

Cabinet
28 September 2007**9. MONEY MATTERS****Financial progress in
this financial year
(Section 1)**

1. The Director of Financial Services recommends that:
 - (a) his conclusions concerning financial progress this year be endorsed (Section 1);
 - (b) the Cabinet recommends to the Council the amendment to the Annual Investment Strategy (Section 2);
 - (c) he completes a detailed response to the questions in the Formula Grant Distribution consultation paper in line with his assessment of the key areas outlined in this report (Section 3) and
 - (d) his initial assessment of the required outcomes from a review of the Dedicated Schools Grant distribution formula be endorsed (Section 4).

(a) Staff Pay Offer

2. The local government employers have offered trade unions representing staff a pay award from 1 April 2007 of 2.475% with an increase of £6 per hour for the lowest paid staff. The total addition to the pay bill would be 2.5% or £0.6 million. This is more than the Treasury guideline figure of 2%. The offer has yet to be accepted. At this stage it has to be noted that the Council's budget planning is founded on Treasury guidelines.

(b) Latest estimate of the cost of the immediate response to the summer floods

3. Costs are likely to be in the region of £0.3 million and will not qualify for government funding as costs have yet to reach the qualifying threshold of £1.089 million.

(c) Money Market activity

4. Over the summer short term interest rates have increased. This has benefited the earnings on day to day money market operations and a favourable variance of around £1 million is forecast. This would mean that the previously mentioned adverse variances are offset by this favourable variance.

(d) Adult and Community Services

5. Adult and Community Services' spending remains broadly in line with budget with no major variations anticipated come the end of the financial year. However, the extent of budget reductions necessary to produce a balanced budget, reported in detail to Cabinet in May, together with ongoing demand for services, require significant ongoing management, not least in terms of dealing with the issues raised by concerned service users and carers. It is expected that the concerted efforts to secure ongoing economies and the consequences of change will continue throughout the financial year.

(e) Flood damage longer term remedial costs – roads

6. The Cabinet considered the scale of the damage to the road network at its special meeting in August. The latest estimate of the remedial costs is still in the region of £6 million. The Department for Transport (DfT) has been informed formally of this cost by the deadline of 17 September.

7. In normal circumstances the DfT would expect the Council to adjust its priorities and meet £1.5 million of this cost. DfT is considering its position in the light of all the bids for funding of remedial works. A decision by Ministers is expected during October.

(f) Local Authority Business Growth Incentive Scheme - use of additional grant allocation

8. On 8 March 2007 it was reported to Cabinet that the Council had been allocated £0.886 million through the Local Business Growth Incentive Scheme (LAGBI). The Council's budget for 2007/08 had already included £0.550 million LAGBI grant. Cabinet resolved that the favourable variance of £0.336 million be held in reserve.

9. Following a judicial review of the way grant allocations were calculated, the Department for Communities and Local Government (CLG) has announced additional LAGBI payments to qualifying Local Authorities. For Worcestershire County Council there is an additional payment of £0.122 million in respect of 2005/06 and £0.274 million in respect of 2006/07, a total of £0.396 million.

10. This additional funding can be used through the Planning Economy and Performance Directorate to support economic development initiatives, with a particular focus on market town initiatives to support economic recovery in areas affected by this Summer's flooding and other key regeneration initiatives such as the Droitwich Canal's restoration. It should be noted that this particular funding source is time limited and will not be used to support

**Amendment to the
Annual Investment
Strategy
(Section 2)**

**Consultation on Local
Government Finance
Formula Grant
Distribution
(Section 3)**

projects with recurring costs.

(g) External audit opinion 2006/07

11. The external auditor has now issued an unqualified audit opinion as expected when the accounts for last year were approved in June.

12. An amendment to the Treasury Management Annual Investment strategy is required relating to the County Council's joint ownership of West Mercia Supplies (WMS).

13. WMS has a foreign currency account and investments of any balances on this account will be classed as a non-specified investment. Currently the County Council's Annual investment Strategy does not have the provision to make this kind of non-specified investment.

14. An amendment to the strategy statement is therefore required and is given below. The amendment will only apply to WMS operations.

“West Mercia Supplies

With regard to the joint ownership of West Mercia Supplies, the Council may, if deemed in the best interest of prudent management of the West Mercia business, undertake transactions pertaining to foreign currencies, such as foreign exchange deals and investments. Such dealings must have relevance to the course of business of West Mercia Supplies. These dealings will be classified as non-specified as they are not sterling denominated.”

Background Information

15. In 17 July 2007, the Department for Communities and Local Government (CLG) issued a consultation document entitled 'Local Government Finance Formula Grant Distribution'. The full version can be found on the CLG web site:

<http://www.local.communities.gov.uk/finance/0809/sumcon/index.htm>

16. Respondents are requested to complete a consultation proforma questionnaire. This contains 29 questions on options for grant distribution changes that could be introduced from the next 3-year settlement period commencing April 2008.

17. The consultation closes on the 10 October 2007. Ministers will then make decisions on the proposed changes and these will be included in the 3 year grant settlement for 2008/09, 2009/10 and 2010/11. The provisional announcement is expected during December 2007.

Options for change and exemplifications

18. The CLG consultation paper includes options and exemplifications of gains and losses which for local authorities cover the areas described below. The options have been exemplified by re-running the 2007/08 settlement as though the particular option had been in place. Gains and Losses in formula grant exemplified for the Council except 4.3 are BEFORE the operation of the floor damping. In 2007/08 the Council's formula grant entitlement is increased by £3 million from floor damping. A summary of all options and a comparison of exemplifications with the shire counties average is attached at Appendix 1.

(a) Area Cost Adjustment (ACA)

19. Changes to the proportions attributable to the Rates Cost Adjustment and Labour Cost Adjustment. The Council loses £0.2 million and gains £1 million respectively.

20. A small review of the geography for those areas already receiving ACA with the most significant wage variation within the area. The Council loses £0.2 million in both options.

(b) Taking Account of Relative Needs and Resources

21. Whether there should be a further judgemental change in the extent to which the system takes account of needs or resources and requests suggestions for the change. No exemplification provided.

(c) Floor Damping

22. Three options for tapering down the level of floor protection over the 3-year period. The Council loses between £0.5 million and £1.9 million AFTER floor.

(d) Capital Finance

23. Alternative arrangements for calculating supported borrowing. No exemplification provided.

(e) Children's Services and Adults Personal Social Services (PSS)

24. Options for reducing the floor damping which was introduced at this level to counteract the considerable distributional turbulence when the formulae for this service were last changed in the 2005 review. The Council gains between £2 million and £7.5 million.

25. An update of the Low Income Adjustment used in the Older People's PSS calculation. The Council gains £0.4 million.

(f) Highways Maintenance

26. Options to use more up-to-date expenditure data. The

Council gains £0.6 million.

(g) Other Areas

27. Other options are proposed:

- for funding restructuring authorities without affecting non-reorganising authorities;
- on the method of distributing funding for Concessionary Fares to District Councils if it was to be added to formula grant;
- to update various indicator data;
- to replace the day visitors indicator taking into account the attractiveness of an area to day visitors;
- to remove the day visitors' indicator from the Highway Maintenance formula; and
- for changing council tax base for student exemptions.

28. There are marginal gains and losses exemplified for the Council from these options as shown in Appendix 1.

Key Response Issues

29. There was a comprehensive review of the formula in 2005. This review is described as mainly looking to update and fine tune the existing system, rather than a full system review. The response should answer the specific consultation questions and comment on issues raised by the CLG. It makes clear that the components of the new system may not be necessarily drawn from the list in the consultation paper. The opportunity is also provided to again make the case for a fairer and more equitable funding for Worcestershire on all relevant issues.

(a) General Comments

30. A number of these options, if implemented, would lead to instability and significant changes in grant to individual authorities. Predictability and stability are both important and any change must consider these principles.

31. The latest available and most up-to-date data should be used wherever possible. Support should be given to all options for more sound and updated data. In cases where this leads to significant volatility, it may be necessary to use an average of several years for stability.

32. Any changes to the grant distribution formula should only affect authorities that have a responsibility for that particular function. As an example, funding for concessionary fares relates to Districts but in two of the options the Council loses grant.

33. A basic entitlement for each service should be the starting point in any formula calculation and this should be

set at a realistic and adequate level to cover basic need. In the current system it is the size of the top ups that causes the large variation in funding between authorities and the unfairness in the grant allocation system.

34. Since this is not a major review of the system, the current 4-block model is set to continue despite little general support as the model remains as complex as ever and is not seen to aid transparency or understanding.

(b) Area Cost Adjustment

35. There should be a larger revision of the geography of the ACA than that proposed in the consultation paper. The revision should not be restricted to London, Cambridge and Hampshire, areas already receiving ACA, but should be applied to all areas of England. Worcestershire, like many other areas of England, also has wide wage differentials across the County and there is no evidence provided to support limiting the review to these three areas.

36. ACA areas should not be based on administrative boundaries but on travel to work areas which reflect working patterns and therefore wage payment rates across the County. The Council has pursued vigorously the receipt of ACA and has supplied the Government with evidence provided by Professors Blanchflower and Oswald to support this case. Members will be aware that their reports have been submitted again to the Department for Communities and Local Government earlier this year.

37. The Council has been severely disadvantaged by not receiving the ACA when it is received by the neighbouring areas of the West Midlands, Warwickshire and Gloucestershire. Of the 34 West Midland areas, Worcester City has the 10th highest wage of £10.49 per hour (ASHE workplace based median wage 2006). However North Warwickshire, Nuneaton & Bedworth, Sandwell, Walsall and Dudley have wage rates less than Worcester City and all receive ACA as part of the West Midlands area. The average wage in Dudley is £8.80 per hour which is 16% less than the average wage in Worcester. It is difficult to justify areas like Dudley receiving ACA when there is no recognition of the higher costs in Worcester City in the Council's grant entitlement.

(c) Resource and Needs Equalisation

38. The Council accepts the need for some form of equalisation but it should be done objectively. The rationale needs to be transparent and not set by ministerial judgement unsupported by evidence. The principles behind the examples described in the consultation paper have not been explained and therefore a technical response is difficult. No changes should be made until sound principles

for equalisation have been established and evidence produced to enable the appropriate calculation.

39. Previous equalisation changes demonstrated that the distribution of grant between authorities can be altered significantly by any change to resource equalisation. The options described are unworkable in the financial climate expected over the next three years. Any change to the method of equalisation should not be left to ministerial judgement.

(d) Floor Damping

40. There is a floor mechanism operating on the overall grant total and also operating within Personal Social Services.

41. It is recognised that the changes made to the Children's Services and Adults' Personal Social Services formulae in the 2005 review created some distributional turbulence. However there is no requirement for a separate floor at this level to ensure stability when this is achieved by the overall grant floor damping mechanism. This floor should be removed as soon as possible.

42. The overall grant floor is set to ensure stability in the funding of local services and tops up the formula grant calculation guaranteeing that a local authority will not receive grant below the floor increase. The floor is self-financing and is paid for by scaling back the grant increase of authorities above the floor.

43. Due to the application of the floor and scaling factors the current formula does not reflect a true position as funding for any demographic or deprivation changes is not reflected fully and not at all if, like the Council, the authority's formula grant is below the floor.

44. If a needs based formula is to be used for allocating grant, then it must be the aim that authorities should receive the full entitlement as reflected through the formula.

45. The last review in 2005 demonstrated the large distributional changes in funding that can occur in reflecting changing needs and resources and widespread floor damping became a significant feature of the grant system.

46. The speed with which authorities can change spending levels or ability to increase the Council Tax to offset the loss of grant must also be considered. With the current level of dependence by many authorities on the floor and with the current forecast of low settlements and the continued use of capping it would not be practical to remove the floor mechanism completely.

47. The best option for achieving the aim of using the grant

**Review of the Dedicated
Schools Grant (DSG)
Distribution Formula
(Section 4)**

formula as designed is by a gradual tapering of the floor over the 3-year settlement, which would allow authorities more time to plan for any change in grant funding.

48. These technical adjustments described above are ways of implementing ministerial judgement. This is the most important feature of the distribution review.

49. The Schools Minister Jim Knight's statement to Parliament of 25 June 2007 sets out the main decisions on the shape of the school funding system for the years 2008-11, after the national consultation on school, early years and 14-16 funding that took place in the Spring 2007.

50. Further to this in July 2007 the Department for Children, Schools and Families (DCSF) also announced a proposed review of the formula used to distribute the DSG to local authorities, which would be introduced for 2011/12. A consultation paper on the terms of reference for the review was issued on 2 August 2007.

51. The aim of the review is to consider the development of a single transparent formula for the distribution of DSG, which distributes resources in line with relative need, recognising the different costs of educating particular groups of pupils and providing education in different areas.

52. It is envisaged that the detailed issues the review team will consider include the calculation of the basic unit of funding per pupil in the system, additional educational needs, high cost pupils, area costs, sparsity, pupil count arrangements, transitional arrangements and the effects of the 2008-11 changes already notified on areas such as early years, 14-19 funding and specific grants.

53. Comments on the published terms of reference are required by 2 November 2007 and the timescales proposed include:

- (a) January 2008 to September 2009 – development phase and publication of consultation proposals;
- (b) October 2009 to March 2010 – formal consultation phase;
- (c) April to June 2010 – build up to decisions;
- (d) July 2010 – Ministers announce broad decisions;
- (e) October 2010 – School funding settlement for 2011/12 onwards.

54. In recognising the need for a new DSG formula, the key outcomes that the Council requires from this review are:

- (a) The narrowing of the significant funding gap that still exists between local authorities;

- (b) A robust and fair calculation of the basic entitlement for all pupils to be made and to be fully funded from the DSG prior to any other factors;
- (c) The continuing requirement to recognise and appropriately fund pockets of significant deprivation within local authorities for Additional Educational Need;
- (d) The fairer treatment compared to other local authorities of the assumptions for entitlement to Area Cost Adjustment;
- (e) A fair transition on the move to the new system protecting the Council's current base funding position.

Supporting Information

- **Appendix 1** - Comparison of exemplified increases in Formula Grant

Contact Points

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Background Papers

In the opinion of the proper officer (in this case the Director of Financial Services) the following are the background papers relating to the subject matter of this report:

1. Annual Financial Statements for 2006/07.
2. Budget Book 2007/08.
3. Cabinet report dated 26 April, 24 May and 19 July 2007.