Section 25 Report from the Chief Financial Officer

1. Introduction

1.1 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.

1.2 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 previous funding reductions announced to the end of the decade and the delay in 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 Interim Financial Plan presented in the main report.

2. Robustness of Estimates in the Budget

2.1 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.

2.2 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.

2.3 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.

2.4 Growth pressures are considered corporately and agreed by the Authority and are factored into 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.

2.5 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.

2.6 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.

3. Risks in the Budget 2019/20

3.1 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, 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 one year Spending Round announced in September last year represented a shift in the policy in respect of grant reductions in the local government and fire sector. The provisional local government settlement announced in December included a real terms increase in Revenue Support Grant for Fire Authorities and this is reflected in the estimates in this budget setting report.

Any 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 granted additional flexibilities in relation to council tax that allow local authorities with responsibility for adult social care to raise the social care precept by up to 2% on top of referendum limit of 2% for 2020/21.

Despite lobbying from the sector the Government did not grant Fire Authorities the ability to set a £5 council tax increase (as is the case with Districts) which is disappointing as this would have made a significant difference the finances of the authority going forward.

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 1.99% is applied in 2020/21, in line with the assumptions in the previous MTFP, particularly given the uncertainty of the funding position post 2020/21.

c) **Pay and Price Risk** – The Medium Term Financial Plan (MTFP) contained provision of 2.5% per annum for increases in firefighter pay. Recent awards have been less than this provision and the impact of this is reflected in the detailed budgets set out in this report. National policy changes on the role of the firefighter 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 provided a grant to meet 90% of this cost in 2019/20 but this underestimated the overall impact across the schemes. The

Government therefore increased the overall funding available and this has provided a benefit of £493,000 to Hampshire Fire and Rescue Authority (HFRA) in 2019/20.

Going forward, the Government has agreed to provide the same grant amount in 2020/21, but there is still uncertainty around the long term position for this funding, which will not be decided until the next Spending Review is completed and this therefore remains the key risk to the Authority's financial stability 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 most of the medium term investments are in products that should return a stable income yield each year.

4. The Adequacy of Reserves

4.1 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 3.6% of net expenditure at the beginning of 2020/21. It is worth noting that the Authority has never needed to dip into its general fund balance.

4.2 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.

4.3 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.

4.4 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 aims to increase over time, and should therefore provide sufficient funding for future change programmes.

4.5 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.

4.6 More recently, the Authority has also set up reserves in respect of equipment and Information and Communications Technology (ICT) replacement in order to provide funding for and to smooth the impact of high cost replacements and refresh in these areas. This change only further strengthens the Authority's financial resilience.

4.7 Similarly, following savings arising from the pension contributions towards past deficits in the Hampshire LGPS Pension Fund, a contribution of £625,000 per annum (at least for the next three years) is being made into a Grant Equalisation Reserve (GER) which will help to mitigate some of the risks as outlined in the Interim Financial Strategy included in the main report.

4.8 As pointed out within the strategy, despite the uncertainty of funding beyond 2020/21, the Authority is well placed to mitigate the risks that this creates, due to the high level of revenue contributions to reserves contained within the base budget.

5. Budget 2019/20 – Conclusion

5.1 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.

6. The Position Beyond 2020/21

6.1 Given the announcement of a one year Spending Round for 2020/21, the Authority is still in the position of not knowing what its financial prospects are beyond a one year planning horizon.

6.2 Once the next Comprehensive Spending Review (CSR) takes place, it is likely that 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 have previously been published. By December next year the multi-year position for funding should be better known and a more robust plan can be put in place.

6.3 At this stage, in response to this position, the budget report for 2020/21 includes an Interim Financial Plan which seeks to strike a balance between maintaining financial stability and ensuring that the Authority is well placed to respond to the potential future financial challenges that may arise from the CSR.

6.4 Whilst there are risks with the Interim 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 and such a change would have a significantly greater impact on the rest of the sector whose financial position is not as stable as Hampshire's.

Rob Carr

Chief Financial Officer

25 January 2020