



Coventry City Council

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Public report

Report to

Cabinet
Scrutiny Co-ordination Committee

20th May 2008
4th June, 2008

Report of

Chief Executive
Director of Customer and Workforce Services
Director of Finance & Legal Services

Title

Application for Capitalisation Direction

1 Purpose of the Report

- 1.1 This report seeks approval to apply for a Capitalisation Direction from Government in respect of any potential successful future claims for backdated equal pay costs. Such a direction would allow the Council to treat these revenue costs as capital expenditure and as such, fund them from borrowing or capital receipts. Government has made this facility available to all Councils, many of which have already taken advantage of it.
- 1.2 It should be noted that this report does not change the City Council's stance in seeking to appeal against the recent equal pay claims tribunal judgement and to continue to defend our current legal position in respect of equal pay legislation. As things stand, no claimants have yet demonstrated an entitlement to back pay because there has been no tribunal hearing yet to consider which, if any, of the claimants are doing work of equal value to their specified "comparators" in the domestic refuse service. However, it is prudent to proceed on the basis that at least some of the claimants may be able to establish this entitlement at a future tribunal hearing.

2 Recommendation

- 2.1 To give approval for the Director of Finance and Legal Services to make an application on the Council's behalf under the Government's "Capitalisation Directions: Policy and Procedures" for the 2008/09 financial year in respect of the costs of potential successful equal pay claims.

3 Information/Background

- 3.1 A report to Council on 18th March 2008 provided members with a detailed update on the Council's current position in respect of equal pay claims and the implications of the recent Employment Tribunal judgement. The report was clear that the Council does not yet face any financial liability and that no successful equal pay claims have yet been made, as in order to succeed in a claim, a claimant must prove to the Tribunal that his or her job is of equal value to the job of the "comparators" (in these cases the comparators being five specific posts within the domestic refuse service). There has been no hearing on this issue yet by the Tribunal. It did establish however that some claimants may now be able to succeed with their claims if they can prove that they have an equal value claim for back pay against the City Council. Although the report approved a decision for the Council to appeal against the Tribunal judgement, it stated that Council taxpayers could nevertheless be faced with a financial liability for back pay claims running into millions of pounds.
- 3.2 It is impossible at this stage to give an accurate estimate of the likely eventual cost of any successful equal pay claims. There are a number of variable factors that could impact upon the size of the bill including:
- The degree to which the Council's challenge to the Tribunal judgement is successful;
 - The success of any subsequent individual equal value backpay claims (in the event of the tribunal judgement being partially or wholly upheld) and the number of claims submitted;
 - The detailed financial ruling by the Tribunal on the calculation of successful individual claims. For example, factors that the Tribunal will have to take into account in relation to each individual claim will include; the claimant's length of service, whether the claimant has been in the same job for the last 6 years or if not, whether in a lower graded job, and the claimant's individual absence and performance and productivity record.
- 3.3 This set of circumstances makes it very difficult to plan for the eventual financial outcome of the legal process for equal pay. The City Council has set aside a financial provision for these costs in previous years and this has been reported to members within the Statements of Accounts for 2005/06 and 2006/07. The amount set aside has not been disclosed on the basis that this could prejudice the outcome of the legal process.
- 3.4 The view of the Director of Finance and Legal services is that over time the amount that we have currently set aside may not be sufficient to fund the financial cost of equal pay claims if an adverse legal ruling is upheld. In the event of a ruling being far worse than we consider to be likely or reasonable, the City Council could face a significant financial liability. In such circumstances it is important that appropriate and prudent steps are taken to safeguard the integrity of the Council's financial position.
- 3.5 Councils across the country are facing the same challenge, and as a result of lobbying, the Government has recognised and now partially addressed the issue by making it possible for councils to have more flexibility to help them borrow funds, if needed, to fund successful equal pay claims. This is known as a Capitalisation Direction.

- 3.6 The 2008/09 budget setting report approved by Council on 19th February 2008 detailed a medium term financial position that included the following features:
- A balanced revenue and capital budget for 2008/09,
 - A revenue financial settlement that will include future real-terms reductions in resources from Government,
 - A medium term revenue position that will only be balanced through the achievement of significant future efficiency savings,
 - A capital programme within which we have not yet identified the resources to continue existing maintenance programmes in the future,
 - Revenue reserve balances that are all earmarked for existing programmes, schemes and purposes.
- 3.7 One conclusion that can be drawn from this position is that the City Council does not have sufficient flexibility within its budgets to deal with an additional financial burden in the shape of potentially significant equal pay claim payouts over and above the provision made. From a financial perspective therefore, it is important to explore any opportunities or mechanisms that can be identified to help manage such costs.
- 3.8 A Capitalisation Direction amounting to £500m was made available nationally for the 2007/08 financial year and Local Government Minister John Healey announced on 5th February that a further amount (as yet undisclosed) would be made available for 2008/09. It is expected that a large number of councils will apply for a Capitalisation Direction in 2008/09.
- 3.9 Capitalisation directions do not make more money available. They do enable local government to treat specified revenue expenditure (in this instance one-off lump sum back-pay costs) as capital expenditure. These costs can then be charged to the revenue account over a number of years, in effect postponing potentially damaging financial difficulties of equal pay settlements.
- 3.10 Unfortunately, this mechanism does not reduce the cost of equal pay claims. Indeed because of the need to pay a revenue provision (a principal repayment) as well as the interest cost of borrowing inherent within a Capitalisation Direction, the overall cash cost of paying for equal pay claims in this way is significantly greater. Therefore, this should not be seen as a means of resourcing equal pay claims. The ultimate cost of claims paid will still fall upon Council Tax payers over a prolonged period of time.
- 3.11 Despite this prolonged impact upon the City Council's financial position the Director of Finance and Legal Services view is that we should apply for a Capitalisation Direction. It is proposed that the City Council should seek the largest Capitalisation amount that it can reasonably justify – Government gives no guarantee that all Directions applications will be granted and indications are that successful applications will be supported at only a proportion of the amount applied for.

4 Alternative Option – Not Applying For Capitalisation

- 4.1 If the City Council does not apply for a Capitalisation Direction then it runs the risk of incurring liability for a value of equal pay claims either in 2008/09 or some later year that is very difficult for the Council to afford. In a worse case

scenario the Council could be faced with a bill for the immediate payment of equal pay claims of millions of pounds. This would require us to identify some stringent and urgent reductions in expenditure that would pose an immediate threat to service delivery standards over a range of services and potentially mean the loss of a number of jobs across the Council. Alternatively, the Council would have to divert its earmarked reserve balances in a way that would threaten its short-term financial standing and raise question marks over its ability to meet its liabilities. In effect, this second scenario would lead fairly quickly back to some stringent and urgent reductions in expenditure because the Director of Finance and Legal Services could not allow the Council to be exposed to such a threat to its financial standing for a sustained period.

4.2 Clearly, the Council will continue to uphold its legal position as outlined in paragraph 1.2 above and the 18th March report. It is important to note that:

- If ultimately the Council does not require the use of an approved Capitalisation Direction then it can make use of a smaller amount or none at all as appropriate.
- Such an application has no bearing upon the legal case currently being contested. A Capitalisation Direction gives the City Council the authority to borrow. This enables the Council to make financial provision for a potentially damaging financial outcome from current legal proceedings but does not presuppose that this will actually be required.
- The Council is required to take this action now because there will be no further opportunity to do so within 2008/09. This will be the last opportunity to take this action in relation to the 2008/09 accounts and there is no guarantee that further rounds of Capitalisation Direction will be available from Government. This important flexibility may therefore not be available if not taken up now.

5 Other Specific implications

	Implications (See below)	No Implications
Best Value		✓
Children and Young People		✓
Climate Change and Sustainable Development		✓
Comparable Benchmark Data		✓
Corporate Parenting		✓
Coventry Community Plan		✓
Crime and Disorder		✓
Equal Opportunities		✓
Finance	✓	
Health and Safety		✓

Human Resources		✓
Human Rights Act		✓
Impact on Partner Organisation		✓
Information and Communications Technology		✓
Legal Implications	✓	
Neighbourhood Management		✓
Property Implications		✓
Race Equality Scheme		✓
Risk Management	✓	
Sustainable Development		✓
Trade Union Consultation		✓
Voluntary Sector – The Coventry Compact		✓

5.1 Finance

5.1.1 The 2008/09 guidance is clear that Government will allow Capitalisation only for lump sum one-off back-pay payments. Our understanding following consultation with the Department for Communities and Local Government is that this includes where we make provisions in the accounts for the same purpose. It will be necessary to work with our auditors to ensure that the appropriate regulations are followed in applying the Direction.

5.1.2 Capitalisation cannot be applied to the legal costs of challenging claims or for the ongoing cost of increased salary payments linked to equal pay agreements. The degree to which we apply a successful direction will still be subject to local discretion within the 2008/09 final accounts process such that this report does not commit the Council to an irrevocable course of action.

5.1.3 It is proposed that we seek a capitalisation amount of £54m. This is an estimate of the maximum potential borrowing facility that might be required. Ultimately, the actual figure will be based on:

- The combined impact of the potential volume of equal pay claims that could be brought against the City Council.
- The likelihood of success of these claims based on the legal advice received.
- The success of any subsequent individual equal value backpay claims in the event of the tribunal judgement being partially or wholly upheld and the detailed financial ruling by the Tribunal on the calculation of successful individual claims.
- The fact that only a proportion of each authority's capitalisation claim is likely to be supported by the final government allocation (that is, the Government is unlikely to approve the full £54m claimed).
- The flexibility to make use of only part (or none) of the capitalisation amount within 2008/09 as required.

5.1.4 Government approval of a Capitalisation Direction for Coventry and a decision by the City Council to apply part or all of this within 2008/09 will lead to the incurrence of ongoing revenue repayment costs from 2009/10 at the rate of

approximately £90k per £1m approved. Depending upon the level of capitalisation approvals granted and applied this would imply an annual revenue cost of between say £1m and £4.5m.

5.1.5 Importantly, the borrowing that would result from capitalising this expenditure would impact upon the City Council's Prudential Indicators that are set as part of the framework governing our capital, treasury management and revenue activity. In effect, the council has discretion to set the key borrowing limits (our "Authorised Limit for External Debt" and "Operation Boundary for External Debt") at whatever levels that it sees fit. However, these limits are driven by the level of expenditure and borrowing that the Council requires to perform its functions and that it has calculated to be affordable. An assessment of the affordability of the borrowing indicated in 5.1.3 would be a key part of the 2009/10 budget setting process.

5.2 Legal

The capitalisation direction will be submitted in line with guidance issued by the Department for Communities and Local Government. Our external auditors will be consulted in applying the capitalisation to ensure that accounting regulations are complied with.

5.3 Risk Management

A successful capitalisation direction for the City Council would significantly reduce the financial risk relating to equal pay that currently exists within the Corporate Risk Register.

6 Timescale and expected outcomes

6.1 Capitalisation Direction applications need to be submitted with Government by 29th May. For this reason the chair of Scrutiny Co-ordinating Committee has been invited to this meeting.

6.2 The Government's decision on the allocation of Capitalisation Directions is likely to be made around September 2008.

6.3 A final decision on how much of the borrowing approval to take up will need to be made as part of the 2008/09 final accounts process. The revenue implications of this will need to be considered as part of the 2009/10 budget setting process.

	Yes	No
Key Decision		√
Scrutiny Consideration (if yes, which Scrutiny meeting and date)	Chair of Scrutiny Co- ordinating Committee to attend √	
Council Consideration (if yes, date of Council meeting)		√

List of background papers

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Papers open to Public Inspection

Description of paper

Location

None