Purpose: Approval

Date 5 December 2018

Title **2019/20 BUDGET UPDATE**

Report of Treasurer

EXECUTIVE SUMMARY

1. This report is to provide an update to members on the current financial position for the 2018/19 Revenue Budget and an update on the 2019/20 budget setting process.

2. An underspend of £1.6m is currently forecast for 2018/19 as detailed in paragraphs 12-15 below, although this will be impacted by further pressures within ICT as outlined in this report.

3. An assumed 2.99% increase in precept for 2019/20 would leave a shortfall of £0.7m based on the MTFP presented to the Authority in September, this report discusses the proposal to meet that gap in the short term, including reducing the RCCO for the year if necessary in line with current policy.

4. The position in respect of the change in the valuation basis for unfunded public-sector pension schemes has progressed since it was reported verbally to the Authority in September. It is now anticipated that there will be an increase in the employer's contribution rate in excess of 12%, which for Hampshire would be an increase in costs of around £3m. However, the Government has agreed that it will fund around 90% of this sum for 2019/20 only and will deal with this issue on an ongoing basis as part of the Spending Review planned for 2019. The Home Office is currently consulting on the proposed methodology for distributing this funding, but at this stage it removes the majority of this risk from the 2019/20 budget setting process.

BACKGROUND

5. The Medium Term Financial Plan was updated and reported to the Authority in September this year. The plan showed a £0.7m funding shortfall for 2019/20, which is down from the £2.2m shortfall expected within the October 2017 MTFP due to the reductions made as part of the 2018/19 budget.

6. Each October, the local precepting authorities provide an updated council tax base estimate, which is usually close to the final figure. This year the amounts provided give a 1.47% rise in the Council Tax Base, which equates to an increase in income of around £200,000 on the figure included within the September MTFP report.

7. The detailed budget setting process is currently underway, which will review all budget lines with the aim of ensuring that they are valid and accurate and will remove any excess funding that is held within departments.

8. A separate Zero Based Budgeting (ZBB) exercise has also been carried out and the results of this are included within this report. The changes identified reflect a greater attention to budget setting and monitoring across the Service in this financial year and the fact that budgets have been reviewed and challenged as part of the organisational changes being implemented this year.

9. The overall net changes from the ZBB exercise have themselves been balanced to zero, but this is an important exercise to ensure that the budgets reflect current structures and activity and will aid in budget monitoring and control during the financial year.

10. Separate to this, extensive work has been undertaken on the position of our ICT set up, following further reviews of our infrastructure and security arrangements and work undertaken by the new interim head of ICT. There are additional one off and recurring costs associated with bringing the ICT infrastructure and applications up to a standard that is fit for purpose for an emergency service and these are detailed in this report.

11. The £0.7m shortfall in the MTFP included the full level of RCCO required for funding the current capital programme. This was reduced in 2018/19 to balance the budget, which could also be done for 2019/20 in line with the existing strategy, now that the risk around the pension changes has been clarified. The actual figure will be dependent on the local government finance settlement and final figures from Districts on council tax base and the surpluses or deficits in their collection funds.

2018/19 QUARTER 2 BUDGET MONITORING

12. The table below shows the budget monitoring for 2018/19 as at 30th September 2018 and shows a net underspend of £1.6m.

	2018/19 Current Budget	2018/19 Forecast as at end Period 6	Variance Underspend / (Overspend)
Employee Costs	50,681	48,793	1,888
Premises	5,710	5,912	(202)
Transport	1,788	1,774	14
Supplies & Services	9,876	10,316	(440)
	68,055	**66,795**	**1,260**
Income	(3,965)	(4,272)	307
Specific Grant	(1,915)	(1,915)	0

Contribution from Transformation Reserve	(3,230)	(3,230)	0
	58,945	**57,378**	**1,567**
Revenue Contributions to Capital	2,339	2,339	0
Contingency	1,459	1,454	5
Interest payable / (receivable)	605	604	1
Net Cost of Service	**63,348**	**61,775**	**1,573**

13. The main points to note are:

    (a) Employee costs are forecast to be under budget by £1.95m at the end of the financial year. A large part of this underspend is due to the transition to the new operating model and the overall reduction in the number of firefighters. There are also some savings due to the staff pay award being slightly lower than budgeted.

    (b) The premises overspend is due to a combination of professional fees and business rates being higher than budgeted. These issues have already been picked up as part of the budget setting process for next year.

    (c) Supplies & Services are forecast to overspend by £157,000. This mainly relates to pressures within the Enabling area, particularly on property services and ICT. Again this report and the Zero Based Budgeting exercise addresses these issues going forward.

    (d) Third Party Payments are forecast to overspend by £284,000. This overspend primarily relates to the misallocation of grant income. The ESMCP control rooms grant was incorrectly applied to NFSP activity during 2017/18 and therefore the gross costs of this expenditure are shown in this financial year. The overall impact on our reserves position is however unaffected.

14. The current forecast is a significant underspend, which in the main, is due to the early achievement of savings as part of Service Delivery Redesign. This is very positive as it will allow a contribution to reserves at the end of 2018/19 and provides confidence for the 2019/20 financial year. However, this does not include other potential pressures on the ICT budget in 2018/19 which are discussed below.

15. Given the certainty of the underspend, it is proposed that £1.2m of the underspend be approved for transfer to the Transformation Reserve in year, rather than waiting until year end. This will be earmarked for the one off costs associated with the NFSP and Windows 10 systems upgrade detailed below, the additional one off pressures within ICT and the potential implementation costs of the CFA.

<u>RESERVE FUNDING</u>

16. Included in the MTFP for 2019/20 is a contribution of £500,000 towards equipment replacement. This was agreed as a way of planning for the replacement of significant equipment and aligns to the contributions already being made for PPE and ICT.

17. The contributions will be transferred to separate reserves, so that the funding is available as required for those purposes. To avoid delays to purchases, delegated authority is requested for use of up to £200,000 per project or procurement and internal officer sign off for expenditure will still be required. Any projects or procurements over this value would require a business case to be presented to HFRA for formal approval. This is in line with the current delegated authority for the Transformation Reserve.

NETWORKED FIRE SERVICES PARTNERSHIP (NFSP)

18. NFSP started as a collaborative project to provide a new Fire Control solution between Hampshire Fire and Rescue Service, Devon and Somerset Fire and Rescue Service, Dorset Fire and Rescue Service, Wiltshire Fire and Rescue Service. Subsequently Dorset Fire and Rescue Service and Wiltshire Fire and Rescue Service successfully merged to form a single service. The three services have procured and implemented a control system. This joint approach has formed the foundation for wider collaborative working with our NFSP partners and will see future opportunities to work together more effectively and more efficiently.

19. The NFSP system is provided under contract by Capita, utilising its' "Vision" software. Each FRS operate a control room for normal day to day business. However, these Fire Control rooms are networked, which provides necessary resilience across the NFSP area. Essentially this means that any one FRS Fire Control room can mobilise a response across all three regions.

20. The current system was implemented in 2012, with the contract period due to expire on June 2021. Part of the original business case contained an option to extend the initial contract by 4 years which was agreed meaning the contract now terminates in June 2025. This provides the maximum benefit operationally and financially to FRS of the NFSP. However, an extension will require a planned system hardware refresh, to ensure the ICT equipment is able to continue to support the software fully and enable the most effective operational system. It is anticipated that an upgrade of hardware will improve the performance of the Vision system significantly and will establish a foundation for the next phase of the Networked Fire Control system. This next phase is the operational alignment of Fire Control where further operational benefits and financial benefits will be delivered.

21. The cost of the system hardware refresh is estimated to be £303,000. Subject to agreement, these funds are planned to be provided from the Transformation Reserve from the current years underspend.

22. As explained in paragraph 16 above, from 2019/20 an operational equipment reserve will be in place. It is anticipated that any future costs for NFSP would be funded from that reserve.

FORWARD BUDGET 2019/20

23. An updated Medium Term Financial Plan (MTFP) was presented to the Authority in September 2018. This showed the Authority being in a good financial position, but with some challenges still ahead.

PRECEPT

24. In the MTFP, it was agreed that a planning assumption for a precept increase of 2.99%, the maximum allowed under the current referendum limit, would be used. This would need to be reconsidered should the referendum limit be changed, however that is not expected at this stage.

25. The total precept received is also affected by the council tax base, which is the total number of dwellings paying the precept within Hampshire. Due to on-going demands for more housing, this figure has increased year on year for many years, but the increase has varied significantly. An increase of 1.0% has been built into the MTFP, but estimates have now been received from the precepting authorities which indicate a higher increase at around 1.47%. This is still subject to confirmation, but an increase at this level would contribute around £200,000 of additional recurring income.

SERVICE DELIVERY REDESIGN (SDR)

26. The Service Delivery Redesign (SDR) programme is in its final stages of re-structuring the Service to improve both efficiency and effectiveness. This programme will deliver £4.1m of savings over 4 years, with £1m having been made for 2017/18. A further £2.3m of savings were included in the September 2018 MTFP for 2019/20, which has now been confirmed at £2.6m. The final £0.5m will be delivered in 2020/21.

ZERO BASED BUDGET

27. As part of the budget setting process, a version of zero based budgeting is being carried out across the organisation. This is a continuation of the work started during the 2018/19 budget process and will be on-going, to ensure that all budgets are as accurate and relevant as possible.

28. This process involves all budget lines being reviewed to ensure that they are valid and of an appropriate amount. This year the process has benefitted from a enhanced level of budget monitoring in the current year and from the review of budgets resulting from organisational changes being implemented this year.

29. In previous years the ZBB exercise has realised savings that have been taken into account as part of the wider balancing of the budget. For 2019/20 there is a net impact of zero mainly as a result of the correction of historic under budgeting in some areas, as outlined in the Quarter 2 monitoring above.

ICT BUDGETS

30. Members will be aware that the Service embarked on a process of ICT Transformation with a view to improving the range and deployment of technology enablers, to make it more agile to respond to the changing needs of the service and to take advantage of cloud based services which were not available through HCC as a provider. These changes also had the benefit of reducing costs, although this was only one of the drivers within the ICT Transformation Programme.

31. It has already been reported to the Authority and Standards and Governance Committee that the ICT Transformation Programme had a number of weaknesses in project management and cost control which led to a significant

overspend which was subsequently reported on and an action plan was put in place to address the identified shortcomings.

32. Since that time a new Chief of Staff and Interim Head of ICT have been appointed and were tasked with ensuring that the technical infrastructure and the arrangements for delivering ICT support to the Service were fit for purpose and secure. This necessitated some remedial action that was undertaken during the year in some areas of security and work has continued to be undertaken to consider what other changes are required to bring the service to a stable position going forward.

33. The table below sets out the estimated one off and recurring pressures that have been identified in order to stabilise the service and provide the necessary resources to support it properly in the future:

	2018/19 £	Ongoing £
Budget shortfall	174,000	174,000
Security software	115,000	55,000
Sharepoint reconfiguration	80,000	40,000
Resource investment	98,000	294,000
Interim ICT management	75,000	0
Total	**542,000**	**563,000**

34. The budget shortfall represents those areas where the current budget does not reflect the actual level of spend being incurred, either as a result of an historic position or following the changes that were made as part of the ICT Transformation Programme.

35. The security software and Sharepoint reconfiguration are items which have been identified by the Chief of Staff and Interim Head of ICT as needing to be improved or upgraded following the review that was carried out. The ongoing costs relating to licensing costs were not included within the original scope of the changes.

36. Resource investment includes additional staffing that it is felt are required to adequately support the ICT infrastructure and provide the necessary resilience for emergency service operations. Whilst a new Head of ICT has been appointed it is also felt necessary to retain the services of the Interim manager to provide a proper handover, to see through the necessary changes and to provide additional capacity in the short term to ensure that momentum is not lost on the stabilisation programme that has been put in place.

37. In terms of the one off costs, the budget shortfall and the Interim ICT management costs have already been taken into account in the net £1.6m underspend highlighted above. There is also an annual provision of £150,000 which is contributed to reserves each year following the up front payment of perpetual licenses as part of the ICT Transformation Programme and it is proposed to make this available to fund these one off and recurring costs going forward. This leaves a balance of £143,000 that needs funding in the year and it is proposed to use part of the £1.2m being set aside from the underspend to fund this expenditure.

38. The recurring costs are significant, but the aim is to find a way of meeting these without increasing the level of savings identified in the MTFP agreed in

September. The MTFP included a provision of £200,000 for ICT stabilisation, which together with the existing £150,000 provision mentioned above leaves a balance of £213,000 to fund. The increase in the income from the council tax base is expected to be in the region of £200,000 and it is therefore proposed to use this to meet the remaining recurring costs of the ICT pressures highlighted above. Final confirmation of the position will be provided when the budget is set in February next year.

WINDOWS 10 UPGRADE

39. Members may recall that additional funding of £10,000 was provided to assess the impact of upgrading to Windows 10 following the cessation of support to the current version of Windows that the Service is using.

40. Whilst this is obviously linked to ICT it is a completely separate issue that the Service needed to address irrespective of the pressures outlined in the section above. A review of the impact of the need to move to Windows 10 has been concluded and one off changes to systems of £130,000 have been identified together with other ongoing licensing and support costs of £25,000 per annum from 2019/20 onwards.

41. Approval is sought in this report to meet the one off costs from the Transformation Reserve and to build the ongoing cost into the final budget position when it is considered in February next year.

PAY INFLATION

42. An inflation rate of 2.5% has been used for both professional services colleagues and firefighters for 2019/20. The 2018 increase for green book staff was agreed at 2% and the award for Firefighters was recently agreed also at 2%, however discussions are on-going about future increases, with the Fire Brigades Union pushing hard for significantly higher increases in future years.

HM TREASURY REVIEW OF PENSIONS

43. It was reported verbally at the last Authority meeting that following an actuarial review of the Fire Fighter's Pension Scheme, indications were that there would need to be a significant increase in employer's contributions to cover increased liabilities as a result of people living longer.

44. The latest intelligence is that increases in the employer's rate will be in excess of 12%, which for HFRA would be an increase of around £3.0m against which we have just under £1m allowed for over the next 3 years.

45. The Autumn Budget that was released on 29 October gave clear indications that the increased costs to the NHS and Schools would be covered on an ongoing basis but were less clear about the impact on emergency services.

46. Since that time, the Home Office have confirmed that they will provide funding next year to meet £97m of the predicted £107m cost to Fire Services nationally, which equates to just over 90%. However, based on current predictions of employer pension costs next year it would appear that the £97m of funding would be enough to cover 100% of the additional cost.

47. The Home Office is currently consulting on options for distributing the funding which will not be confirmed until the local government finance settlement is released later in December. It is not clear whether or not the Home Office will reduce the total funding to take account of the lower cost predictions, but in any event the announcement removes the bulk of this risk for the 2019/20 budget setting process.

48. The ongoing impact however is still a major issue for all Fire and Rescue Services and will be taken into account as part of the Spending Review 2019. It will therefore be some time before we can assess the potential impact of this on our MTFP going forward.

REVENUE CONTRIBUTIONS TO CAPITAL OUTLAY (RCCO)

49. As HFRA no longer receive an annual capital grant, the majority of capital expenditure has to be funding from revenue contributions, known as RCCOs. In the October 2017 MTFP it was agreed that these contributions should be based on the calculated future requirement, rather than being ad hoc savings and underspends.

50. Due to significant budget pressures, the amount included in the 2018/19 budget for RCCO could not be increased to the full £3.9m requirement. In the September 2018 MTFP £3.9m has been included for 2019/20 and it is expected that will be possible within the budget envelope. This would help to build up a good capital reserve but could be used for other purposes if required in the short term.

51. However, should a balanced budget not be possible with the current plans, it is proposed that the RCCO be reduced to remove any deficit for 2019/20. This would be a temporary measure until further savings from SDR and other areas can be implemented in future years, at which point the RCCO would be increased back to the planned level.

52. In the event that HFRA were required to meet the full increased costs of employers pension contributions beyond 2019/20, it would be necessary to remove the majority of this provision in order to balance the budget in the short term, whilst long term savings plans can be put in place to cover the additional cost. Although HFRA is in a fortunate position to be able to deal with the problem in this way this will have implications on meeting future liabilities.

53. Decisions on funding associated with the pension changes and the Fair Funding Review and 100% Business Rate Retention will not be known until we have the outcome of the 2019 Spending Review. In reality we will not know what our future grant position will be until around December 2019 and it is therefore proposed that we would delay the next update of the MTFP until after this date.

TREASURY MANAGEMENT

54. The mid-year Treasury Management Report is attached at Appendix A. It provides an update of the Authorities treasury activities, its return on investment and prudential indicators as at 30th September 2018.

SUPPORTING OUR SERVICE PLAN AND PRIORITIES

55. Ensuring that funding is appropriately accounted for is vital for all public-sector organisations. Good budget management in the past has allowed underspends to be achieved, which will help to fund the Service priorities and enable key changes required to make the budget reductions at the same time as service improvements.

CONSULTATION

56. The Authority undertook a major consultation process during 2015 that sought residents and stakeholders' views about the proposed changes arising from the Risk Review as well as other issues around budgets and council tax levels. The most relevant point to note for this report is that the majority of respondents were happy to see a rise in council tax in order to protect services provided by the Authority.

57. Further consultation is expected to take place with business and Unions as part of the budget setting process for 2019/20.

RESOURCE IMPLICATIONS

58. There are no direct resourcing implications resulting from this report.

LEGAL IMPLICATIONS

59. The proposals within this report are considered compatible with the provisions of the equality and human rights legislation and do not change any policies.

PEOPLE IMPACT ASSESSMENT

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

OPTIONS

61. There are no options for consideration within this report, although budget setting and forecasting by its very nature means that assumptions are made around several variables that can be changed over time.

RISK ANALYSIS

62. 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.

63. 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 year and will be aligned with the review of the Integrated Risk Management Plan due to take place next year.

64. There continues to be 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 significant contributions to reserves to meet the gap thereby mitigating this risk.

65. The potential impact of increasing employers pension contributions is a significant risk to the sound financial management of the Authority going forward, but the immediate risk for 2019/20 has largely been mitigated by additional Government funding.

CONCLUSION

66. It is recommended that the Authority approve the assumptions made within this report, which will be used as the basis for 2019/20 budget setting.

RECOMMENDATIONS

67. That the RCCO be reduced in order to balance the budget, after all other savings and adjustments have been taken into account, if necessary.
68. That the Authority notes the significant risk in respect of employers pension contributions beyond 2019/20.
69. That £1.2m of the 2018/19 underspend be transferred to the Transformation Reserve and used to fund the items highlighted in paragraph 15
70. That delegated authority be given to the Chief Fire Officer to approve the use of all specific reserves up to £200,000.
71. That approval be given for £303,000 from the Transformation Reserve for the NFSP system refresh and upgrades.
72. That approval be given for £130,000 from the Transformation Reserve for the changes associated with moving to Windows 10 and that the ongoing costs of £25,000 are taken into account when the budget for 2019/20 is set in February 2019.
73. That the Authority approves the approach for dealing with ICT pressures as outlined in this report.
74. That the mid-year review of treasury management activities be approved.

APPENDICES ATTACHED

75. Appendix A – Treasury Management Mid-Year Report

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