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 continued lack of a multi-year settlement, this report considers not only the short term position but also the position beyond 2023/24.

Robustness of Estimates in the Budget

The budget setting process within the Fire Authority has been operating effectively for many years and is based on incremental changes to the budgets each year allowing for pay and price inflation and other marginal base changes in the cost or levels of service. For the 2023/24 process, necessary increases to budgets resulting from delivery pressures were identified and robustly challenged by the Executive Group, before being presented to the Fire Authority for initial approval. These pressures are a mixture of strengthening resources in key areas and ensuring that reserve contributions are sufficient to allow for the timely refresh of assets.

The Executive Group also considered the ability of the service to deliver efficiencies, to manage the budget gap and ensure value for money in service delivery. The first phase of a two year efficiency programme is on course to deliver in 2022/23, with plans well developed to deliver the second phase during 2023/24, mainly from additional income and savings on non-pay spend.

The trend for increased inflation rates seen during budget setting for 2022/23 continued throughout the year, with some categories of spend such as energy costs increasing at unprecedented levels. It has been necessary to “bake in” these price rises to the budget as well as make assumptions about future inflation running at higher levels than we have become accustomed to in recent years. In addition, a general contingency has been included as a prudent measure given the high levels of economic uncertainty.

The final sign off of the 2021/22 accounts is expected imminently. The accounts process has been subject to delay, mainly as a result of issues with asset valuations. An unqualified opinion is expected.

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

Risks in the Budget 2023/24

The most significant financial risks to the Authority relate to the uncertainty of the medium term position and specifically to the risk that Government funding may reduce, and that pay and price inflation may outstrip the Authority's resources.

a) **Government Funding and Policy.** The provisional local government settlement was announced in December 2022. In recognition of the challenging financial position, the settlement included rises in grant income in line with inflation. Therefore, the position is better than forecast in the December Budget Update report.

   The settlement did not contain any information on Home Office grants, which tend to be announced after the budget has been set. Any reductions in these grants would need to be managed from contingencies or reserve balances. Apart from the uncertainty around Home Office grants, no further in-year grant changes are anticipated.

b) Council Tax. In recognition of the challenging economic climate, the Government has granted additional flexibilities to allow Fire Authorities to increase council tax by £5 (6.63%) for a Band D property. Alongside the inflationary grant increases and the services own efficiency measures, this increase allows the service to largely close the significant budget gap forecast in the Budget Update report. In addition, it allows the service to make a strategic investment in the on-call workforce, addressing the reality of steadily declining on-call availability.

   Were the opportunity to raise Council Tax by £5 not taken, the strategic investment in our on-call workforce would not be possible. In addition, there would be a significant budget gap in 2023/24 year, which would increase in future years of the Medium Term Financial Plan. The gap would exhaust the Budget Equalisation Reserve and would mean that contributions to committed reserves would need to be diverted in the short term to close the gap. It would be necessary to use reserves to close the gap in 2023/24 while options for savings, including service reductions, were explored.

c) **Pay and Price Risk.** This risk was moved on to the organisational risk register during the past financial year, reflecting the increasing challenge of pay and price inflation. Reasonable allowances for inflation have been built into the budget, plus one-off resources have been used to strengthen risk reserves as set out in the Reserves Strategy. The grey book pay increase from July 2022 is yet to be resolved although a new two year pay offer was made late in the budget setting process. Increases in line with the latest NJC offer have been built into the budget. Should the eventual staff or firefighter pay award be greater than the current offer, it will be necessary to use risk reserves to finance the award in the year. Similarly, were price inflation to exceed the allowances made in the budget, risk reserves would be used to address this.

In light of these mitigations, it would take a major departure from the Authority's assumptions to create a financial problem that we could not deal with in year.

d) **Treasury Risk.** The Authority has limited exposure to interest rate risk as most long term borrowing is undertaken on a fixed rate basis. As a result of the significant prudential borrowing required for the Station Investment Programme, the Authority will need to start borrowing externally. Decisions on when best to take out this borrowing will need to be considered to limit the ongoing revenue liabilities that this will create.

Rising interest rates have prompted a review of schemes within the Station Investment Programme and a revised plan was presented to the Authority in December 2022. This plan means that improvements will be delivered to a larger number of stations and the plan remains affordable, even with higher interest rates. Sufficient allowances for the costs of this additional borrowing have been built into the budget for the coming year. In addition, a specific reserve to mitigate financial risks to the capital programme has been created.

On the investment 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 most of the medium term investments are in projects that should return a stable income yield each year.

e) **Economic outlook.** Although the specific financial risk presented by the Covid-19 pandemic has passed, the longer term impacts of the pandemic on the economy as well as the war in Ukraine mean a challenging national economic outlook. In addition to pay, price and interest rate risks outlined above, a recession is likely to have a negative impact on council tax and business rate income to the Authority, as well as on overall Government tax yield. Although this is not likely to present a significant risk in year, it is an area of increasing concern for future years.

<u>The Adequacy of Reserves</u>

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 2.7% of net expenditure at the beginning of 2023/24 and it is considered that this remains a comfortable level. It is worth noting that the authority has never needed to dip into its general fund balance.

In line with its Asset Management Policy, the Authority continues to make annual contributions to earmarked reserves for investment in capital assets and for the refresh of ICT and operational assets. The balance on these earmarked reserves remains high, although progress on the capital programme means that balances have reduced considerably this financial year. These reserves are essential in ensuring that the Authority is able to invest in assets to ensure that its estate, equipment and vehicles are of a reasonable standard and that the Authority is not creating an unsustainable burden of asset replacement for future years. Due to the significant impact of inflation, it has been necessary to inflate the contributions to these reserves to ensure that funding for asset replacement is sustainable.

The uncertain economic position means that prudent measures have been taken in respect of risk reserves. The first has been to re-designate the Grant Equalisation Reserve as a Budget Equalisation Reserve to broaden the use to include responding to budget shortfalls resulting from pay and price inflation. The implications of the late firefighter pay award mean that it has been necessary to balance the budget from the BER this year. The use of this reserve to balance the budget reduces a mitigation to financial risks. Should the latest offer be accepted however, the risk of unplanned pay inflation is reduced considerably for 2023/24.

In addition, a Capital and Investment Risk Reserve has been created from one-off resources. This reserve mitigates risks to the capital programme from increases in prices or interest rates.

Although the total balances of these risk reserves are relatively modest, they strengthen the Authority’s ability to withstand financial shocks. Should the Authority face financial issues greater than can be managed from these reserves, it would be possible to reduce revenue contributions to earmarked reserves while plans were developed to address budget gaps as a last resort.

Budget 2022/23 – Conclusion

Provided that the Authority considers the above factors and accepts the budget recommendations, especially the recommendation to increase Council Tax by the proposed maximum allowable amount, a positive opinion can be given under Section 25 on the robustness of the estimates in the budget and level of reserves for 2023/24.

The Position Beyond 2023/24

Given the announcement of a further one-year spending round for 2023/24 the Authority is still in the position of not knowing what its financial prospects are beyond a one-year planning horizon.

There are a number of initiatives that may impact significantly on the Authority's finances, such as the proposed Fair Funding Review or any changes to Business Rates. Inflation and the impact of a recession on the service and the wider economy are significant unknowns.

The service continues to plan for and deliver cashable efficiencies and efficiencies for reinvestment as set out in the Efficiency Plan. These are necessary for ensuring the medium term sustainability and value for money of the service.

Whilst there are risks within the Medium Term Financial Plan these have been mitigated as far as possible and it would take a significant change in the funding regime to create a scenario which the Authority could not cope with.

Catherine Edgecombe
Chief Financial Officer
10 February 2023