Agenda Item
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Shetland Islands Council

Audit and Standards Committee **11 August 2011**
Executive Committee **3 October 2011**

Review of Internal Controls 2010/11 and Action Plan	
F-033-F	
Report Presented by Head of Finance	**Finance Services**

1.0 Summary

1.1 The purpose of this report is to present the findings of the review of internal controls by Audit Scotland in relation to the 2010/11 accounts and approve the Action Plan to address the four weaknesses identified.

2.0 Decision Required

2.1 There are no options to consider in reaching a decision. All four identified weaknesses can be addressed within existing resources.

2.2 The Audit and Standards Committee is asked to RECOMMEND to the Executive Committee approval of the Action Plan.

3.0 Detail

3.1 Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts. Appendix 1 contains the Report from Audit Scotland in full.

3.2 Audit Scotland's overall assessment is that, " the key controls operating over the council's main financial systems are operating satisfactorily, with the exception of the capital accounting system which has been experiencing ongoing technical difficulties".

3.3 There are four areas where Audit Scotland have highlighted areas of weakness which require to be addressed. These four issues were known to Finance Services, having been highlighted through the work of Internal Audit or through observation of errors in day to day activity. The four areas of concern are set out below:

Access and Authorisation Rights

If not regularly reviewed, there is a risk that access and authorisation rights are out of date and therefore may not be assigned to appropriate staff.

Payroll Documentation

Without all necessary information, there is a risk that the standing payroll data is inaccurate or out of date.

Capital Accounting System

There is a risk of material errors arising in the financial statements as a result of the technical problems with the council's capital accounting system.

Finance department

There have been a number of key staffing changes over recent months. There is a risk that statutory deadlines may not be achieved if inadequate levels of resources are deployed within the finance department until the sign-off date of the accounts.

3.4 An Action Plan has been developed to ensure that these weaknesses are addressed, over the next six months. One area is outwith the remit of Finance Services (regarding payroll documentation) which will require management cooperation at a corporate level to address.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – None.

4.2 Community /Stakeholder Issues – None.

4.3 Policy And/Or Delegated Authority – The Audit and Standards Committee remit includes consideration of all reports from the external auditors as well as an overview of the regulatory framework, including systems of internal control.

4.4 Risk Management – The Section 95 officer is required to maintain a sound system of internal control. This assists the organisation in managing risk and helps in the attainment of organisational policies, aims and objectives. It ensures that assets are safeguarded and efficient and effective systems and procedures are in place.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial – the actions to address the key weaknesses can be addressed within the approved budgets of the Council. This Report therefore has no direct financial implications.

4.8 Legal – None.

4.9 Human Resources – the staffing implications for Finance Services will be addressed through the current review of management arrangements, the detail of which will fall within the remit of the new Corporate Director. This includes a development plan and training proposals.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 The annual review of internal controls by Audit Scotland has demonstrated that reliance can be placed on most of the Council's key financial systems. The items highlighted as weaknesses which require action will be address over the next six months, through the actions set out in Appendix 1.

For further information please contact:
Hazel Sutherland, Head of Finance
hazel.sutherland@shetland.gov.uk
Telephone:
Direct Line: 01595 74 4607
Mobile: 07825 088925

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Executive Summary

Context

1. The Section 95 officer for Shetland Islands Council is required to maintain a sound system of internal control. A sound system of internal control assists the organisation in managing risk, and helps in the attainment of organisational policies, aims and objectives.

2. In carrying out our audit, we seek to gain assurance that the council:

   - has systems of recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests
   - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
   - complies with established policies, procedures, laws and regulations.

3. The report focuses on findings from our testing on financial systems.

4. The aim of our 2010/11 review was to consider the adequacy of the council's financial systems to provide us with assurances on the reliability of internal controls to support the preparation of the financial statements. Where appropriate, we also take assurance from the work being carried out by Internal Audit. In relation to financial control systems, internal audit have reported separately on local taxation, treasury management, and contract and tendering procedures. The 2009/10 payments audit was also followed up by internal audit during 2010/11, and we are awaiting the outcome of the payroll and pensions follow up work.

Key Findings

5. Our overall assessment is that the key controls operating over the council's main financial systems are operating satisfactorily, with the exception of the capital accounting system which has been experiencing ongoing technical difficulties.

6. Where controls have not been tested or where the evidence of a control's effective operation does not exist, we have adjusted our planned coverage of the financial statements to obtain sufficient evidence that they are free of material misstatement. System weaknesses which require to be addressed by management are detailed below and are included in the action plan at appendix A.

Risk Exposures

7. During our review we identified a number of areas where improvements could be incorporated into current operational practice, in particular by ensuring that:

   - issues with the capital accounting system are progressed to ensure that fixed assets are accurately recorded
   - desk top procedures are available for all main financial systems
   - authorisation rights are reviewed regularly and that the signatory database is kept up to date
   - all documentation is fully completed and authorised by the relevant person
   - mitigating controls are in place where full segregation of duties is not possible.

Audit Scope and Objectives

Introduction

8. Section 95 of the Local Government (Scotland) Act 1973 requires local authorities to make arrangements for the proper administration of their financial affairs and appoint one of its officers to have responsibility for those arrangements. The Executive Director of Education and Social Care is currently the acting section 95 officer in Shetland Islands Council.

9. The Section 95 officer is required to maintain a sound system of internal control. This assists the organisation in managing risk and helps in the attainment of organisational policies, aims and objectives. This report focuses on findings from our testing on the main financial systems.

Audit Objectives & Approach

10. Our responsibilities under the Code of Audit Practice require us to assess the systems of internal control put in place by management. In carrying out our audit, we seek to gain assurance that the council:

    - has systems of recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests
    - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
    - complies with established policies, procedures, laws and regulations.

11. As explained in our Annual Audit Plan 2010/11 we seek to rely on the work of internal audit wherever possible and we concluded that the council's internal audit service continues to operate in accordance with *CIPFA Code of Practice for Internal Audit in Local Government.*

12. The main systems that we have identified for review and to place assurance on for the 2010/11 financial statements are set out below. For a number of systems we are relying on the work of internal audit on the adequacy of internal controls. In relying on internal audit work we consider their testing to allow us to focus on different areas. A final review of internal audit's files has been carried out to confirm we can rely on this work.

Table 1		
Key System	**Reliance on Internal Audit**	**Review by External Audit**
Main Accounting		✓
Payroll	✓*	✓
Accounts receivable		✓
Cash & banking		✓
Capital accounting		✓
Housing rents		✓
Council tax billing and collection	✓	✓
NDR billing & collection	✓	✓

* audit not yet complete

Risk Identification

13. Our audit risk review involved the identification and assessment of the risks inherent in the key systems, based on the likelihood of them occurring and the impact they could have. We have also assessed the adequacy of the procedures and controls in place to address the identified risk and the extent to which these reduce the risk to an acceptable level.

Management Action

14. A summary of those areas where identified risk exposure requires management consideration is included in appendix A. Planned action, responsibilities and timescales for action in response to the identified risk exposure have been provided by management.

15. The issues identified in preparing this report are only those which have come to our attention during the course of the review and are not necessarily, therefore, all the risk areas that may exist. It remains the responsibility of management to determine the extent of the internal control system appropriate to the council. We would stress, however, that an effective system of internal control is an essential part of the efficient management of any organisation.

Acknowledgement

16. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The high level of assistance and co-operation we received during the course of our audit is gratefully acknowledged.

Audit Findings

Internal audit

17. Internal audit supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses in internal control to management for action.

18. Our review identified that the council's internal audit service continues to operate in accordance with the CIPFA *Code of Practice for Internal Audit in Local Government.* The 2010/11 internal audit plan was substantially completed at the time of our review which also concluded that internal audit work is of a good quality.

19. The conclusion of internal audit, reporting to the Audit & Standards Committee on 2 June 2011, was that the council's system of internal control was generally adequate and effective to provide reasonable assurance that the assets were safeguarded, waste or inefficiency was avoided, reliable financial information was produced and that value for money was continuously sought.

Review of systems

20. Audit work was performed in the key systems detailed in Table 1 above. The issues identified through our review, which require action by the council, are detailed below.

Main Accounting

21. Our review of the main accounting system identified that user access and authorisation rights are not subject to regular review. Finance relies on information coming in from service departments and processes any changes as required.

22. This was confirmed by our testing which found that in two cases, officers had authorised journals for ledger codes which were not included in their authorisation rights. Discussions with finance confirmed that the officers did have the right to approve these codes but the authorised signatory list had not been updated to reflect this.

23. There is a risk that inappropriate adjustments are made to the ledger leading to errors in the financial statements and possible financial loss to the council.

Action plan point 1

Payroll

24. The review of payroll found that, in two cases, change forms had been authorised by officers who did not have this right as per the authorised signatory database. Discussions with payroll, however, confirmed that these people should have had the authorisation rights for such amendments and that this was an administrative oversight.

25. There is a risk of inappropriate changes to employees' details being made if checks between the change forms and the authorised database are not performed.

Action plan point 1

26. The review also found that the necessary payroll documentation was not always fully completed as expected, for example, the relevant boxes had not been checked for staff transfers and some documentation from the employee verification exercise had not been positively verified as requested.

27. Without all necessary information, there is a risk that the standing payroll data is inaccurate or out of date.

Action plan point 2

Capital accounting

28. There have been ongoing technical issues with the council's capital accounting system which have prevented us from placing any reliance on the system in previous years. In addition, significant work was required during the 2009/10 final accounts audit to confirm the fixed assets figures and to explain a significant balancing figure within the financial statements.

29. This remains a risk area for 2010/11, however, much progress has been made to date. The council has assigned specific staff to review the system with particular focus on reconciliations and year end outputs. This work is currently ongoing and will be reviewed during the financial statements audit.

Action plan point 3

Non Domestic Rates

30. The non domestic rates system was reviewed by internal audit during 2010/11 as part of their work on local taxation. Two action plan points were raised, one in relation to NDR administration – rates relief and one in relation to the recovery of arrears. Internal audit also reported that the council still does not have a fully comprehensive set of NDR procedures in place. Target dates were set for the implementation of internal audit's recommendations and these will be followed up during 2011/12.

General Issues

31. Due to the small size of some departments, it is not always possible for the council to ensure the full segregation of tasks or duties. This was considered as part of the controls testing, and testing was focused on the mitigating controls that the council has in place, for example, authorisation requirements and key reconciliations. No issues were identified from this testing.

32. A number of staffing changes have taken place during the time of this review. This creates some potential risks around the loss of knowledge and experience within departments. The council has taken positive steps to mitigate these risks by bringing in additional resources where required. The audit team now attends regular meetings with finance staff to discuss progress on the financial statements timetable and the key significant issues currently being faced by the council. To ensure that the forthcoming statutory deadlines are achieved, the council should deploy adequate resources throughout the audit process until the date of sign-off of the accounts.

Action plan point 4

Appendix A

Risk Areas and Planned Management Action

No	Issue and Risk	Planned Actions	Responsible Officer	Target Date
1	***Access and Authorisation Rights*** If not regularly reviewed, there is a risk that access and authorisation rights are out of date and therefore may not be assigned to appropriate staff.	The forthcoming review of the Financial Regulations, combined with the Council's own management restructuring, means that there is an opportunity to critically review the number and levels of authorisation rights. In the meantime, the Section 95 officer will sign off new requests for authorisation rights and establish systematic checks on a 3-monthly basis. In the medium term, the review of Financial Administration will need to ensure that there is an automatic mechanism for Finance staff knowing about changes to personnel, throughout the organisation.	Head of Finance	3 monthly systematic review – immediate. Section 95 authorisation for new requests – immediate. Financial Regulation approved and review of levels of authorisation – from Autumn 2011
2	***Payroll Documentation*** Without all necessary information, there is a risk that the standing payroll data is inaccurate or out of date.	*The Financial Administration Review, commencing in September 2011, will ensure that fully robust processes are established to ensure updates are made timeously and accurately to all standing Payroll data to reflect any establishment or other changes by March 2012.*	Human Resources Manager and Administration Managers across the various services.	Financial Administration Review, including HR processes, project scheduled for 2010/11, as part of Corporate Improvement Action. Start September 2011, for completion by March 2012
3	***Capital Accounting System*** There is a risk of material errors arising in the financial statements as a result of the technical problems with the council's capital accounting	Revise procedures and annual plan. Provide training to all Management Accountancy staff. Computerise year-end production of journal entries for the ledger and other data for the final accounts directly from	Head of Finance	December 2011

No	Issue and Risk	Planned Actions	Responsible Officer	Target Date
	system.	the system.		
4	***Finance department*** There have been number of key staffing changes over recent months. There is a risk that statutory deadlines may not be achieved if inadequate levels of resources are deployed within the finance department until the sign-off date of the accounts.	External resources have been deployed to assist with the planning and preparation of the Final Accounts to March 2011. External support will be secured for the audit period, to September 2011. Work is in hand to prepare a development plan and training needs analysis to ensure that the tasks can be completed in-house in future years.	Head of Finance	2010/11 by September 2011 2011/12, by December 2011

Agenda Item

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Shetland Islands Council

Audit and Standards Committee — **11 August 2011**
Pension Fund Consultative Committee — **23 September 2011**
Executive Committee — **3 October 2011**

Review of Internal Controls Pension Fund 2010/11 and Action Plan	
F-034-F	
Report Presented by Head of Finance	**Finance Services**

1.0 Summary

1.1 The purpose of this report is to present the findings of the review of internal controls by Audit Scotland in relation to the 2010/11 Pension Fund accounts and approve the Action Plan to address the weaknesses identified.

2.0 Decision Required

2.1 There are no options to consider in reaching a decision. All three identified weaknesses can be addressed within existing resources.

2.2 The Audit and Standards / Pension Fund Consultative Committee are asked to RECOMMEND to the Executive Committee approval of the Action Plan.

3.0 Detail

3.1 Each year, the external auditors undertake an assessment of the internal controls in operation in the Council, to determine whether they can place reliance on them in the preparation of the final accounts. Appendix 1 contains the Report from Audit Scotland in respect of the Pension Fund (which is now audited separately).

3.2 Audit Scotland's overall assessment is that, "the pension fund has adequate systems of internal control".

3.3 There are four areas where Audit Scotland has highlighted areas of weakness which require to be addressed, three of which I have assessed as requiring action. The four areas of concern are set out below:

AXISe – Member Data

There is a risk that Members' information held on AXISe is inaccurate or out of date. This could potentially impact on members' benefit calculations

Pension Fund Investments

There is a risk that fund managers are not complying with legislation.

Statement of Investment Principles

There is a risk that the Council's statement of investment principles does not comply with the necessary legislation.

Governance Arrangements

There is a risk that the Council has not given due consideration to the Pension Fund's required governance arrangements going forward.

3.4 An Action Plan has been developed to ensure that these weaknesses are addressed. The move to unitised products has, in my view, removed the risk of non compliance with legislation on the Pension Fund Investments so I am recommending no further action meantime on that risk.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – None.

4.2 Community /Stakeholder Issues – None.

4.3 Policy And/Or Delegated Authority – The Audit and Standards Committee remit includes consideration of all reports from the external auditors as well as an overview of the regulatory framework, including systems of internal control. The Pension Fund Management Consultative Committee has an overview of the management of the Local Government Pension Scheme.

4.4 Risk Management – The Section 95 officer is required to maintain a sound system of internal control. This assists the organisation in managing risk and helps in the attainment of organisational policies, aims and objectives. It ensures that assets are safeguarded and efficient and effective systems and procedures are in place.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial – the actions to address the key weaknesses can be addressed within the approved budgets of the Council. This Report therefore has no direct financial implications.

4.8 Legal – None.

4.9 Human Resources – None.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 The annual review of the Pension Fund by Audit Scotland has made an assessment that there is in place adequate systems of internal control. The items highlighted as weaknesses which require resolution will be addressed over the next eight months, through the actions set out in Appendix 1.

For further information please contact:
Hazel Sutherland, Head of Finance
hazel.sutherland@shetland.gov.uk
Telephone:
Direct Line: 01595 74 4607
Mobile: 07825 088925

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2010/11 Review of Internal Controls, July 2011

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Address:
7th Floor
Plaza Tower
East Kilbride
G74 1LW

Telephone
0845 146 1010

Email:
info@audit-scotland.gov.uk

Website:
www.audit-scotland.gov.uk

AUDIT SCOTLAND

20 June 2011

Hazel Sutherland
Executive Director of Education and Social Care
Shetland Islands Council
Town Hall
Lerwick
SHETLAND
ZE1 0HB

Dear Hazel

Shetland Islands Council Pension Fund
Review of internal control systems - 2010/11

Audit Scotland's Code of Audit Practice requires us to assess the systems of internal control put in place by management. In carrying out this work, we seek to gain assurance that Shetland Islands Council Pension Fund (the pension fund):

- has systems for recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests
- has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
- complies with established policies, procedures, laws and regulation.

The following table summarises the key systems that were tested during 2010/11 including those where we have placed formal reliance on internal audit work to avoid duplication of effort.

Key System	External audit coverage	Reliance on aspects of internal audit work
Pension Administration (Contributions & Payroll)*	✓	✓
Pension Investments	✓	

***** audit work not yet complete

Risk identification

Our review involved the identification and assessment of the risks inherent in the key systems, based on the likelihood of them occurring and the impact they could have. We have also assessed the adequacy of the procedures and controls in place to address the identified risks and the extent to which these reduce the risk to an acceptable level.

The issues identified in preparing this management letter are only those which have come to our attention during the course of our normal work and are not necessarily, therefore, all the risk areas that may exist. It remains the responsibility of management to determine the extent of the internal control system appropriate to the pension fund. We would stress, however, that an effective system of internal control is an essential part of the efficient management of any organisation.

Audit findings

Audit work was performed in the key systems detailed in the table above. The issues identified through our review, which require action by the council, are detailed below:

Pensions Administration

Our testing on pensions administration found that there is no independent review of new entrants' records after they are input onto the pension fund system (AXISe). Our sample testing highlighted an instance where the date of entry into the pension fund was different on the AXISe system from that on the documentation. This will have an impact on the further calculations performed for members' benefits. The pension fund has now commenced the independent checking of new entrants' details and this is evidenced on the form by a signature and date.

Action plan point 1

At the time of our controls testing it was identified that there were 169 mismatches from 2009/10 where contribution data from payroll had not been matched to the relevant account within AXISe. These mismatches have since been investigated and resolved. Work is due to commence on the 2010/11 mismatches with the aim of these being resolved by 31 July 2011. If not properly transferred, there is a risk that members' information held on AXISe is inaccurate and out of date.

Action plan point 1

Pensions Investments

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 places limits on the type and percentage of permitted investments. These regulations are considered when an agreement is prepared between the council and a fund manager.

The main fund manager for the pension fund is Black Rock which manages approximately 92% of the pension fund's assets. When the contract with Black Rock commenced, the pension funds were invested in accordance with the regulations. However, once the investment allocations were agreed, investments were subsequently made in various unit trusts. Due to the nature of these investments, the pension fund does not know the composition of the unit trusts. There is a risk that fund managers are not complying with the legislation regarding the type and percentage of permitted investments.

Action plan point 2

Our work on pension investments also highlighted that the council's Statement of Investment Principles (SIP) does not include any comments in consideration of the Myners principles as required by the Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Amendment Regulations 2003. The council intends to review its current SIP and consider the revised Myners principles, although a final timetable has yet to be set for completion.

Action plan point 3

Governance Arrangements

2010/11 is the first year that a separate audit opinion on the pension fund has been required. Given the complexities involved, including the arrangements and reporting framework to support a separate audit, there is a risk that the council has not given due consideration to the fund's required governance arrangements. Trustees may require further training to ensure that they can give adequate levels of scrutiny to the pension fund's financial statements.

Action plan point 4

Management action

A summary of those areas where an identified risk exposure requires management consideration is included in the accompanying Appendix. Planned action, responsibilities and timescales for action in response to the identified risk exposure have been provided by management.

Overall conclusion

Based on our review and testing of selected financial systems our overall conclusion is that the pension fund has adequate systems of internal control.

Acknowledgement

The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

Yours sincerely

Carol Hislop
Audit Manager

Risk Areas and Planned Management Action

No	Issue and Risk	Planned Actions	Responsible Officer	Target Date
1	***AXISe – Member Data*** There is a risk that members' information held on AXISe is inaccurate or out of date. This could potentially impact on members' benefit calculations.	Member data input. Independent checks are now performed so this task is complete. Mismatches – this is part of normal year-end processing.	Head of Finance	Complete 31/7/2011
2	***Pension Fund Investments*** There is a risk that fund managers are not complying with legislation.	The council is accepting the risk that fund managers are not complying with legislation and is of the view that no action is required as the pension fund invested in unitised products in line with the investment regulations.		
3	***Statement of Investment Principles*** There is a risk that the council's statement of investment principles does not comply with the necessary legislation.	Statement of Investment Principles is to be reviewed.	Head of Finance	31/3/2012
4	***Governance Arrangements*** There is a risk that the council has not given due consideration to the pension fund's required governance arrangements going forward.	Assessment of current practice with SPPA Guidance Circular SPN/LG No. 3/2011. Draft the Governance Statement and Compliance Statement. Develop Action Plan for any areas of non-compliance with guidance. Report to Pension Fund Management Consultative Committee.	Head of Finance	30/9/2011

Agenda Item

3

Shetland Islands Council

Executive Committee **3 October 2011**

Management Accounts Overview: April – June 2011
F-036-F

Report Presented by Chief Executive and Head of Finance	**Finance Services**

1.0 Summary

1.1 The purpose of this report is to enable the Executive Committee to monitor the overall financial performance of the Council, on the revenue and capital accounts, in order to determine that the financial policies are being met with regard to:

- the overall performance, by service area, of actual expenditure and income against the approved budget;
- the impact, if any, on the overall Reserves Policy framework, with a reserves floor target of £250m and the agreed draw on reserves in the current year of £47.4m;
- the delivery of efficiencies and savings in the current financial year;
- actions taken on the estimated deficit in the current financial year on the revenue account; and
- overview of corrective action to ensure that the approved budget is achieved.

2.0 Decision Required

2.1 The Executive Committee is asked to RESOLVE to:

- review the Revenue Management Accounts, from 1 April 2011 – 30 June 2011; and
- review the Capital Management Accounts, from 1 April 2011 – 30 June 2011; and
- review the progress on securing savings and efficiencies in the year

- support the Chief Executive and Corporate Management Team in their actions to continue to critically review all spending decisions to ensure that the expected deficit in the current year is met by the end of the financial year.

3.0 Detail

3.1 This report presents the first quarters' Management Accounts, the 3-month period from 1 April 2011 to 30 June 2011. This report shows the overall position on:

- the Revenue Account (which will include the General Fund, the Reserve Fund, the Support Services ledger, Recharged ledger and the trading accounts);
- the Housing Revenue Account, which is kept separate for the purpose of setting council house rents; and
- the Harbour Account, which is kept separate for the purpose of setting the harbour charges; and
- the capital programme.

3.2 This report describes any changes to expenditure or income which has occurred since the time the budget was set in February 2011. In the next cycle, each Committee will receive details on the services within their remit.

3.3 This report provides a commentary on the impact on reserves and the overall financial policy framework from activity and spend in the year.

3.4 The Executive Committee is invited to consider any corrective action required, to ensure that the Council's overall financial policies are met.

3.5 The high level management accounts for the General Fund (and related funds and ledgers), is summarised in Table 1 below, showing the revised budget and a comparison of the actual spend and income against what was expected at the time the budget was set. The key finding from a review of the first three months is the expenditure is broadly in line with the approved budgets.

Table 1: – Revenue Management Accounts for Quarter 1 (April – June 2011)

Description	Annual Revised Budget * 2011/12 £m	Quarter 1 Budget 2011/12 £m	Quarter 1 Actual 2011/12 £m	Quarter 1 Difference 2011/12 £m
Schools	38.0	10.00	10.21	(0.21)
Community Care	25.3	7.61	6.91	0.70
Sports/Com Work/Adult Lrng	4.4	1.01	0.96	0.04
Children's Services	6.6	1.62	1.46	0.16
Roads & Transport	21.8	5.55	6.83	(1.27)
Environment & Building	6.8	2.38	2.38	0.00
Planning	1.9	0.45	0.29	0.16
Development	8.1	2.66	1.50	1.17
Central Services	18.6	4.29	4.84	(0.55)
Housing	5.7	0.49	0.95	(0.47)
Corporate Savings	(6.1)	(6.06)	0.00	(6.06)
Sub-total Net Controllable Costs	**131.1**	**29.99**	**36.33**	**(6.34)**
Financing Costs	0.1	0.00	0.00	0.00
Recharges	(4.2)	0.00	0.00	0.00
Total Cost	**127.0**	**29.99**	**36.33**	**(6.34)**
Funded by:				
Government Grants	(91.6)	(22.90)	(22.90)	0.00
Council Tax	(8.0)	(2.01)	(2.01)	0.00
(Surplus)/Deficit funded by Reserves	**27.4**	**5.08**	**11.43**	**(6.34)**

* The revised budget includes additional approvals by the Council i.e.a grant to Hjaltland Housing Association of £3.5m and budget carry forwards from 2010/11outturn report of £2.5m.

3.6 Members may recall that the approved budget had a shortfall to be met from Reserves of £21.5m (General Fund £12.5m and Reserve Fund £8.7m) after savings of £9.4m were approved. At the end of June 2011, £7m out of the £9.4m has been identified as savings achieved. There is a reasonable degree of certainty of achieving some of the remaining £2.4m savings in the remaining 7 months of the year, which makes up the £9.4m agreed to be saved. However, there were further unallocated savings included in the budgets which when added to the savings still have to be achieved, results in a corporate savings requirement of £6.1m. In order to achieve the overall target savings in the year, it may be necessary to delay or defer some non-recurring items of expenditure in order to achieve the approved budget. Appendix 1 provides a summary of activity.

3.7 In terms of additional and unexpected costs to be incurred in the year, £0.7 m has been identified for ferry fuel and heating oil, due to price increases. The one-off costs of phase one of the management restructuring exercise will be incurred this financial year, with the benefits accruing in future years on an ongoing basis.

3.8 Overall, therefore, at the end of June 2011, it is expected that the Council may be about £6m overspent in the current year, if no corrective action is taken at this time. This represents a saving requirement of about £0.8m per month, for the remaining 7 months of the year.

3.9 The Housing Revenue Account summary is included in Table 2 below. There are no key issues in quarter 1. The favourable difference is due to spending on maintenance not progressing in line with the budget for the first 3 months of the year.

Table 2: Housing Revenue Account – Management Accounts for Quarter 1 (April – June 2011)

Description	**Annual Revised Budget 2011/12 £000**	**Quarter 1 Budget 2011/12 £000**	**Quarter 1 Actual 2011/12 £000**	**Quarter 1 Difference 2011/12 £000**
Supervision & Management	0.7	0.04	0.06	(0.02)
Maintenance	2.4	0.52	0.00	0.52
Garages, Voids, Rents & Charges	0.2	0.05	0.00	0.05
Capital Charges	3.2	0.00	0.00	0.00
TOTAL	**6.5**	**0.61**	**0.06**	**0.55**
Funded by:				
Government Grant	(1.0)	(0.25)	(0.25)	0.00
Rents	(5.8)	(1.44)	(1.44)	0.01
Contribution (to)/from Housing R&R Fund	**(0.3)**	**(1.08)**	**(1.63)**	**0.55**

3.10 The Harbour Account summary is included in Table 3 below. The key issue to draw to the attention of Executive Committee is the reduced income from Harbour Dues with less tanker throughput than anticipated. This will only be exacerbated by the shutdown of Schiehallion which is expected to be longer than originally planned.

Table 3: Harbour Account – Management Accounts for Quarter 1 (April – June 2011)

Description	Annual Revised Budget 2011/12 £000	Quarter 1 Budget 2011/12 £000	Quarter 1 Actual 2011/12 £000	Quarter 1 Difference 2011/12 £000
Management	0.1	0.27	0.22	0.05
Sullom Voe	12.0	2.49	2.55	(0.06)
Other Piers	0.8	0.16	0.07	0.09
Engineering	0.0	0.14	0.11	0.03
Jetties & Spur Booms (BP)	1.3	0.28	0.25	0.03
TOTAL	**14.2**	**3.35**	**3.20**	**0.15**
Funded by:				
Fees & Charges	(15.1)	(3.49)	(3.16)	(0.34)
BP funding of Jetties & Spur Booms	(1.3)	(0.31)	(0.09)	(0.22)
Surplus Contributed to the Reserve Fund	**(2.1)**	**(0.46)**	**(0.04)**	**(0.41)**

3.11 The Capital Programme summary is described in Table 4 below. The detail of individual projects and programmes will be reported to each committee so this analysis provides an overview at a strategic level, to enable the Executive Committee to see the overall performance of the programme. The Table format is slightly different, to focus on the likely outturn for the year. The key issues to highlight are the need to split the capital programme into the funding elements ie capital, repairs & maintenance to match the funding sources and secondly the low level of spending in the first quarter which indicates the programme may require some projects to be re-profiled.

Table 4:– Capital Management Accounts for Quarter 1 (April – June 2011)

Description	**Annual Revised Budget 2011/12 £000**	**Quarter 1 Actual 2011/12 £000**	**Estimated Outturn 2011/12 £000**	**Estimated Difference 2011/12 £000**
Central Services	1.1	0.1	1.1	0.0
Development	1.0	0.1	1.0	0.0
Schools	3.4	0.1	3.5	(0.1)
Community Care	4.4	0.3	4.4	0.0
Sports and Leisure	1.7	0.2	1.7	0.0
Housing	9.3	0.1	8.7	0.6
Roads & Transport	7.8	1.7	7.8	(0.0)
Environment & Building	1.0	0.3	1.0	(0.0)
Ports & Harbours	7.2	0.3	7.2	(0.0)
TOTAL	**36.8**	**3.2**	**36.4**	**0.4**
Funded by:				
Government Grants	(5.9)	(2.9)	(5.9)	(0.0)
Other Grants	(0.1)	(0.1)	(0.1)	0.0
Harbour Account	(0.4)	0.0	(0.4)	0.0
Debt Charges on Harbour	(1.2)	0.0	(1.2)	0.0
Debt Charges on HRA	(9.2)	(0.1)	(8.6)	(0.6)
Capital Fund	(20.0)	0.0	(20.2)	0.2
Balance	**0.0**	**0.0**	**0.0**	**0.0**

Reserves

3.12 The anticipated earnings from fund managers is set at a net 5.75% for 2011/12. Average return for the year to date is standing at -10% There is no expectation that policy changes will occur in the year as a result of fluctuations in the earnings of funds, as the Council takes a long term approach to financial planning based on the average over a number of years.

3.13 The Council has approved an overall combined budget draw from reserves of £47.4m in the current year for Revenue (General Fund and Reserve Fund of £27.4m) and Capital (£20m). In the first quarter, £12m has been recalled from fund managers. This is because the monthly income is less than the expenditure levels so a draw on reserves is required to balance the cash flow. The expected draw on reserves, based on the balances held at 31 March 2011 and the approved budget in the year, is included at Table 5 below. If the predicted £6m overspent is not addressed during the year, this would further increase the draw on reserves.

Table 5: Movement on Reserves 1 April 2011 – 31 March 2012

Description	Opening Balances 1 April 2011 £000	Expected Income 2011/12 £000	Expected Draw 2011/12 £000	Est Closing Balance 31 March 2012 £000
Capital Fund	108.2	6.2	17.3	97.1
R & R Fund	63.4	3.6	9.9	57.1
Reserve Fund	58.4	5.5	20.2	43.7
Spend to Save	5.5	0.3	0.0	5.8
Provision	11.4	0.7	0.0	12.1
Balances	3.0	0.2	0.0	3.2
Total	**249.9**	**16.5**	**47.4**	**219.0**

3.14 In order to take corrective action to ensure that the remaining £6m of savings is achieved in the current year, the Chief Executive and Corporate Management Team are critically reviewing all areas of discretionary spend.

3.15 Separate reports on this agenda are presented to advise Council Members on the overall position on the Council's medium / long term financial planning arrangements, the reserves policy and the Budget Strategy for next financial year.

3.16 No corrective action is required on the Capital Programme at this stage in the year, beyond appropriate management challenge to ensure projects secure value for money, are delivered on time and on budget and that the significant slippage of previous years is actively managed.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – There is a specific objective within the Corporate Improvement Action plan to ensure that, "the Council has established a rigorous process to ensure that its use of resources is on a footing consistent with implementing and sustaining its financial strategy, and demonstrate that it delivers services in a way which achieves Best Value".

4.2 Community /Stakeholder Issues – There are no specific community or stakeholder issues concerned with this Report but the broader approach to engaging with the community over the Council's financial position and priority setting is being planned from the autumn of 2011.

4.3 Policy And/Or Delegated Authority – The relevant policy is the overall financial policy framework, which includes the objective of securing general useable reserves at a floor level of £250m and adhering to the balanced budget in the year.

4.4 Risk Management – Failure to reduce the net ongoing running costs of the Council carries a significant risk of the Council's financial policies not being adhered to.

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4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial – The overall message from this Report is that the Council is expected to be £6m over budget by March 2012, if no immediate corrective action is taken in the year. Every effort will be made by the Chief Executive and Corporate Management Team to ensure that the overall reserves draw of £47.4m is not exceeded.

4.8 Legal – None.

4.9 Human Resources – None.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 This Report presents the Council's revenue and capital management accounts for the first 3 months of the year (1 April 2011 – 30 June 2011). On the Capital Account, the first 3 months demonstrate a continued pattern of significant underspend against approved budget (with 8.6% of gross budget spent in the first quarter of the year). On the Revenue Account, expenditure and income on the core budgets is on track for the first 3 months. Significant progress has been made on identifying specific savings to ensure that the Council can be confident that the target of £9.4m will mostly be secured by the end of the year. New pressures and unallocated savings have been identified, estimated at £6m in the year. This level of deficit is concerning to the extent that the Chief Executive and Corporate Management Team will review all areas of discretionary spend to ensure that the approved draw on reserves is not exceeded. The medium to long term financial planning process is progressing, with separate reports presented today on the Reserves Policy and the Strategic Budget Plan.

For further information please contact:
Hazel Sutherland, Head of Finance
01595 744607 or 07825 088925
hazel.sutherland@shetland.gov.uk

5 September 2011

List of Appendices
Appendix 1, Summary of Savings to be Delivered in the Year 2011/12.

Background documents:
Financial Policy Report, SIC March 2011
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=11959

Approved Budget Report, SIC February 2011
http://www.shetland.gov.uk/coins/agenda.asp?meetingid=3195

END

Appendix 1

Summary of Savings to be Delivered in the Year 2011/12

REVENUE SAVINGS

Department	Approved Budget Reduction Totals	Not Deliverable	Under Consideration/ To be Confirmed	Undeliverable in Year 1 alternative Savings identified for 2011/12 only	Savings Actioned	% Savings confirmed for 11/12	Additional Savings identified in 2011/12	Pending Savings Identified in 2011/12 only
Executive Services	2,686,022	619,564	452,000	0	1,614,458	60%	363,856	50,000
Education & Social Care	4,350,928	87,027	2,335,821	75,000	1,853,080	44%	151,374	838,000
Infrastructure Services	2,409,738	262,000	393,800	75,000	1,678,938	73%	0	30,000
	9,446,688	**968,591**	**3,181,621**	**150,000**	**5,146,476**	**56%**	**515,230**	**918,000**

CAPITAL SAVINGS

Department	Positive Revenue Impact	Capital Only Impact	TOTAL
Executive Services	25,000		25,000
Education & Social Care	178,000		178,000
Infrastructure Services			370,000
TOTAL	**203,000**	**-**	**573,000**

Agenda Item

4

Shetland Islands Council

Executive Committee 3 October 2011

Reserves Policy Update	
Report Number F-040-D1	
Report Presented by Head of Finance	**Finance Service**

1.0 Summary

1.1 The purpose of this report is to enable the Executive Committee to consider some preliminary principles on the use of reserves for the 2012/13 Budget Strategy. It is proposed that the Council's current reserves policies are appropriate, still relevant and provide a sound basis upon which to build the Budget Strategy.

2.0 Decision Required

2.1 The Executive Committee is asked to recommend to the Council the approval of some preliminary reserves principles, as the framework for developing the 2012/13 Budget Strategy:

- the General Fund discretionary Reserves (the Reserve Fund, Capital Fund and Repairs and Renewals Fund) should be maintained at no less than £250 million (the Reserves Floor policy).
- the Council should set a target to re-instate the reserves to that value, over the medium term;
- the draw on the Capital Fund for the 5 Year Capital Programme be set at £28m;
- the Council remains debt free for general capital investments;
- the draw on the Repair and Renewal Fund to be set at £3.3m for 2012/13;
- the draw on the Reserve Fund to be set at £3.3m for 2012/13;
- The objective for the General Fund revenue account is to be in balance by 2013/14;
- the Council takes a specific decision as part of the 2012/13 budget exercise to agree the draw on reserves appropriate to balance the budget in that financial year, as part of the transitional arrangements required to move towards the account being in balance from national grant and Council Tax by 2013/14;

- note that future reports will be presented on the average rate of return projections and book versus market value assessments; and
- note that the final policy proposals will be developed in line with the Strategic Budget Plan (a separate item on today's agenda) and reported formally in February 2012.

3.0 Detail

3.1 Appendix 1 contains a Fund Analysis, including sections on:

- rate of return and earning potential;
- the Capital Fund
- the Repairs and Renewals Fund
- the Reserve Fund
- the value of discretionary reserves; and
- movement in reserves: good case, bad case and actual case scenarios

3.2 On 4 July 2011, the Executive Committee agreed a set of proposals to set the framework for carrying out a review of the Reserves Policy, set out below (Minute Reference 09/11):

(a) to set the baseline for reserves levels for forward planning at £258.6 million, from March 2010 which excludes any funding set aside for a specific purpose;

(b) to establish a separate policy framework and budget for each fund, to recognise their distinct legal status and purpose;

3.3 The value of the funds, held on the Balance Sheet at "book cost" is shown in Table 1 below. The total funds stand at £265.9m, of which £249.9m is available for general use, within the legal parameters of each fund, and £16m is ring fenced for specific purposes.

Table 1: Final Accounts at March 2011

Funding	General Reserves £m	Ring Fenced Reserves £m
Capital Fund	108.2	
Renewal and Repair	63.4	
Reserve Fund	58.4	
Capital Spend to Save	5.0	
Revenue Spend to Save	0.5	
Potential Contingent Liabilities	11.4	
General Fund Revenue Balance	3.0	
Pilot Boat Renewal		0.9
Housing Renewal and Repair		11.9
Marine Superannuation		2.7
Insurance Fund		0.2
Hansel Funds		0.1
Central Energy Efficiency Fund		0.1
Quarry Repairs and Renewals Fund		0.1
Total	249.9	16.0

3.4 The anticipated earnings from fund managers is set at a net 5.75% for long term financial planning purposes. Average earnings in the year stand at -10%. There is no expectation that policy changes will occur in the year as a result of fluctuations on the earnings of funds, as the Council takes a long term approach to financial planning based on the average over a number of years. This average is being updated. A further report will be presented on the appropriateness of continuing to use that average for long term financial planning purposes.

3.5 The Council has approved an overall combined budget draw from reserves of £47.4m in the current year for Revenue (General Fund / Reserve Fund £27.4m) and Capital (£20m). In the first quarter £12m has been recalled from fund managers. This is because the monthly income is less than the expenditure levels so a draw on reserves is required to balance the cash flow. The expected draw on reserves, based on the balances held at 31 March 2011 and the approved budget in the year, is included at Table 2 below.

Table 2: Movement on Reserves 1 April 2011 – 31 March 2012

Description	Opening Balances 1 April 2011 £000	Expected Income 2011/12 £000	Expected Draw 2011/12 £000	Est Closing Balance 31 March 2012 £000
Capital Fund	108.2	6.2	17.3	97.1
R & R Fund	63.4	3.6	9.9	57.1
Reserve Fund	58.4	5.5	20.2	43.7
Spend to Save	5.5	0.3	0.0	5.8
Provision	11.4	0.7	0.0	12.1
Balances	3.0	0.2	0.0	3.2
Total	**249.9**	**16.5**	**47.4**	**219.0**

3.6 On 4 July 2011, the Report also set out for Members the tasks required to determine its medium to long term reserves policy, as follows:

- Is the policy level of £250 m adequate and appropriate?
- If not, how will it be determined what an adequate level of reserves might be (higher or lower)?
- What level of investment returns will be used for planning purposes?
- In what circumstances would the Council consider borrowing money?
- Consider whether it is appropriate to use book value or market value?

3.7 It might be helpful to restate the discussion presented in the then Head of Finance's Report to Council in September 2010, which sets out three potential scenarios to follow.

> "The .....question is whether it is the settled will of the Council to pursue the maintenance of the current financial policy framework, and whether it is fully committed to the achievement of a savings programme .... It is implicit in all that has gone before that this is the position of the Council. However, I am concerned that there may be differences of view on this subject which have not been explicitly debated and decided in the Council chamber. A range of views may reasonably be held on this subject, and I set out some of these below for consideration:
>
> View A (the status quo): the Council's current financial policy framework set a sound objective of stabilising the Council's reserves at no less than £250m and this should not be abandoned (at least one Councillor has spoken on several occasions for strengthening this by index linking the Reserves Floor figure of £250m), endorsing the ....savings target and associated programme of work.
>
> View B (the opposite extreme): the Council's reserves are there for a rainy day, and that day has come. The Shetland economy is not strong enough to handle major real cuts in Council expenditure, and these should be avoided by using the Reserves and abandoning the reserves floor policy, at least temporarily.
>
> View C: the scale of cuts in Scottish Government support have not yet been announced, and the resolve of the current UK Government and Scottish Government to carry them out have not yet been tested, and the longevity of both Governments is unknown. In view of that, and the as yet unrealised potential for new income streams for the Shetland community (eg from the new gas plant and possible renewable energy projects), the time is not yet right to make long term strategic decisions on spending and reserves. Under such a view it may be appropriate to look pragmatically for an acceptable mix of spending cuts and changes to reserves policy which represents a compromise between Views A and B."

3.8 The earnings from the Council's reserves can be predicted, in the long term, to be in the region of £13m per annum. This support projects and activities beyond that which a normal local authority could afford. Specifically it funds a healthy level of capital expenditure and through that has supported the local construction industry.

3.9 The return on reserves funds an economic development programme, beyond what national government support would provide. That supports the Council's overall objectives of retaining a healthy working age population and a strong economy.

3.10 More generally, use of reserves allows the Council to support a range of public services beyond the statutory norm. This allows services to be provided throughout the isles, rather than being centralised in the main centres of population.

3.11 Retaining reserves at a significant level will enable these investments, and services to be continued into the future. Using the reserves now, for current expenditure, will deplete them over a short period of time (estimated at 5-6 years) and reduce services to the community. In those circumstances, the Council would revert to providing services equal to that able to be funded from national grant and Council Tax.

3.12 It is imperative that the Council sets challenging and ambitious financial targets to get the draw on reserves back to a sustainable level, to secure the long term stability of the funds at a level for future generations to enjoy.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – the Council's overall financial policy framework is a key mechanism for delivering the Council's corporate objectives, as described in the Community Plan, the Corporate Plan and other strategic documents.

4.2 Community /Stakeholder Issues – The Council has agreed to undertake specific stakeholder engagement on the Council's finances, with staff and the wider community. Any changes to the Council's capital and revenue expenditure plans has a direct impact on the local economy, through changes to services, jobs and household income.

4.3 Policy And/Or Delegated Authority – The Executive Committee's remit is to advise the Council in the development of its strategic objectives, policies and priorities, including financial matters. Approval of the financial strategy and budget framework is a matter reserved by the Council.

4.4 Risk Management –

Failure to secure a sustainable use of reserves may result in:

- The Council's financial policy not being achieved, with the reserves being utilised now to support the current models of service delivery and not retained for enjoyment by future generations.
- Not being able to address growing and changing services needs, so there is the potential that those in our community who require more services may not have all their service needs met.
- Difficulty in demonstrating value for money and best value in service delivery models, so not meeting a core statutory duty.

Making the necessary cuts to expenditure levels could result in:

- Staffing cuts and job losses, in a time of recession where other job opportunities might not be readily available.
- Disruption to services and services users, as any changes are implemented.
- Dissatisfaction from the community about reduced services.
- Disagreement within the community as to where the service reductions should be targeted.
- The Council taking decisions which are in Shetland's overall best interests but are not seen by individual communities to be in their best interest.
- Staff and union unrest and dissatisfaction to any changes which may have a negative impact on staffing arrangements.

4.5 Equalities, Health And Human Rights – none.

4.6 Environmental – none.

Resources

4.7 Financial – none; the decisions of this Report will inform the future level of capital and revenue expenditure.

4.8 Legal – none; the legal framework of each of the funds has been set out in the Report.

4.9 Human Resources – none.

4.10 Assets And Property – none.

5.0 Conclusions

5.1 This Report presents a set of preliminary recommendations on the reserves policies, to develop a framework upon which to build the Budget Strategy for 202/13. A separate Report on today's agenda entitled Strategic Budget Plan, sets out the arrangements for developing next year's budget. This Report sets the limits on the draw on reserves, as the basis for budget preparation. It is recognised that this is a period of transition and that the Strategic Budget Plan sets challenging targets to get the budget back into balance. The proposals are therefore presented as preliminary recommendations. There are several risk factors still to consider so it is appropriate to keep this policy framework live as the budget for 2012/13 is developed and enable Members to take specific decisions on any draw from reserves beyond the sustainable level, once all the information is available on the impact on corporate priorities and service delivery through the budget process. In that regard the Council is continuing in its support of "View C" expressed in paragraph 3.7, to finely balance the financial situation with local service delivery choices and the impact on the local economy from any major change to Council's funding programmes over a short period of time.

For further information please contact:
Hazel Sutherland, Head of Finance
01595 744607 or 07825 088925
hazel.sutherland@shetland.gov.uk

7 September 2011

List of Appendices

Appendix 1: Fund Analysis.

Appendix 2: Value of Discretionary Reserves at Cost (Balance Sheet Values)

Appendix 3: Movement in Reserves 2006 to 2011: Good Case, Actual Case and Bad Case Scenarios

Background documents:

Long Term Financial Planning –
COUNCIL RESERVES AND BUDGET STRATEGY, 2006/07 AND BEYOND, Report to Shetland Islands Council 14 September 2005
http://www.shetland.gov.uk/coins/viewDoc.asp?c=e%97%9Dg%8Eo%81

Overall Financial Review Report: March 2011
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=11959

Financial Planning and Budgeting Framework Report to Executive Committee, 4 July 2011
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=12297

Outlook for Scottish Government Expenditure, June 2010
www.scotland.gov.uk/Resource/Doc/918/0101175.pdf

END

Appendix 1

Fund Analysis

Rate of Return and Earning Potential

For long term financial planning purposes, the rate of return for average earnings is set at 5.75%. This is based on historical trends, information secured from fund managers and Hymans Robertson (the Council's external adviser on fund management matters), on potential future performance and the knowledge gained by the Council's own in-house team. It is based on an average of earnings from equities, bonds, property and cash.

It is always difficult to predict future earnings, particularly given the fluctuating nature of the world economy, with particular difficulties in America and Europe at the moment and inflation rates creeping ever higher. In order to test if 5.75% remains a reasonable long term assumption, an up to date analysis is being sought from the Council's fund managers and external advisers. In the meantime, for this stage in the reserves fund policy update, I have used the current average rate of return of 5.75%.

Book Value or Market Value

There are two schools of thought as to the baseline value which the Council should use for determining the value of funds for long term financial planning purposes. The current policy is set using Book Value (or historical cost price) as the baseline value. The alternative is to use Market Value (or the current value of the funds, based on market conditions).

There are risks associated with each of the two methods, depending on the economic climate, interest rates and inflationary assumptions. In time, Members will be asked to determine what mechanism would best suit the current, volatile, market conditions, whilst recognising the need to even out peaks and troughs in the markets to ensure more measured plans and consistent funding levels, upon which the Council and local community can expect. The analysis will be presented in the next report.

The Level of £250m

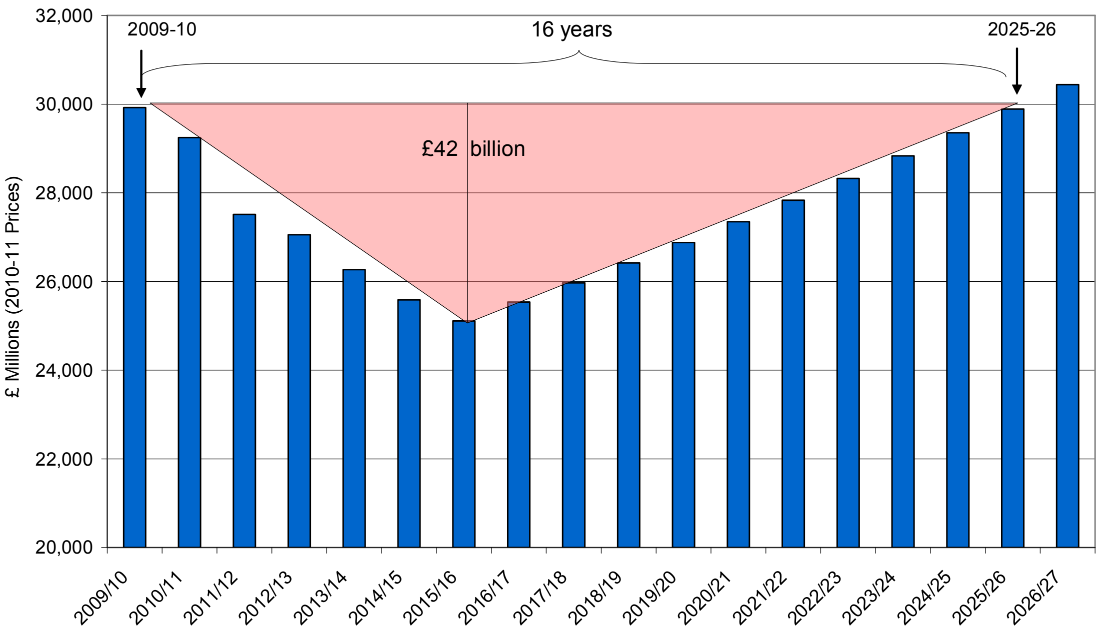
The question now needs to be posed as to whether or not the £250m is the "right" level of reserves. Members will note that decisions taken on the current years' budget means that the estimated value of the fund by March 2012 will be £219m, or £30 below the reserves floor target. At the outset, it is important to understand that there is no "right" answer and it is a question of judgement. The level at which the reserves floor policy was set at £250m is explained in the background report referenced below (Long Term Financial Planning – COUNCIL RESERVES AND BUDGET STRATEGY, 2006/07 AND BEYOND) Report by Head of Finance). That level was appropriate for the economic circumstances, service aspirations and investment programme at that time.

The value of the reserves under consideration from 1998 to 2011 is shown graphically at Appendix 2. The Balance Sheet (at book value, or cost) of the funds peaked at £345m in 2003 and at 31 March 2011 stands at £268m (both discretionary and ring-fenced). Between 1992 to March 2011, the Council has withdrawn £360m from reserves for use to support services, projects and local investments.

The predictions going forward of a "good case", "actual or likely case" and "bad case" scenario is included as a graph at Appendix 3. The good case scenario presumes that the Council's capital and revenue expenditure plans will be brought into line with the expected income streams and that the reserves will stabilise at £250m or thereabout. The bad case scenario presumes that the level of current spend will continue, with reduced support from central government and lower than expected earnings on fund balances. This case predicts that the reserves would be exhausted within 5 – 6 years. There is also an "actual case" scenario, which aims to build in known adjustments as decisions are taken by the Council. If the Council takes no further actions to balance the books, it is predicted that the discretionary reserves will fall to below £100m within 5 years.

The public sector expenditure levels now expected as a result of the recent economic changes have had, and will continue to have, a significant impact on the Council's financial resources. The future settlements are not yet known and will be determined through the Government Spending Review process in the autumn. The general expectation is for a few more years of reduction in public sector expenditure levels (predicted at least 4% per annum until 2016/17), followed by a long slow recovery to 2025/26. The diagram below has been taken from a Scottish Government report on public sector finances.

Estimated Scottish Government DEL Expenditure – June 2010 Budget Results (2010/11 Prices)



The level of impact of local authority spend on the isles economy is significant. As part of the Economic Development Services Input / Output study, a specific piece of work will be commissioned to try to measure the impact (through multipliers) of changes to the global spending patterns of the Council. The latest analysis of employment by sector would indicate that the Council's workforce at 2.362 full time equivalent (fte) posts represents about 26% of the total local workforce (8,949 fte). The Council expenditure on jobs, goods and service has a direct impact on a significant proportion of household income in the isles. General economic trends look positive, with overall population levels stabilising (and growing in some parts), the birth rate has risen slightly and unemployment remains low. However, the pattern of poverty and deprivation and health inequalities remains the same.

The level of reserves held by the Council and the level of services able to be supported is envied by others. The level of reserves is still significant and the Council can still make positive contributions to services and projects within the isles, beyond what other authorities might be in a position to do. In essence, Members need to determine the balance from the economic benefits generated from public sector spending levels against the overall policy objective of retaining reserves at a healthy and sustainable level for future generations to enjoy.

To analyse the current use of Reserves, Table 1 below explains the overall funding position for each of the funds. Members will note that the overall draw on reserves estimated in the current year at £47.4m represents over 25% of the gross spend in the current year. If the Council only had income from the core Government Grant and Council Tax, the revenue expenditure would be about £102m of what the Council currently spends (about 22% less than the current level). This analysis presumes that the Council's historic agreement for being debt free will continue at the current level of £13.5m within the overall grant settlement.

Table 1: Overall Funding by Fund Estimated 2011/12

Fund	Gross Spend £m	Fees & Charges £m	Government Grants £m	Draw on Reserves £m
Capital Fund	23.2	0.0	(5.9)	17.3
Reserve Fund	9.6	0.0	0.0	9.6
Repairs & Renewals	9.9	0.0	0.0	9.9
General Fund	131.3	(29.1)	(91.6)	10.6
Sub-Total	174.0	(29.1)	(97.5)	47.4
Harbour Account	14.2	(16.3)	0.0	(2.1)
Housing Revenue Account	6.5	(5.8)	(1.0)	(0.3)
Total	194.7	(51.2)	(98.5)	45.0

Using the current average rate of return of 5.75%, the Council could expect, on average, to generate £13m per annum (using all the general discretionary reserves). Moving from an overall drawn on Reserves of £47.4m to £13m is a very significant drop in one year. It constitutes a cut of £34m on the current approved overall draw on reserves. It is slightly higher than the current predicted deficit of £26m by 2013/14 (due to one-off items and carry forwards from previous years).

What is very different is that by disaggregating the overall policy target into individual funds, means that the ability of the Council to rely on underspends on the capital programme to off-set overspend on the revenue account will be reduced. In essence, this approach protects the Reserve Fund (the only fund with the flexibility to support capital or revenue spend).

Debt Free Policy

In a normal Scottish local authority, with no access to reserves to fund capital expenditure, there are a number of mechanisms to pay for capital investment. These include: prudential borrowing; capital grants; sale and leaseback arrangements. Previously a scheme of supported borrowing was available (where part of the cost of borrowing was met through government grants) but that is no longer open.

In terms of the overall funding package from the Government, Members may recall that the Council receives a sum of £13.5m per annum to remain debt free. This is based on historic spending levels. This arrangement was reconfirmed in the most recent review of the grant aided assessment framework but may be open to review in the future.

If the Council wished to consider taking out an external loan to fund capital investments, it would require to comply with the Prudential Code, the rules around capital finance in local authorities.

It is the duty of a local authority to determine and keep under review the maximum amount with it can afford to allocate to capital expenditure, under section 35 (1) of the Local Government in Scotland Act 2003.

In this regard, the Prudential Code states that, “the fundamental objective in the consideration of the affordability of the authority’s capital plans is to ensure that the level of investment in capital assets proposed means that the total capital investment of the authority remains within sustainable limits, and in particular to consider its impact on the local authority’s “bottom line” and hence council tax. Affordability is ultimately determined by a judgement about acceptable council tax levels”.

Then, “in considering the affordability of its capital plans, the authority is required to consider all of the resources currently available to it / estimated for the future, together with the totality of its capital plans revenue income and revenue expenditure forecasts for the forthcoming year and the following two years. The authority is also required to consider known significant variations beyond this timeframe.”

In terms of the test of affordability, the Council will require to consider;

- to what extent resources are likely to be available to finance proposed capital expenditure immediately (through capital receipts grants, revenue contributions and, for the Council, earnings from the Capital Fund)
- the revenue consequences of proposed capital expenditure in both the short and long term. The may be any combination of increased revenue expenditure / revenue savings / increased revenue income.
- Estimates of total interest costs and interest receivable.
- Existing expenditure commitments, both capital and revenue.
- Planned change to revenue income and expenditure, whether through growth or through savings
- The extent to which financing costs are supported by government grants or contributions from other bodies

At the moment, there is limited scope for government grants to support new capital expenditure. The Council's focus is on securing ongoing revenue costs to live within a sustainable draw on reserves. The financial plans at the moment do not include any leeway for incurring additional revenue costs of loan repayments and interest charges. The Council would be required to demonstrate that there was a "need" to borrow and that the revenue costs of loan repayments and interest could be met going forward. It would be difficult for the Council to meet the test of affordability unless the capital investment proposal was beyond the sum which could be drawn from the Capital Fund (it is readily available) and unless it could demonstrate significant ongoing revenue savings to meet the loan repayment and interest costs.

At the moment, as there are no additional funding streams available to the Council to pay for capital expenditure under any of the alternative funding routes, there is no merit in changing the Council's overall debt free policy. This policy should be reviewed if the government grant arrangements for borrowing changes to support the ongoing debt repayment costs.

There is also merit in continuing to consider the high value project separately, namely the Anderson High School and the Fixed Links projects.

Capital Fund

The general Capital Fund was established under the Local Government (Scotland) Act 1975 and may be used to defray certain items of capital expenditure and for the repayment of the principal of loans, but not any payment of interest on loans. It receives contributions by appropriation from the consolidated revenue account or from the direct credit of capital receipts.

The Council is currently debt free on the General Fund so the Capital Fund is used in its entirety to pay for the Capital Programme.

Members may recall that an exercise is being done to extract the non-capital items from presentation in the Capital Programme. Table 4 below presents purely the "capital" elements of the current capital programme, shown for the previous two years and the current year.

<u>Table 2: Actual and Estimated Capital Expenditure and Funding 2009/10 – 2011/12</u>

Capital	Actual 2009/10 £m	Actual 2010/11 £m	Estimated 2011/12 £m
Gross Expenditure	24.9	18.0	36.8
Funded by:			
Grants	(6.1)	(4.5)	(6.0)
Debt Charges/Leasing	(12.0)	(3.6)	(12.8)
CFCR	(0.2)	(1.8)	(0.1)
Reserve Fund	(0.2)	(0.2)	(5.6)
Expenditure funded by Capital Fund	6.5	7.9	12.3

The current policy describes the amount to be allocated for General Fund capital expenditure as £100m over a 5 year period. The current approved capital programme is £97m over a 5 year period.

There is currently in place a grant of £5.9m from the Scottish Government, as a general contribution to the Council towards the Capital Programme. It will be clearer at the time of the Government's Spending Review if capital grants will continue in future expenditure programmes. The element of the revenue support grant settlement which relates to the policy of the Council being debt free is not used to fund capital; it is required in its entirety to support the current level of revenue spend.

From an estimated closing balance position of £97.1m at March 20112, the Council can expect to generate 5.75% return, on average. This equates to about £5.6m per annum, or about £28m over a five year period.

The Capital Fund can (and is) only used to fund the capital expenditure so its use is restricted to expenditure on the creation or acquisition of physical assets, which can be held on the Council's Balance Sheet. The Council can, through other planning mechanisms, determine what capital projects it might wish to invest in. For example, the Council may use the Capital Programme to support the emerging policy direction from the Scenario Planning exercise or it may use capital investment as a "spend to save" philosophy to generate ongoing revenue spend. From a purely financial perspective, however, the Council simply needs to determine how much it wishes to spend year on year and there is a need to make a judgement as to what that might be (based on the economic climate, advice from fund managers on future performance and the level of risk that is comfortable to carry). It goes without saying that capital investments by the Council has been, and will continue to be, one of the key major economic drivers which the Council can use to support business activity in the islands, particularly in the construction, civil engineering and professional services sectors.

Repair and Renewal Fund

The general Repairs and Renewals Fund was established under the provisions of the Local Government (Scotland) Act 1975 for the purpose of defraying expenditure in repairing, maintaining, replacing and renewing any buildings, works, plant, equipment or articles belonging to the Council. It should be noted that the statutory power exists for a singular fund and not funds. However, it is recognised that for practical purposes Councils may use the fund for various purposes. It is expected therefore that there will be disclosure of one fund on the Balance Sheet but that in the accompanying notes, the extent of earmarking for different purposes will be disclosed.

The general Repairs and Renewals Fund is therefore used to pay for many of the Rolling Programmes and all of the General Fund revenue maintenance programme on the Council's assets (buildings and infrastructure, including roads).

The Council can choose the level at which the fund can be held. The only way in which the value of the fund can be increased is by a contribution from the Revenue Account. This has not been the practice of the Council lately, as the pressure for savings is on the revenue account and no surplus has been generated to apply to any of the reserves.

The Council holds a significant portfolio of physical assets, in the form of infrastructure, roads, buildings, plant and equipment. Through the budgeting process, it will be important to determine the extent to which the expenditure relates to:

- Legislative requirements
- Health and safety matters
- Maintaining assets in a “fit for purpose” condition; and
- Development or enhancement works.

The current estimated spend on repairs and renewals projects is £9.9m per annum. Using the current standards rate of return of 5.75% on an estimated fund balance of £57.1m, the Repairs and Renewals Fund will generate about £3.3m per annum. This is significantly less than the current level of spend.

Reserve Fund

The Reserve Fund was established under Section 67(1) of the Zetland County Council Act 1974. This Act empowers the Council to transfer to the fund surpluses arising on the Harbour Account. The fund may be used to defray certain expenditure on the harbour undertaking and for any other purpose which is solely in the interest of the County and its inhabitants.

Section 67 of the Zetland County Council Act 1974 states,

Reserve fund

> “(l) If in respect of any financial year the moneys received by the Council on account of the revenue of the harbour undertaking exceed the moneys expended or applied by the Council in respect thereof, the Council may in respect of that year apply out of the county fund and carry to the credit of a reserve fund in respect of the harbour undertaking such a sum as they consider reasonable not exceeding the amount of such excess.
>
> (2) Any moneys for the time being standing to the credit of the reserve fund may be invested in any securities in which trustees are for the time being authorised to invest trust moneys and any debenture stock or other security created by the Council.
>
> (3) Any reserve fund provided under this section may be
> applied—
>
> (a) in making good to the county fund any deficiency at any time arising in the income of the Council from the harbour undertaking; or
>
> (b) in meeting any extraordinary claim or demand at any time arising against the Council in respect of the harbor undertaking; or
>
> (c) for defraying any expenditure in connection with the harbour undertaking for which capital is properly applicable, or in providing money for repayment of loans (but not in making any annual payment required to be made in respect of loans); or

(d) for defraying expenditure to be incurred from time to time in repairing, maintaining, replacing and renewing any buildings, works, plant, vessel, equipment or article forming part of the harbour undertaking; or

(e) for any other purpose which in the opinion of the Council is solely in the interests of the county or its inhabitants."

The Reserve Fund is one of the funds which the Council enjoys as a benefit of the historical arrangements with the oil industry. The value at 31 March 2011 of £58m is the balance remaining from the profits generated on the Harbour Account less the expenditure on infrastructure, economic development activity and other projects (as agreed on an annual basis). Its use is flexible as it is able to support expenditure of both a capital and revenue nature.

The previous years and current estimated level of spend to be met from the Reserve Fund is set out in Table 3 below.

Table 3: Actual and Estimated Revenue Expenditure and Funding 2009/10 - 2011/12

Service Area	Actual 2009/10 £m	Actual 2010/11 £m	Estimated 2011/12 £m
Harbour Undertaking	0.4	0.2	0.4
Economic Development	7.4	7.3	7.1
Other	5.5	3.9	2.6
Total	13.3	11.4	10.1
Funded: by a Contribution Contribution from the Reserve Fund	(13.3)	(11.4)	(10.1)

The current policy framework presumes a net contribution from the Harbour Account to the Reserve Fund of £2.1m per annum.

The Ports for the Future project will result in a significant change to the actual level of surplus on the Harbour Accounts in future, as the fixed costs are removed from the cost structure. Equally, income assumptions will need to be adjusted to take account of the current and expected level of traffic to the port, combined with the new arrangements for the TOTAL income stream. The increase in income is due to start in 2014.

At the current average rate of return of 5.75%, the level of earnings on the fund can be expected to be in the region of £3.3m per annum. When the surplus from the Harbour Accounts get taken into account, the overall available draw on Reserves can be estimated in the region of £5.4m. Funding on economic development services is also supported through the repayment of loans from the Shetland Development Trust and, potentially, surpluses generated.

Appendix 2

Value of Discretionary Reserves at Cost (Balance Sheet Values)

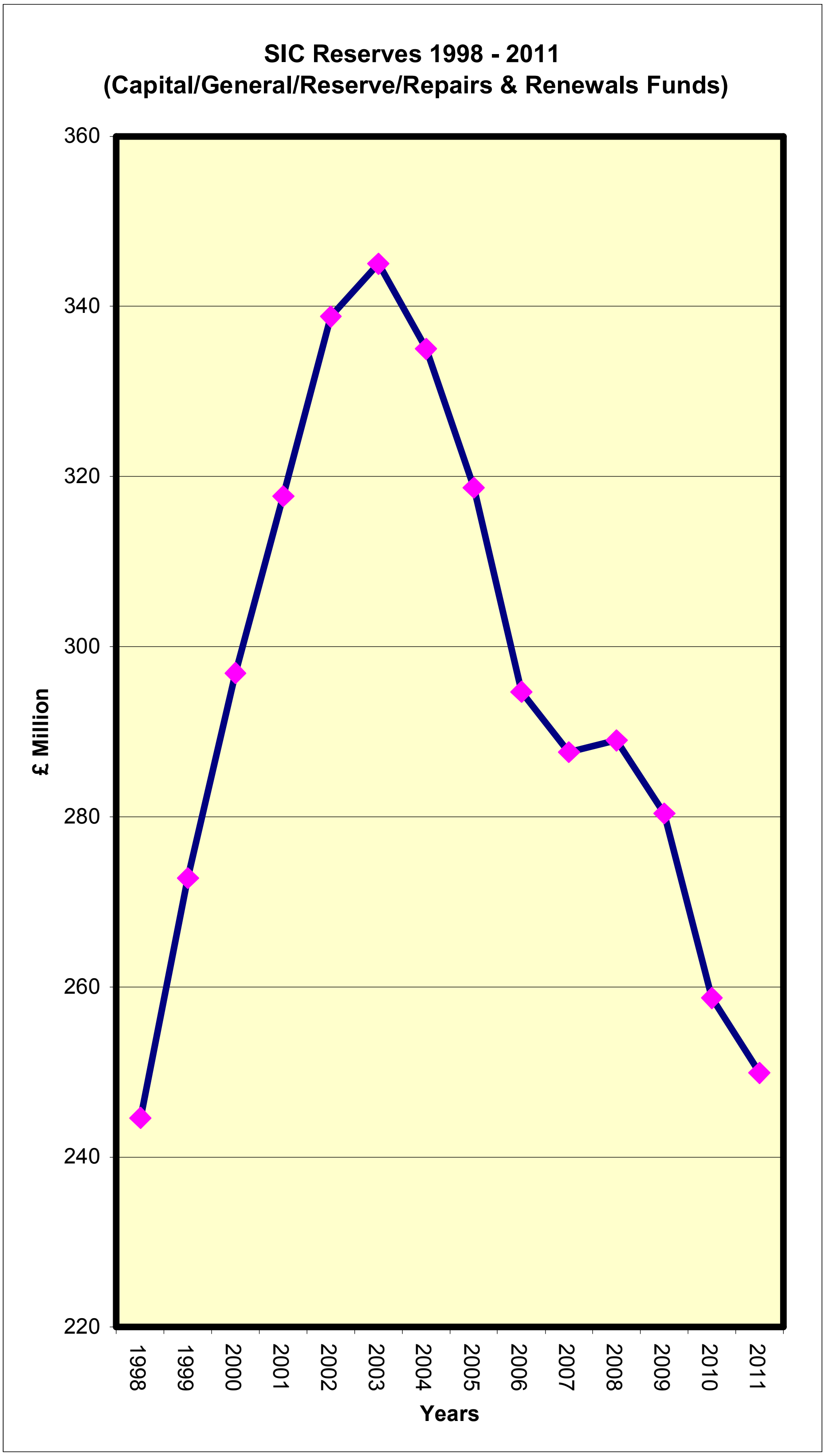
Shetland Islands Council Discretionary Reserves

(values on Balance Sheet at cost)

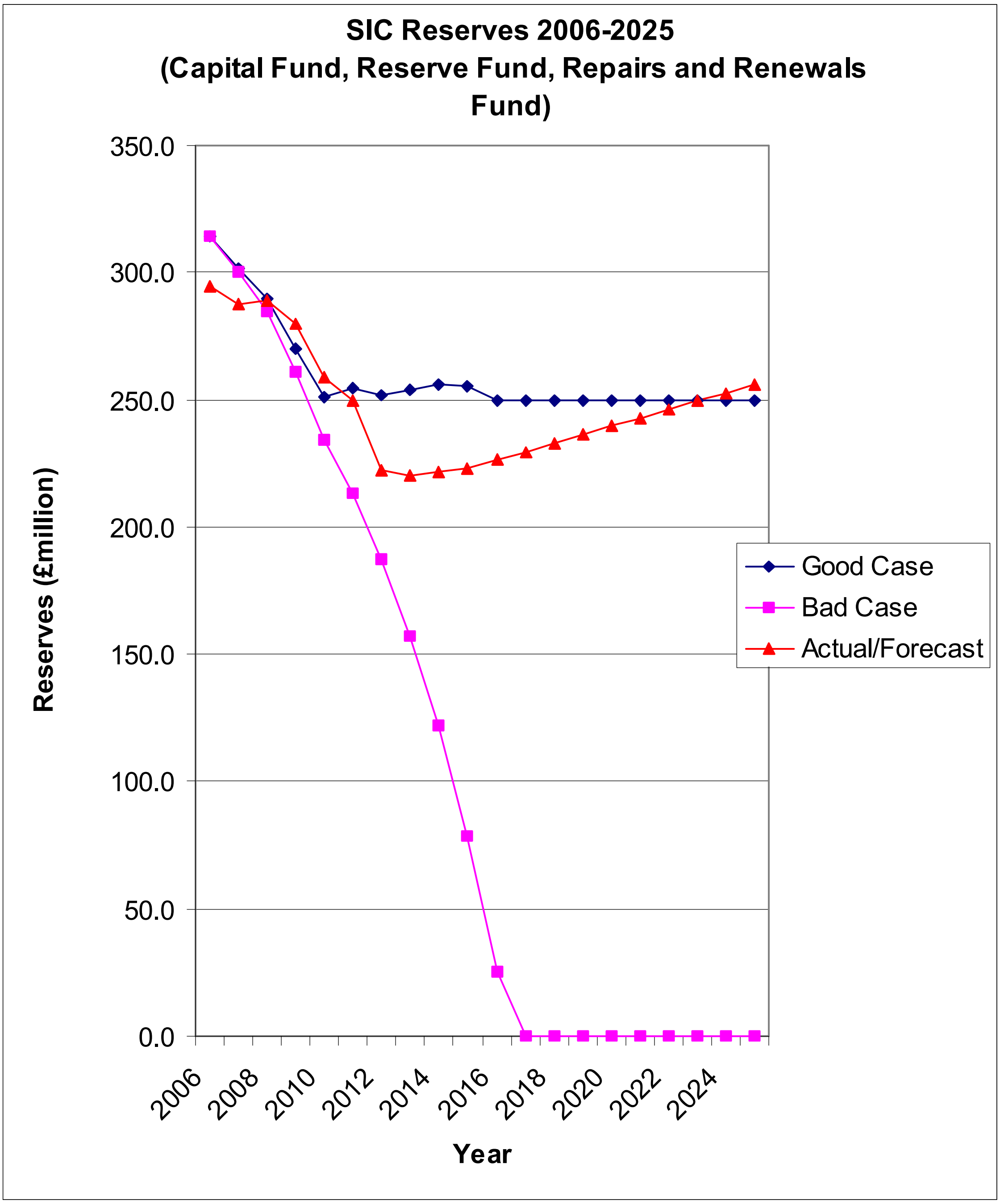
As at March	TOTAL	Capital Fund	Capital Receipts Reserve	General Fund	Reserve Fund	Repairs & Renewals Fund	Annual Increase	Annual Inflation	Real Annual Growth
	£m	£m	£m	£m	£m	£m	%	%	%
1993	**217**	125	0	0	36	55			
1994	**201**	116	0	0	34	51	(9)	2	(11)
1995	**194**	108	0	0	38	48	(6)	4	(9)
1996	**198**	108	2	0	44	44	(8)	3	(10)
1997	**230**	104	28	0	53	45	2	3	(1)
1998	**245**	109	24	0	58	54	20	3	16
1999	**273**	125	24	0	68	56	4	2	1
2000	**297**	134	28	0	81	54	(3)	3	(5)
2001	**318**	142	28	0	84	63	17	2	15
2002	**339**	149	22	0	97	72	14	1	12
2003	**345**	153	14	0	104	74	3	3	(0)
2004	**335**	147	4	0	109	76	2	3	(1)
2005	**319**	153	0	0	89	77	2	3	(1)
2006	**295**	127	0	0	88	80	4	2	1
2007	**288**	118	0	0	85	85	7	5	2
2008	**289**	116	0	0	84	89	4	4	1
2009	**280**	114	0	0	85	82	(8)	(0)	(7)
2010	**259**	118	0	0	67	74	(10)	4	(14)
2011	**250**	108	0	20	63	58	(21)	5	(27)

Appendix 2

Value of Discretionary Reserves at Cost (Balance Sheet Values)



Appendix 3
Movement in Reserves 2006 to 2025
Good Case, Actual Case and Bad Case Scenarios



Agenda Item

5

Shetland Islands Council

Executive Committee **3 October 2011**

Strategic Budget Plan	
F-041-F	
Report Presented by Head of Finance	**Finance Services**

1.0 Summary

1.1 The purpose of this report is to present the Strategic Budget Plan for 2012/13 and beyond.

2.0 Decision Required

2.1 The Executive Committee is asked to RECOMMEND to the Council approval of the Strategic Budget Plan (Appendix 1).

3.0 Detail

3.1 The Council's financial position has been well documented over the past while. By way of reference, I have included weblinks to reports from June 2010, February 2011 and March 2011 on this subject. The general message has been consistent. The Council needs to get the ongoing revenue expenditure limits back into balance with what can be withdrawn from reserves to keep the capital base at or near £250m.

3.2 A separate report on today's agenda covers progress on achieving a balanced budget in the current financial year. That report indicates that the approved draw on reserves means that the Council's financial policy framework of retaining reserves at £250m is likely to be breached by March 2012. The projected balance on useable reserves at March 2012 is £219m.

3.3 Another report addresses the question of the reserves policies, in light of the current financial and economic circumstances.

3.4 This Report provides the practical framework within which the budget will be prepared for 2012/13. The proposed Strategic Budget Plan, at Appendix 1, draws on the Savings Plan approved in February 2011. It extends that work to challenge the corporate centre to secure savings of £5.4m on the way in which the internal business systems of the Council works. At service level, it places a challenge on each

Directorate to secure an additional 5% of savings, to that put forward in the Savings Plan in February 2011. It promotes a continuous cycle of seeking savings on an ongoing basis, until the budget is balanced. The revenue savings required is £26M which has to be found on a recurring basis. A determined push at this stage to get the Council's spending plans into balance will put the Council on a strong platform to manage less significant adjustments in future.

3.5 Appendix 1 sets out recommendations on the budget process for 2012/13, including:

- strategic and service priorities, built on the Single Outcome Agreement commitments
- financial planning assumptions and targets, with risks highlighted for income assumptions (particularly around government grants) and potential growth in expenditure
- key messages and communication tools
- governance and project management arrangements
- the budget process, including staff and community engagement
- the timetable, for completion of the process by February and March 2012.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities – A key aspect of the Corporate Improvement Action Plan is to establish clear priorities and objectives against which resources can be allocated. This extends to establishing a clear financial planning framework, then ensuring that the policy framework is adhered to. This is in line with the recently approved Planning and Performance Management Framework.

4.2 Community /Stakeholder Issues – None.

4.3 Policy And/Or Delegated Authority – The Executive Committee's remit is to advise the Council in the development of its strategic objectives, policies and priorities, including financial matters. Approval of the financial strategy and budget framework is a matter reserved by the Council.

4.4 Risk Management – There are significant financial, economic, community, human resources and reputational risks associated with decisions on the budget framework.

Failure to address the budget deficit could result in:

- The Council's financial policy not being maintained, with the reserves being utilised now to support the current models of service delivery and not retained for enjoyment by future generations.

- Not being able to address growing and changing services needs, so there is the potential that those in our community who require more services may not have all their service needs met.
- Difficulty in demonstrating value for money and best value in service delivery models, so not meeting a core statutory duty.
- Members potentially facing challenges from the Accounts Commission, and others, that the Council is not able to take, “difficult decisions” and provide “clear and consistent leadership” to their staff and to the community with regard to financial matters.

Taking the difficult decisions, which may be required, could result in:

- Staffing cuts and job losses, in a time of recession where other job opportunities might not be readily available.
- Disruption to services and services users, as any changes are implemented.
- Dissatisfaction from the community about reduced services.
- Disagreement within the community as to where the service reductions should be targeted.
- The Council taking decisions which are in Shetland’s overall best interests but are not seen by individual communities to be in their best interest.
- Staff and union unrest and dissatisfaction to any changes which may have a negative impact on staffing arrangements.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial – This is the key policy document which will shape the budget setting process for 2012/13, including the amount of resources to be allocated to each service area.

4.8 Legal – None.

4.9 Human Resources – Several of the proposals will impact on staffing levels and, potentially, existing staff terms and conditions. The Efficiency Partnership Group has been established as the mechanism to bring that work forward. Detailed proposals for change will be worked up through the budget process.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 The Council continues to face significant challenges to secure ongoing revenue savings at a level which can be sustained into the future. The Strategic Budget Plan puts in place the framework within which the budget for 2012/13 will be prepared. It is a challenging strategy, but one which has the backing of the Corporate Management Team to ensure that reserves can be secured and maintained to support service delivery and projects into the future. It is part of a continuous process of seeking savings and efficiencies, until the Council reaches the point at which it can be satisfied that the level of service is affordable and sustainable into the future.

For further information please contact:
Hazel Sutherland, Head of Finance
hazel.sutherland@shetland.gov.uk
Telephone:
Direct Line: 01595 74 4607
Mobile: 07825 088925

6 September 2011

List of Appendices

Appendix 1: Strategic Budget Plan

Background documents:

Strategic Planning, Service Planning and Budget Savings: June 2010
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=10884

General Fund Estimates and Council Tax Setting: February 2011
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=11758

Overall Financial Review: March 2011
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=11959

END

Shetland Islands Council

Strategic Budget Plan: Policy Framework

Introduction and Purpose

This Report presents the three-year Strategic Budget Plan, for financial years 2011/12, 2012/13 and 2013/14. This plan relates to all funds, except the Housing Revenue Account and the Harbour Account.

Contents

This Report will discuss and make recommendations with regard to the following elements of the budget process:

- strategic and service priorities
- financial planning assumptions and targets
- key messages and communication tools
- governance and project management arrangements
- the budget process
- the timetable.

Elements

It is intended to report the budget for approval in four parts: the revenue account; the Housing Revenue Account; the Harbour Account; and the capital programme.

- the revenue account will include:
    - the General Fund, support services ledgers, rechargeable costs and trading accounts; and the Reserve Fund.

Fund specific proposals will be developed for the Housing Revenue Account and the Harbour Account, to address the separate charging arrangements for council house rents and harbour charges.

Strategic Priorities

An underlying requirement for any budget strategy is the need to determine priorities and to define those priorities so that it can be clearly demonstrated that resources are being allocated to meet these priorities

The proposed strategic and service priorities to influence resource allocation choices through the budget process will be:

- Population – impact on the number of economically active people in Shetland
- Equalities – impact on the fair and equitable distribution of resources in a way which does not widen the equality gap
- Economic – impact on employment opportunities and building economic potential
- Early Intervention – impact on the distribution of resources which supports the early intervention of services and avoidance of higher cost services later
- Carbon reduction – promotion of carbon reduction initiatives, which reduce carbon emissions and tax implications

Service Priorities

The four significant service reviews will continue, as follows:

- Education Blueprint
- Community Care
- Infrastructure Services
- Centralise functions and rationalise administration

Financial Planning Assumptions and Targets

The financial planning assumptions used and the risks associated with those assumptions are set out below.

Item	Risk Assessment
Revenue Grant and Non Domestic Rates, presume same level as last year	The Spending Review in September will provide an indication of the likely level of revenue grant (previous predictions suggest a 3.3% cut is possible, equal to c £3m.
Council Tax, presume Council Tax freeze continues.	Impact on household income from current economic conditions and future welfare reforms may mean rate of collection for Council Tax goes down and level of write offs goes up. Minimum financial implication.
Fees and Charges, no inflationary increase built in.	Review of charges will critically review charging philosophy and level of charges.
Staff Costs, no inflationary increase	National agreement in place.
Staff Pension Costs, no inflationary increase	Triennial valuation of the Pension Fund may recommend an increase to employers' contributions. Current employers' contribution is 17.7%. Potential national insurance increases.
Teachers Costs, no inflationary increase	McCormack Review is due to report in September 2011, which may make recommendations on teachers' terms and conditions of service.
Teachers Pension Costs, no inflationary increase	Potential industrial action issue.
Asset costs, no inflationary increases	Current and predicted increases in fuel and energy costs c £0.8m. Cost of Carbon Tax. Net increase in cost from move to North Ness office accommodation. Potential savings from sale of vacant or obsolete properties, dispersed working arrangements, shared premises, etc.
Good and Services, no inflationary increase	Consumer Price Index currently at 4.4%

The deficit of £26m by 2013/14 has been calculated on the following key assumptions:

- that savings of £5m banked at 1 April 2011 will continue and be part of the baseline budget
- all the savings (or an equivalent amount of) approved in the 3 year savings plan (February 2011) will be secured
- if savings as originally predicted cannot be found, an alternative saving to an equal value will be identified and implemented
- all non-recurring savings are converted to recurring savings by the end of 2013/14.

The overall position for the Revenue Account is shown in the Table below.

	2011/12 Original Budget £m	2011/12 Projected Budget £m	2012/13 Target Estimate £m	2013/14 Target Estimate £m
Total Expenditure	124.8	119.7	102.3	99.6
Funded By:				
Government Grants	(91.6)	(91.6)	(91.6)	(91.6)
Council Tax	(8.0)	(8.0)	(8.0)	(8.0)
Total Income	(99.6)	(99.6)	(99.6)	(99.6)
Deficit to be Funded by Reserves	25.2	20.1	2.7	0.0

It is important to ensure that all internal efficiencies are made in the first instance. The strategy therefore presumes that the following corporate savings projects will secure savings.

Item	Indicative Savings Target for Planning Purposes £m
Management Review: Stage 1	(0.7)
Single Status Terms and Conditions	(2.0)
Reduce Non Contractual / Non Terms and Conditions Overtime	(1.0)
Centralised Functions and Rationalise Administration	(0.5)
Procurement	(1.0)
Eliminate Cross Charging	(0.1)
Estate Management Review	(0.1)
Total	(5.4)

The allocation of savings can be summarised as follows:

Item	Indicative Savings Target for Planning Purposes £m
Overall Budget Deficit	26.0
Less: Savings Plan Approved February 2011, still to be achieved and additional 5% Savings Challenge for 2012/13	(20.6)
Additional Corporate Savings Challenge for 2012/13	(5.4)
Total Efficiency and Savings Plan	(26.0)

No figures have been included for:

- The revenue consequences of any capital funding arrangement for the Anderson High School or Fixed Link projects

The budgets for asset investment, renewal and maintenance will be reported separately, as follows:

- Capital projects, funded by the capital fund – separately presented as the Asset Investment Plan
- Asset renewal, repair, replacement or maintenance – separately presented as the Asset Maintenance Plan and incorporated into the revenue account budget

Specific spend to save budgets are available to support additional expenditure requirements on projects which can identify significant and ongoing revenue savings and efficiencies. There is £5m available for capital initiatives and £0.5m available for revenue projects.

Key messages and communication tools

The key messages for the 2012/13 budget process are:

- The financial situation for 2012/13 and 2013/14 means that overall we have to find £26M of savings over the two years.
- Any recurring savings we find this year will be subtracted from that total, we are estimating that circa £6M - £8M will be found on a recurring basis this year leaving us with £18M - £20M to find over the next two years.
- It is now time to be looking for savings for the next two years as well as this year.
- Every effort needs to now be made to secure the savings approved by Council in the Savings Plan from February 2011 (or an equivalent amount).
- There is a presumption that the Council as a corporate body can secure up to £5.4M per annum, through a number of initiatives and projects, which do not directly impact on service delivery.
- Each Directorate will be accountable for finding an overall savings target of 10% for next financial year 2012/13 (which includes the Savings Plan targets approved in February 2011). The savings plan target represents about 5% of the total budget so the Budget Strategy sets a challenge of an additional 5% for each Directorate.

Savings will be sought in a number of ways:

- we will look to see what can be done overall within the Council such as seeing if there are any services that can be managed more efficiently if it is centralised e.g. finance.

- We will consider staff Terms and Conditions by seeking to establish a strategic agreement with Unions

- Reviews have already begun in some services such as, community care and infrastructure.

- Staff involvement is key to identifying future savings: as well as working within departments, staff views are being fed in through a new Partnership Efficiency Group comprising Chief Executive, Senior Management and Union Leads

Savings should be sought both through:

- Internal efficiencies - those that can be made by managers through re-design processes whereby the service the public receives will not be substantially affected although the detail of delivery may be altered.

- Service change - those are proposed changes that require political decisions. This category has to fill the financial gap left when internal efficiencies have been exhausted.

Governance and project management arrangements

The Executive Committee has overall responsibility for policy decisions on the budget process, including the reserves policies, service prioritisation and overall resource allocation decisions. The matter is not delegated so overall policy decisions need to be referred to the Council, supported by a recommendation from the Executive Committee.

Corporate Management Team has overall responsibility for directing the budget process, alongside the other corporate improvement activities. Corporate Management Team has a responsibility to advise Executive Committee on strategic direction and financial policy decisions. An Efficiency Partnership Group has been established with union heads, the Chief Executive, the human resources manager and other managerial representatives. The aim of the Group is to facilitate much closer working on the major challenge of identifying efficiency savings and implementing efficiency programmes.

It is proposed to establish a "Future Finances" team to oversee the budget process. The remit of the "Future Finance" team will include:

- The revenue planning and budgeting process
- The capital planning and budgeting process
- The efficiency programme and projects
- Consideration of Spend to Save projects
- Managing significant growth items which impact on the baseline assumptions
- Overview of the vacancy management arrangements
- Communications and consultation on the Council's finances

The "Future Finances" team will report on progress to every meeting of the Corporate Management Team and will report regularly to Council through the Executive Committee.

Members of the Corporate Management Team and the Executive Committee will be required to lead the community information and engagement events.

The dates for the public meetings are being scheduled from late October 2011 onwards. The focus on the public engagement process will be both information sharing and community engagement.

The first set of meetings will cover:

- a financial overview
- the financial choices facing the Council
- how that impacts on services and projects
- why there needs to be savings and the timescales for that
- what people feel is important to consider when making cuts.

The next set of meetings will:

- feedback on the first set of meetings
- consider options and alternatives
- make suggestions for efficiencies, savings and priorities

The budget Process

The guidelines for budget preparation will be:

No new services and avoid growth in existing services

Presumption against service extension, which will cost more

Presumption against new posts (unless fully funded from external sources or to meet new legislative duties which cannot be accommodated by reallocation of tasks from existing posts).

Presumption against external recruitment and a presumption for prioritising posts and activity through the internal movement of staff into priority areas

Focus on efficiencies, especially internal efficiencies

Reduce significantly (by at least 50%) the current level of non-contractual and non terms and conditions overtime payments

Priority to be given to the provision of statutory services, delivered to national standards with an allowance for cost of Shetland factors (geographically dispersed population, diseconomies of scale, etc).

That by 2012/13, the total expenditure on the revenue account will be no greater than £102.3M.

Timetable

The overall timetable is set out below:

Policy Direction

15 September 2011	Informal Meeting of Leaders, Chairs and Vice Chairs
22 September 2011	Informal Meeting of Leaders, Chairs and Vice Chairs
28 September 2011	Finance Seminar
3 October 2011	Executive Committee - Management Accounts - Reserves Policy Principles - Strategic Budget Plan

Working Up the Detail

Fortnightly	Finance Futures Team
Fortnightly	Progress Report from Finance Futures Team to Corporate Management Team
	Update to Efficiency Partnership Group
Monthly	Informal Finance Seminars
Cyclical	Progress Reports to Executive Committee / Council

Strategic / Policy Decisions

February 2012	Council Tax Setting and Budget Overview
March 2012	Detailed Budget Plans and Approved Draw on Reserves
	Overall Budget Approval for 2012/13

Hazel Sutherland

Head of Finance

6 September 2011