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ESPO MANAGEMENT COMMITTEE – 3 MARCH 2012

AGENDA ITEM NO. 6

FORECAST OUTTURN 2011-12 AND BUDGET 2012-13

REPORT OF THE INTERIM DIRECTOR AND CONSORTIUM TREASURER

Purpose of Report

1. This report sets out the Forecast Outturn for 2011-12 and Budget for 2012-13 with explanations for the more significant variances.

Trading Environment

2. The major reductions in Central Government grants will continue to impact on ESPO particularly on catalogue sales volumes. This reduction in member authority spending can be expected to continue for the medium term. In addition the move to schools becoming academies also presents a significant change in the trading environment. 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 2011-12 and the budget for 2012-13. Details of variations from the original budget for 2011-12 are explained below where these have a significant impact on the operating surplus.

Forecast Outturn 2011-12

Income:

4. Despite adverse economic conditions limiting authorities' expenditure the value of Stores turnover this year has remained flat year on year. Growth has been achieved by targeted non-member areas, particularly schools, and this has offset the effect of spending restrictions in core customer authorities. Stores margins are forecast to decrease by 0.7% (£175k) from the prior year level of 32.3% mainly as a result of increased price discounts.

5. Sales of non-stock catalogue products have been affected by reduced demand for furniture and furnishings and has fallen by 18% from budgeted oncost (£205k). This has been offset by the involvement in the government project of Phonics which was known but not budgeted for this year as the

project scope had required ministerial approval, and was assumed to have a degree of risk attached. Phonics has a turnover value in excess of £3.6m to ESPO based on the year to date figures

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 has been supported by developments in national procurement initiatives, joint Pro5 contracts and active marketing to new customers. Phonics is a twenty month Department of Education (DfE) initiative through match funding of £36m (a maximum potential sales generation across English Key Stage 1 schools of £72m).

7. The overall income for this year is expected to be £17.0million, £1.1million lower than the prior year and £0.3million above budget. The variance to last year is mainly as a result in a change to the accounting policy on rebates requested by Price Waterhouse Coopers (PWC) our external auditors which resulted in additional rebate income of £0.8m being recognised as a one off. The remaining £0.3m is down to higher price discounts on stores sales and hence reduced margin. The variance to budget of £0.3m is down to rebates and procurement fees, mainly on Energy.

Expenditure:

8. Savings of £0.5m from the 2011-12 budget of £9.6m result from not increasing the headcount to 365 from the prior year level of 354. Staffing costs are expected to show a slight fall from 2010-11 expenditure of £9.2m as the number of employees has fallen to 346.

9. Overhead expenditure will be £0.1 million higher than the prior year costs but in line with budget. The significant variations from the prior year are explained as follows:

- Catalogues and Marketing (Increase of £70k or 16%). The increase is a result of a new initiative to direct mail our catalogue to new customers, development of new markets and customer incentives including tactical discounting to smooth peaks and troughs.
- Transport (Increase of £100k or 6%). Increased renewals provision for replacement vehicles.

The significant variations from this year’s budget are explained as follows

- Staff Training (Below budget £50k or 50%) Additional spend on training not incurred.
- Staff Advertising (Above budget £30k or 150%) Additional spend on replacement Director and two Assistant Directors.
- Lighting and Heating (Below budget £50k or 27%) Lower spend on electricity as a result of lower energy bulbs.
- Renewals Fund Contribution (Above budget £80k or 27%) Additional provision for replacement vehicles.
- IT Renewals Fund Contribution (Above budget £20k or 15%) Additional provision for replacement IT software in particular the GEMS system.
- Major Project Fees (Below budget £80k or 45%) Ceased activity in BSF.

- Consultancy and Professional Fees (Below budget £90k or 58%) Additional marketing and promotional consultancy not incurred.
- Central Support Services (Above budget £60k or 59%) Additional HR support as ESPO staff have been absorbed into LCC's staff (Corresponding lower ESPO staff costs).

Allocations from Operating Surplus

10. Provisional of £0.1million from the 2011-12 Operating Surplus has been included for the finalisation of the Warehouse Efficiency Project.

Surplus:

11. The Operating Surplus is estimated to be £1.8 million which is £0.8m ahead of budget. This is the result of total expenditure being £0.5m below budget and income being £0.3m ahead of budget. The net surplus for the year after provisions is forecast to be £1.7 million.

Budget 2012-13

12. The overall approach to the budget is one of steady growth. The potential increase in stores turnover is matched by increased associated costs (transport, staffing, etc.), and a marketing plan that has clear targets of where growth will be achieved. It is planned that growth will support some of the increased costs and that if growth was not to occur then such costs would not be generated. The budget takes into account the potential new structure which will enable the organisation to have the appropriate resources to meet its strategic targets.

Income:

13. Stores sales volumes have been budgeted to increase by 5.7% from 2011-12 level (£2.1m). The impact of the price increases of 1.94% is to add £0.7m to stores revenue.

14. The result of these decisions is an increase in Stores turnover of 7.6% to £39.6 million. The projected increase forms part of ESPO's four year target to increase stores volume turnover by 20%. Included in this is a one year initiative of special growth through Phonics (£7m Direct and £1m Stores). Since the launch in early 2011ESPO has achieved sales through this of £3.5m (approximately 31% of total sales across Pro5).

15. There is also an assumption that one element of the existing stores volume will decline; a potential decrease of c£1m in stationery products as larger customers such as local authorities (LA's) buy direct through the new Pro5 Office Solutions contract.

16. The gross margin is budgeted to increase by £0.6m compared to the prior year value of £8.9 million mainly down to increased volume as gross margin percentage is budgeted at 31.3% compared to 31.6% forecast out turn for 2011-12. Income from Directs sales is budgeted to increase by £0.4m mainly as a result of Phonics. Major Projects is budgeted to fall by £0.4m as a result

of decreased BSF activity. Catalogue advertising is budgeted to remain at prior year levels at £0.9m.

17. Anticipated major changes to rebate income include

- A new joint stationery contract with YPO (Yorkshire Purchasing Organisation) which will result in lower prices, and a lower rebate margin.
- A new joint MFD (multi-functional devices) contract with GPS (Government Procurement Services) and YPO; existing rebates of c4% will be reduced to 0.7%, but with anticipated volume changes.
- Decline in rebates through advertising as LAs recruitment freeze continues.
- Increasing rebates through increase in uptake of the MSTAR framework.

Overall net income is budgeted to rise by £0.5m in 2012-13 which is made up of a £0.6m increase in gross margin and £0.1m overall decrease in rebate income.

<u>Expenditure:</u>

18. Employee costs for 2012-13 are reflected to assume there will be no pay award for staff. The increased cost over 2011-12 relates to increased headcount of 13.5 FTE overall. The budget reflects continuing development of staff, particularly supervisors and middle managers, to increase management competencies. The 2012/13 budget includes provision of £0.6m for the proposed restructure and staff development.

19. Other overhead expenses are budgeted to increase by £0.1 million though prudence and efficiency continue to be key priorities. The most significant variations from prior year are explained as follows:

- <u>Transport Commercial Vehicles (Increase of +£100k or +9%).</u> This is a combination of providing for continued increases in fuel prices and carriers charges which will be partially offset by efficiency savings.

- <u>Training (Increase of +£60k or +117%)</u>. A new programme of staff development and improvement has been planned.

Overall expenditure is budgeted to increase by £0.8m.

<u>Operating Surplus:</u>

20. The combined effect of the increased income and expenditure is an operating surplus of £1.5m compared to a forecast out turn in 2011-12 of £1.8m, a variance of £0.3m year on year.

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;

	31/03/11	**31/03/12**	**31/03/13**
	Actual	**Forecast**	**Forecast**
	£'000	**£'000**	**£'000**
General Fund	2,137	2,483	2,792
Earmarked Reserves	2,045	1,551	1,094
Vehicles and Equipment Reserve	1,553	1,807	2,097
Stores Maintenance Reserve	188	224	261
Total	**5,923**	**6,065**	**6,244**

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 2012 is forecast to be £2.49 million which is a significant increase of £0.35 million (16%) in 2010/11 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 dividends for 2009-10 and 2010-11 were not distributed and currently remain in reserve. Subject to members' acceptance of proposed allocations from the 2011-12 operating surplus, the forecast

dividend will be £1.4 million and it is anticipated that this sum will be retained in reserves.

Resources Implications

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

Supplementary Information Informing the Budget

28. Further information which informs the budget, of a commercially sensitive nature, is contained in Item 11 (Exempt Report H), elsewhere on the agenda.

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 2011/12; and

    (c) approve the budget for 2012/13.

Equal Opportunities Implications

32. None identified.

Risk Assessment

33. None identified.

Background Papers

None.

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Appendix

Appendix 1A-1D – Forecast Outturn 2011-12 and Budget 2012-13