 and Budget for 2011-12 with explanations for the more significant variances.

Trading Environment

2. The major reductions in Central Government grants will inevitably impact on ESPO which will impact on catalogue sales volumes, initially as a result of reduced staff numbers at member authorities. This reduction in member authority spending can be expected to continue for the medium term.. This will present a challenge to ESPO to continue the growth that the organisation has achieved in previous years. ESPO management decisions regarding the services offered, the relevance and competitiveness of contracts, catalogue products pricing and focussed marketing, will be directed towards the continuing objective of delivering value for member authorities.

3. Appendix 1 and attachments summarise the forecast outturn for 2010-11 and the budget for 2011-12. Details of variations from the original budget for 2010-11 are explained below where these have a significant impact on the operating surplus.

Forecast Outturn 2010-11

Income*:*

4. ESPO has seen continued growth in the value of Stores turnover this year despite adverse economic conditions limiting authorities' expenditure. Growth was achieved in targeted non-member areas and has offset the effect of spending restrictions in core customer authorities. The expected increase of £1 million is primarily the effect of price changes in April 2010 and sales volumes have been retained at the level achieved in 2009-10. Stores margins are forecast to decrease by 2.7% from the prior year level of 35.2% which has returned £0.74 million to customers through improved value.

5. Sales of non-stock catalogue products have been affected by reduced demand for furniture and furnishings and have fallen by 3% from the prior year levels.

6. The major area for growth this year has been in the use of ESPO framework contracts. This has been widespread over our range of both strategic and commodity contracts and was supported by developments in national procurement initiatives, joint PRO5 contracts and active marketing to new customers. PwC, ESPO's external auditors, has also required a change to accruing for rebate income at the year end. The resulting rebate income is likely to be £0.8 million (+19%) higher than the prior year which includes an estimated £0.3 million as a one-off increase in apparent income because of this change in accounting practice.

7. The overall income for this year is expected to be £17.5 million, £0.5million higher than the prior year and £1.5 million above budget.

Expenditure:

8. Staffing costs are expected to remain similar to 2009-10 expenditure of £9.2 million as the number of employees and pay rates have continued at the prior year level. Savings of £0.2 million from the 2010-11 budget result from a 2% reduction in employee numbers and from a pay freeze.

9. Overhead expenditure will be £0.55 million lower than both the prior year costs and the budget. The significant variations from budget are explained as follows:

- Catalogues and Marketing (Decrease of £0.19 million or 30%). A planned Sustainable Products catalogue was cancelled and the cost of the general catalogue reduced by 16% from 2009-10.

- Major Projects Costs (Decrease of £0.27 million or 51%). Anticipated fees for the further development of two major BSF projects were not spent following the reduction in the BSF programme in June 2010. ESPO also withdrew from quoting on newly approved BSF projects.

- Consultancy and Professional Fees (Increase of £0.16 million or 278%). A provision of £0.15 million has been included for expenditure relating to the Strategic Business Review and for anticipated legal claim fees.

Allocations from Operating Surplus

10. Provisional allocations from 2010-11 Operating Surplus have been included for anticipated exception expenditure. A provision of £0.52 million is proposed for the outcome of the Strategic Review of ESPO relating to the Staff Annual Bonus Scheme.

11. A provision of £0.5 million is proposed for possible additional costs of a legal action. If not required this amount would be added to the distributable net surplus.

12. A provision has also been included for an 'invest to save' project costing £0.45 million for the warehouse operation. The measurable annual savings from this project from 2012-13 onwards are forecast to be £0.3 million.

This project is covered in greater detail within the Interim Director's Progress Report but the financial detail can be summarised as:

Total cost of hardware/software and hand-held terminals equates to £0.45 million. Forecast cashable benefits are savings in staff time equivalent to £0.3 million per annum. This means the initial outlay of £0.45 million will be recovered within 2 years. Additional benefits include a reduction in order errors and paper consumables.

Surplus:

13. The Operating Surplus is estimated to be £2.6 million which is a record level. This is the result of exceptional growth in rebate income combined with reduced overhead expenditure. The amount available for distribution after provisions is forecast to be £1.1 million. This will be added to members' reserves pending a decision on distribution. A previous allocation from 2009-10 surpluses amounting to £0.8 million is also held in members' reserves.

Budget 2011-12

14. The approach to budgeting in prior years has been to adopt a conservative view of income usually based on volumes achieved two years prior. This year the budget has been constructed to present challenges both in terms of Stores sales volumes included in income forecasts and in efficiency improvements included within operating expenditure forecasts. Estimates have also been included for provisional costs of changes proposed in the Strategic Review.

Income:

15. In line with the policy adopted last year, the margins on Stores products have been further reduced by 1.9% from the level budgeted for 2010-11. This is intended to help mitigate the effects of inflationary buying price increases which for the in this year have increased by an average of 4.8%. Stores sales volumes have been budgeted to remain at the 2010-11 level. This challenges sales and marketing staff to achieve continued growth in non-member areas to compensate for expected reductions in established markets.

16. The result of these decisions is an increase in Stores turnover of 2.6% to £37.5 million whilst the gross margin is budgeted to be maintained at the prior year value of £8.9 million. Income from Directs sales, Advertising and Major Projects is budgeted to remain static or fall slightly. Buyer Teams have forecast that Rebate income will return to 2009-10 level as they anticipate the effect of reduced expenditure by local authorities.

Expenditure:

17. Employee costs for 2011-12 are reflected to assume there will be no pay award for staff. The increased cost over 2010-11 of £0.14 million relates to grade progression increases.

18. Other overhead expenses are budgeted to increase by £0.21 million. The most significant variations from budget are explained as follows:

- Transport Commercial Vehicles (Increase of +£0.085 million or +6.6%). This is a combination of providing for continued increases in fuel prices and carriers charges which will be partially offset by efficiency savings.

- Catalogue and Marketing (Increase of +£0.084 million or +19%). Additional expenditure is planned to support maintenance of sales volumes and continued growth in new markets.

- Training (Increase of +£0.06 million or +117%). A new programme of staff development and improvement has been planned.

Operating Surplus:

19. The combined effect of lower margins on Stores sales, a return to lower rebate income and unavoidable inflationary increases is a budgeted operating surplus of £1.3 million.

20. A provisional allocation of £0.3 million has been made for expected expenditure to implement changes recommended in the Strategic Business Review. The Net Surplus is budgeted at £1.0 million of which 20% will be retained in the organisation's reserves and 80% is members' dividend of £0.8 million. If the dividend is not distributed, this will result in a cumulative fund value at March 2012 of £2.5 million.

Robustness of Estimates and Adequacy of Reserves

21. The Local Government Act 2003 requires the Chief Finance Officer to report on:

(a) The robustness of the estimates included in the budget; and
(b) The adequacy of the proposed financial reserves.

Robustness of Estimates

22. The budget is prepared by the Director of ESPO and the Assistant Director (Finance). The budget is then reviewed by the Treasurer of ESPO. The main business risks are reviewed annually and an update is included in the Director's Progress Report to the Committee.

Reserves and Balances

23. The main cash reserves held by ESPO are set out below;

	31/03/10	31/03/11	31/03/12
	Actual	**Forecast**	**Forecast**
	£'000	**£'000**	**£'000**
General Fund	1,893	2,111	2,312
Earmarked Reserves	269	1,140	120
Vehicles and Equipment Reserve	1,324	1,403	1,485
Stores Maintenance Reserve	192	202	203
Members Funds	790	1,662	2,465
Total	**4,468**	**6,518**	**6,585**

24. The General Fund is primarily to meet any adverse trading conditions, provide funding for stock balances and other expenditure prior to the receipt of income.

25. In any one year 20% of operating surplus is added to the General Fund up to a maximum of 2.5% of turnover. The General Fund at 31st March 2011 is forecast to be £2.11 million which is a significant increase of £0.22 million (12%) in 2010/10 and reflects the improved trading surplus. Should the General Fund prove to be insufficient to support the business requirements in any year, ESPO have agreed temporary borrowing arrangements with Leicestershire County Council.

Members' Funds

26. The dividend payable to member authorities for the current year is normally finalised at the September Committee meeting and based on the prior year's apportionments. The dividend for 2009-10 was not distributed and currently remains in reserve. Subject to members' acceptance of proposed allocations from the 2010-11 operating surplus, the forecast dividend will be £0.87 million.

Supplementary Information Informing the Budget

27. Further information which informs the budget, of a commercially sensitive nature, is contained in Item 14 (Exempt Report J), elsewhere on the agenda.

Resources Implications

28. This budget report is the key financial plan for ESPO.

Conclusion

29. Having taken account of the overall control framework, expenditure plans and income projections, assurance can be given that the estimates are considered to be prudent and take account of the key factors that influence expenditure and income.

30. Given the basis on which the budget is prepared, taking account of the main business risks faced by ESPO, the forecast level of reserves is considered to be at the middle of the range for cash flow and risk management purposes. In the event of a major event which significantly impacts on the ability of ESPO to trade there is a risk that reserves may be inadequate.

Recommendation

31. Members are asked to:

    (a) note the report and appendices;

    (b) note the forecast outturn for 2010/11; and

    (c) approve the budget for 2011/12.

Equal Opportunities Implications

32. None identified.

Risk Assessment

33. None identified.

Background Papers

None.

Officers to Contact:

Dave Summersgill
Interim Director

d.summersgill@espo.org

Tel: 0116 265 7931

Brian Roberts
Consortium Treasurer

Brian.roberts@leics.gov.uk

Tel. 0116 305 7830

Appendix

Appendix 1 – Forecast Outturn 2010-11 and Budget 2011-12