

**Hampshire Fire and Rescue Service**

**Finance and General Purposes Committee**

**Item 6**

**6 November 2014**

**Financial Update Paper**

**Report by Head of Finance**

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## **1. Introduction**

- 1.1. This report combines two financial papers which were previous separate agenda items, Budget monitoring quarter 2 and the medium term financial strategy update. It also provides information to the Committee on the following areas of financial interest;
  - Budget setting for 2015/16
  - Update on injury pensions
- 1.2. Overall the Authority continues to perform well financially. The Authority is still on target to meet all phase 1 efficiencies and there continues to be savings made during the year on top of these, which can be used to fund service improvements in the short term in line with the previously agreed strategy.
- 1.3. Measures to close the deficit in 2015/16 have been identified, meaning there should be no requirement to consider using reserves temporarily to bridge the gap in 2015/16. The predicted budget deficit by 2017/18 still however remains at £12m.
- 1.4. Following national publicity, a recent issue relating to injury pensions has been uncovered within HFRA and this report provides the background and impact of this on the Authority.

## **2. Recommendations**

- 2.1. That the position relating to injury pensions and the amount which the Authority will be required to return to the DCLG is noted as explained in section 3.
- 2.2. That the measures for meeting the 2015/16 budget deficit and the assumptions from which to begin preparing the 2015/16 budget are agreed, as set out in Section 5
- 2.3. That the Finance and General Purposes Committee **RECOMMENDS** to the Full Authority:
  - A) That the Authority notes the latest financial position for 2014/15 as set out in Appendix A.
  - B) That the Authority notes the changes to the profiled spending on the capital programme as set out in Appendix C.
  - C) That the Authority notes the mid year Treasury Management position, and agrees to increase the prudential indicator limit for the exposure of investments variable interest rates to £45m, as set out in Appendix D

### **3. Pension Liabilities**

- 3.1. In 2006, a new national pension fund was introduced for fire fighters, which involved new accounting arrangements for dealing with normal pensions compared to injury pensions. Under the new scheme, normal pensions were funded by the national scheme, but some other pensions as detailed below were required to be charged to an authorities own revenue account. These were as follows:
- All ill health lump sums spread over three years.
  - Ill health pensions for existing Retained Duty Service (RDS) pensioners or RDS firefighters who were not a member of the pension scheme (new entrant RDS or existing RDS firefighters who joined the 2006 scheme would have ill health pensions funded from the pensions account).
  - All injury awards and awards payable on the death of a firefighter. This was only the injury element, not the whole pension.
  - All continuing payments in respect of previous injury awards.
- 3.2. Following national reporting that many Fire and Rescue Authorities have been incorrectly accounting for injury pensions and further guidance issued by DCLG, extensive work has been undertaken within Hampshire Fire and Rescue Authority (HFRA) to identify whether any similar problems exist.
- 3.3. Initial investigations confirmed that current processes for administering, processing and coding of injury pensions was in line with the national guidance and that following the national changes to pension arrangements in 2006 all new injury pension awards since that date had been treated correctly.
- 3.4. However, further analysis comparing past injury pension awards against the detailed financial transactions has uncovered a total of 14 injury pensions granted prior to 2006 that were historically miscoded as normal pension payments instead of injury pensions.
- 3.5. Further work has also been carried out to check the arrangements for all of the payment types outlined in paragraph 3.1. For the majority of items, no further errors have been uncovered. However, for death in service payments there are a number of payments which we believe have been treated in error, but the regulations and guidance around these is somewhat complex and not as clear as we would have liked.
- 3.6. For the purposes of the 2013/14 accounts, it has been assumed that these payments are in error and the accounts have been restated on that basis and are submitted for approval by Standards and Governance Committee on 31<sup>st</sup> October. We will however pursue the legal issues around these payments with DCLG, which may lead to a reimbursement at a later date.

#### **Financial Impact**

- 3.7. In respect of the injury pension coding errors prior to 2006, this miscoding was not an issue as all costs were met by the Authority and were funded in part from general formula grant. Post 2006, normal pensions were funded by the new national pension scheme and certain ill health and injury pensions were required to be charged to the Authorities revenue account.
- 3.8. The total error for injury pensions from 2006/07 to 2013/14 amounts to £1.326m and there is an ongoing liability of around £175,000 that will need to be met from the revenue account. For the death in service payments, the one off cost is £159,000, with an ongoing liability of £40,000 per annum.

## **Recovery Arrangements**

- 3.9. It is not yet clear what the arrangements are for the potential recovery of this money by DCLG as in effect the national Fire Fighters pension fund has funded these amounts in error. It is almost certain, however, that these amounts will be payable to DCLG.
- 3.10. From an accounting point of view, External Audit have required restatement of the 2011/12 opening balance sheet and the 2012/13 & 2013/14 accounts to show the effect of over claiming this money since 2006. Due to the late identification of the errors, this means that there will be a late submission and audit opinion on the Authority's final accounts for 2013/14.
- 3.11. So far, 10 authorities have identified errors of this type in their accounts and a meeting is planned with the DCLG and those Fire and Rescue Authorities that are impacted to discuss what the next steps will be in dealing with this issue. Having identified a similar problem, DCLG will be notified and HFRA will seek to be represented at that meeting.

## **Medium Term Financial Impact**

- 3.12. On the assumption that the Authority will have to repay these amounts in full, there is a potential total one off cost of £1.485m and an ongoing liability of around £215,000 per annum.
- 3.13. This will not impact on the Authority's Medium Term Financial Strategy, since the one off cost can be met from within predicted savings already identified in the current financial year (the Heads of Service Team (HoST) savings built into the original budget and savings in contingencies, both this year and on an on going basis), it will not therefore impact on the existing reserves position overall.
- 3.14. However, the reserves position in the statement of accounts will need to be adjusted to reflect the fact the money would not have been in our reserves if it had not been over claimed in error. The ongoing liability can be met from recurring savings arising from lower inflation and pay awards already identified in the current financial year.

## **4. Budget Monitoring Quarter 2**

### **4.1. Revenue Expenditure**

- 4.1.1. The position as at August 2014 is shown at Appendix A.
- 4.1.2. The new budget forecasting system (Budgeting, Planning and Consolidation) is not fully working yet so a spreadsheet based approach has been taken to calculate the projected outturn. This is a relatively simple approach based on last year's profile spend and has been sense checked against last year's outturn position.
- 4.1.3. The position in the table below is shown after a transfer has been made from existing HoST budgets to the service improvement budget of £691,000. The main variations can be summarised as follows:

	Adjusted Approved Budget £'000	Projected outturn Q2 £'000	Forecast variance £'000	Variance %
Community Response	41,714	41,644	-70	-0.2
Community Safety	4,846	4,546	-300	-6.2
Management and support services	15,581	14,491	-1,090	-7.1
Contingency	2,274	1,992	-282	-12.4
Other	1,463	1,463	0	0
Total budget / projected outturn	65,878	64,136	-1,742	-2.6

#### **Community response (Under spend of £70,000, -1.4%)**

- 4.1.4. The wholetime firefighters pay budget is forecast to overspend mainly due to providing cover for firefighters on long term ill health. This is more than offset by lower than expected retained firefighters pay and savings in non pay budgets such as hydrant maintenance, staff car allowances and leased car business rentals, and water charges.

#### **Community Safety (Under spend of £300,000, -6.2%)**

- 4.1.5. The underspend is mainly due to wholetime firefighter vacancies. In addition there are savings in staff car allowances and leased car business rentals.

#### **Management and support services (Under spend of £1,090,000, -7.1%)**

- 4.1.6. The main reason for the underspend is support staff vacancies. Due to the recruitment freeze and the planned Professional Services Redesign a number of vacant posts have been filled with temporary agency staff, however over 20 posts remain vacant.
- 4.1.7. Insurance premiums are also lower than budgeted reflecting last year's outturn position. Similar to other directorates, staff car allowances are forecast to underspend. These savings are partly offset by increased costs in workshop spares and consumables.
- 4.1.8. Income is also forecast to increase, mainly due to fleet income from partners, such as Royal Berkshire Fire and Rescue Service, South Central Ambulance Service and fitting out new appliances and vehicles in the capital programme.

#### **Contingency (Under spend of £282,000)**

- 4.1.9. The grey book pay award from 1 July 2014 has been settled at 1%. This is 1% less than budgeted, saving £282,000 this financial year and £376,000 in a full year.
- 4.1.10. It is anticipated that the saving in the current year, together with the HoST savings already in the budget will be used to fund the one off cost of the pension

liabilities detailed above. The ongoing liability of £215,000 can be met from the full year savings.

**Service Improvement budget**

- 4.1.11. The unspent balance from 2013/14 of £1,021,000 has been carried forward, of which £416,000 had already been committed for 2014/15, leaving a net balance of £605,000 available in 2014/15. In addition £691,000 has already been transferred from existing budgets making a total of £1,296,000 available this year.
- 4.1.12. New investments agreed in quarter one total £411,000 leaving £885,000 available at the beginning of quarter 2. In this quarter £589,000 of new investments have been identified as listed below:

	2014/15	
	£'000	£'000
Uncommitted balance available from 2013/14		605
Increased funding from existing budgets		691
Balance available for 2014/15		1,296
Less investments agreed in quarter 1		-411
<b>Balance available for quarter 2</b>		<b>885</b>
<b>New investments this quarter:</b>		
Pathway 2020 Communications Executive 12 months	-33	
Database Administrator for 12 months	-38	
Replacement of gym equipment	-95	
Extend temporary contracts for BI developers for 6 months	-40	
Maternity pay – central budget	-50	
Extend temp contract for PA secretary until PS review	-26	
RDS briefings re Risk Review / Joint Working / PSR	-20	
Service Conference - RDS / WDS claims	-7	
Extend funding for Project management office until PS review	-60	
Deferred deletion of Staff Review posts due to delays with FireWatch	-82	
Tom Toms for 90 vehicles	-93	
NFCSP interface developments	-45	
<b>Total new projects this quarter</b>		<b>-589</b>
<b>Balance available</b>		<b>296</b>

4.1.13. The balance available for further investment is £296,000.

4.1.14. Expenditure against the service improvement provision will only be undertaken on approval of a viable business case. All items that are put forward against this budget will be approved by Heads of Service and anything in excess of £100,000 must be approved by the Finance & General Purposes Committee. Full details of how this budget is being used will be reported as part of the quarterly monitoring reports during the year.

## 4.2. Corporate efficiency savings

- 4.2.1. The latest forecast of corporate efficiency savings is shown at Appendix B. The CSR1 savings are £5.5m to date compared to a forecast £5.8m. Most of the projects are complete, however; some are not due to end until March 2015. The Network Fire Control Strategic Project (NFCSP) has been delayed until January 2015 resulting in reduced savings in 2014/15 but still on target for 2015/16 onwards.
- 4.2.2. Similarly selective paging is not expected to deliver any savings this year due to the delays in the NFCSP. Staff Review is on target subject to the successful implementation of Firewatch and NFCSP when 4 administrator and control posts will be deleted.
- 4.2.3. The savings from the carbon management (energy efficiency programme) appear to be less than expected due to the overspend in energy bills in 2013/14. An analysis of the use of energy is currently being undertaken to establish whether this is correct or if there are other factors contributing to the overspend.

## 4.3. Reserves

- 4.3.1. The balance of reserves at the end of the year (before any in year underspend has been added) is forecast to be £24.5m. The details of which are set out in the table below:
- 4.3.2. A row has been inserted to show the adjusted opening balance of reserves in line with what the expected restated figures in the accounts will be once the repayment of the over claimed injury pensions as explained in section 3 has been made.

	Balance as at 31/03/2014 £000's	Contribution to the reserve £000's	Contribution from the reserve £000's	Estimated balance as at 31/03/2015 £000's
Capital payments reserve	-18,333		200	-18,133
Improvement & Sustainability reserve	-4,006		3,231	-775
Grant equalisation reserve	-2,105		200	-1,905
Designated underspend reserve	-743		743	0
Revenue grants unapplied reserve	-1,470		849	-621
Capital receipts reserve	-1,118	-3,007	2,096	-2,029
Capital grants unapplied reserve	-424		424	0
General fund	-2,500			-2,500
Repayment of incorrectly reclaimed injury pensions	1,485			1,485
	-29,214	-3,007	7,743	-24,478

- 4.3.3. The use of reserves has increased this quarter compared to the budget due to £179,000 NFCSP expenditure planned for 2013/14 slipping into 2014/15, £200,000 of exit costs relating to Joint Working being met from the grant equalisation reserve, and £1,071,000 of the Investment and Sustainability reserve used for investment in renewable energy sources. The I&S reserve has also been used for the Firewatch project and a temporary Product Development manager post.

#### **4.4. Changes to Budgets Over £100,000**

- 4.4.1. Under financial regulations virements over £100,000 are required to be approved by members of this Committee. Whilst there are no formal virements to approve this quarter, the Committee is asked to note that £729,000 of staff pay costs have been transferred to supplies and services following the transfer of staff to Hampshire County Council as part of Joint Working, this is a technical adjustment.

#### **4.5. Capital Expenditure**

- 4.5.1. The updated capital programme is shown at Appendix C. There are no significant changes to the capital programme.

##### **Buildings**

- 4.5.2. On the 2012/13 programme there has been an update to the profile of expenditure on the Fire Control System project and on the new Basingstoke Fire station project. It is expected that orders will be placed for works on the new fire station in early 2015/16 subject to the outcome of the current review being undertaken. Expenditure to date has been incurred on professional fees and feasibility.
- 4.5.3. The remainder of the 2013/14 programme, with exception of the rope training facility will be completed this year. The rope training facility is now expected to be built in 2015/16.
- 4.5.4. The 2014/15 major buildings repair budget is yet been assigned to projects. It is expected this will not be assigned until the outcome of the risk review project is known and has therefore the expenditure is not likely to occur until 2015/16.
- 4.5.5. The Estates Transformation project is now included in the programme, with the HFRS spend being funded from the capital payments reserve, with a contribution from Hampshire Constabulary next year and transformation grant funding, which has now been confirmed by DCLG.

##### **Vehicles**

- 4.5.6. On the 2013/14 vehicles programme the incident command unit has further slipped into 2015/16.
- 4.5.7. On the 2014/15 vehicles programme, 2 of the frontline pumping appliances and 2 of the personnel carriers have now slipped pending the results of the risk review.

#### **4.6. 3S Fire Ltd**

- 4.6.1. The following section provides a short update on the important issues for the company, their future trading and the relevant financial information concerning the Authority.

### **Fire Industry Association EU Challenge**

- 4.6.2. The Fire Industry Association (FIA) has submitted a complaint to the European Commission Competition Directorate Director General. The specifics of the complaint are quite complex but in essence allege that the trading arms of UK Fire and Rescue Authorities are gaining benefit (State Aid) from their association with fire and rescue services. This has been termed a 'Brand' by the FIA. It is alleged in the complaint that this in turn is impacting the market thereby affecting members of their association. A number of FRAs are named in the complaint including HFRA. The Department for Local Government and Communities (DCLG) have received notification of the complaint which is directed at the UK Government (not individual FRAs) and they are required to respond to the EU in September.

There is a complex legal argument as to what constitutes a brand. This issue is being considered by CFOA and a considered collective response has been passed to DCLG. A separate response has also been passed directly to DCLG on behalf of the HFRA. The Government is responsible for responding to the EU.

### **Governance**

- 4.6.3. 3S Fire has been successfully trading for over a year and as reported at the AGM in July is gaining momentum in terms of future business activity. A review of the Service Level Agreement for support services from HFRS is now being undertaken to ensure a robust framework remains in place between the two organisations.

### **Future trading**

- 4.6.4. The 3S Fire business activity is continuing to grow steadily across their key business areas. A mix of new and repeat business is building up to provide 3S Fire with a sustainable revenue stream. This includes a blend of some long term contracts with other smaller contracts which are ensuring liquidity. 3S Fire report confidence in being able to meet the profit target that is detailed within our medium term financial plan for 2017/18 and are currently well under way to achieving this.

### **Financial information**

- 4.6.5. To date 3S Fire Ltd has drawn down £145,200 of the loan facility available.
- 4.6.6. No repayments of the loan have been made. However, the 3S Fire Board are due to consider at their next meeting whether a repayment can be made.
- 4.6.7. The company has recently obtained a credit card, which should also assist in managing their cash flow.
- 4.6.8. As the company are yet to make a profit, no dividends are payable to the Authority at the present time. A method to track contributions to overheads from each service area has been established.

## **5. Budget Setting 2015/16**

- 5.1. The medium term financial strategy paper presented at The Finance and General Purposes Committee last October predicted a £2.547m deficit in 2015/16 based on the following assumptions

- Council Tax freeze grant of 1% in 2015/16
- 2% increase in business rate income
- Pay award of 2%
- General non pay inflation of 2.2%
- £1m extra to fund the costs of allowing RDS firefighters to join the modified pension scheme

5.2. The Authority is currently on schedule to make all phase one efficiency savings predicted and the 2015/16 base position has now been re-examined. The following measures are proposed to close the 2015/16 deficit, each of which are further explained in more detail in the paragraphs below the table:

<b>Measure to close the deficit in 2015/16</b>	<b>£'000</b>
Removal of technical changes	-1,225
Funding assumption changes	-173
Increase in interest on balances held	-50
Removal of Host savings already achieved	-1,087
3S Fire Contribution to overheads	-12
<b>Total of all measures proposed to close the deficit in 2015/16</b>	<b>-2,547</b>

### **Technical changes**

5.3. In 2014/15 the Authority made a provision for inflation which consisted of;

- £277k for non pay inflation not applied to budget heads
- £752k for pay inflation to cover a maximum 2% pay increase

5.4. During 2014/15 a 1% pay award has been awarded for grey book staff and it is assumed green book will follow suit. This means £376k in the contingency will not form part of the base budget starting position for 2015/16. A decision has also be made that the £277k for non pay inflation can be removed from the starting position in 2015/16.

Other proposed inflation savings can be achieved in 2015/16 by not applying the 2.2% non pay inflation again and by reducing the pay award inflation assumption to 1.5%. In total these inflation changes would contribute £1.2 million towards the funding gap in 2015/16.

5.5. Previous proposals had recommended using these technical savings to bolster RCCO contributions. However, as it is not essential to make these increased RCCO contributions in 2015/16 it is recommended that this is postponed until 2016/17, pending the receipt of wider information on the potential impact of the savings programme.

### **Funding Assumptions**

- 5.6. Funding assumptions have been revised in light of clarifications received during the year. HFRA are now expected to see a net increase in funding of £173,000 in 2015/16 mainly resulting from the increase in the council tax base in 2014/15.

### **Interest on balances**

- 5.7. Interest on balances has been revised in light of the increase in the Authority's reserves. The impact of reducing reserves in the future should be offset by increases in the base rate during the period.

### **3S Fire Ltd contribution to overheads**

- 5.8. A draft Service Level Agreement (SLA) is currently being developed which will see 3S Fire Ltd paying a fixed £1000 per month to cover the use of office accommodation, utilities, finance staff, insurance and parking to defined levels. This will contribute a £12,000 contribution to overheads at the current level of provision in 2015/16.

### **Budget Preparation**

- 5.9. It is proposed to start detailed work on 2015/16 budget preparation based on these assumptions and a working assumption of no increase in council tax.

## **6. Medium Term Financial Strategy Update**

- 6.1. No further updates have been made to the expenditure assumptions used for the medium term projection to 2017/18. These were;
- Pay inflation of 2% per annum
  - General inflation of 2.2%, with the exception of pensions, waste, business rates and fuel
  - £1m added to revenue for the loss of the contracting out rebate on pension contributions from 2016/17 onwards
- 6.2. Government grant funding assumptions have been revised throughout 2014/15 based on the latest information available, which confirms the partial rolling up of the 2011/12 council tax freeze grant into the overall grant settlement.
- 6.3. With reference to the table in paragraph 5.2, if we assume RCCO will need to be increased in line with the technical savings that have been made this year and next from 2016/17 onwards (after allowing for the on going costs of injury pensions) then our 'base' position will remain at an estimated deficit by 2017/18 of £12m.
- 6.4. The other items in the table are in effect savings which can count against the £12m in the longer term. Depending on the decisions we make in respect of RCCO and the outcome of the RDS pension issue (which at this time the funding arrangements are still not clear) then it will be possible to make a better assessment at this point next year of the likely gap in 2016/17 that will need to be closed from other savings. This will have an impact on the required profile of savings and how quickly they need to be delivered, but does not change the basic assumption that we will need to secure £12m by the beginning of 2017/18.

## **7. Supporting our corporate aims and objectives**

- 7.1. Budget monitoring and analysis of future spending plans underpin the HFRA service plan for the medium term. Close monitoring of budgets allows money to be identified which allows the Service Plan priorities to be addressed over the coming years.

- 7.2. The Service has begun formulating proposals for phase 2 efficiency savings, building on the work to date of the Safer Stronger Board and the Budget Alignment Group to address the funding deficit predicted for 2016/17 and 2017/18.
- 7.3. The Risk Review, a fundamental examination of the way operational services are provided, is underway and has been challenged with coming up with savings proposals that will form a major element of meeting the budget deficit.

## **8. Risk analysis**

- 8.1. The Authority has an established process for planning ahead to meet financial targets. This has helped considerably in managing the reductions in Government grant as set out in this report.
- 8.2. The current savings programme has progressed according to plan but development and implementation of a new savings programme will need to be kept under review over the coming years in particular.
- 8.3. There is a real risk of a budget deficit in future years which will require reductions across the Service and increases in council tax. The Service has begun early planning to identify how a shortfall could be overcome, including examining other potential income sources. However, as a backstop position, the Authority has sufficient reserves to meet the gap thereby mitigating this risk in the short to medium term.

## **9. People impact assessment**

- 9.1. The proposals within this report are considered compatible with the provisions of the equality and human rights legislation.

## **10. Background papers**

- 10.1. The following documents disclose the facts or matters on which this report, or an important part of it, is based and has been relied upon to a material extent in the preparation of the report:

None: Note: The list excludes: (1) published works; and (2) documents that disclose exempt or confidential information defined in the Act.