REPORT BY THE CHIEF FINANCE OFFICER TO THE ESSEX POLICE, FIRE AND CRIME COMISSIONER FIRE AND RESCUE AUTHORITY

1. This paper provides a report by the Chief Finance Officer that reviews of the risks within the 2018/19 budget:

INTRODUCTION

2. The Local Government Act 2003 Section 25 includes a specific personal duty on the "Chief Finance Officer" to make a report to the Authority when it is considering its budget and Council Tax. The report must deal with the robustness of the estimates included within the budget and the adequacy of reserves for which the budget provides. The Act requires the Authority to have regard to the report in making their decisions.

3. Section 26 of the Act gives the Secretary of State power to set a minimum level of reserves for which an Authority must provide in setting its budget. The Secretary of State indicated that 'the provisions are a fall back against the circumstances in which an Authority does not act prudently, disregards the advice of its Chief Finance Officer and is heading for serious financial difficulty'.

4. Sections 32 and 43 of the Local Government Finance Act 1992 also require billing and precepting authorities to have regard to the level of reserves needed for meeting estimated future expenditure when calculating the net budget requirement. There is also a range of safeguards, which either are in place or are about to be introduced, to ensure local authorities do not over-commit themselves financially. These include:

    1. The Chief Finance Officer's S.114 powers, which require a report to the Authority if there is or is likely to be unlawful expenditure or an unbalanced budget; and
    2. The Capital Financing Regulations.

RISK ASSESSMENT

LOCAL GOVERNMENT ACT 2003

5. The Local Government Act does not provide any specific guidance on how to evaluate the robustness of the estimates. The explanatory notes to the act do however identify the need to allow for risks and uncertainties that might lead to expenditure exceeding budget by:

    1. Making prudent allowance in the estimates; and in addition
    2. Ensuring that there are adequate reserves to draw on if the estimates turn out to be insufficient.

6. It is stressed that decisions on the appropriate level of reserves should not be based on a rule of thumb but on an assessment of all the circumstances considered likely to affect the Authority.

CIPFA GUIDANCE NOTE ON LOCAL AUTHORITY RESERVES AND BALANCES

7. The Chartered Institute of Public Finance Accountancy (CIPFA) states that the following factors should be taken into account when the Chief Finance Officer considers the overall level of reserves and balances:

    1. Assumptions regarding inflation;

2. Estimates of the level and timing of capital receipts;
3. Treatment of demand led pressures;
4. Treatment of savings;
5. Risks inherent in any new partnerships etc.;
6. Financial standing of the Authority (i.e. level of borrowing, debt outstanding etc.);
7. The Authority's track record in budget management;
8. The Authority's capacity to manage in-year budget pressures;
9. The Authority's virements and year-end procedures in relation to under and overspends;
10. The adequacy of insurance arrangements.

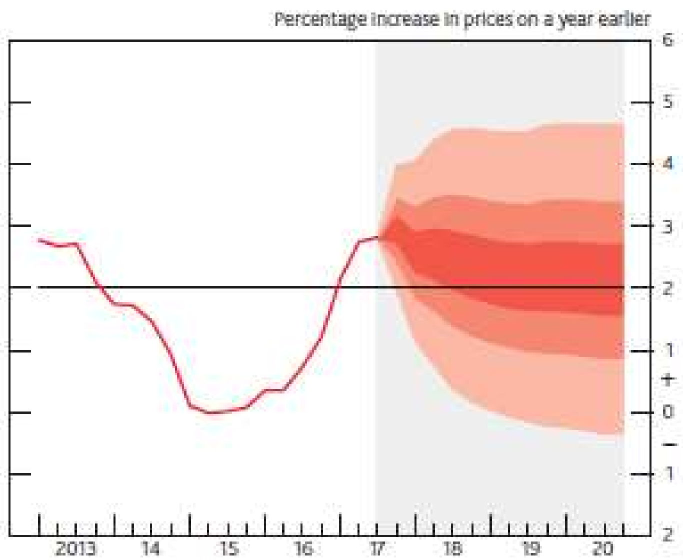
The above are also of relevance when evaluating the robustness of the budget and the subsequent analysis includes comments on these issues.

ISSUES CONSIDERED WHEN EVALUATING THE ROBUSTNESS OF THE ESTIMATES AND THE ADEQUACY OF THE PROPOSED FINANCIAL RESERVES

INFLATIONARY PRESSURES

8. The background economic climate has a higher degree of uncertainty than in recent years with the Brexit negotiations and a higher degree of economic uncertainty. The outlook for inflation is above the 2% target set for the Bank of England. The Bank of England's November 2017 inflation forecast (CPI) is shown below:

Chart 5.2 CPI inflation projection based on market interest rate expectations, other policy measures as announced



9. A key element in the budget preparation process is building in an appropriate allowance for inflation up to 31 March 2019. The budget assumes that fuel and utility prices will increase, no other specific allowances have been built into the budget for pay or price inflation. Instead, an overall inflation and contingency allowance of £700K has been used. If the requirement to increase cash budgets because of pay awards exceeds this provision then either offsetting savings will need to be found elsewhere in the budget, or the additional costs in 2018/19 will

have to be funded from reserves. In most cases, Budget Managers absorb inflationary pressures within their departmental budgets.

10. To assess whether the inflation allowance is adequate it is necessary to consider the impact of both pay and non-pay inflation pressures. Firefighters accepted a 1% pay increase in 2016 and the Fire Brigades Union is consulting its members on whether to accept a similar interim offer with effect from 1 July 2017. Discussion on higher increases, linked to changes to the Firefighters role map are in progress, and the employers have indicated that any higher increase would need additional government funding or precept flexibility.

11. One indication of the adequacy of the inflation provision is whether it would be sufficient for a similar increase. The same level of increase in 2018 across all firefighters would add just £360k to the budget. Government expectations are that public sector pay increases will continue to be limited over the next few years. Local government has already complied with government pressure, but future increases, perhaps linked to changes in the overall terms and conditions agreements are expected. The main pressure within local government is for the lowest paid staff and the move towards increasing the national living wage. These changes do not materially affect the Authority's pay bill.

12. The forecast for inflation is increasing with cost pressures associated with the decline in the exchange rate future economic uncertainty. There is a risk that external factors such as oil and commodity prices will flow through to the prices of goods purchased by the Authority. An overall 4% increase in such costs could add £500k to the Authorities costs. Existing contractual arrangements for key items including utilities and personal protective equipment means that price inflation will be limited to significantly less than this amount in 2018/19.

13. In summary, inflationary pressures remain a financial risk to the Authority's budget, but this is manageable within the overall context of the budget and level of General Balances. In addition there is potential for short term cost savings through restricting activity if necessary.

ESTIMATES ON THE LEVEL AND TIMING OF CAPITAL RECEIPTS

14. There are no material capital receipts expected in 2018/19.

TREATMENT OF DEMAND LED PRESSURES

15. The budget process has sought to identify and allow for demand led pressures. The main uncertainties relate to the following areas:-

    1. Wholetime Duty System Firefighter Numbers

16. The budget makes provision for an average of 632 wholetime firefighters in 2018/19. The staffing forecast reflects recent experience in the timing of retirement decisions by firefighters and the promotion of staff to other Services. If firefighters chose not to retire then there is a potential risk that firefighter numbers would exceed the budgeted number.

    2. On-Call (Retained Duty System) Firefighters

17. This budget has been managed within its overall cash limit in recent years as incident numbers have reduced or plateaued. The use of these staff on a wider

range of community safety and medical activities has the potential to increase the level of expenditure. The budget for 2018/19 reflects the current level of activity.

18. Management controls enable the Authority to mitigate the risk and manage the level of expenditure, demand led pressure for operational activity could increase costs in this area. There is a specific earmarked reserve to manage any major increase in the costs of on-call firefighters with an allowance of £0.5m proposed for any potential in-year budget pressures resulting from increased activity levels.

3. Other

19. Other potential expenditure pressures could result from factors such as an unanticipated need for urgent replacement of operational equipment and a need to respond to nationally driven changes in operational procedures. Such factors are viewed by the Service as relatively low risks and while if they did materialise it could lead to additional expenditure of in the order of £0.3m, there would be some scope to meet such costs within the existing budget provision by re-prioritisation.

4. Industrial Action

20. It should also be borne in mind that the Service is going through a time of change. At the time of writing this paper there is one long standing national dispute affecting the Authority on pensions and the potential for a further dispute if agreement is not reached on a pay settlement. There is potential for these to result in strike action. The present resilience arrangements have a fixed (and budgeted) cost of £0.4m. The implementation of these resilience arrangements costs depends on the nature of the strike action taken. To date such costs have been managed within the overall budget.

RISKS INHERENT IN PARTNERSHIP ARRANGEMENTS ETC

21. The Authority is involved in a range of partnership arrangements mainly in the area of community safety. The financial risks from these partnerships could lead to lower levels of income and partnership funding. A partnership policy is in place, all partnerships are actively managed to mitigate this risk.

FINANCIAL STANDING OF THE AUTHORITY (LEVEL OF BORROWING, DEBT OUTSTANDING ETC.)

22. This is becoming a less significant issue for the Authority. At 31 March 2017, the Authority had £28.0m of long term debt to fund capital expenditure and a further £0.3m of finance lease obligations. No additional borrowing is planned for 2018/19. Further significant capital spending is projected over the next few years. The revenue impact of the planned spend for 2018/19 is included within the budget, and the level of borrowing is within the limits set as part of the bi-annual review of capital financing.

23. At 30 November 2017, the cash balance is projected to be £16m.

THE AUTHORITY'S TRACK RECORD IN BUDGET MANAGEMENT, INCLUDING ITS ABILITY TO MANAGE IN-YEAR BUDGET PRESSURES

24. The Authority has a proven track record in financial management and has been able to restrict expenditure to keep within the overall budget. The most recent internal

audit report confirmed that the Fire & Rescue Authority can take substantial assurance from the budgetary controls in place.

25. However, the discipline of Financial Regulations – not incurring spending without the necessary budget provision – must be rigidly observed and the monitoring of the riskier budgets must be given priority. It remains of paramount importance that regular reports continue to be produced on all budgets throughout the year to identify emerging problems at the earliest opportunity. This will allow maximum benefit to be accrued from any corrective action taken.

26. Incremental improvements to financial processes to ensure that all orders and commitments are captured have been made and an Authority wide Contracts Register is in place. There is a high degree of visibility in the level of financial commitments and expenditure for managers who control budgets and their Directors. Management accounts are produced on an accruals basis to ensure that all expenditure incurred is included.

27. The Authority has managed to restrict expenditure in advance of the expected cuts in government funding and achieved significant efficiency savings over the past few years. We have an excellent track record in anticipating and preparing for significant change, and on delivering planned budget savings.

THE AUTHORITY'S VIREMENT AND YEAR-END PROCEDURES IN RELATION TO UNDER AND OVERSPENDS

28. The Authority has embedded virement procedures that require senior approval to allow funds to be moved to areas of pressure. Budgeted expenditure is only transferred from one budget year to the next with the agreement of the Authority.

THE ADEQUACY OF RISK PROTECTION ARRANGEMENTS

29. Current risk protection arrangements are through a company created in partnership with a consortium of nine fire and rescue authorities. The Authority is one of the larger Authorities in the group (along with Devon & Somerset, Hampshire and Kent) who bear the first part of each loss. These limits are £50k for motor claims (own damage only), £25k for public and employers liability and £5k for property. In addition, the Authority maintains a provision for the value of unsettled and unknown claims. These arrangements have delivered significant savings to the Authority over recent years and are providing stability in risk protection costs,

30. There is a potential risk that this will expose the Authority to an increase in costs if consortium members experience a high level of claims. To reflect this potential risk the level of reserves held for risk protection related costs has been set at £50k. This is the amount of a potential call on the Authority for funding for FRIC. The consortium continues to work together on benchmarking and improving risk management to help to mitigate this risk, and FRIC now has more than £500k of reserves and as a result the likelihood of the risk occurring has reduced.

PENSION LIABILITIES

1. Fire-fighters

31. The liability for firefighter pensions, whilst remaining with the Authority has been transferred to a separate account funded by government grants. The level of authority contributions remains unchanged in 2018/19.

   2. Support staff

32. The Authority contributes to the Essex County Council Local Government Pension Fund in respect of its control and support staff, which are invested in order to meet its liability to provide for the benefits provided to past employees and future benefits for existing employees. The Fund is valued every three years with the most recent valuation based on the position as at 31 March 2016. The level of contributions by the Authority is fully reflected in the 2018/19 budget and these rates will be fixed until March 2020.

RESERVES

33. The general reserves of the Authority were £6,754k on 1 April 2017. In addition there were ear marked reserves of £5,459k and a Capital receipts Reserve of £7,025k. In 2017/18 there have been no material additional capital receipts. The present forecast suggests that the Authority has a net use of the capital receipts reserves of £269k in 2017/18 compared to the budget requirement of £1,361k. The budget for 2018/19 requires a balance of £2,564k from the capital receipts reserve.

EARMARKED RESERVES

34. The Authority has established specific reserves to manage key financial risks. Movements between these specific reserves are determined by the Treasurer and reported to Members. The table below considers the specific reserves planned and the timetable for their review:

Specific Earmarked Reserves	Comment & Review	March 2017 Balance £'000s	March 2018 Projected Balance £'000s	March 2019 Projected Balance £'000s
Emergency Planning	To hold savings on the costs of Emergency Planning. Balance to be transferred to Essex County Council after 31st March 2018	437	428	-
On-Call Demand Pressures	Main area of risk is retained pay budget. Need to provide £0.5m in case of in-year pressure	600	500	500
Spend to Save Reserve	March 2018 - Balance of Funding for Sprinklers and £200k for Apprentices support	932	571	-
Taxbase and Collection Account Reserve	Last shortfall in 2012/13. Since then average of over £500k favourable balance.	200	100	100
National Non-Domestic Rates Collection Reserve	Risk remains through pooling arrangements, but considered low. Managed in-year	200	100	100
Infrastructure Reserve	To support future capital expenditure on buildings.	2,400	2,400	2,400
Rolling Budgets Reserve	To hold balances of expenditure carried forward into the next financial year.	140	-	-
Business Continuity Reserve	To provide funds for any business interruption event not covered through risk protection funding. Reduced to reflect participation in FRIC	300	100	100
Risk Protection	Expected limit of calls from FRIC.	250	50	50
Total Earmarked Reserves		**5,459**	**4,249**	**3,250**
General Reserve		6,754	6,754	6,754
Capital Receipts Reserve	Receipts from the sale of capital assets (property and vehicles). £1,361k used to balance 2017/18 budget.	7,025	6,756	4,192
Total Usuable Reserves		**19,238**	**17,759**	**14,196**

35. The planned changes in ear-marked reserves by March 2018 allows the release of £1,479k of reserves. It is recommended that these are used to make voluntary contributions to capital financing.

36. The assessment of the general level of reserves takes into account the factors noted below:

Factor	Comment	Lower Limit	Upper Limit

Factor	Comment	Lower Limit	Upper Limit
Inflation and interest rates	The increase in the overall level of borrowing exposes the Authority to a degree of risk in the future if loans cannot be replaced at a similar interest rate. An increase of 2% on a loan of £20m would add £0.4m of costs equivalent to 0.6%	0.6%	1.5%
Level and timing of capital receipts	At present, the Authority is funding a significant capital programme with a gap before capital receipts will be realised. This risk is offset by high cash balances which eliminate the need for borrowing in 2017/18	0.2%	0.5%
Savings Track Record in Budget Management Capacity to Manage in Year Budget pressure	Good track record of delivering savings identified.	1.5%	5.0%
Partnerships	Increased risks associated with Community Budgets. Limited partnership funding of £0.2m pa	0.2%	1.0%
Financial Standing	Increasing level of borrowing limits future flexibility. Separate provision for future years.	0.5%	2.0%
Total		3.0%	10.0%

37. The lower limit of 3.0% of turnover equates to £2.1m and the upper limit of 10.0% of turnover equates to £7.0m. The Authority is close to the upper point of this range.

CONCLUSION

38. Given the level of total usable reserves available in 2018/19 of £17.8m; the prudent approach to the budget setting process for next financial year; and the Authority's good past record of budget management, it is my conclusion that there is sufficient capacity in the budget to cope with the financial risks the Authority faces in 2018/19 and future years.

C Garbett
Chief Finance Officer