Section 25 Report from the Chief Financial Officer

Section 25 of the Local Government Act 2003 requires the Chief Financial Officer to report to the Authority when setting its council tax on:

- the robustness of the estimates included in the budget, and
- the adequacy of the financial reserves in the budget.

The Authority is required to have regard to this report in approving the budget and council tax. Section 25 concentrates primarily on the risk, uncertainty and robustness of the budget for the next financial year rather than the greater uncertainties in future years. Given the significance of the funding reductions announced to the end of the decade and the uncertainty surrounding the outcome of the next Comprehensive Spending Review (CSR), this report considers not only the short term position but also the position beyond 2020 in the context of the Authority's Medium Term Financial Plan (MTFP).

Robustness of Estimates in the Budget

The budget setting process within the Authority has been operating effectively for many years and is based on increasing the budgets each year allowing for pay and price inflation and other marginal base changes in the cost or levels of service. Each year a zero based budgeting exercise is also carried out to review whether or not there are elements of the budget that do not reflect the current activity or need. In more recent years adjustments have also been made to the budgets to reflect the savings that have been implemented in order to balance the budget in the face of Government grant reductions.

Appropriate provisions for pay and price inflation are included within each successive MTFP and these are then refined by the Chief Financial Officer in rolling forward the detailed budget for the next financial year.

In general terms, the forecasting for the MTFP is undertaken on a very prudent basis, particularly in respect of allowances for pay and price inflation and increases in the council tax base and business rate income.

Growth pressures are considered corporately and agreed by the Authority and are factored in to future budgets on a recurring basis. In the main, these growth pressures have been absorbed within the bottom line of the budget without the need to increase future years savings targets, this is as a result of the prudent approach to forecasting.

Budget management within the Authority remains strong as demonstrated by the outturn position each year since funding reductions began and as reflected in the annual opinion of the External Auditors who has given an unqualified opinion on the annual accounts and in securing value for money / financial resilience.

As Chief Financial Officer for the Authority I have a close involvement with the budget setting process and I am content that the estimates are robust based on the knowledge we have available to us at this time.

Risks in the Budget 2019/20

In some respects, the significant changes to local government finance since 2010 have changed the profile of risk faced by most public sector organisations. In reality, the biggest financial risks now relate purely to reductions in government funding and government policy. As a Fire and Rescue Authority we do not face demand pressures in the same way as those with social care responsibilities and therefore key cost risks tend to be around pay and price inflation and the impact of pensions. These items together with other traditional risks are outlined below:

a) **Government Funding and Policy** – The MTFP includes the announced reductions in government grant over the current CSR period and plans are in place to deliver a balanced budget by 2019/20 based on the phase 2 and 3 savings programmes that were put in place.

   Following acceptance by the then Department for Communities and Local Government (DCLG) of the Authority's Efficiency Plan for the period to 2019/20, the expectation was for minimal change for 2019/20 when the Provisional Local Government Finance Settlement was announced in December; which was the case for general grant income, although there was some additional one off grant provided through the redistribution of the business rate levy.

   Other significant changes to funding or policy during the year would have to be covered by contingencies or general balances, but generally once grant levels have been set in the final settlement due in January they do not change.

b) **Council Tax** – The Government have increased the limit for the core council tax to 3% in 2018/19 and 2019/20 (increased from 2%) without the need to hold a referendum. Increases in council tax form a key part of closing the predicted budget deficits over time and this report therefore recommends that an increase of 2.99% is applied in 2019/20 in line with the assumptions in the MTFP, particularly given the uncertainty of the funding position post 2019/20.

c) **Pay and Price Risk** – The MTFP contained provision of 2.5% per annum for increases in fire fighter pay. Recent awards have been less than this provision and are reflected in the detailed budgets set out in this report. National policy changes on the role of the fire fighter will be something to consider in future MTFP updates.

   The impact of price inflation has been considered in setting the budget and it would take a major departure from the Authority's assumptions to create a financial problem that we could not deal with.

d) **Employers Pension Risk** – Changes to the actuarial assumptions applied by the Government Actuary Department resulted in significant increases to employers pension contributions for 2019/20, which were not budgeted for within the MTFP.

   The Government has now announced that it will meet the increased costs through a one off grant in 2019/20 which completely mitigates this risk for the Authority. However, the future funding position will not be decided until the next Spending Review is completed and this therefore remains a significant risk to the Authority going forward.

e) **Treasury Risk** – The Authority has limited exposure to interest rate risk as most long term borrowing is undertaken on a fixed rate. At the present time we are not undertaking any new long term borrowing as the capital programme does not require it. However, if the Authority were to approve future investment for the Station Investment Programme, this is likely to require significant prudential borrowing and decisions on when best to take out this borrowing would need to be considered.

On the investments side, the Authority has a very prudent approach to forecasting its investment returns and they also represent a very small part of the overall funding for the budget. The investment strategy protects capital ahead of yield and even some of the medium term investments are in products that should return a stable income yield each year.

The Adequacy of Reserves

The Authority's policy on general balances is to hold a minimum prudent level which is currently set at £2.5m. This was increased significantly at the beginning of the period of austerity to reflect the potential volatility caused by grant reductions and the need to implement savings programmes. The projected level of general fund balances will be 3.65% of net expenditure at the beginning of 2019/20. It is worth noting that the Authority has never needed to dip into its general fund balance.

The Authority has two key earmarked reserves that it uses to effectively manage its medium term financial position. The Capital Payments Reserve receives contributions each year and is the major source of funding for the capital programme. The balance on the account mainly reflects the timing differences between planning for capital spend and the profile of capital spend which can be over several years for major projects.

The Transformation Reserve receives regular one off contributions from underspends in the year and is used to pay for transformational change that achieves further savings. Significant resources have been channelled into the Service Delivery Re-Design project but this was to achieve ongoing savings of over £4m a year, which represents an excellent return on investment.

As grant reductions and savings programmes impact on the level of budgets, the ability to make contributions to the Transformation Reserve will be restricted and to mitigate this, the MTFP includes a recurring contribution to the Reserve each year that increases over time, and should therefore provide sufficient funding for future change programmes.

The Authority does however need to be cognisant of the rate of spend on transformation programmes and the extent to which these could be resourced by existing capacity rather than through additional new spending.

Budget 2019/20 – Conclusion

Given the details outlined above, provided that the Authority considers the above factors and accepts the budget recommendations, including the level of earmarked reserves and balances, a positive opinion can be given under Section 25 on the robustness of the estimates and level of reserves for 2019/20.

The Position Beyond 2020

The latest MTFP was approved by the Authority in September last year and considered a planning horizon to 2021/22. The next CSR is due to take place this year and will set the framework for public spending over the next four years.

Local government and Fire Authority finances will be impacted over this period not only as a result of the total amount of funding that will be made available but also as a result of the Fair Funding Review and the extension of Business Rate Retention, on which consultation papers were published in December last year as part of the provisional settlement.

In keeping with its previous planning cycle, the Authority has identified a budget gap of £4m that must be closed by 2021/22 and key to the planning for this will be the review of the Integrated Risk Management Plan due to be reviewed and updated this year.

In addition to the general uncertainty around the funding of public services, there are two further items that could impact on the Authority over the medium term. Firstly, the increase in employers pension contributions, which without separate recurring funding from the Government will place a very heavy burden on all Fire Services from 2021/22 onwards and secondly, but more locally, the decision of both Authorities to move ahead with the submission of a business plan to the Secretary of State for a new Combined Fire Authority will clearly impact the financial landscape going forward.

At this stage however, in the absence of the outcome of the CSR and other changes to the local government finance regime, the Authority must focus on planning for the next major savings programme and I believe it is well placed to do that underpinned by the reserves that are already in place.

Rob Carr

Chief Financial Officer

25 January 2019