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 2019-20 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.

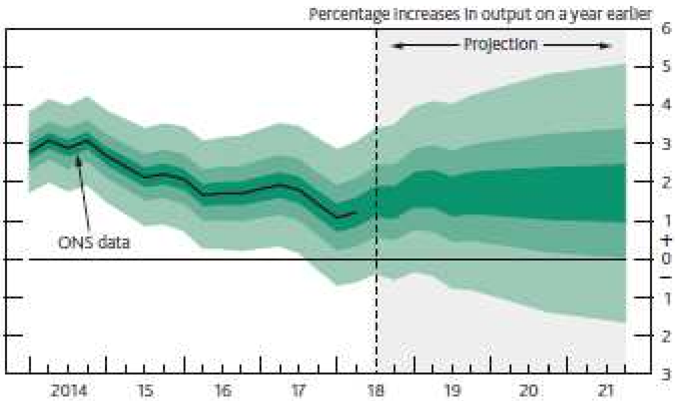
The above are also of relevance when evaluating the robustness of the budget and the subsequent analysis includes comments on these issues.

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; the outlook will depend significantly on the nature of EU withdrawal. The outlook for inflation is above the 2% target set for the Bank of England. The Bank of England's November 2018 inflation forecast (CPI) is shown below:

Chart 5.1 GDP 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 2020. The budget assumes that fuel, utility and business rates will increase, no other specific allowances have been built into the budget for non-pay price inflation. Pay budgets include 2% pay inflation in the year. 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 2019/20 will have to be funded from reserves. In most cases, Budget Managers absorb non-pay 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. Any further across the board pay inflation above the 2% allowed for in the 2019-20 budget would increase the pay

bill by c. £500k for each additional 1% of pay costs. The representatives for the employers and employees on the National Joint Council are currently negotiating fire service pay rates. In this context the FBU have recently lodged a pay claim of 17%. Any pay increases above 2% would need to be funded by a further call on reserves in 2019-20 and increase savings required beyond March 2020.

11. 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 the nature of EU withdrawal and associated future trading conditions will flow through to the prices of goods purchased by the Authority. An overall 4% increase in such costs could add £640k 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 2019/20.

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. A plan for the disposal of surplus day-crewed housing stock will be put forward during the early summer of 2019. No other material capital receipts are expected in 2019-20.

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. Whole-time Duty System Firefighter Numbers

16. The budget makes provision for an average of 666 whole-time firefighters in 2019/20. 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 2019/20 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 £0.6m 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, 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 ongoing firefighter pay negotiations. There is potential for these to result in industrial 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.

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. At 31 March 2018, the Authority had £27.0m of long-term debt to fund capital expenditure and a further £0.1m of finance lease obligations. The affordability of the capital programme will be a key factor for the Authority over the next few years. Only if the overall capital programme can deliver financial benefits to offset the additional revenue burden of its financing costs will projects be initiated. The revenue impact of the planned spend for 2019-20 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 31 March 2019, the cash balance is projected to be £8.1m. There is potential for the Authorities cash balances to become depleted because of ongoing needs to use reserves to balance the budget. This will need to be considered as the Authority prepares its medium term plan 2020 to 2024. In addition, the budget is prepared on the basis that a plan is prepared to balance the budget without the use of reserves by the 2021-22 financial year.

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 independent internal audit report published in February 2018 confirmed that the Fire Authority could 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 £250k. 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.
National changes in employer contribution rates for firefighters pension schemes are due to come into effect from April 2019. Following a revaluation of Firefighters, pension schemes the national average increase is material at 12.6% of pensionable

pay.
This would equate to an additional cost burden to the Authority of c. £3.3m pa, this is not allowed for in the draft budget as government has indicated that for 2019-20 this additional cost burden 88% funded" by a separate grant.
Provision has been made in the 2019-20 for the additional cost burden of £0.3m to be borne by the Authority.

From 2020-21 it is expected this will be allowed for in the funding settlement although the methodology and transparency of this has not yet been announced.

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 2019-20 budget and these rates will be fixed until March 2020.

RESERVES

33. At 31 March 2018, the Authority had £20.4m of usable reserves. This is made up of earmarked reserves (£5.8m), capital receipts reserve (£7.8m) and general reserve (£6.8m). A re-allocation of earmarked reserves forms part of the 2019-20 budget process.
Although useable reserves were £20.4m at 31st March 2018 the cash balances of the Authority were £10.1m at 31st March 2018. One of the main reasons for this is that cash balances have been used to settle outstanding long term PWLB loans of £11.5m since 2013 with no new loans taken out since 2010.

EARMARKED RESERVES

34. The Authority has established specific reserves to manage key financial risks and provide funding for specific projects. Movements between these specific reserves are determined by the Treasurer and require approval from the Commissioner. The table below considers the specific reserves planned and the timetable for their review:

Useable Reserves Summary	Comment & Review	March 2018 Balance £'000s	Change in 2018/19 £'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	469	(469)	0
On-Call Demand Pressures	Main area of risk is retained pay budget. Need to provide £0.6m in case of in-year pressure	600	0	600
On-Call - Support	To support one off costs associated with on-call recrutment and retetention initiatives	0	400	400
Operational Training Reserve	To support one off costs associated with new operational training initiatives in 2019-20	0	600	600
Spend to Save Reserve	March 2019 - Balance of Funding for Sprinklers £372K, and Innovation 560k.	932	0	932
Taxbase and Collection Account Reserve	Last shortfall in 2012/13. Since then average of over £500k favourable balance. Review scheduled 2020-21	200	0	200
National Non-Domestic Rates Collection Reserve	Risk remains through pooling arrangements, but considered low. Managed in-year. Review Scheduled 2020-21	200	0	200
Innovation and Transformation	To support service transformation in line with new Integrated Risk Management Plan requirements	2,400	(440)	1,960
Rolling Budgets Reserve	To hold balances of expenditure carried forward into the next financial year.	410	(410)	0
Business Continuity Reserve	To provide funds for any business interruption event not covered through risk protection funding. Reduced to reflect participation in FRIC	300	(150)	150
Risk Protection	Expected limit of calls from FRIC. Review scheduled 2020-21	250		250
Total Earmarked Reserves		**5,761**	**(469)**	**5,292**
General Reserve		**6,823**	**0**	**6,823**
Capital Receipts Reserve	**Receipts from the sale of capital assets (property and vehicles). £2,569k used to balance 2018/19 budget.**	**7,790**	**(987)**	**6,803**
Total Usuable Reserves	**Balance per Year End Accounts**	**20,374**	**(1,456)**	**18,918**

35. *The table above assumes that the forecast budget deficit of £987k in 2018-19 will be funded by a reduction in the capital receipts reserve. In addition, a number of earmarked reserves have been reallocated. These changes will require the approval of the Police, Fire and Crime Commissioner and agreement with our auditors.*

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

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 2018/19	0.2%	0.5%

Factor	Comment	Lower Limit	Upper Limit
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 expected total usable reserves available in 2019/20 of £18.9m; 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 2019-20. As the Authority is required to balance its budget, it is recommended that the Commissioner instruct the Chief Executive/Chief Fire Officer to prepare a plan to achieve a balanced budget, without using reserves by the 2021-22 financial year. This will ensure that the Authority remains financially sustainable in the medium term.

G McGuinness
Acting Chief Finance Officer