STATES OF GUERNSEY

TREASURY AND RESOURCES DEPARTMENT

2007 INTERIM FINANCIAL REPORT

JUNE 2007

TREASURY AND RESOURCES
A STATES OF GUERNSEY GOVERNMENT DEPARTMENT

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The Chief Minister
Policy Council
Sir Charles Frossard House
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1 June 2007

Dear Sir,

INTERIM FINANCIAL REPORT

I enclose a copy of the above Report which I should be grateful if you would lay before the States.

Yours faithfully,

L S Trott
Minister
Treasury and Resources Department

2007 INTERIM FINANCIAL REPORT

Background

1.1 **This Report has been prepared to provide States Members, States Departments and the general public with a brief financial overview of the States finances and the work that needs to be done in preparation for the 2008 Budget to be presented to the States in November 2007. It does not therefore contain any specific resolutions and is presented to the States for information purposes only and Members are therefore being asked to note its contents.**

1.2 The financial position can be summarised as follows:

	2007 Estimate £m	2006 Actual £m	2005 Actual £m	2004 Actual £m	2003 Actual £m
Revenue Income	341	325	311	285	288
Revenue Expenditure	(301)	(295)	(292)	(276)	(254)
Operating Surplus	40	30	19	9	34
Capital Income	1	1	0	5	5
Capital Allocations	(18)	(13)	(12)	(16)	(18)
Transfer to / (from) Reserves	23	18	7	(2)	21

1.3 Capital expenditure, which is funded from individual Department's capital allocations or from the Capital Reserve, can be summarised as follows:

	2007 Estimate £m	2006 Actual £m	2005 Actual £m	2004 Actual £m	2003 Actual £m
Capital Expenditure	60	42	50	44	51

1.4 Capital expenditure in recent years, as predicted, has increased significantly in order to redress the lack of investment in the Island's infrastructure in previous years. This level of capital expenditure is considerably in excess of the annual operating surpluses and has been funded by monies put aside previously in the Capital Reserve. Ongoing capital expenditure will be less than in recent years but will still need to be more than the average amounts spent in the 1990's.

1.5 The necessity for public sector financial restraint set the background for the 2006 and 2007 Budgets. This will continue and, as a result, the Treasury and Resources Department, in conjunction with the Policy Council and the other States Departments, undoubtedly has a more difficult task than has faced the States for many years. However, the Department is confident that public services will be delivered in an efficient and effective manner and that States expenditure will become more focused on high priority areas.

1.6 As part of the consultation process on the Future Economic and Taxation Strategy a number of areas for protecting States revenues were identified and, in general, supported. These included increasing indirect taxes and restricting various personal income tax allowances and reliefs with such measures being introduced on a phased basis. The 2007 Budget included the following:

- An increase of 6.2p per litre on petrol duty and a commensurate increase in motor vehicle taxation for diesel vehicles.

- Tobacco duty increased by 6.5% (RPI plus 3%) – in line with the April 2002 States decision that increases in the rate of excise duty on tobacco and tobacco products should be "at least RPI plus 3% for a minimum of five years commencing with the proposals for the 2003 Budget".

- Alcohol duty increased by 20%.

- Tax on Rateable Values increased, including 100% increase for commercial premises **and 25% for domestic properties**.

- Basic personal income tax allowances for 2008 will remain the same as those in 2007.

1.7 The Policy Council supported the increases in indirect taxes as they are in accordance with agreed economic, social and environmental policies.

1.8 In September 2006, the States agreed the Social Security Department's proposals to increase the 2007 upper earnings limit for employers, employees and the self-employed to £53,664 per year from £36,036 per year. This is anticipated to reduce the 2007 States grants from General Revenue to the Guernsey Insurance Fund, the Guernsey Health Service Fund and the Long-term Care Insurance Fund by £10million.

1.9 The May 2007 States Report concerning the implementation of the Economic and Taxation Strategy clearly sets out the 2008 projected income which will be required to fund the anticipated level of public sector expenditure. It is against this background that the 2008 Budget Report will be prepared which will include specific proposals on the following:

- Income tax rates and related allowances.
- The revision of income tax relief on interest payable (including mortgages on principal private residences).
- The revision of income tax relief on life assurance premiums.
- Indirect taxation rates.

1.10 In September 2007, the Social Security Department will bring forward proposals for contribution and benefit rates for 2008 which, in line with the resolutions of the States in June 2006 (Billet d'Etat XI) will increase the employers' contribution rate by 1% to 6.5% and increase the upper earnings limit to the equivalent of £100,000 for employers and £60,000 for employees, self employed and non-employed. These changes are anticipated to reduce the grant from General Revenue to the Social Security Funds by a further £15million per annum.

1.11 In the coming months the Treasury and Resources Department will be working closely with Departments to prepare the detailed expenditure Budgets for 2008.

1.12 During that process every effort must be made to ensure that Budgets are, as far as possible, contained. Difficult decisions will be needed and, if necessary, previous States approved spending plans revisited. Although this is likely to prove challenging to achieve, it is essential that States revenue expenditure continues to be controlled, not least to enable funds to be set aside for high priority capital expenditure.

1.13 There is clearly a general recognition of the need for the careful control and prioritisation of expenditure and this year's Budget will need to continue to place restraint on States expenditure. This is a joint responsibility that all States Members, Departments and staff must continue to share.

1.14 Finally, it is important to remember the achievements and progress that has been made. The ongoing process to improve the Island's infrastructure has made considerable progress, public services are generally of a high standard, the economy is strong, rates of personal and indirect taxes are, by comparison with other jurisdictions, very low and the States still has reasonable reserves and is unencumbered by debt. **These are very solid foundations on which to build and face the challenges of the future.**

SECTION 2: FINANCIAL POSITION

2.1 The 2006 Accounts Billet d'Etat, which was presented for approval at the June 2007 States meeting, contained full details of individual Department's Accounts and a Financial Report (previously titled States Treasurer's Report) summarising and commenting on the financial outturn for 2006.

2.2 The Financial Report showed that:

- Revenue income increased by 4.7% in cash terms with income tax receipts increasing by £11.4million (4.4%) compared to 2005.

- Ongoing revenue expenditure increased by 1.0% in cash terms but decreased by 3.4% in real terms compared to 2005. This represents the first decrease in real terms for many years and is a marked turnaround in the trend of year on year above inflation increases.

- Overall, Departments underspent by £9.3million compared to their authorised budgets.

- The 2006 Operating Surplus of £30.5million was substantially more than that achieved in 2004 and 2005. However, it is still a considerable decline compared to previous years (the average Operating Surplus for 2000 to 2003 was £48million).

- Total capital expenditure for 2006 was £41.8million (2005: £50.2m).

- As at 31 December 2006, the balances on the Capital Fund and the Capital Reserve were £34.5million and £30.1million respectively (2005: £45.8m and £42.4m).

2.3 **If expenditure had increased at the average real terms growth seen in the period 2000 – 2005, the outturn for 2006 would have been at least £20million more than that incurred.**

2.4 The Treasury and Resources Department used its delegated authority as part of the States Financial Procedures to *"increase an individual committee's (Department's) revenue expenditure budget by the greater of £250,000 or 2% in any one financial period"* on the following occasions during 2006:

- To increase the budget of the Health and Social Services Department by £675,000 to cover the increased expenditure on 'Out of Island Placements' (budgeting for this area is difficult as unanticipated and expensive placements can occur without warning) in excess of compensatory savings achieved elsewhere within the budget.

- To increase the budget of the Environment Department by £200,000 to progress the implementation of various elements within the Road Transport Strategy prior to the introduction of paid parking. This amount was not required in 2006 and will be 'carried forward' to 2007.

- To increase the budget of the Education Department – Grants to Colleges and Libraries by £125,035. This was in accordance with the States decision in June 2005 to approve a new model of funding for the Colleges (2006 was the first full calendar year in which the new model was applied).

2.5 The Treasury and Resources Department has registered its considerable disappointment with the Health and Social Services Department that its forecast that the additional expenditure on 'Out of Island Placements' would be fully compensated for by underspends elsewhere within its budget did not materialise.

2.6 The Treasury and Resources Department is clearly aware that there is strong direction from the States and an understandable expectation from the public that States expenditure is being actively controlled. Departments should regularly review expenditure including areas of unexpected underspends in order that such incidents do not happen again as they could have a serious detrimental effect on States financial planning.

2.7 The graphs and pie-charts appended to this Report provide an overview of the financial trends over the period 2000 to 2006. From these it can be seen that:

- Following a plateau in States income levels, 2005 and 2006 saw significant increases, particularly in ETI receipts which recorded real terms growth.

- The rapid growth in States expenditure (both in real and cash terms) seen in recent years has been halted, with 2005 showing a smaller real terms increase and 2006 expenditure was 3.4% less in real terms.

- The Operating Surplus in 2006 was £30million which, although only half of that achieved in 2001, is a substantial improvement of that achieved in 2004 (£9million) and 2005 (£19million).

- Since 2003, capital expenditure has substantially exceeded the annual operating surplus. This capital expenditure has largely been funded from the Capital Reserve, which at 31 December 2006 had a balance of £30million, compared to just under £100million in 2002.

- Nearly half of all States revenue expenditure in 2006 was in respect of staff costs. This proportion will increase in the coming years due to the reduction in the Formula-Led grants to the Social Insurance Funds.

- **73.2% of all the States revenue expenditure is on Health, Education and Social Welfare (2005: 72.1%).**

Capital Reserve

2.8 The past few years have seen a period of unprecedented expenditure on the Island's infrastructure, partly necessitated by underinvestment in the past. The Treasury and Resources Department believes that a period of measured consolidation is now required. However, investing in public infrastructure will not cease and the mistakes of the past will not be repeated. Significant amounts will still need to spent, albeit less than in recent years.

2.9 It is important to remember that capital expenditure levels are dependent on the continued restraint in revenue expenditure. **If Departments do not remain within revenue expenditure budgets, the inevitable consequence is that there will be less money available for capital projects.**

2.10 The Capital Reserve plays an essential role in the management of the States finances. The purpose of the Capital Reserve is to provide a means of funding future major capital projects within a controlled and prioritised strategic framework. Appendix III provides a summary of the movements on the Capital Reserve since the beginning of 2006 and the anticipated movements during 2008 and 2009.

2.11 In October 2006, the States agreed a capital prioritisation programme, which identified the Health and Social Services Department's Clinical Block as the key capital expenditure priority for the States of Guernsey. This project will virtually exhaust the balance of the Capital Reserve as at 1 January 2007 (including the appropriation approved as part of the 2007 Budget).

2.12 However, appropriations to the Capital Reserve are anticipated in 2008 and 2009 and the States agreed that, subject to adequate funding being available, the following capital projects would receive the highest priority for funding from either the Capital Reserve or existing capital allocations:

- Belle Greve Wastewater Disposal
- Electronic Health and Social Care record (approved December 2006)
- States Residential Homes renovation and upgrade
- Alderney Commercial Quay – additional funding
- Network Extension Plan – Creux Mahie Connection
- Fire Station essential repairs

2.13 In addition, it is anticipated that there will be up to £8million available for other uses including extending the life of buildings identified as low priority for replacement.

2.14 As part of the capital prioritisation process, the States also agreed those projects which should not be progressed in the foreseeable future. It is emphasised that if those projects were to be progressed, it would be at the expense of projects already identified as a higher priority.

2.15 The Capital Reserve must also be protected from capital project overspends which inevitably mean that the available funding for other future projects will be reduced. It is absolutely essential that all capital projects should be rigorously costed and controlled and that all costs associated with the project (such as property purchases, consultants fees, equipment and relocation costs) be included and not just the "headline" construction costs. Otherwise, any form of capital planning and prioritisation is severely undermined. The States Property Services Unit has a key role in overviewing the quality and cost management together with the risks associated with large scale capital projects.

2.16 However, it is worth remembering that the vast majority of capital projects are delivered on time and on or below budget. It is understandable, but nonetheless unfortunate, that these successful projects do not receive the same level of attention as those that experience problems.

2.17 One successful project that was completed in 2006 was the Health and Social Services Department's construction of a new building to house the States Analyst's Laboratory and Environment Health Section. This project was completed on time and the original capital vote of £3.35million underspent by £529,908 which has been returned to the Capital Reserve.

Ports Holding Account

2.18 The Ports Holding Account was established by States Resolution in the 1960's with the basic principle that any capital expenditure in these areas should be funded out of the trading surpluses of the Ports (Harbours and Airport).

2.19 During the past few years the Ports Holding Account has funded and continues to fund several significant projects including the new Airport Terminal, St Sampson's Marina and the St Peter Port New Jetty major refurbishment.

2.20 The Airport Terminal project is now complete. The original budget for this project was £19.5million including consultants fees. In March 2007 a settlement was agreed with the contractor, which was significantly less than the amount being claimed, and the final account has now been paid. At 30 April 2007, total expenditure on this project was £25.8million. The Public Services Department is seeking advice from the Law Officers on the possibility of taking legal action to recover some of the amounts expended on this project. The resultant overspend will be charged to the **Ports Holding Account**.

2.21 As expected, the Ports Holding Account's reserves are used to fund these major projects. At the beginning of 2003, the Ports Holding Account had a balance of £24.4million but by the end of 2006 this had reduced to £7.6million. The annual operating surplus, including interest income was £2.1million (2005: £1.6m).

2.22 Furthermore, significant but as yet unquantifiable expenditure in excess of the amounts originally approved is being claimed on the St Sampson's Marina and New Jetty refurbishment projects.

2.23 The St Sampson's Marina project has now been completed but the final account is still to be settled. The original budget for this project was £3.4million but as at 30 April 2007, amounts totalling £4.3million have been paid of which £3.6million has been paid to the contractor (original tender £3.2million). The contractor's total claims for this project (which are disputed and are being contested) are at present £7.1million. The resultant overspend will be charged to the **Ports Holding Account**. It is expected that this project will result in additional income from mooring fees and rents of at least £250,000 per annum.

2.24 The St Peter Port New Jetty major refurbishment project is now substantially complete. The original estimate for this work was £3.3million. As at 30 April 2007, amounts totalling £6.7million have been paid. A timetable for dealing with the contractor's claim through a formal arbitration process has been agreed. Since the move towards arbitration the contractor's claim (which is disputed and will be contested) has risen from £19.7million to £27.3million. The resultant overspend will be charged to the **Ports Holding Account**.

2.25 **It is emphasised that contractors' claims values are the amounts that the contractors themselves are seeking to claim and that final settlements are expected to be substantially less.**

2.26 As a matter of best practice full post implementation reviews will be carried out on the above projects.

2.27 This significant, but as yet unquantifiable expenditure that may be required on the St Sampson's Marina and St Peter Port New Jetty major refurbishment projects may put the Ports Holding Account in a deficit position, possibly for a number of years. As a consequence any future major capital projects will only be possible if the Ports continue to make a reasonable level of operating surpluses.

Contingency Reserve Fund

2.28 The purpose of the Contingency Reserve Fund is to provide protection against major emergencies including significant economic downturns having a severe adverse effect on the Island.

2.29 In June 2006 the States resolved that up to half of the Contingency Reserve (interest and capital) may be used to fund the shortfall in public sector expenditure during a transitional phase of the implementation of the Economic and Taxation Strategy. At that time the Contingency Reserve had a balance of approximately £200million. It is therefore intended that £100million of that balance, plus any new monies transferred into the Reserve, plus the interest accumulated on such sums may be used to fund public services during the transitional phase.

2.30 As a result of the stronger than originally projected outturn for 2005 and 2006, and the phased introduction of increased indirect taxes and social security contributions in 2007, a transfer of £15million to the Contingency Reserve Fund was made on 1 January 2007.

2.31 The balance on the Contingency Reserve Fund as at 30 April 2007 was £221.0million with £118.1million being available to fund the shortfall in public sector expenditure during the transitional phase of the implementation of the Economic and Taxation Strategy.

2.32 It is emphasised that transfers into or out of the Contingency Reserve Fund can only be made with a specific resolution of the States.

SECTION 3: DETAILED FINANCIAL MATTERS

3.1 The recommended cash limits as approved by the States **as part of the 2007 Budget** were as follows:

	Non-Formula Led	Formula Led	Cash Limit
	£'000	£'000	£'000
Policy Council	6,250	1,400	7,650
Treasury and Resources			
General	13,725	1,825	15,550
Courts and Law Officers	5,750		5,750
States of Alderney	1,450		1,450
Commerce and Employment	11,500		11,500
Culture and Leisure	3,200		3,200
Education			
General	54,750		54,750
Higher and Advanced	6,500		6,500
Grants to Libraries and Colleges	5,830		5,830
Environment	8,600		8,600
Health and Social Services			
General	84,500		84,500
St. John Ambulance & Rescue	1,800		1,800
Home	26,900		26,900
Housing	1,725		1,725
Public Services	7,550		7,550
Social Security	2,150	55,125	57,275
Public Accounts Committee	270		270
Scrutiny Committee	200		200
	242,650	58,350	301,000

3.2 Since the approval of the above figures in December 2006, there have been a limited number of minor adjustments to the above budgets, including transfers between Departments (with no net financial impact). Updated Formula-Led estimates for 2007 (totalling £58,300,000) are included in Appendix I).

Future Cash Limits

3.3 Although the level of States expenditure has risen in the past few years, the independent benchmarking exercise carried out in co-operation with Jersey and the Isle of Man showed that, in general, Guernsey has a well-deserved reputation for delivering good public services at a cost which compares favourably with the other jurisdictions. **Nevertheless, as demonstrated in 2006, efficiencies and savings must continue to be identified and delivered.**

3.4 The latest financial projections for 2007, which are based on the 2006 outturn which was significantly less than the Cash Limits, anticipate that an underspend will also be achieved in 2007.

3.5 As set out in its comments on the 2007 Budget, the Policy Council *"continues to support the Treasury and Resources Department in ensuring that States expenditure is controlled and directed to priority areas"*.

3.6 The Treasury and Resources Department remains committed to ensuring that public sector expenditure is controlled and that waste and inefficiency are eliminated. It believes that there is strong support for this stance in the States.

3.7 As set out in the May 2007 States Report concerning the Implementation of the Economic and Taxation Strategy, the target for 2008 Cash Limits is £290million (after taking into account the reduction in the grants to the Social Insurance Funds). This is in line with the objective set out in the Government Business Plan to contain increases in revenue expenditure to RPI or less.

3.8 In addition, the 2008 Cash Limits will also include £8million in respect of routine capital expenditure, £1million as the final phase of funding the Network Extension Plan Creux Mahie Link and £7.5million transfer to the Corporate Housing Programme Fund in respect of rent rebates. It is emphasised that these are not additional revenue expenditure items – it is merely a change in funding and accounting arrangements.

3.9 **Against this background, the Treasury and Resources Department will be working with Departments in the coming months to prepare detailed Budgets for approval in November 2007.**

Capital Funding and Accounting

3.10 As set out in the Report on Capital Prioritisation which was debated in October 2006, the States noted *"the Treasury and Resources Department's intention to review the method of funding and accounting for Departmental routine capital expenditure and to report back as soon as practicable."*

3.11 There is an ongoing level of routine capital expenditure by Departments of approximately £8million per year on items such as the routine replacement of essential equipment, plant and vehicles, maintenance and minor repairs / upgrades to buildings and IT projects. In practice (partly as a legacy of the old committee system) a number of Departments treat expenditure on some of these items as revenue costs.

3.12 The Treasury and Resources Department believes that the time is right for the introduction of a system where Departments are allocated a single annual Cash Limit which would fund both "revenue" and "routine capital" expenditure. This would increase Departments' ability to manage their own affairs although major capital items would continue to be funded specifically, from the Capital Reserve.

3.13 Therefore, it is intended that the 2008 Budget Report will include recommended Cash Limits that include the following allowances for routine capital expenditure:

- Treasury and Resources Department (includes Courts and Law Officers and States of Alderney) £1.5m
- Commerce and Employment Department £0.1m
- Culture and Leisure Department £0.2m
- Education Department £1.0m
- Environment Department £0.3m
- Health and Social Services Department £2.8m
- Home Department £1.0m
- Public Services Department £1.1m

3.14 In addition, the Cash Limit for the Public Services Department will also include £1.0million specifically to complete the last tranche of the vital Creux Mahie link of the Network Extension Plan.

3.15 However, Revenue and Capital Expenditure will continue to be separately disclosed within the States Accounts.

3.16 All States Departments are mandated to be *"accountable for the management and safeguarding of public funds and other resources entrusted to it"* and this is subject to review by the Public Accounts Committee. Furthermore, the States Property Services Unit will, in conjunction with Departments, be compiling asset management plans and will closely review expenditure programmes to ensure that Departments are fulfilling their responsibilities to maintain infrastructure and not diverting monies to fund ongoing revenue expenditure.

3.17 Any consequential changes to the States Financial Procedures, including the introduction of authority to individual Departments to approve certain capital expenditure will be included in the 2008 Budget Report.

Use of Delegated Authority

3.18 In order to speed up decision making and to avoid the States having to spend considerable amounts of time on routine financial matters, the Treasury and Resources Department has been granted delegated authority for certain financial matters.

3.19 In summary, the Treasury and Resources Department has delegated authority to approve as follows:

- An increase in an individual Department's revenue expenditure budget by the greater of £250,000 or 2% in any one financial period.
- Capital votes (straightforward replacements without limit and projects up to £250,000).
- Capital overspends up to £250,000.
- Property purchases and sales.

3.20 It is emphasised that just because the Treasury and Resources Department has delegated authority does not mean that it cannot, or will not, refer specific instances to the States.

3.21 The Department is required to report on the use of its delegated powers to the States twice a year, i.e. as part of the annual Budget and Interim Financial Reports (Appendix II).

3.22 The Department also has the delegated authority to allow Departments to borrow temporarily by way of overdraft from banks or from the States Treasury and to make loans or grants to registered charities and similar organisations.

SECTION 4: OTHER MATTERS

Operations of the States Treasury

4.1 The following loans, with interest payable at the States Treasury rate (formerly States Treasurer's rate), have been made as at 30 April 2007:

- Public Services Department Energy from Waste: £1.8million (30.09.06: £2.7m).
- Health and Social Services Department Accommodation Fund: £2.8million (30.09.06: £2.9m).

4.2 In the 2007 Budget Report, the States were advised that "*As part of the consideration of the 2005 Annual Report of the Gambling Control Commission, the States noted that the Commission's loan facility is now unlikely to be repaid.*" Subsequently, as reported in the 2006 Accounts Financial Report, this loan which had a balance of £106,762 (£92,000 – capital and £14,762 – accrued interest) has been written off against General Revenue on 31 December 2006.

4.3 It is emphasised that, as a general principle, loan arrangements are only entered into where there is an income stream which can be used to support the repayment of the loan and associated interest charges.

4.4 The interest and capital associated with the loan for the Energy from Waste Plant is, as originally envisaged, being repaid out of increased waste disposal charges. As part of the package of waste handling measures, £500,000 of this additional revenue stream was allocated to the Environment Department in 2006 to fund expenditure in this area, including recycling initiatives. It is anticipated that similar arrangements will be made in 2007 and 2008 (for the Public Services Department), to fund interim waste processing facilities and services to support the recycling initiatives which were agreed by the States in February 2007.

Aurigny Group

4.5 In June 2005, the States agreed the Treasury and Resources Department's recommendation that *"the retention of the Aurigny Group is in the overwhelming public interest, and represents the best strategic option for the Island at the present time."* The encouraging results achieved in 2006 and the forecasts that the Group will continue to be profitable serve to highlight that the right decision was made, although this will be kept under review.

4.6 Appendix V sets out the 2006 financial results of the Aurigny Group. The Treasury and Resources Department is very pleased to report that an overall profit of £255,000 was recorded, compared to a forecast loss of approximately £400,000. These results were achieved in the face of an extremely competitive environment and record fuel prices.

4.7 As part of the June 2005 States debate (which endorsed the retention of the Aurigny Group) the Treasury and Resources Department was authorised to *"facilitate (if necessary by providing guarantees) the Aurigny Group's borrowing from third parties"*.

4.8 In July 2005 Cabernet Limited (the holding group of Aurigny and Anglo-Normandy Engineering) obtained a loan facility from a local financial institution at normal commercial terms and rates. The Treasury and Resources Department, acting on behalf of the States in accordance with the above Resolution, is the guarantor of that facility up to £4.2million. As at 30 April 2007, the amount borrowed under that facility was £3.3million (30.09.06: £3.9m).

4.9 At its meeting in June 2007, the States will be asked *"To endorse the Treasury and Resources Department's conclusion that the purchase of two new ATR72-500 aircraft by the Aurigny Group at a cost of $37million is the best strategic and financial option."* It is emphasised that, if approved, the States will **not** be providing the funds to purchase the aircraft but facilitating, if necessary by providing guarantees, the Aurigny Group borrowing the necessary funds from the private sector. No public monies will be used.

<u>Corporate Housing Programme</u>

4.10 The Housing Department is continuing to take significant steps to reduce the demand for States capital funding to provide new social housing, in particular by its relationship with the Guernsey Housing Association and Housing 21. Within the last year, properties for rental and partial ownership have been completed at Roseville and La Chaumiere and an "extra care" housing scheme for the elderly at Rosaire has been developed.

4.11 The Corporate Housing Programme Fund and its constituent parts can, with the Treasury and Resources Department's agreement, borrow from the States Treasury (or even commercially) and pay interest which is therefore a cost to the Fund.

4.12 As reported previously, a £25million borrowing facility in respect of the Housing Development and Loan Fund (HDLF) has been obtained. The Fund is currently borrowing £5million from this source.

4.13 The Guernsey Housing Association has a private sector borrowing facility of £28million to fund its development programme for which the States acts as guarantor. However, in the event of a default, the properties owned by the Guernsey Housing Association would revert to States ownership.

4.14 The Housing and Treasury and Resources Departments continue to work together to ensure that the appropriate funding mechanisms are employed. In the 2006 Budget, it was agreed that the Housing Department, with the approval of the Treasury and Resources Department, should be able to transfer amounts, including those obtained by third party borrowings, between the various constituent parts of the Corporate Housing Programme and, specifically, to modify the use of the HDLF to permit this.

4.15 Although thus far, it has not been necessary for the Housing Department to utilise the above facility, it is nevertheless important to have such a mechanism available. The Housing Department is currently working on a five year development programme that will see the remainder of the States Housing stock modernised and new social housing built by the Guernsey Housing Association on the site of old estates which are no longer considered to be fit for purpose.

4.16 The Housing Department is permitted to sell "incompatible" properties, with the sale proceeds being credited to fund Corporate Housing Programme initiatives. Recent sales have included Baubigny Cottages (six properties realising £1.4million). It is intended that the Petit Bouet estate will be sold, realising approximately £5million which will be used to grant fund the redevelopment of the Grand Bouet Estate in partnership with the Guernsey Housing Association.

4.17 In October 2006, the States noted *"the Treasury and Resources Department's intention to review the method of funding and accounting for the Housing Department's rent rebate scheme and to report back as soon as practicable."* In recent years the Housing Department has received substantial capital allocations (£5million in 2005 and £7million in each of 2006 and 2007) in respect of the Corporate Housing Programme.

4.18 The Housing Department and Treasury and Resources Department are both firmly of the view that a more appropriate long-term funding mechanism would be for the Housing Department's annual revenue budget to be increased to take into account the Rent Rebates granted to tenants (both those in States Houses and those nominated tenants in the Guernsey Housing Association's properties).

4.19 The value of these rent rebates was £6.86million in 2006 (2005: £5.08m) and are anticipated to increase significantly in 2007, 2008 and 2009 as the new Rent and Rebate Schemes come fully into effect and as a result of the Housing Department's tenancy review policy to terminate the tenancies of those who could afford to obtain private sector accommodation (generally higher earners who do not qualify for a rebate) and accommodate lower income earners (who will receive large rebates).

4.20 Therefore, as a transitional measure, the Rent Rebates granted to tenants will be funded by transfer to the Corporate Housing Programme Fund from the Housing Department's revenue budget but with a cap of £7.5million in 2008 and £8.0million in 2009. **This is a significant move in securing the future funding of the Corporate Housing Programme.**

Insurance Arrangements

4.21 In recent years, the States of Guernsey have seen substantial increases in its insurance premium costs. A feasibility study has been commissioned to investigate in detail whether there might be advantages for the States in operating some form of captive insurance structure. Possible advantages could arise in the following four main areas:

- Potential savings in premiums.
- Better control and understanding within the States of its insurable risks.
- Cheaper / better access to the reinsurance market.
- Improved Risk Management across the States.

4.22 However, it should be borne in mind that any substantial financial savings will arise only if the States is prepared to adopt an approach that will involve more risk than under the current arrangements.

4.23 If it is determined that there could be advantages to the States operating a captive insurance structure, a detailed States Report would be presented for debate during 2008.

Public Sector Employees: Superannuation Fund

4.24 The States of Guernsey, in common with most public sector employers, maintains benefit-defined pension schemes. In general terms, this means that the pension payable to employees is determined by their years of service and their final salary. Stock market performance does not impact upon the pension benefits accruing to the employees as it does with a contribution-defined scheme.

4.25 All States employees pay a fixed percentage of their pensionable remuneration as their contribution to the Fund. The amount paid by the employer (i.e. the States) is set by actuarial valuation at rates which are affected by a range of assumptions including future benefit rates, mortality rates and stock market performance. Any gains or losses arising from these assumptions can affect the contribution rate of the employer.

4.26 Professional independent actuaries carry out actuarial valuations on a triennial basis. The valuation for the period ended 31 December 2004 was presented to the States in November 2005. An actuarial valuation will be carried out as at 31 December 2007 with the results presented to the States during the latter part of 2008. Any changes to the contribution rates of the employer will be effective from 1 January 2009.

4.27 In October 2006 (Billet d'Etat XVII), the States agreed that the pensions for public sector employees in Guernsey should continue to be broadly comparable to the (changing) provisions in the United Kingdom public sector. It was resolved that a Review Panel of the Pensions Consultative Committee would produce a detailed report, setting out any necessary Rule changes for consideration by the States. It is anticipated that this report will be considered in Autumn 2007.

Staff Number Limitation Policy

4.28 The Department is mandated with the responsibility for the administration of the Staff Number Limitation Policy. Appendix VI of this Report provides a summary of the staff numbers covered by the Staff Number Limitation Policy and Appendix VII shows the actual direct costs of employing those staff in General Revenue Departments only. Almost 50% of General Revenue expenditure relates to staff costs.

4.29 In March 2007, the States agreed that the Staff Number Limitation Policy should not continue in its current form. It was suggested that a system based solely on budgetary control be introduced. The Treasury and Resources Department is currently developing an alternative policy for controlling staff numbers and expenditure. It is currently anticipated that a Report will be presented to the States in September.

4.30 The Department is concerned to note however that since March there has been a marked increase in requests from Departments for additional staffing. One of the principal concerns the Treasury and Resources Department has is that every new post created within the public sector can mean that there is one less person available to work in the wealth creating private sector.

4.31 **It must be reasoned that, conversely, controlling the size of the public sector will directly result in the wealth creating private sector being able to expand and contribute towards the maintenance of economic growth at sustainable levels which is a key component of the Future Economic and Taxation Strategy. This will need to be one of the factors taken into account in developing an alternative policy to replace the Staff Number Limitation Policy.**

4.32 The replacement system which is introduced will need to continue to exert downward pressure to contain the costs of employing staff and at the same time give Departments greater freedom to operate within their agreed Cash Limits. The overall aim must continue to be to provide efficient services with the minimum number of staff possible.

4.33 The Treasury and Resources Department has recently approved an increase of 4.00FTE in the establishment of the Law Officers Chambers due to a significantly increasing workload in several areas, including legislative drafting, contract and commercial matters and civil litigation.

4.34 Other requests, which are currently under consideration, have been made by the Environment Department, Health and Social Services Department, Home Department and Public Accounts Committee.

4.35 By comparison, in 2006, the Department did not approve any increases in permanent establishment. Indeed, overall staffing levels decreased by the deletion of established posts and by reductions in contract and temporary staff.

Restructuring and Reorganisation Fund

4.36 As part of the 2006 Budget, the Restructuring and Reorganisation Fund was established, by transferring £5million from the Contingency Reserve Fund with effect from 1 January 2006. The balance of the Fund at 30 April 2007 was £2.1million. Major uses of the Fund have been:

- Redundancy Costs £1.2m
- Electronic Health and Social Care record £0.8m
- Housing Control – IT system £0.7m

4.37 Access to the Fund is only available to Departments to meet the cost of initiatives where short term investment will have long term advantages (i.e. genuine spend to save initiatives). The following criteria are used by the Treasury and Resources Department when determining whether to agree to a request for funding from the Restructuring and Reorganisation Fund:

- Redundancy costs - Provided long term savings are made, i.e. the post is permanently deleted or replaced by a significantly more junior post with resultant salary savings.

- Improvements to systems (usually IT) - A pay-back must be available through the reduction of revenue expenditure or the introduction / increase of fees and charges.

- Termination of contracts / leases – Provided the equipment / property is no longer required and where the cost of terminating the contract will be offset by the consequent savings.

- Investigations / feasibility studies - Initiatives for which there is a high probability that their implementation will result in reduced expenditure or increased income.

Property Rationalisation Strategy

4.38 In February 2006, (Billet d'Etat V) the States approved the formation of a centralised States Property Services Unit within the Treasury and Resources Department.

4.39 As part of that process, the States recognised that the improved management of the States of Guernsey's extensive property portfolio (land and buildings) could result in substantial benefits for the Island. It was therefore acknowledged that it was vital that the property portfolio was properly managed in a professional manner.

4.40 A key component of the above States Report, to support the proper management of the estate, was to put in place a Rationalisation Strategy to unlock the potential of these assets.

4.41 Later this year, an update on the Rationalisation Strategy will be presented to the States, seeking approval for the disposal by sale or lease of several major States properties. These have all been assessed as priority for disposal under the Asset Management Plan which is part of an on-going exercise being carried out by States Property Services Unit.

4.42 To date relocations to the markets development (a public / private partnership) and to St Barnabas has enabled the termination of two leases on private buildings, previously leased in at an annual cost of over £140,000. Furthermore, the sale of Vauquiedor Farm realised capital income of in excess of £660,000 and the leasing of the property on Lihou Island to a private organisation has relieved the States of the burden of long-term maintenance expenditure on these properties.

Information and Communications Technology (ICT) Strategy

4.43 A Head of Profession has recently been appointed who has been working closely with States Departments to ensure the provision of a stable and secure ICT environment that is flexible enough to support the various and changing needs of States Departments and the wider community. This involves consolidation and standardisation of the corporate infrastructure in line with Good Computer Practice, with services managed and coordinated centrally, where appropriate. This collaborative approach has lead to the compilation of a corporate ICT Strategy Document detailing the direction to be taken and highlights the key ICT enabled projects to be carried out across the States and its Departments.

4.44 In addition, major corporate contracts have been secured with Hewlett Packard to supply computer hardware and with Microsoft to supply desktop and underlying operating and database systems. These two contracts represent large savings to the States as a whole and ensure consistency across all Departments.

Tax on Real Property

4.45 In June 2007, the States will be considering detailed proposals from the Treasury and Resources Department for the introduction in 2008 of a revised scheme of property taxation (Tax on Real Property – TRP) in place of the current Tax on Rateable Values (TRV). The TRP system will be much simpler, transparent, objective and more equitable.

4.46 **For the vast majority of domestic properties, it is anticipated that the TRP bills will be broadly similar to those they would have been under the TRV system.** However, the actual rates for 2008 will be set as part of the Budget Report to be presented to the States in November 2007.

APPENDIX I

FORMULA LED EXPENDITURE

	Actual 2006 £'000	Original Estimate 2007 £'000	Revised Estimate 2007 £'000
Payments to States Members *	1,817	1,825	1,800
Legal Aid Scheme	1,685	1,400	1,400
Social Insurance Grant	27,939	23,325	23,310
Health Service Grant	9,195	7,180	7,230
Long-Term Care Grant	1,455	-	-
Supplementary Benefit	12,142	13,720	13,605
Family Allowance	8,055	8,340	8,300
Attendance and Invalid Care Allowance	2,050	2,060	2,185
Concessionary TV Licences	483	500	470
TOTALS	**64,821**	**58,350**	**58,300**

* Includes payments to Alderney Representatives, Non-States Members Attendance Allowances and non-contributory pensions paid in respect of pre-1990 service.

APPENDIX II

USE OF DELEGATED FINANCIAL AUTHORITY

The States Financial Procedures require the Treasury and Resources Department to report periodically on the use of its delegated financial authority. The Department last reported to the States on these matters as part of the 2007 Budget, since that time:

The following increases in 2006 revenue budgets have been approved:

	£
Education Department	
Grants to Libraries and Colleges	125,035
Health and Social Services Department	
Out of Island Placements	675,000

The following capital projects have been approved:

	£
Treasury and Resources Department	
Income Tax On-line electronic forms system	250,000
Stones Yard surveys/remedial works	175,000
Cambria House dilapidations	75,000
Town seafront lighting replacement	75,000
Royal Court asbestos removal	60,000
St James Chambers alterations	25,000
Courts and Law Officers photocopiers replacement	20,000
States of Alderney	
Whitegates repairs and renovations consultants fees	30,000
St Annes Church renovations consultants fees	20,000
Island Hall annexe consultants fees	13,500
Old fire station consultants fees	5,000
Education Department	
Grammar School sports hall floor replacement	100,000
Automatic fire protection/lighting upgrades	93,000
Vale Junior School asbestos removal	55,000
Fire Inspections remedial works	50,000
Various Minor capital works	50,000
Energy conservation works	50,000
Electrical remedial works	40,000
La Houguette / La Mare de Carteret air quality improvements	32,000
Floraville, Vauvert conversion (additional)	10,054
College of Further Education concrete corrosion specialist	8,000
Grange House roofing (additional)	2,250
Oakvale School classrooms (additional)	1,927

Environment Department	
Les Banques cycle path extension	25,000
Candie Gardens lower greenhouse repairs (additional)	9,322
Health and Social Services Department	
Hospital and other equipment additional/replacement	935,000
Pathology clinical chemistry system	250,000
Albecq ward upgrade	235,000
Flooring programme replacement	100,000
Home Department	
IT Equipment replacement	100,000
Prison cell call system replacement	49,000
Probation Service equipment	49,000
Prison CCTV additional equipment	48,000
Police Professional Standards section relocation	29,000
Fire Brigade vehicles replacement	25,000
Police vehicles replacement (additional)	4,036
Housing Department	
Guernsey Youth Housing project (additional)	20,257
Public Services Department	
Foul water network extension plan	3,021,000
Sewage tankers replacement	153,000
Ports	
Guernsey Airport	
Apron, taxiway and runway rehabilitation consultants	390,000
Voice communication and control system replacement	276,000
Public car park extension	150,000
Hangar refurbishment	13,500
St Peter Port Harbour	
Vehicles replacement	40,000
Dive team equipment	14,000

The following property purchases and sales have been approved:

	£
<u>Purchases</u>	
Public Services Department	
Route de la Rocquaine strip of land	2,000
<u>Sales</u>	
Treasury and Resources Department	
Le Vauquiedor Farm	662,000
Housing Department	
1, Baubigny Cottages	250,000
2, Baubigny Cottages	217,500
3, Baubigny Cottages	230,000
4, Baubigny Cottages	230,000
5, Baubigny Cottages	215,000
6, Baubigny Cottages	240,000
Highfield, La Villiaze Road, St Andrews	370,500

APPENDIX III

MOVEMENTS ON THE CAPITAL RESERVE

	£m	£m
Balance 1 January 2006		42.4
2006 Withdrawals		
EDP	(12.7)	
Electronic Health & Social Care record	(3.1)	
Beau Sejour Centre overspend	(1.4)	
		(17.2)
Savings on Projects funded from Reserve		1.0
2006 Interest		3.9
Balance 31 December 2006		30.1
2007 Budget appropriation		5.0
2007 Withdrawals		
EDP (Les Nicolles final tranche)	(5.0)	
Clinical Block 1st Tranche	(17.2)	
		(22.2)
2007 Interest		3.0
Balance 31 December 2007		15.9
Anticipated 2008 Budget appropriation		8.5
Anticipated 2009 Budget appropriation		8.0
2008 / 2009 Withdrawals		
Clinical Block 2nd Tranche	(17.1)	
Belle Greve Wastewater Disposal	(6.0)	
Alderney Commercial Quay - additional	(2.0)	
Residential Homes	(1.0)	
		(26.1)
2008 / 2009 Interest		1.3
Amount available for other Major projects		**7.6**

APPENDIX IV

UNSPENT BALANCES

	2006 £	2005 £
Policy Council	1,766,575	1,021,976
Treasury and Resources Department	3,150,106	1,982,976
Commerce and Employment Department	2,652,458	1,952,790
Culture and Leisure Department	591,007	563,397
Education Department	1,236,514	1,009,413
Environment Department	2,723,390	1,646,436
Health and Social Services Department	793,885	791,247
Home Department	3,157,372	2,445,810
Housing Department	315,590	441,840
Public Services Department	1,036,190	1,701,914
Social Security Department	12,223	8,985
Public Accounts Committee	123,923	154,027
Scrutiny Committee	139,496	107,830
TOTAL	**17,698,729**	**13,828,641**
31 December 2004	17,071,744	
31 December 2003	16,368,609	
31 December 2002	15,680,910	
31 December 2001	15,372,473	
31 December 2000	15,497,965	

Note: The above figures are before transfers and returns to General Revenue.

APPENDIX V

AURIGNY & ANGLO NORMANDY:

TRADING POSITION 2006

Aurigny Air Services Limited

	2006 Actual £'000	2006 Budget £'000	2005 Actual £'000
Revenue	25,650	24,025	24,162
Direct Costs	(19,926)	(19,131)	(18,332)
Operating Result	5,724	4,894	5,830
Overheads	(5,165)	(5,082)	(5,396)
Other Operating Income	90	94	91
Operating Profit / (Loss)	649	(94)	525
Net Interest Payable	(169)	(181)	(189)
Exceptional Costs	-	-	(941)
Profit / (Loss)	480	(275)	(605)

Anglo Normandy Aero Engineering Limited

	2006 Actual £'000	2006 Budget £'000	2005 Actual £'000
Revenue	5,287	4,667	5,043
Direct Costs	(4,089)	(3,424)	(3,855)
Operating Result	1,198	1,243	1,188
Overheads	(1,422)	(1,362)	(1,327)
Operating Profit / (Loss)	(224)	(119)	(139)
Net Interest Receivable / (Payable)	(1)	-	2
Profit / (Loss)	(225)	(119)	(137)

APPENDIX VI

ESTABLISHMENT STAFF NUMBERS

	Total Establishment 31.12.2006 FTE	Total Establishment 31.12.2005 FTE
Policy Council	65.64	75.75
Treasury and Resources : Income Tax	85.17	85.17
Treasury and Resources : Others	104.97	69.47
Commerce and Employment Department	118.31	135.61
Culture and Leisure Department	114.09	113.09
Education : Teachers and Lecturers	671.71	671.71
Education : Others	228.98	228.98
Environment Department	76.56	76.56
Health and Social Services : Nurses	828.22	828.22
Health and Social Services : Others	830.81	837.31
Home Department	297.45	296.45
Housing Department	104.68	104.68
Public Services Department	564.50	595.20
Social Security Department	113.17	113.17
Public Accounts Committee	1.00	1.00
Scrutiny Committee	2.00	2.00
Legal Services	72.95	69.95
TOTAL	**4,280.21**	**4,304.32**
Number of Police Officers	177.00	177.00
GRAND TOTAL	**4,457.21**	**4,481.32**

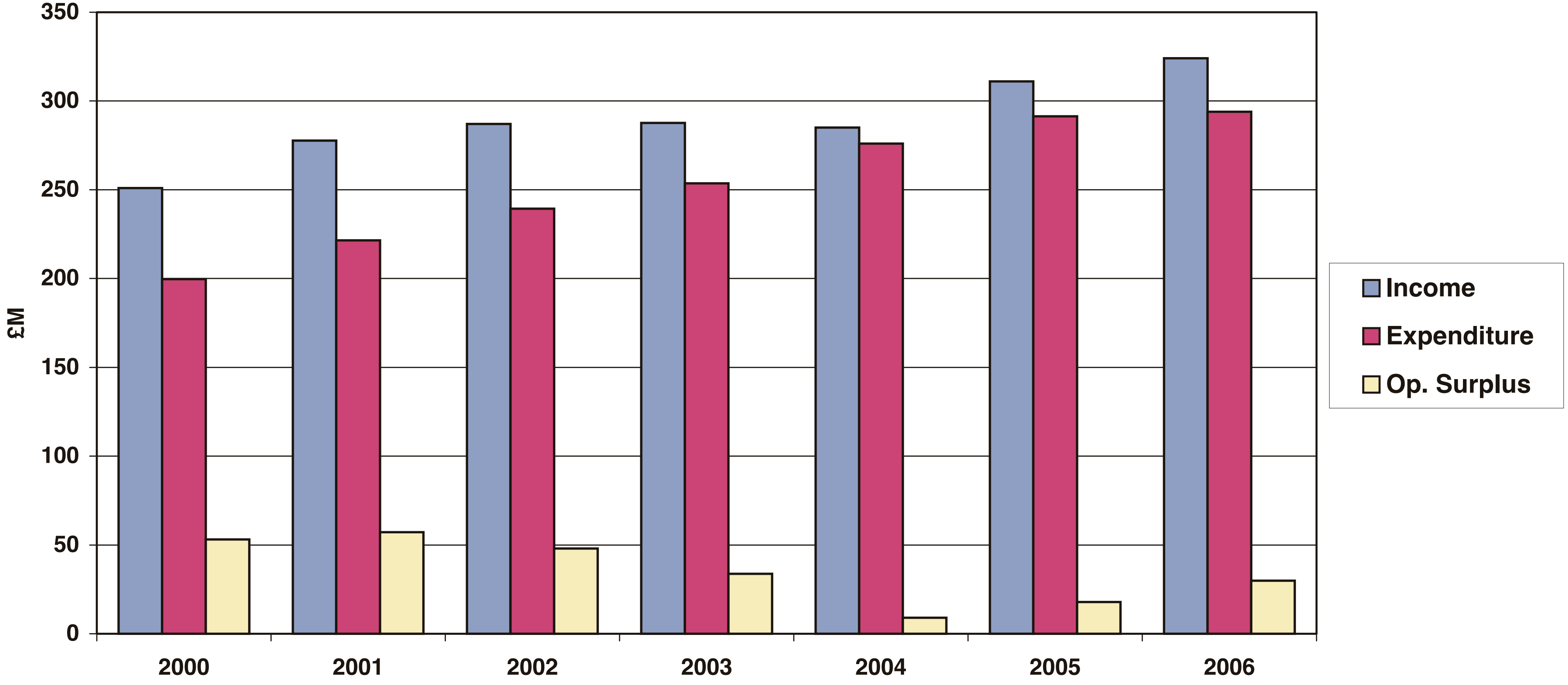
- Not included in these figures are States of Guernsey staff working in Alderney and Sark.
- There were a number of transfers of establishment in 2006, mainly in respect of the centralisation of States Property Services.
- Number of Police Officers set by States and not included in Staff Number Limitation Policy.

APPENDIX VII

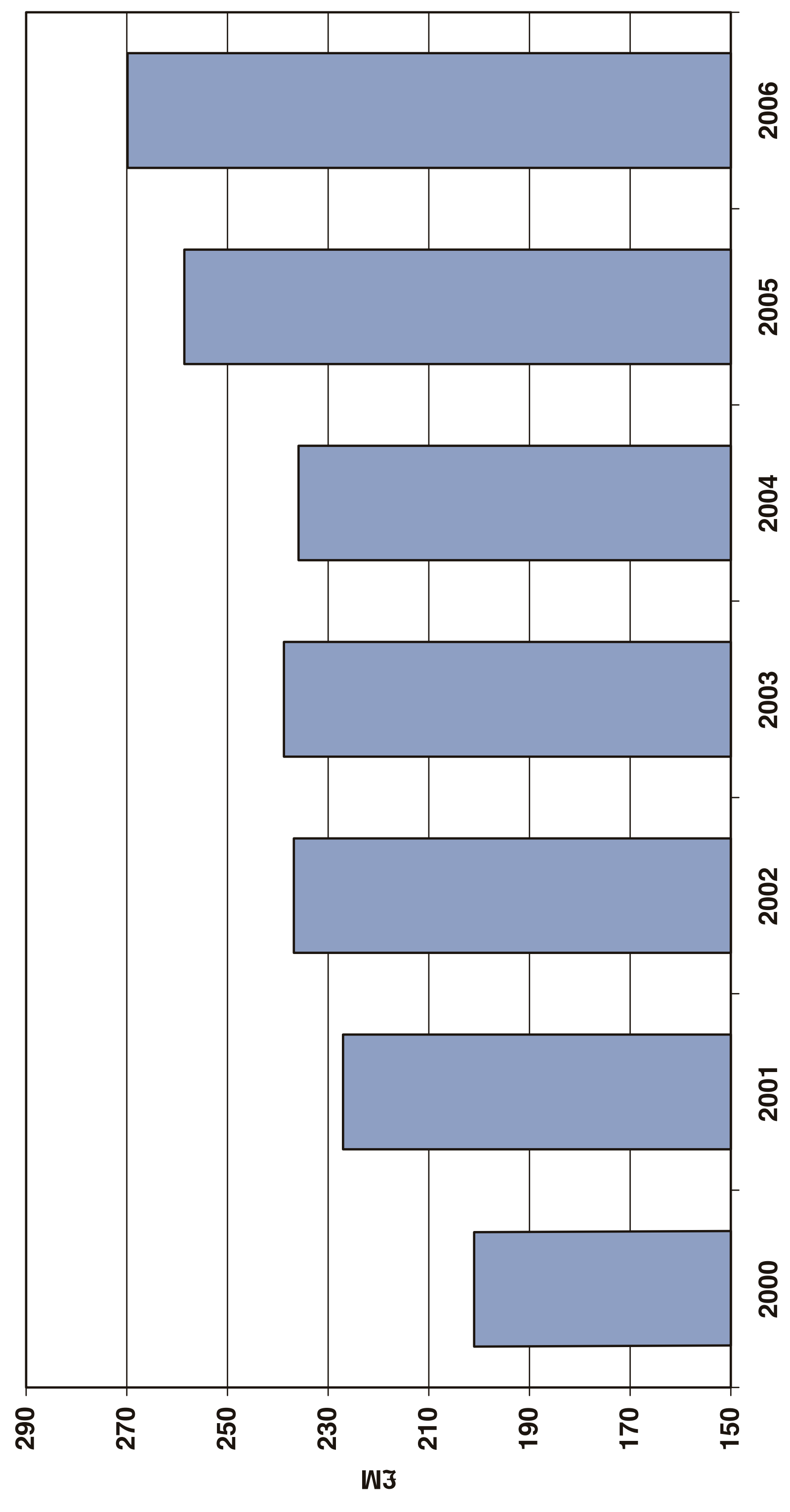
PAYROLL COSTS

	2007 Estimate £'000	2006 Actual £'000	2005 Actual £'000	2004 Actual £'000	2003 Actual £'000
Policy Council	2,336	2,492	2,427	2,376	2,419
Treasury and Resources	8,155	7,625	7,812	7,414	7,016
Commerce and Employment	3,407	3,145	3,512	3,260	3,210
Culture and Leisure	4,081	3,914	3,932	3,437	3,187
Education	42,013	41,257	39,396	36,057	33,715
Environment	3,731	3,210	3,380	3,071	2,720
Health and Social Services	57,845	54,960	52,939	49,654	46,153
Home	21,252	19,248	18,785	17,368	15,789
Housing	2,196	2,040	1,996	1,831	1,969
Public Services	2,111	2,102	1,904	1,994	1,860
Social Security	1,062	1,025	972	914	848
Public Accounts Committee	87	97	77	53	-
Scrutiny Committee	179	162	110	34	-
Legal Services	5,363	4,834	4,333	3,997	3,554
TOTALS	**153,818**	**146,111**	**141,575**	**131,460**	**122,440**
% Increase	5.3%	3.2%	7.7%	7.4%	9.0%

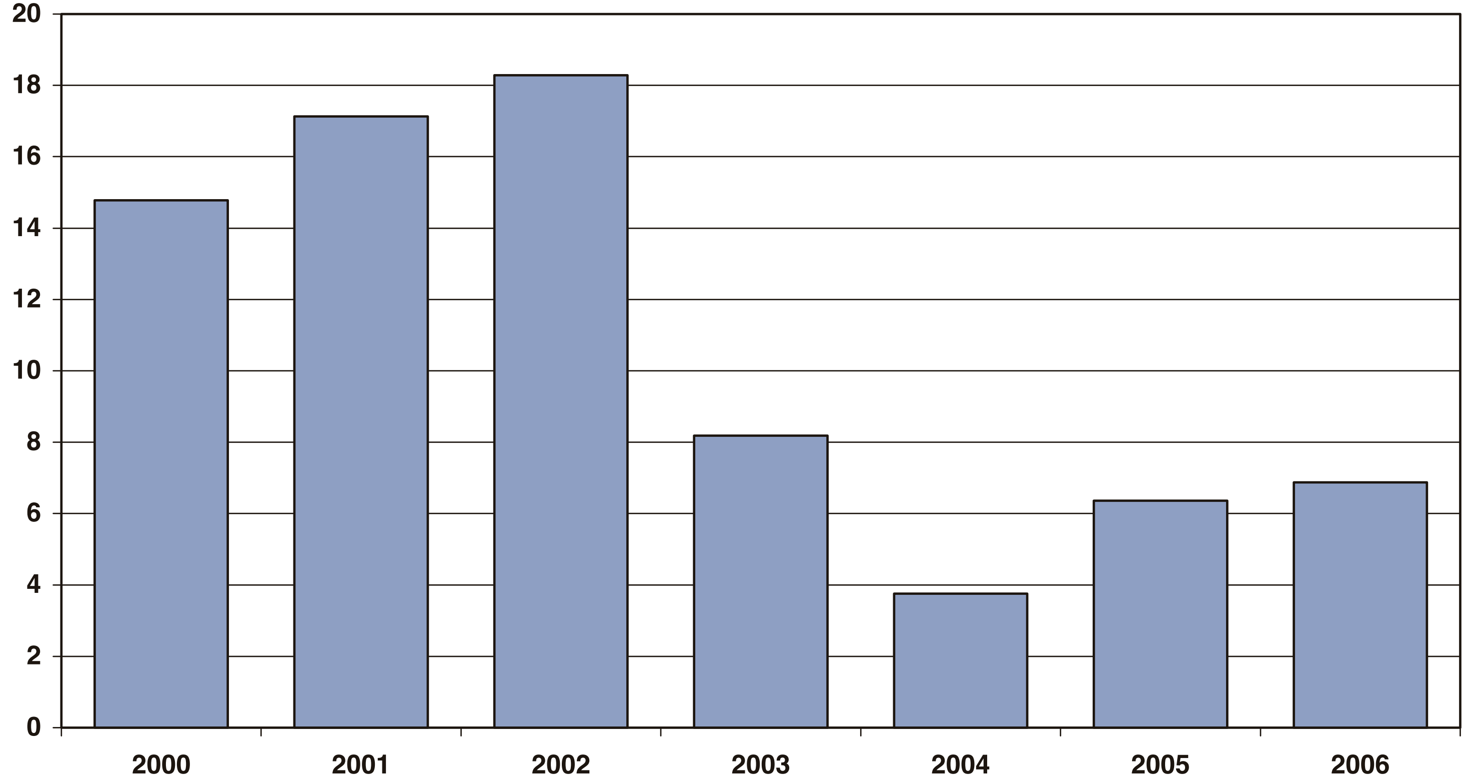
FINANCIAL OVERVIEW



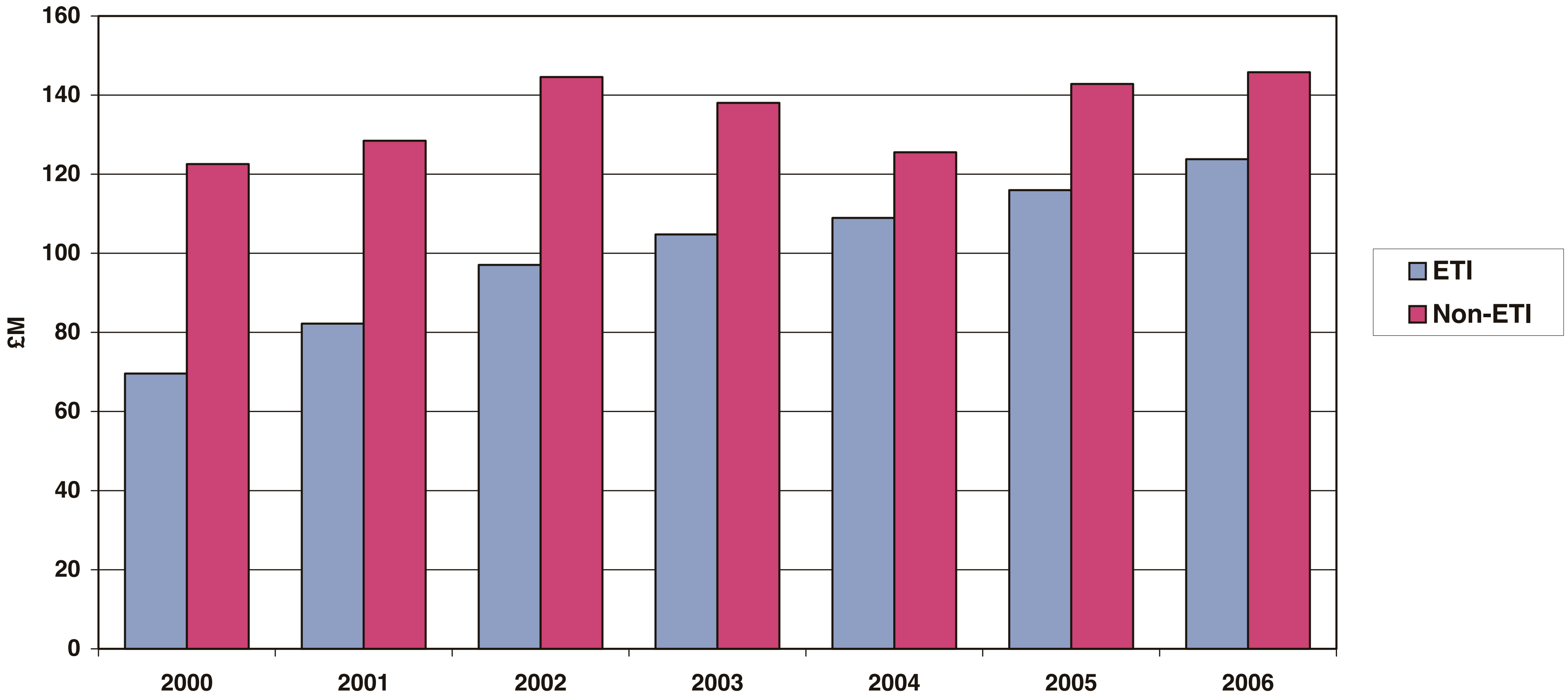
INCOME TAX RECEIPTS



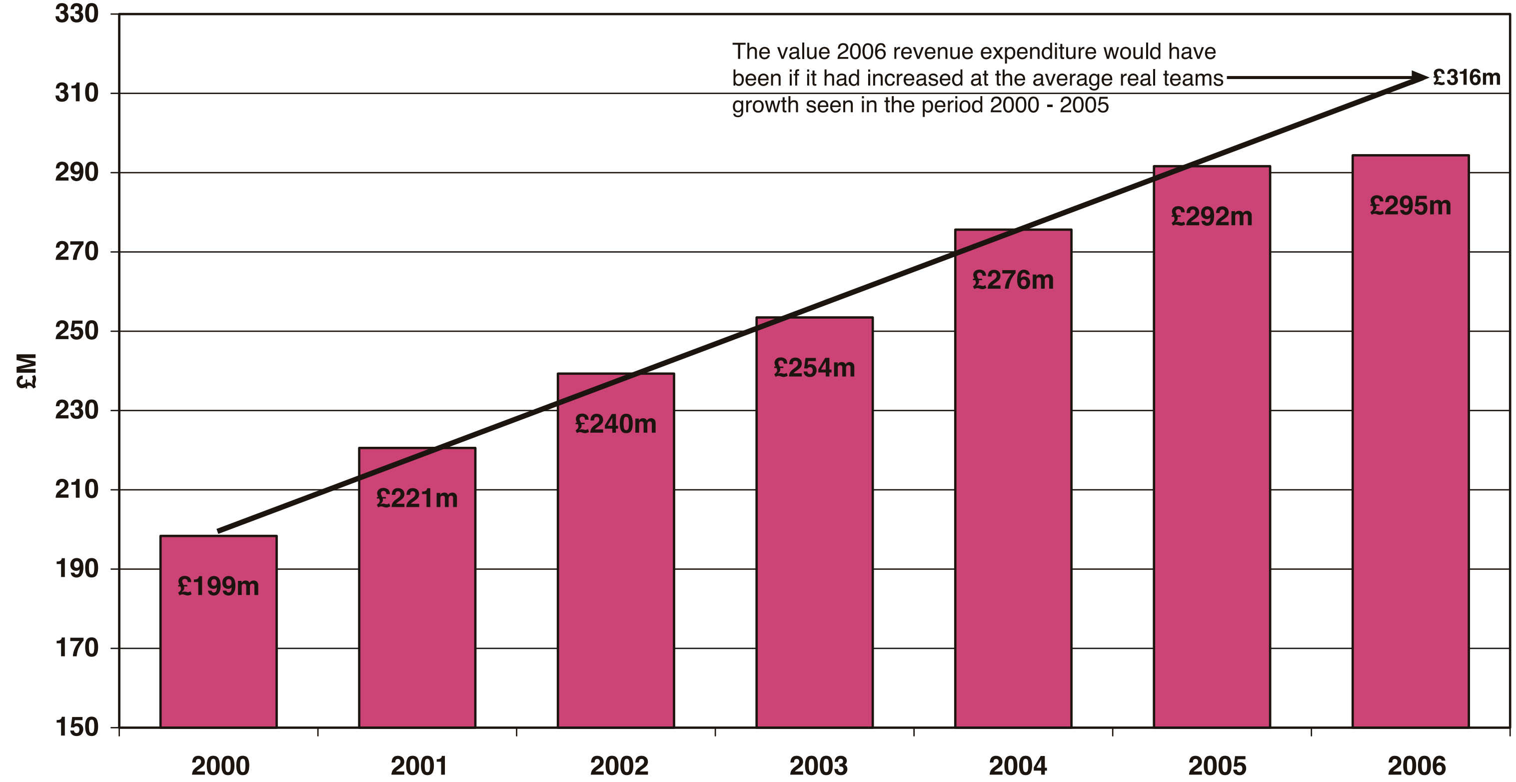
ETI TAX RECEIPTS: NOMINAL % INCREASE



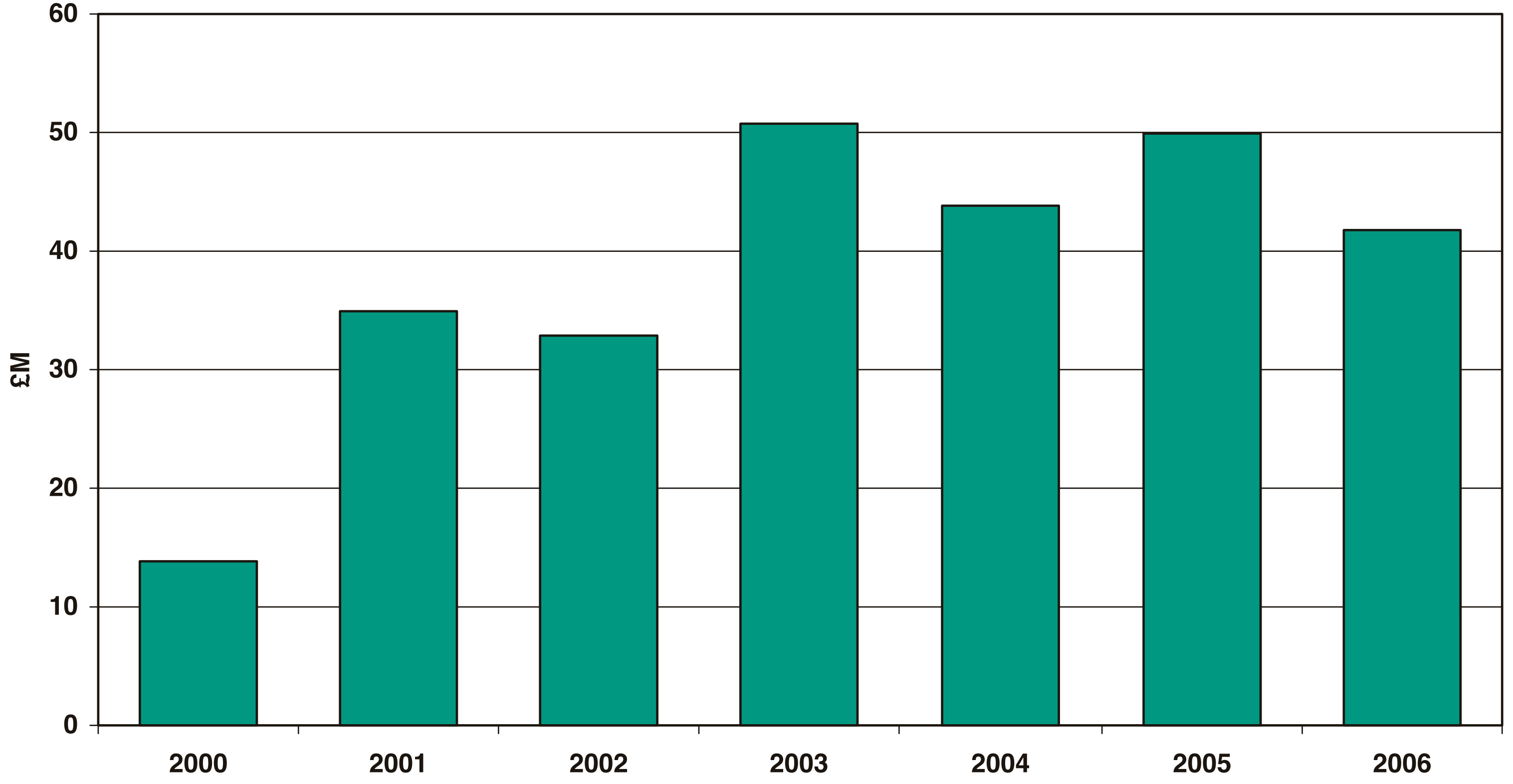
TAX RECEIPTS



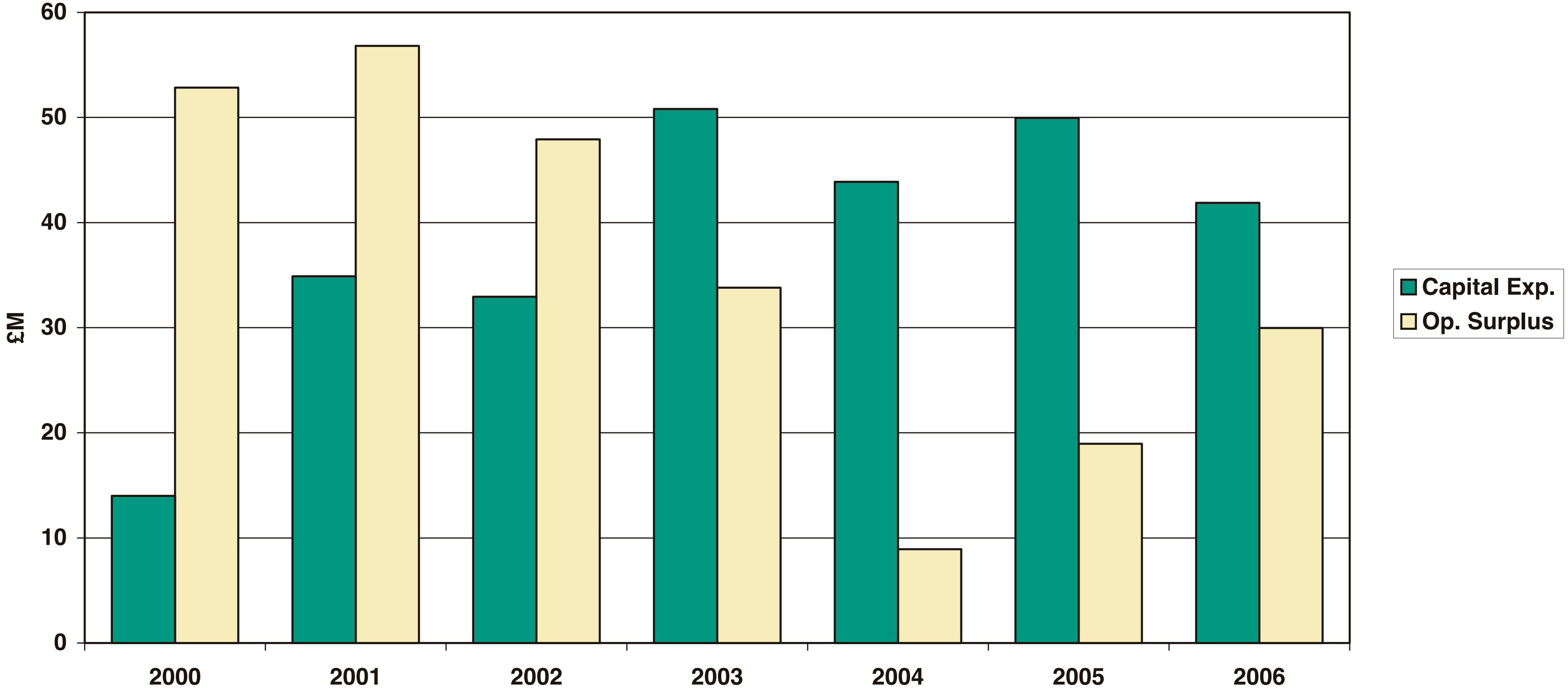
REVENUE EXPENDITURE



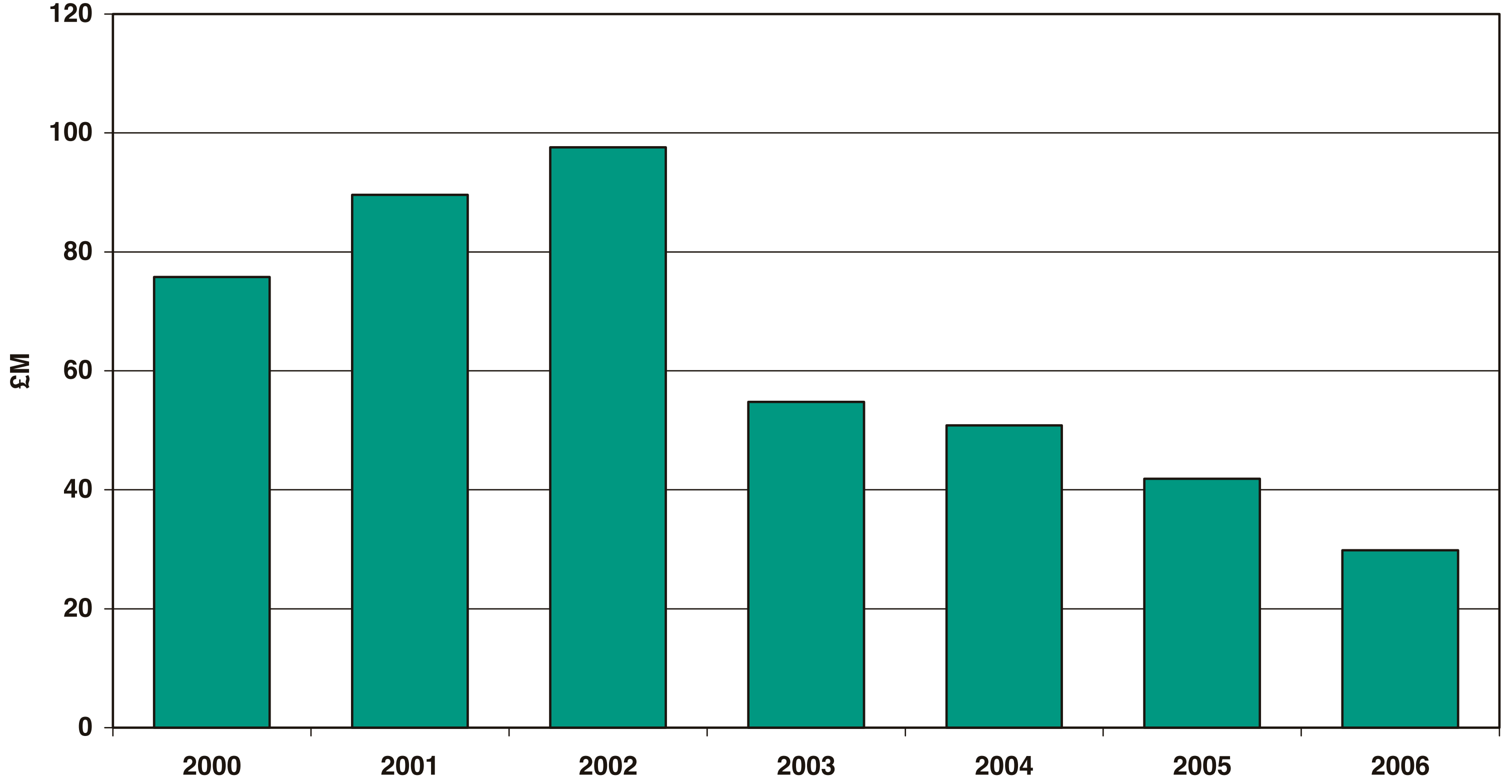
CAPITAL EXPENDITURE



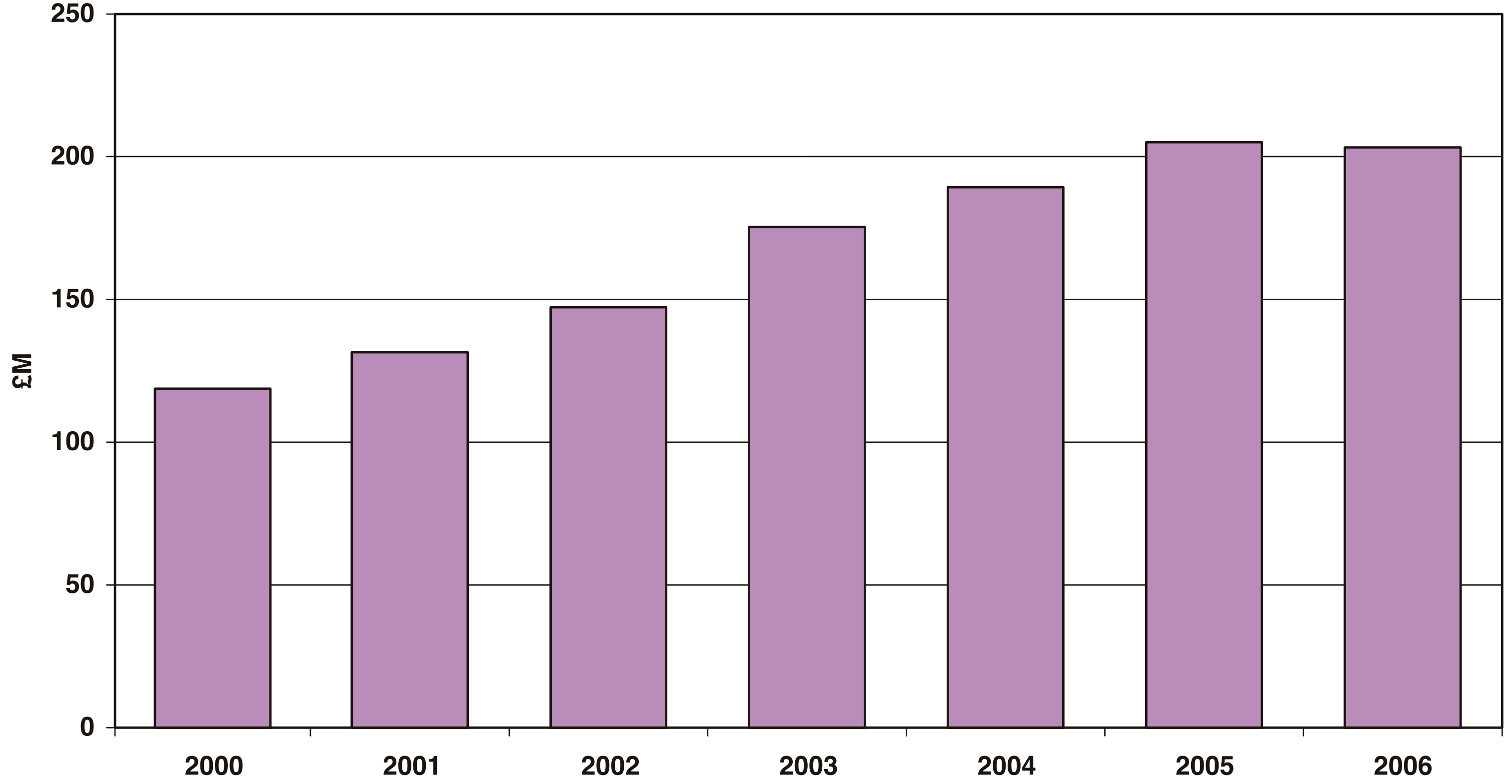
CAPITAL EXPENDITURE vs OPERATING SURPLUS



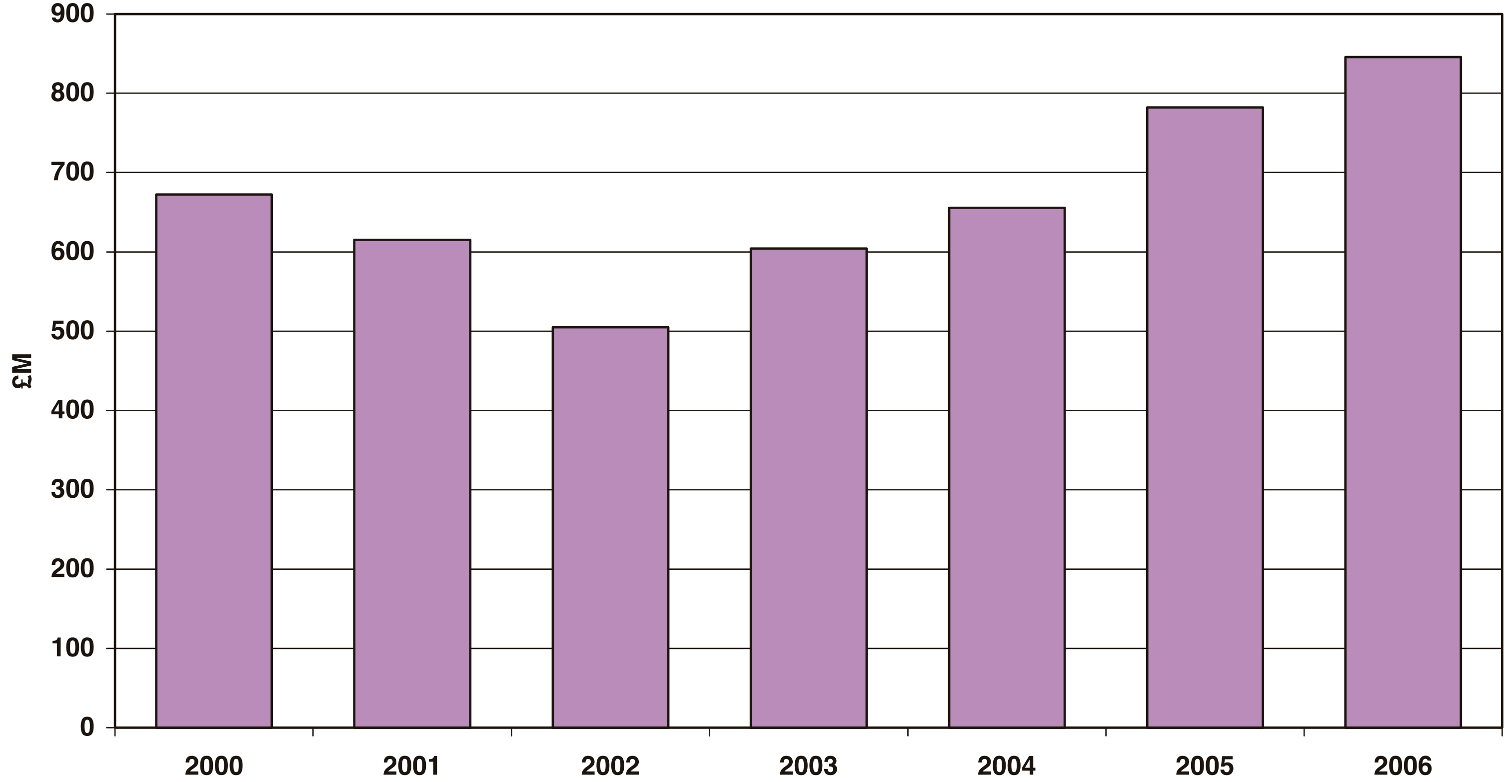
CAPITAL RESERVE



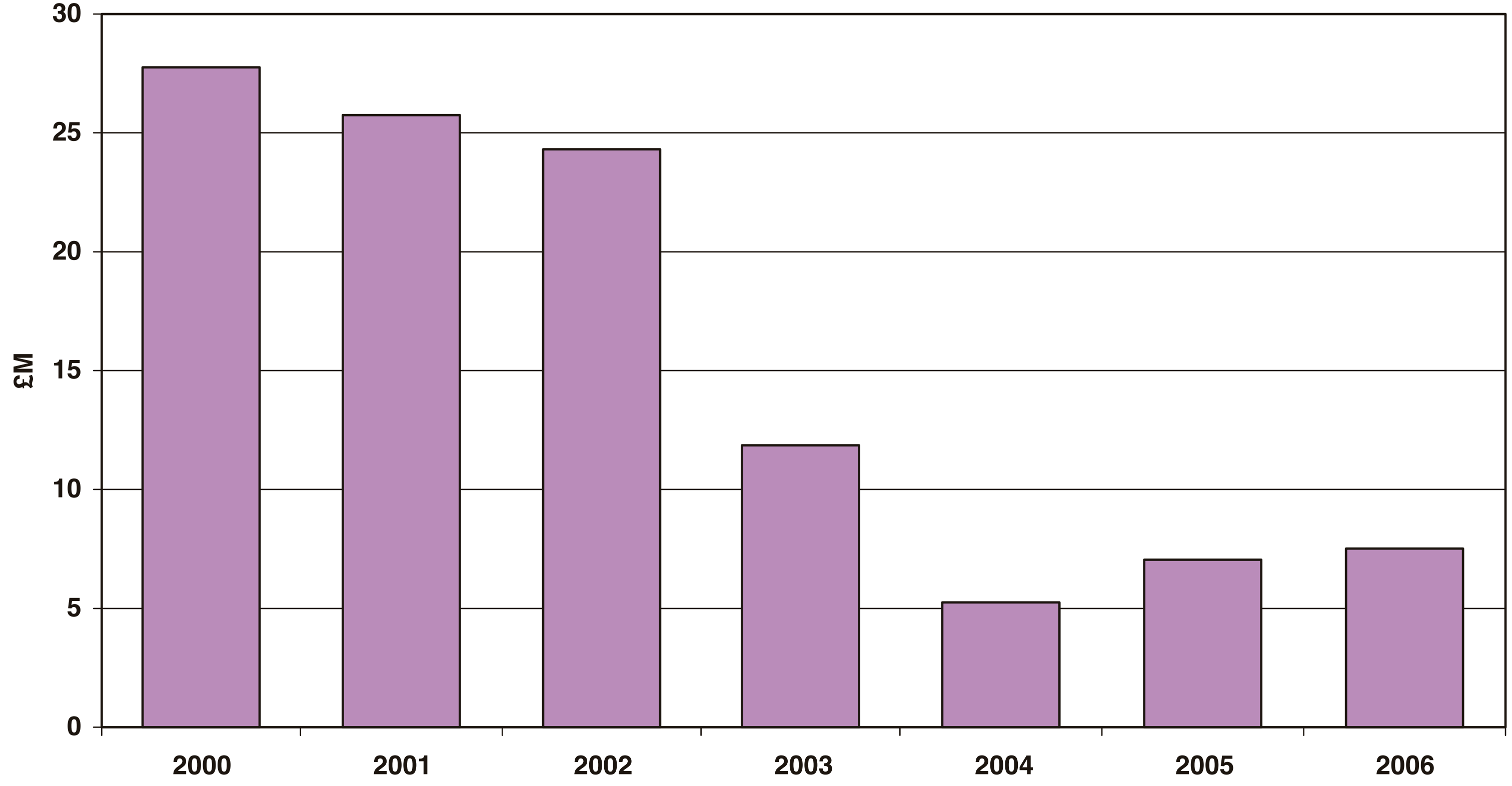
CONTINGENCY RESERVE



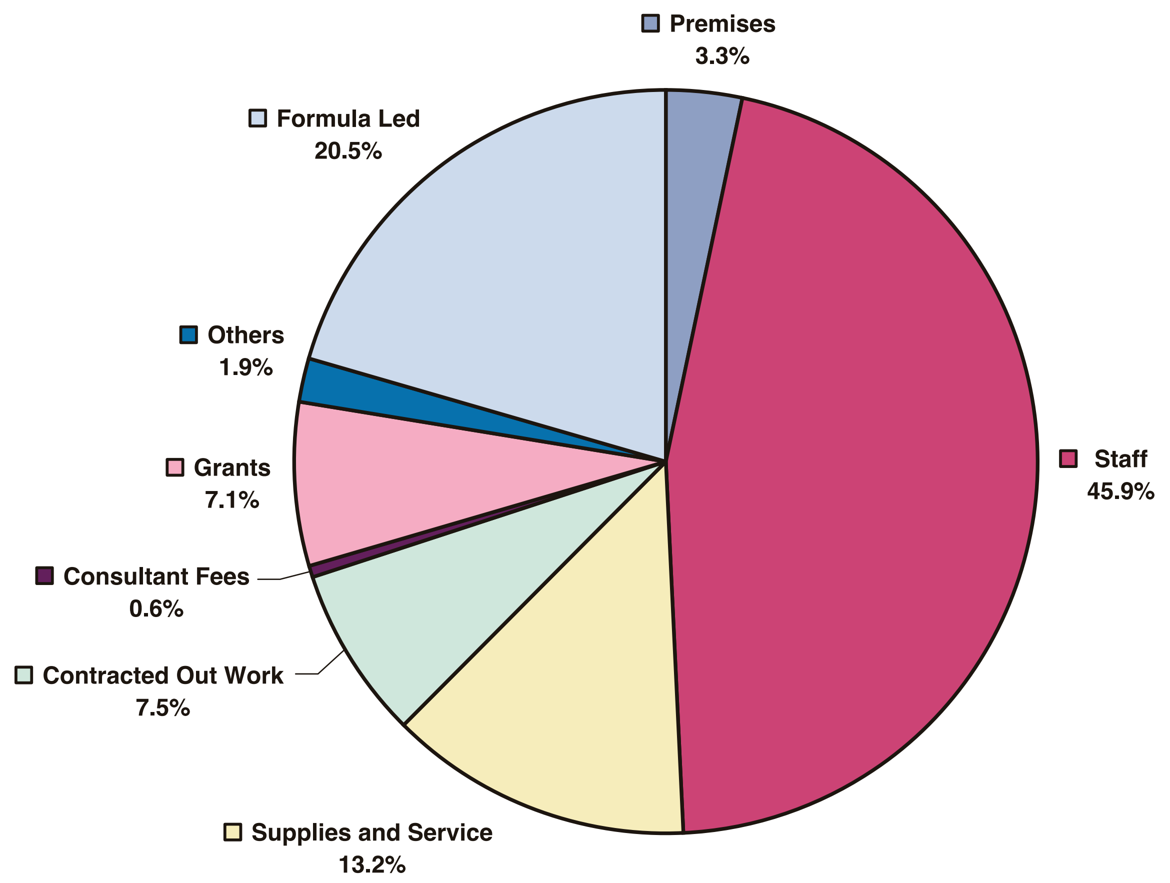
SUPERANNUATION FUND



PORTS HOLDING ACCOUNT BALANCE



2006 REVENUE EXPENDITURE BY STANDARD HEADING



2006 REVENUE EXPENDITURE BY TYPE