

18th January 2017

Mr. Clive Howey,  
Director of Finance,  
Eden District Council,  
Town Hall,  
Penrith,  
Cumbria.  
CA11 7QF.

Sent by e-mail.

Dear Mr. Howey,

## **Budget Consultation**

I write in response to your budget consultation in my capacity as a resident of the Eden District and as Managing Director of 'AWICS Limited' a management consultancy company that is based in the district. My observations are as follows.

### Revenue Reserves

I have always been surprised at the high level of general fund reserves that are maintained by the Council. I obviously understand that it is prudent to maintain an adequate level of reserves but there is a difference between an adequate and prudent level and an excessive level. In the draft budget reserves are shown at £8.2million at 31<sup>st</sup> March 2016. This represents 25 months of Council Tax revenue. In effect, every penny of Council Tax that residents have paid from March 2014 to March 2016 remained unspent in the bank!

The Council is planning to reduce reserves to £6.6million by 31<sup>st</sup> March 2018. However, this still appears to be a high figure and experience shows that in fact reserves are likely to increase still further due to 'over budgeting' (see below).

The usual reason for a Council to hold reserves is to guard against unforeseen overspending. However, I would hope that the Council's budget monitoring processes would be sufficiently good to avoid an overspend of up to £8.2million on a £7.3million budget! Another reason would be to ensure that the Council has sufficient cash but cash balances appear to be more than sufficient at £9.7million (see below).

Furthermore, the Council also held a further £3.8million in useable earmarked reserves at 31<sup>st</sup> March 2016 so the total reserves actually stood at £12.0million (representing three years' Council Tax revenue). This included the following:

- Affordable Housing Fund - £1.7million
- Renewals Fund - £0.9million.
- Homelessness Reserve - £0.5million.
- Capital Funding Reserve - £0.4million.
- Other Reserves - £0.3million.

These reserves all appear to me to be general reserves rather than sums set aside to meet specific liabilities.

It appears to me that the Council may have a policy of managing risk by having large reserves. Accumulating reserves on this scale by failing to use the resources that are available to the Council may be a sign of poor financial management rather than a sign of good financial management.

It appears to me that an opportunity exists to bring forward capital or non-recurring schemes to improve the infrastructure of the district and / or to 'invest to save' that may be being missed in the draft budget as it is currently being presented.

The view was expressed in the budget report for 2015/16 and again in this year's budget report that reserves should be maintained at between £1.5million and £2.0million – equivalent to about a quarter of the annual spend. I would suggest that the Council budget to reduce its reserves to that level.

### Council Tax

In view of the need for the Council to maintain important services in the district I would support the proposal to increase Council Tax by 1.99%; but only if the Council can demonstrate that it has a robust plan to spend these resources in a way that would benefit the people of the district.

### Over-Budgeting

The Council's budget for 2015/16 referred to 'over-budgeting' and the budget for 2016/17 and proposed budget for 2017/18 both include provision of £150,000 a year for 'over-budgeting'. If I understand what is meant by 'over-budgeting' correctly I find this rather disturbing. My understanding of the situation is that, because some of the Council's budgets are excessive they are likely to be underspent (accountants sometimes call this 'budget slack') and so the Council has decided to count on an underspending of £150,000 occurring each year.

I note that in 2015/16 the Council yet again underspent on its budget, this time by £1.5million on a net expenditure of £7.5million – a 20% under-spend when it is generally considered to be evidence of good financial management if there is an under-spend of less than 2%. Eden District Council usually reports a significant under-spend on its revenue budget and that leads me to suspect that the Council may be over-cautious in the preparation of its estimates with the result that its budgets contain significant 'budget slack'.

The budget report seems to admit that this is the case and states (for example) that:

*"Based on previous years, there is a tendency for a degree of underspend. This is a function of having a large number of budgets, some of which are not always fully used due to circumstances. Such a provision has been included in the last few years. The proposed level of £150,000 was used for 2015-2016.*

*"Interest returns will be 0.6% in 2018-2019 and 0.5% thereafter. This may be over prudent."*

This does not appear to me to represent good practice. There are two reasons for this: Firstly, if managers have budgets that are excessive there is little incentive for them to exercise effective budgetary control; and secondly, if the estimated 'underspend' does not materialise the Council will 'overspend'. Most accountants would say that it would be good practice to identify the excessive budgets and reduce them to a reasonable level rather than indulging in 'over budgeting'. I wonder if this approach to budgeting is linked with the apparent policy of managing risk by having high levels of reserves!

The Chartered Institute of Public Finance & Accountancy, in its workbook for students of Management accounting considers 'budget slack' as a problem and defines it as follows:

*"Carrying forward past inefficiencies to future periods within the budget is one reason for the existence of budgetary slack. Budgetary slack refers to areas of the budget where the value of the budget is more than is really required for delivery of the budget."*

I would suggest that the Council consider changing its approach to this matter.

### Central Services

It has appeared to me for some time that the Council is tending to reduce budgets for direct services and increase budgets for central services. This appears to be happening in the draft budget for 2017/18 as shown below:

	2015/16 Actual £,000	2016/17 Estimate £,000	2017/18 Estimate £,000
Leader's Portfolio	146	104	105
Resources Portfolio	<u>2,035</u>	<u>2,324</u>	<u>2,355</u>
Central Services	2,181	2,428	2,460
Variation		+11.3%	+12.8%
Services Portfolio	2,371	2,943	2,705
Economic Development Portfolio	869	948	912
Housing & Health Portfolio	1,676	1,319	1,101
Communities Portfolio	<u>1,169</u>	<u>1,218</u>	<u>928</u>
Direct Services	6,085	6,428	5,646
Variation		+5.6%	-7.3%

In 2016/17 the Council budgeted for an increase of 5.6% in direct services and an increase of 11.3% in central services compared with 2015/16; and in 2017/18 it is budgeting for a reduction of 7.3% in direct services and an increase of 12.8% in central services compared with 2015/16. I would suggest that the Council considers focusing its resources more on delivering front line services.

### Capital Programme and Prudential Borrowing

The summary capital programme shows the Council's investment in the district declining from £1.5million in 2017/18 to £250,000 in the following years that solely provides mandatory renovation grants funded by the Better Care Fund and not by the Council. There are also capital growth proposals of £379,000 in 2017/18 and £50,000 in 2018/19. I would suggest that the Council should consider what options exist for sustaining a larger capital programme into the future. When I was Finance Director at Copeland Borough Council we resourced a capital programme that peaked at £19.6million a year.

The Council's balance sheet shows total assets of £56.0million and reserves of £43.7million as at 31<sup>st</sup> March 2016. This is a considerable sum and I am not convinced of the evidence that the Council is making best use of its resources and assets to invest for the benefit the community. For example:

- £9.7million is held as cash and short-term investments. Is this a good use of resources?
- £21.0million is held as investment property and long-term investments. Is this a good use of resources?
- Only £21.5million is held in Property, Plant, Equipment and Heritage Assets. Should the Council be investing more in infrastructure for the benefit of the community rather than in cash investments?

If the Council was a housing association, it would be required to 'sweat its assets'. Perhaps the Council should act more like a housing association and use its considerable assets to improve the infrastructure of the district including for housing and economic development.

To illustrate this point, Impact Housing Association (where I used to be Chair) has reserves of £8.5million and long-term loans of £63.1million that enables it to invest in £71.6million of social housing (net of grant). In contrast, Eden District Council has reserves of £43.7million, long-term loans of £0.1million and physical assets of £21.5million. Impact Housing Association's physical assets are 842% of their reserves while Eden District Council's physical assets are 49% of their reserves.

If Eden District Council were as ambitious as Impact Housing Association to invest in the infrastructure of the district, it would combine its reserves of £43.7million with borrowing of £324million to invest £368million in the district compared with the £22million that it currently has invested. Obviously, the government's system for controlling local government finance limits the scope for the Council to do this. However, I think that some movement in that direction would be welcome and in that connection I am pleased to see that the Council is establishing 'Heart of Cumbria' although I feel that its ambitions so far are too modest.

The draft budget does not propose to make any use of the prudential borrowing powers that the Council has enjoyed under the 2003 Local Government Act ever since 2004/05. Instead the draft report states that:

*"For planning purposes, it is assumed that no borrowing will be undertaken beyond that currently in place, as the Council currently has sufficient capital resources to fund the current Capital Programme. When these resources are fully exhausted, a detailed business case will have to be undertaken to identify if borrowing can be justified within the framework of the Prudential Code."*

This appears to me to be a circular argument: If the capital programme is based on what can be afforded without borrowing it follows that borrowing will not be required to fund it. However, the Council has identified important objectives not least in economic development and housing (see below) that require capital resources to be committed. I therefore feel that the Council may be missing an opportunity by not even considering the use of its borrowing powers.

I would therefore suggest that the Council should review its borrowing policy annually to ensure that it considers its finances and its capital programme in a comprehensive way. Indeed, it is my understanding that The Chartered Institute of Public Finance and Accountancy's code of practice on treasury management and the Prudential Code require local authorities to determine a treasury management strategy statement and set prudential indicators, on an annual basis. All local authorities with which I am familiar do this.

As outlined above, I think there is potential to increase the size of the capital programme by using reserves to fund revenue contributions to capital outlay.

I also note that in 2015/16 the Council's revised capital programme was £1,593,000 while actual expenditure was only £778,000 (only 49% of budget). This was due to significant 'slippage' in budgets including housing renovation grants and the affordable housing innovation fund both of which have been identified as being of strategic importance. There may therefore be a need to consider how the Council can improve its project management arrangements.

### Economic Development

I think that the Council has correctly identified economic development as a major priority. While the district enjoys low levels of unemployment, much of the employment that is available is part-time, seasonal, low wage and / or insecure. There is a need to build an environment in which more secure high-value businesses will develop.

### Housing

I think that the Council has correctly identified affordable housing as a major priority. However, it is not proposing to provide any significant budgets to support this priority. I would suggest that the Council should support this priority with significant budgets for new affordable housing, disabled facilities grants and discretionary housing payments.

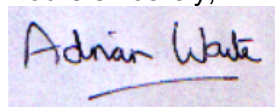
### Conclusion

In conclusion. I think that the Council is being insufficiently ambitious in this budget and that there appears to be scope to improve financial management. I would suggest that the Council consider:

- A more significant capital programme to address especially the economic development and housing objectives that it has identified, funded through surplus reserves, prudential borrowing and more effective asset management.
- Approving revenue budgets that do not contain 'budget slack', that aim to reduce reserves to an appropriate level and that focus resources on direct services.

I hope that you find these observations useful. If you have any questions about any of the issues that I have raised I would be pleased to hear from you.

Yours sincerely,



**Adrian Waite**  
**Managing Director**